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President G.D. Woods Briefs - 20th Annual Meeting
Latin America

1965

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George D Woods - Twentieth Annual Meeting Briefing Papers, 1965 - Latin America



1076806



CONFIDENTIAL

September 14, 1965

BRIEFING PAPER - 1965

AFGHANISTAN

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JUL 11 2016

WBG ARCHIVES

I. MEETING WITH DELEGATION

Staff: Monday, September 27, at 4 p.m.

Management: No meeting planned.

II. MEMBERS OF DELEGATION

Abdullah Yaftali	Governor (IBRD) Minister of Planning
Habibullah Mali Achezczi	Governor (IMF) President, Da Afghanistan Bank
Zia Noorzoy	Alternate Governor (IBRD) President, Treasury Department, Ministry of Finance
Abdul Wahab Haider	Temporary Alternate Governor (IMF) Ministry of Finance

III. BANK/IDA PROSPECTIVE OPERATIONS

Relations with Afghanistan have improved substantially over the past year, following our first operation in November 1964 in the form of an IDA credit of \$3.5 million for education, and the Bank's agreement in April 1965 to organize and help finance an irrigation study in northern Afghanistan to select a suitable area for a pilot project. Reflecting the improvement in relations, the Government has requested IDA assistance for agricultural credit and for road maintenance, as well as for development of tourist facilities; has revived the question of assistance to an industrial financing institution; and, most recently, has requested a Bank mission to visit Afghanistan next year to review and advise on the draft Third Plan.

An FAO project identification mission visited Afghanistan in June/July 1965 to examine the Government's request for assistance in reorganizing the existing agricultural bank and for financial assistance to agricultural credit operations. The mission's back-to-office report indicated definite possibilities of developing a project suitable for IDA financing; the mission is now preparing its final report.

In August 1965 Mr. Woods received a request from the Planning Minister for financial and technical assistance from IDA in establishing a road maintenance program. We have informed the Government that we are prepared to send a mission to examine the request further; the timing of the mission would be determined after the receipt of additional information requested from the Government.

The Bank is meeting the foreign exchange costs, estimated at \$350,000, for the irrigation study which is being carried out by the consulting firm of SOGREAH (France). The field work is now in progress and the report is expected to be available in May or June 1966. Provided agreement can be reached on the project to be studied, the Bank would then finance the foreign exchange costs of a feasibility study.

The scope of operations in Afghanistan will, however, continue to be limited by organizational and managerial problems which lower its capacity to absorb aid.

IV. TOPICS FOR DISCUSSION

(a) To be raised by Bank at staff level

- (i) Education credit: The IDA credit of November 1964 is still not effective (though work under the project is proceeding) because of Government delays in acquisition of school sites and in completing arrangements for the UNESCO/UNICEF contribution to the project. We should ask about the status of these two remaining steps for effectiveness.
- (ii) SID Convention: If not completed by that time, we should ask about status of Afghanistan's adherence to SID Convention.

(b) Likely to be raised by Delegation

- (i) Agricultural credit and road maintenance projects: Delegation will probably ask about the status of IDA

consideration of these projects. We should explain that we have not yet received the FAO mission report on agricultural credit; and remind the delegation that we are still awaiting data requested from the Government on the road maintenance project.

- (ii) Planning advice: The Planning Minister wrote to Mr. Woods on September 1, 1965, requesting that a "small group of competent planning experts" with appropriate "technical and subject matter specialization" come to Afghanistan in June or July 1966 to review critically the draft Third Five-Year Plan and offer suggestions for revisions and improvements. Answer is now being prepared for Mr. Woods' signature, and will be attached hereto.

- (iii) Industrial finance: The Finance Minister also stated that the Government still has under consideration the report of an IFC mission on the establishment of an industrial finance institution, which the Bank transmitted to the Government in November 1963. We suggested at that time that a private development finance company might be premature and that the Government might wish to consider the merits of alternative institutional arrangements; our letter was intended to start a dialogue with the Government, but no reply was received and we learned later that our letter had been considered completely negative. We have had inconclusive discussions of this proposal with various Afghan officials over the last year or so, but we have no evidence that any progress has been made. We should remind the delegation that basic decisions on organization and capital structure of the institution have still to be made by the Government, and we will be glad to consider specific requests for assistance.

- (iv) Tourism: As to financing of tourist facilities, we have discouraged this request. If it is nevertheless raised by the delegation, we should make clear the Bank policy against financing such facilities.

V. BACKGROUND INFORMATION

(a) Bank loans as of July 31, 1965

None.

(b) IDA credits as of July 31, 1965

Date		(US \$ Millions)	
		Amount less cancellations	Undisbursed Balance
Nov. 23/64	Education	3.5 ^{1/}	3.5

^{1/} Not yet effective.

(c) Technical Assistance Activities

Irrigation study in Kunduz-Khanabad basin in northern Afghanistan (see section III above).

(d) Access to Private Capital Markets

None.

(e) Bank 9% Capital Subscription

\$2.7 million. No release. Government should not be pressed for a release at this time.

(f) IDA Subscription

Part II member. 90% subscription amounts to \$0.9 million. The Government should not be pressed for a release at this time.

(g) Holdings of Bank Bonds

None.

(h) I. F. C.

A report on a proposed industrial development financing institution in Afghanistan was submitted to the Government in 1963. The Afghan Finance Minister recently informed the Executive Director for Afghanistan that the Government is still interested in obtaining Bank assistance in this field (see IV(b) (iii) above).

VI. POLITICAL SITUATION

Political situation continues stable. The government of Premier Mohammad Yousuf is more progressive in social and economic affairs than previous governments and appears to have increasingly wide popular support while at the same time retaining the confidence of the King, who continues to hold effective political power.

A significant step in the direction of strengthening representative institutions was the holding of national elections this month for a new parliament, which is to be inaugurated on October 14 when the new constitution proclaimed last year will come into effect. Under the new constitution, no member of the royal family can become the prime minister or any other minister of the government or participate in political parties. The lower house of the parliament is formed by universal, secret and direct elections. Of the upper house, one-third will be nominated by the King; some of the others are elected by the provincial council and the remainder are directly elected.

The cause of friction with Pakistan over the issues of "Pushtunistan" continues to exist but has been muted in the last year. Relations between the two countries have been correct if not cordial since transit trade across the Pakistan border was reopened in 1963. Afghanistan continues to pursue a neutralist foreign policy and is obtaining substantial aid from both the U.S. and U.S.S.R. Aid has also been received from West Germany and from Czechoslovakia, and in April 1965 it was announced that China had agreed to make a long-term loan equivalent to \$28 million to Afghanistan.

VII. ECONOMIC SITUATION

- (a) Population (1964 estimate): 8-10 million (some estimates are considerably higher).
- Per capita GNP (approximate): \$100.
- Exchange Reserves (June 1965): \$44 million including currency cover (4 months' imports).
- (b) Afghanistan's economy is still very primitive. The lack of an entrepreneurial class has forced the Government to take the lead in promoting economic development. However, its capacity to work out and implement investment programs is sharply limited by the lack of skilled personnel and modern

organization. The Second Plan's expenditure target (1962/63 - 1967/68) amounted to Afs. 45 billion, to be financed 56 per cent by foreign assistance. In the event, actual expenditures ran much lower, and about 70 per cent was foreign financed. Planning has mainly been an effort to coordinate the various economic assistance programs sponsored by foreign countries. Engineering of projects is also mainly performed by the assisting countries through their own technicians.

The increase in current expenditures, due notably to the operating needs of past investment projects, has greatly strained the financial resources of the Government. Despite the resources drawn from a complex and changing multiple exchange rate system, the Government also had to borrow regularly from the Central Bank. Public savings are probably negative. An exchange and fiscal reform was worked out in conjunction with a drawing on the IMF in 1963, and led to a brief improvement of the foreign exchange situation. However, fiscal deficits persisted and by early 1965 the free market rate had fallen to more than Afs. 70 to the dollar as compared to the par value of 45. During the year beginning March 1965 there was a loss of free foreign exchange reserves of \$1.5 million, in addition to which Afghanistan also drew \$5.6 million from the IMF thus exhausting its rights under the 1963 agreement. In March 1965 only \$9.5 million reserves were left; the gold stock, worth \$36 million, is used as backing for the currency and is not considered to be available for external payments.

In June 1965 the IMF agreed to a new stand-by arrangement authorizing a total drawing of \$6.5 million. Afghanistan undertook to carry out exchange reforms, the main effect of which is to reserve foreign exchange sales at the official rate to specific foreign exchange purchases of the Central Government. Export taxes on karakul and wool were reduced, but exporters of these goods are still obliged to convert their earnings at the official rate. To reduce the Government deficit Afghanistan also agreed that public sector borrowing from the banking system, which was about Afs. 1,000 million in three of the four past years, is not to exceed Afs. 330 million in the current fiscal year. This would be equivalent to about 8 per cent of total domestically financed expenditures.

The Government appears to be making a determined effort to implement the agreement with the IMF. Some increase in taxation has been undertaken but not on a sufficient scale. The tendency is to cut current expenditures. Further substantial increases in tax revenues are necessary to narrow the deficit without impairing the benefits of past capital investments.

Service on Afghanistan's existing external debt is about \$6.5 million per year, somewhat less than 10 per cent of exports. It will rise to \$14 million in 1968/69 and \$17 million in 1969/70, after the expiration of the three-year moratorium recently granted by the U.S.S.R., which holds more than 80 per cent of the country's external debt (not including obligations to the IMF). Prospects for increasing exports are not particularly bright.

Afghanistan is eligible for IDA assistance from the standpoint of its poverty and on grounds of lack of creditworthiness. It is marginally eligible from the standpoint of economic performance, though the Government seems to be making very real efforts to improve this.

Attachments: Letter from Finance Minister to Mr. Tazi of July 19, 1965, and memorandum from Mr. Stevenson to Mr. Tazi of August 27, 1965.

Letter from Mr. Knapp to Planning Minister of August 16, 1965, on road maintenance program.

Letter from Planning Minister to Mr. Woods of September 1, 1965, regarding mission to review Third Plan, and Mr. Woods' reply.

Letter from Mr. Woods to Planning Minister of November 29, 1963, on industrial financing institution.



Record Removal Notice



File Title George D. Woods - Twentieth Annual Meeting Briefing Papers, 1965 - Latin America		Barcode No. 1076806
Document Date July 19, 1965	Document Type Letter	
Correspondents / Participants To: Mr. Abderrahman Tazi, IBRD From: S. Kassem Rishtiya, Minister of Finance, Afghanistan		
Subject / Title Mr. Chedley Ayari's visit to Kabul		
Exception(s) Communications of Governors and/or Executive Directors' Offices		
Additional Comments		The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.
		Withdrawn by Shiri Alon
		Date 25-Jul-16



Record Removal Notice



File Title George D. Woods - Twentieth Annual Meeting Briefing Papers, 1965 - Latin America		Barcode No. 1076806		
Document Date August 27, 1965	Document Type Memorandum			
Correspondents / Participants To: Mr. Abderrahman Tazi From: Alexander Stevenson				
Subject / Title AFGHANISTAN: Finance Minister's letter of July 19, 1965				
Exception(s)				
Additional Comments Declassification review of this record may be initiated upon request.		<p>The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.</p> <table border="1"><tr><td>Withdrawn by Shiri Alon</td><td>Date 25-Jul-16</td></tr></table>	Withdrawn by Shiri Alon	Date 25-Jul-16
Withdrawn by Shiri Alon	Date 25-Jul-16			

September 20, 1965

His Excellency
Abdullah Yafali
Minister of Planning
Government of Afghanistan
Kabul, Afghanistan

My dear Mr. Minister:

This is with reference to your letter of September 1, 1965, proposing that the Bank organize a team of planning and technical experts to review and advise on Afghanistan's Third Five-Year Plan when it is ready in a preliminary form next year.

We shall be very glad to provide such assistance. We have in fact extended similar assistance to several other member countries, and we would of course be happy to take on the task of making a qualified team available to Afghanistan for this purpose. As to timing, we shall stay in touch with your Government regarding the progress of development of the preliminary Plan so as to determine the scheduling of the mission's visit. I would suggest that you would wish the mission to arrive in Afghanistan at least four months prior to the time you expect to begin putting the Plan into final form. This would allow sufficient time for field investigations, discussions of the Plan with the Afghan authorities, and the preparation of the mission's report.

We shall discuss this matter further with your delegation to the Annual General Meeting. I am sorry that you will not be among the delegation, and that I will not have the pleasure of seeing you again at that time.

With kindest regards,

Sincerely yours,

(Signed) George D. Woods

George D. Woods

SMTolbert:bl
IBRD:lh

Cleared with and cc: Mr. McDiarmid
Mr. Riley
cc: Mr. Knapp
Mr. Wilson
Mr. Chadenet
Mr. Pinto
Mr. Hasal

August 16, 1965

His Excellency
Abdullah Yaftali
Minister of Planning
Kabul, Afghanistan

My dear Mr. Minister:

In the absence of Mr. Woods I am replying to your letter of July 19, 1965 regarding financial and technical assistance from the International Development Association in the establishment of a highway maintenance program. We are in full agreement that an effective maintenance program is of great importance to your country if it is to protect the large investment made in highway construction over the past decade and to continue to improve the road system. We are therefore prepared to send to Afghanistan, as soon as our personnel commitments allow, one or more members of our staff to discuss the request further with you and with the Ministry of Public Works and other agencies concerned. The Mission would go over with your officials your needs and plans in this field, and form a judgment regarding the suitability of the program for IDA financing and the extent of the possible IDA contribution.

In the meantime, it would expedite our consideration of the matter if, to the extent you can, you would forward to us information on the following points:

- (a) The organization and staffing of the Highway Maintenance Department in the Ministry of Public Works, and a description of its responsibilities.
- (b) Budgetary expenditures for highway maintenance in recent years, and, if possible, the projected expenditures in future years.
- (c) Equipment now available for the maintenance program, indicating how many of each major type of equipment are actually being used, are operable, or are capable of being reconditioned.

His Excellency
Abdullah Yaftali

- 2 -

August 16, 1965

If you wish us to pursue the matter along the lines suggested above, please let us know, and we will then arrange for a mission to come to Kabul to discuss it further.

Sincerely yours,

J. Burke Knapp
Vice President

cc: Mr. Wilson
Mr. Wishart
Mr. Baum/Mr. Bergan
Mr. Eccles
Mr. Hasal/Mr. T. Mitchell
Mr. Riley

SMTolbert/ASTevenson/WBaum:rgw
August 13, 1965
IDA:lh

KABUL

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SEP 10 1965

دیلان وزارت

دخارجی تعاون دارتباط لوی مدیریت

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د تلفون نمبر ۲۲۰۷۸ یا ۲۰۶۵۹

MINISTRY OF PLANNING
LIAISON DEPARTMENT FOR
FOREIGN ASSISTANCE

No: 5347

Date September 1, 1965

Tel. 20659 or 22078



Mr. George D. Woods, President
International Bank for Reconstruction & Development

Dear Mr. Woods:

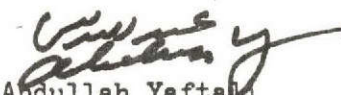
As you may be aware Afghanistan is now mid-way through the fourth year of the Second Five Year Plan. Work is just getting under way on the preparation of the Third Five Year Plan which should start in March, 1967. An evaluation of progress made and difficulties encountered in carrying out the Second Plan is a first step in this preparatory work. Projections into the Third Plan Period will follow.

At an appropriate stage in the work on the next multi-year plan it would be of great value to Afghanistan to have the advice and assistance of a small group of competent planning experts from the International Bank for Reconstruction & Development. The ideal time for such assistance would be after most of the preparatory work has been done and a preliminary draft of the main outlines of the next plan is available. At that time there will still be opportunity for such changes as may be found desirable.

I would like to request on behalf of the Royal Government of Afghanistan that the International Bank for Reconstruction & Development send a small team with appropriate technical and subject matter specialization to Afghanistan in June or July, 1966 to review critically the preliminary plan that by that time will have taken shape and to offer constructive suggestions for revisions and improvements.

Thanking you in advance for your sympathetic consideration of this request, I am

Sincerely yours,


Abdullah Yaftali
Minister of Planning
Ministry of Planning

485

9/15

November 29, 1963

His Excellency
Abdullah Yaftali
Minister of Planning
Government of Afghanistan
Kabul, Afghanistan

Excellency:

Early last summer, His Excellency the Minister of Planning, the late Abdul Hai Azis, informed us that your Government was considering the establishment of an institution to finance private industrial enterprises in Afghanistan, and asked our advice regarding its creation. In response to his request, our consultant, Mr. James Raj, Assistant General Manager of the Industrial Credit and Investment Corporation of India Limited, and Mr. Joseph Filippi of the staff of the International Finance Corporation, visited Afghanistan in July. I have pleasure in transmitting herewith three copies of their report.

The mission has informed us that your Government strongly believes that a financing institution under private control would make a major contribution to the industrial growth of Afghanistan. We share the conviction that this type of institution is an effective instrument for stimulating economic development. The mission's report concludes that it would be desirable to have such an institution and suggests a framework for its capital structure, operational policies, etc.

The report makes the point, however, that conditions may not be ripe for the establishment of an institution along these lines at the present time, suggesting that it might be difficult to obtain the private financing, both domestic and foreign, which is a necessary part of the proposal. The availability of such financing depends on the profitability of the proposed institution, which in turn depends on subordinated, cheap, long-term money of the kind the mission calls "quasi-equity", or on some other type of subsidy from Government. You are in a better position than we to judge the feasibility of finding domestic investors, but our experience suggests that capital from both foreign and domestic sources would be difficult to obtain without substantial subsidization. In this event, you might wish to defer your plan for a private institution until its prospects of profitability are sufficiently great to attract private investors.

Meanwhile, we understand that you are faced with the need to find finance for sound projects considered important to the growth of the Afghan economy. The mission has suggested that, to help finance such projects, the Government might set up a temporary "Industrial Assistance Fund", which could in due course be converted into a private investment institution.

His Excellency Abdullah Yaftali

November 29, 1963

There are, of course, other possibilities. For example, each project might be dealt with on an ad hoc basis. As it is proved feasible, an effort might be made to find an experienced foreign sponsor who would go into partnership with Afghans, if Afghan investors could be found; and loan finance might be provided by the Government or by some foreign aid agency. Still another possibility would be to create a promotional company which could not only finance but also set up and manage a few important new projects until such time as they could be sold and their ownership distributed more widely. To the extent that the present need is to establish a few particular industrial enterprises, and so long as the prospects for a continuing demand for long-term finance are uncertain, a company of this kind might be more appropriate than a financial institution of the kind the mission was asked to consider. It might, indeed, be easier to obtain some private capital for such a company, whose profit expectations should be greater than those of a financial institution.

It is difficult to state with certainty what is the optimum alternative, since the decision can only be made by your Government in the light of your further discussions with potential private investors and other sources of capital. We hope our report will help to illustrate the relative advantages and disadvantages of various approaches and that, if you proceed with the originally-planned investment institution, the mission's suggestions as to its organization and capital structure will be useful.

I hope you will feel free to call on us if there are any points in the report on which you would like amplification, or if there are any matters you would like to discuss at greater length. We stand ready to help in any way possible.

Sincerely yours,

George D. Woods

Enclosures (3)

WDiamond/ASTevenson:vmv

cc: Messrs. M. Rosen
W. Diamond/J. Filippi
E. Reid/A. Stevenson
A. El Emary

India

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Rev.
CONFIDENTIAL

September 16, 1965

BRIEFING PAPER - 1965

ARGENTINA

I. MEETING WITH DELEGATION

Date: Friday, October 1

Time: 9:15 a.m.

Attended by:

Management: Mr. Woods
Mr. Knapp

Staff: Mr. Alter
Mr. Paterson (IFC)
Mr. Wright
Mr. Knox

(A joint Fund-Bank lunch for the Argentine delegation will be held on September 29.)

II. MEMBERS OF DELEGATION

Felix Gilberto Elizalde

(B)

President,
Central Bank
(Governor of IBRD)

Juan Carlos Pugliese

(F)

Minister of Economy
(Governor of Fund)

Advisers

Bernardo Grinspun

-

Executive Secretary,
National Development Council

Luis Ignacio Bobillo

-

General Adviser to the
Minister of Economy

Abel Auzmendi

-

Adviser to the
Minister of Economy

III. BANK/IDA PROSPECTIVE OPERATIONS

Purpose	Amount (\$ million)	Status	Tentative date of negotiations
Steel (ACINDAR)	40-45	Appraisal report being prepared.	open
Livestock	10-12	Project preparation report presented to Government.	open
Power (SEGBA)	unde- termined	Awaiting resolution by SEGBA of financial and management problems.	open

Matters related to these operations are described in Section IV.

*Res.*IV. TOPICS FOR DISCUSSION(a) To be raised by Bank at staff level

The livestock project preparation report was transmitted to the Government by FAO in August. On the basis of this report, the Government apparently expects to present in early October an application for a loan of about \$10-12 million to finance part of the cost of a project in the Balcarce area of Buenos Aires province. We should enquire into the status of this application and say that, on its receipt, we shall try to send an appraisal mission as soon as possible. We may also raise the question of procurement of agricultural equipment and explain that we would be prepared to afford a legitimate degree of preference to local supplies and to consider applying in price comparisons a realistic rate of exchange, but that we would not depart from international competition and accept local goods regardless of price.

We should inform the delegation of the Bank's plans for a 2-year bond issue of \$100 million in March 1966 and seek to obtain some idea of how much might be bought, and if none, why not.

(b) To be raised by Bank at meeting with President

We might refer to the memorandum of understanding on economic policies agreed upon in January 1965 between the Minister of Economy and the Bank, and express our satisfaction with the successful efforts to reconstitute Government resources and greatly reduce borrowing by the Treasury from the Central Bank. But we should stress our concern about the difficulties the Government has encountered in implementing the incomes policy contained in the memorandum, limiting wage increases to 22%, which contributed to price increases higher than the 20% envisaged in the Government plan. Moreover, the Bank is not convinced that the total effect of the two devaluations of April and September 1965 has been sufficient to meet the undertaking in the memorandum of understanding to move the exchange rate in line with domestic price increases. We fear that there may not be adequate incentives for traditional exports and for the development of new industrial exports. As is made clear in the memorandum of understanding, the Bank, for its lending program, stresses the need for a Government policy which will provide the necessary incentives to assure higher export levels over the long run.

The ACINDAR project was appraised by a Bank/IFC mission in April/May. The appraisal report has not yet been completed and further study is required of the various aspects of the project. We may tell the delegation that if the Bank can satisfy itself as to the economics of billet production in Argentina, the preparation of a comprehensive financial plan to meet the project cost of \$114 million will be necessary. The provision of additional equity of about \$25 million by Argentine and non-Argentine investors may prove difficult, even if prospective shareholders were told of the Bank's interest in the project and possible participation in its financing.

August 30, 1965

Assuming that equity were obtained, about \$90 million in loans would have to come from the Bank and from European banks, which may finance equipment ordered in their respective countries on the basis of international competitive bidding. In recent months, we exchanged views with Banque de Paris et des Pays-Bas, the Belgian Societe Generale, Barings and Commerzbank, who may still be interested in a joint operation. We might add that, in connection with the expansion, the need may arise for strengthening the management and that we propose to discuss this with the company at the proper time.

SEGBA would like the Bank to finance 50% of the cost of a \$200 million expansion program for 1965/67. Our reaction to this is contained in a letter of July 27 to Admiral Favaron, copied to Dr. Elizalde, and may be restated to the delegation as follows: While the Bank would like to help, it could consider a new loan only, if SEGBA, with the Government's support, took and began implementing decisions to strengthen its financial condition: (a) definite steps on the measures which SEGBA has outlined for raising additional capital; (b) a program for reducing operating costs; and (c) assurances that rates will be set at a level to yield the net return specified in the Concession and a depreciation rate of at least 3%. Moreover, we think that a crucial step will be to overhaul and strengthen the company's management so that the Executive Vice-President, Admiral Favaron, has a strong team to assist him in improving administration and controlling costs. (In this connection, we were discouraged to learn, after despatching our letter, of the appointment of Mr. Lainz, who - we think - lacks the necessary experience and professional competence, to the position of Director of the Technical Department.) Finally, the Bank could not lend, if SEGBA insisted on buying from local suppliers, regardless of price, a substantial part of the goods required for the program; on the other hand, the Bank would agree that local suppliers be permitted a preference of say 15% over international prices and would consider applying in price comparisons a realistic exchange rate.

(c) Likely to be raised by delegation

The delegation may enquire into the approximate rate of Bank lending in the next few years in support of the development plan. We should answer that our lending would depend on a review of the economic situation, which we hope to undertake early in 1966, and on the availability of soundly prepared projects.

The El Chocon hydroelectric project might come up in this context. We should then refer to our letter of early September to President Storani of the Water and Energy Authority, copied to

Dr. Pugliese, and press for an early and final choice by the Government between El Chocon and the Salto Grande hydroelectric development on the Argentine-Uruguayan border. We may further say that, if the Government decided for El Chocon as having economic priority, we would be glad to advise the Government as to additional information required for the Bank to appraise the project and to discuss with the Government the proper organizational framework for the execution and operation of hydroelectric projects of this magnitude.

The delegation would probably ask the Bank whether, and on what conditions, it would lend for the rehabilitation of the railways. We might respond that we would have to know more about Government policy vis-a-vis the railways and see evidence of a determination to face up to, and tackle, the issues raised by the 1960/62 U.N. Special Fund transportation study, for which the Bank acted as executing agency. Among these issues would be abandoning certain lines and closing certain repair shops, changing operating methods, re-equipment, reduction and retraining of personnel, improved management and adequate rate structure.

If the delegation asked about the continuation of disbursements under the 1961 road loan beyond the present closing date of December 15, 1965, we should say that this would depend on the progress of the works and the performance of the new office in charge of the project between now and December. The presence in Buenos Aires of the Bank's technical representative, Mr. Parmeggiani, would help us in assessing the chances of completing the project satisfactorily within a reasonable period.

V. BACKGROUND INFORMATION(a) Bank Loans as of July 31, 1965

(US \$ Millions)				
Year	Borrower	Purpose	Amount less cancellations	Undisbursed Balance
1961	Republic of Argentina	Road construction	32.0	17.5
1962	Servicios Electricos del Gran Buenos Aires	Buenos Aires power	<u>93.4</u>	<u>-</u>
	Total		125.4	17.5
	of which has been repaid		<u>2.5</u>	
	Total outstanding		122.9	
	Amount sold	.9		
	of which has been repaid	<u>.6</u>	<u>.3</u>	
	Net amount held by Bank		122.6	

(b) IDA Credits as of July 31, 1965

None.

(c) Technical Assistance Activities

- 1959/60 - Executing Agency, UN Special Fund power study
- 1960/62 - Executing Agency, UN Special Fund transport study
- 1964 - Review of 1965 development program and sector studies
- 1965 - Preparation of a livestock project by FAO

No prospective activities.

(d) Access to Private Capital Markets

The last issue - \$25 million, 6½, 12-year Government bonds, priced at 95 - was made in Switzerland, Germany, Belgium, U.K., France, Italy and The Netherlands in 1961. Since then, Argentina was, in fall 1962 and earlier this year, compelled to ask her creditors to reschedule debt maturities; a further request in respect of 1966 maturities is pending. This and the general economic position of the country preclude borrowing in the private market in foreseeable future.

(e) 9% Capital Subscription

\$33.6 million, of which \$6.7 million was released in 1961, and \$1.0 million transferred into dollars and used by early 1962. Further transfers were suspended at that time because of heavy loss of reserves. In March 1962, we informed the Central Bank that we would not plan to use or convert any additional amounts until we have further consulted with them.

(f) IDA - 90% Subscription: \$16.9 million

No releases.

(g) Holdings of Bank Bonds

No information available.

(h) IFC

IFC has three active investments in Argentina: ACINDAR steel plant (\$3,660,000), automotive transmissions (\$1,500,000), and pulp and paper (\$2,500,000). IFC is presently considering a project for expanding the ACINDAR steel plant and an investment in CORDONSED for the production of intermediates for making artificial textile yarn.

VI. POLITICAL SITUATION

President Illia's Government of the Union Civica Radical del Pueblo has now been in power for nearly two years. It would seem that its approach to the problems facing the country, particularly in the economic sphere, has become more realistic, although basic divergencies persist within the ministerial team and the deeply entrenched ways of the bureaucracy do not appear to have changed. The position of the Government is difficult, in that it holds only 69 of the 192 seats in the Chamber of Deputies and a narrow majority in the Senate. Despite this, the Government party appears reluctant to envisage merging with certain moderate parties which recently gave some indication of their wish to come to terms with it. The Army, not playing a political role openly at present, is nevertheless concerned about the outcome of the March 1965 election, which gave about one-third of the popular vote to the pro-Peron parties, and apparently determined not to permit further Peronist gains in the parliamentary and gubernatorial elections of 1967.

VII. ECONOMIC SITUATION

Population:	22 million
GNP per capita:	US\$ 500
Foreign Exchange Reserves:	US\$ 96.1 million

The Argentine economy has considerable potential for long-term growth provided suitable and consistent policies are followed. However, for a number of years now it has experienced virtual stagnation of output in agriculture, high cost industry, severe inflation and uneven economic growth.

During approximately its first 15 months in office, the present Government followed a policy of economic recovery from the severe depression of 1962-63. This policy was essentially an acceleration of the expansionist monetary policies adopted by the previous Government in 1963. The result was an estimated rise in real income by eight per cent and a drop in unemployment during 1964. According to preliminary estimates GNP has continued to grow at an annual rate of approximately six to seven per cent during the first quarter of 1965.

The economic recovery of 1964 was purchased at the cost of increased inflationary pressures, with prices rising by between 25 per cent and 30 per cent during 1964. The Government's monetary program for 1965 aimed at limiting price inflation to 20 per cent this year, by holding down wage increases to 22 per cent and by appropriate credit and fiscal policies. However, the wage ceiling was exceeded by railroad and telephone workers and so far it is reported to have been adhered to only little in the private sector. The official cost of living index rose more rapidly during January-May of this year than during the same period of 1964. Greater efforts at enforcing the monetary and wage policies will be required during the remainder of the year if the Government's plan to decelerate inflation in 1965 is to be realized.

Public finances deteriorated very seriously during 1964 with the result that gross savings of the National Government became negative to the extent of M\$N 28 billion. The Treasury cash deficit reached some 55 per cent of expenditures and an estimated M\$N 70 billion was borrowed from the banking system in 1964. The fiscal program for 1965 calls for an increase in savings of the National Government to M\$N 55 billion and a limitation of the recourse to the banking system to M\$N 40 billion. According to most recent reports, fiscal receipts during the first semester have been in line with projections. As a result the public sector was able to finance all its outlays during the second quarter of 1965 without recourse to the banking system. However, reported

pressures for new wage increases in the public sector may place additional strains on expenditures and eventually endanger the savings target despite the commendable performance on the revenue side.

Exports performed well during 1964 as a result of an excellent grain harvest and continued high prices for meat in world markets, while imports rose even more than exports as a result of increased domestic economic activity. The current account surplus of US\$ 130 million permitted the Government to meet its heavy external obligations; but these together with repayments on private capital account and some capital flight led to a decline in gross foreign exchange reserves by more than US\$ 100 million during 1964 and some transfer arrears were built up. The continued domestic inflation necessitated further devaluations of the Peso in April 1965 from M\$N 150 to M\$N 171 to US\$ 1 or by 14 per cent and again in September to M\$N 179 or by 5 per cent. These were in accord with the Government's policy of moving the exchange rate in line with domestic price movement. However, the effects of the devaluations were partly nullified by the introduction of exchange retentions on a number of important exports. Moreover, it is by no means certain that the second devaluation is sufficient to meet the changes in domestic prices between April and September. This hesitation to adjust the exchange rate adequately stems from the authorities' (a) continued preoccupation with avoiding short-term foreign exchange losses and (b) fears of contributing to a further increase in the domestic cost of living.

An important element in the balance of payments situation for 1965 is the refinancing of the external debt. The Argentine Government sought refinancing for 1965 of US\$ 300 million. Through July relief was obtained from the Paris Club, the IMF and private banks in the amount of US\$ 224 million for 1965. In addition a new request has recently been made for a drawing of US\$ 40 million from the IMF, while Argentine authorities are seeking some further refinancing of US\$ 20 million on selected foreign debts. But even with reasonable prospects for Argentina obtaining financing close to the amount originally requested, balanced external accounts will depend on a current surplus of around US\$ 300 million during 1965. Imports during the first semester of 1965 were somewhat on the high side. The export target for 1965 may be attained as a result of extraordinary grain sales to Russia and China, and despite a slow movement of meat exports. Moreover, unless the exchange rate is adjusted further in line with domestic price movements, it is difficult to see how Argentina will be able to fulfill the commitment made toward the Paris Club in June 1965, i.e., maintenance of net reserves at December 1964 levels while reducing external arrears and permitting an uninterrupted flow of current transactions. A new meeting of the Argentines with the Paris Club for rescheduling 1966 maturities is planned in November-December 1965. This meeting is not likely to be very productive unless Argentina fulfills adequately these commitments. On the other hand, some external debt rescheduling of the 1966 maturities is required for balance of payments viability during the next calendar year. Thus, the manageability of the balance of payments in late 1965 and in 1966 will depend primarily on a realistic exchange policy.

Argentina may be regarded as creditworthy for new external borrowing on a substantial scale, provided that the Government continues to pursue the policies agreed upon in January 1965 between the Minister of Economy and the Bank, particularly those relating to the management of its exchange rate and external debt. In view of the relatively high per capita income, Argentina is not eligible for IDA credits under present IDA criteria. The creditworthiness is due for further review in early 1966.

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- Rev. y. 1

September 21, 1965

BRIEFING PAPER - 1965

BOLIVIA

I. MEETING WITH DELEGATION

Date: September 27, 1965

Time: 3:00 - 3:30 p.m.

Attended by:

No meeting with Management

Staff: Mr. Alter
Mr. Chaufournier
Mr. Weiner
Mr. Knox
Mr. Wyss
Mr. Assimakis

II. MEMBERS OF DELEGATION

Tcnl. Carlos ALCOREZA MELGAREJO

Minister of Finance

Cnl. Alberto IBANEZ GONZALES

President, Banco Central
de Bolivia (Governor)

Cnl. Enrique VARGAS GUZMAN

President, Corporacion Boliviana
de Fomento (Alternate Governor)

Wenceslao ALBA QUIROZ

Manager, Monetary Department,
Banco Central de Bolivia

Advisers

Gaston GUILLEN

Director-General of Banking,
Money and Public Credit,
Ministry of Finance

III. BANK/IDA PROSPECTIVE OPERATIONS

Purpose	Amount (\$ million)	Status	Tentative date of negotiations
Livestock- Development Program	Unknown (possibly under \$3 million)	Project Identifica- tion report under preparation.	open

In addition, the Bolivian Government has submitted a request to the UN Special Fund for technical assistance for railways. This is under consideration by the Special Fund and the Bank may be asked to act as executing agency.

IV. TOPICS FOR DISCUSSION(a) To be raised by Bank at staff level

Under the credit agreement 61-BO, the Bolivian Government undertook to organize the Direccion Nacional de Electricidad (DINE) as a regulatory agency responsible for reviewing and approving rates and tariffs of all entities engaged in the production or distribution of power. No firm date was fixed in the credit documents for this organization of DINE, which was formally established in 1962, but it was to be ready in good time to review rates for 1966. This requires that DINE be ready to function not later than October 1, 1965 when rate adjustments for 1966 will have to be submitted for approval. Consultants have been appointed to advise on this matter and some progress has been made, but it seems unlikely that DINE will be fully organized by the end of this year. The Bolivian Government should be asked to expedite this matter.

(b) No meeting with the President or the Vice President(c) Likely to be raised by delegation

The Bolivian Representatives may wish to explore the possibility of obtaining additional finance for education, railways, and possibly power. We should explain that Bolivia's economic position (especially the budget deficit, the performance of the nationalized mines, and the lack of creditworthiness) limit any finance we may provide to IDA credits and only on a fairly restricted scale. We have, however, noted some recent economic improvements (see Section VII). If these continue we should be able to consider a greater level of lending. We propose to review Bolivia's economic position early in 1966. With regard to the specific areas where the Bolivians have asked about assistance, we might reply as follows.

(i) Railways: Before deciding our position we would wish to see a general transport study to determine the role of the railways in Bolivia's transport system. We note that some recommendations of the 1962 Sofrerail Report have apparently been carried out, including the closing of the La Paz-Beni line and the centralizing of accounts at headquarters in La Paz. We would,

however, also wish to know what action has been taken or is planned on other recommendations, especially the centralizing of the administration of the Western Railway system, the reorganization of the general management, the establishment of an inspection system at major centers, the centralization of all matters relating to supplies and statistics, and the establishment of railway staff regulations and of a centralized staff division. The Bolivians may reasonably reply that their success in doing all of these will depend in part on whether they obtain the technical assistance for which they are seeking UN Special Fund finance.

(ii) Education: We have told the Minister of Education that we need specific projects and a general education program.

(iii) Power: Earlier this year we decided to defer consideration of further power projects on the grounds that available IDA funds might be absorbed by a livestock project. If the economic situation improves, we might be able to reconsider.

V. BACKGROUND INFORMATION(a) Bank Loans as of July 31, 1965

None

(b) IDA Credits as of July 31, 1965

(US \$ Millions)

Date		Amount less cancellations	Undisbursed Balance
July 24, 1964	Power Development	10	8.7
July 24, 1964	Power Development	5	3.6
		<u>15</u>	<u>12.3</u>

(c) Technical Assistance Activities

	Approved Sept, 1961	Completed June, 1962	Allocation	Revised Est Cost
Railways Studies (Sofrerail)			\$43,000	\$42,791

(d) Access to Private Capital Markets

None

(e) Bank 9% Capital Subscription

US \$ 1.89 million. None released.

(f) IDA Subscription

US \$ 0.954 million. None released.

(g) Holdings of Bank Bonds

None

(h) I.F.C.

No investments in Bolivia and no pending applications.

VI. POLITICAL SITUATION

The Civilian Government of Victor Paz Estensoro was overthrown on November 4, 1964 by a military Junta. The Junta is still in power headed by two Presidents, Gen. R. Barrientos and Gen. A. Ovando, and there is no indication at present of a return to civilian government. During June, 1964 there were serious disturbances within the country arising principally from conflict between the Government and the unions in the Government-operated tin mines. The Government finally managed to control the situation. Union leaders have been exiled and a number of reforms introduced in the mines. In general, the Government is thought to have some popular support outside the mining areas.

VII. ECONOMIC SITUATION

Population:	4.1 million
GNP per capita:	\$100-\$150
Foreign Exchange Reserves:	US\$27 million (July 1965)

In 1964 GNP increased by about 3-4 per cent. Exports increased by 30 per cent and foreign exchange reserves were nearly doubled. The price level remained relatively stable.

Nevertheless, Bolivia's overall economic performance is still not very satisfactory. There is no evidence that Bolivia has been able to utilize its ample resources although considerable improvement has been accomplished during the recent months, especially in exports. Fiscal performance has been rather poor. During 1964 the Central Government's operating deficit increased by 30 per cent. There are no data for 1965 but it seems likely that the Government will manage to decrease the budget deficit by the end of the fiscal year. There is no evidence that the Bolivian Government has adopted a comprehensive investment program. The external debt is large and debt service payments are estimated at about 20 per cent of export earnings. There are still accumulated arrears of principal and interest owed mainly to the Eximbank, but the Government has recently stated its intention of trying to eliminate these.

It should be noted, however, that in certain sectors, economic development has been satisfactory. The power development program, for example, which IDA is financing is proceeding on schedule. Productivity in the mining sector has been considerably improved; and for the first time after a lengthy period of deficits COMIBOL is showing monthly cash surpluses. The Government seems to be determined to freeze wages and other fringe benefits and modernize the company's operations. Its efforts, if successful, should increase export earnings. The Government has also taken steps to prepare the administrative basis for developing a national cattle program for which the Bank-IDA has already provided project preparation assistance, under the Bank-FAO Cooperative Program.

Bolivia is not creditworthy for Bank loans, but its poverty and the satisfactory performance in specific sectors make it eligible for IDA credits. If the improvements in COMIBOL continue, and the Government succeeds in reducing its budget deficit, the case for IDA credits will be strengthened.

BRAZIL

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BRIEFING PAPER - 1965

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September 23, 1965

BRAZIL

I. MEETING WITH DELEGATION

Date: October 1, 1965

Time: 10:00-10:30 a.m.

Attended by:

Management: Mr. Woods
Mr. Knapp

Staff: Mr. Alter
Mr. Weiner
Mr. Wiese
Mr. Husain
Mr. Sirken

II. MEMBERS OF DELEGATION

Octavio Gouvea de BULHOES	(B-F)	Minister of Finance Governor
Denio Chagas NOGUEIRA	(B-F)	President, Central Bank Alternate
Gastao E. de Bueno VIDIGAL		Private Banker Special Adviser to the Delegation
Theodoro Quartim BARBOSA		Private Banker Special Adviser to the Delegation
Walther Moreira SALLES		Private Banker Special Adviser to the Delegation
Eugenio GUDIN		Special Adviser to the Delegation
Mauricio Chagas BICALHO		Executive Director, IMF - Adviser
Antonio de A. COUFINHO		Alternate Exec. Director, IMF Adviser

III. BANK/IDA PROSPECTIVE OPERATIONS

(i) Loans presently under consideration:

Purpose	Approximate Amount (millions \$)	Status	Tentative Date for Negotiations
Jaguara Power Project	49.5	Appraisal mission in September 1965.	Nov/Dec. 1965
Eletrobras Power Cos. distribution	45.0	Appraisal mission for the fall of 1965.	Early 1966
Furnas Power transmission	58.0	Appraisal mission in September 1965.	Nov. 1965

(ii) Technical Assistance Projects Under Consideration

Transport Survey

A Bank technical assistance grant of approximately \$1.5 million would finance 50% of the foreign exchange cost of a comprehensive railway study, a survey of the road network in four states, a study of the three major ports and of coastal shipping between them. The study is expected to take 9 months beginning in November 1965. A mission headed by Mr. Aldewereld has been negotiating details of the agreement with the Government since late August.

Survey of the Steel Industry

A Bank technical assistance grant of about \$750,000 would cover the foreign exchange cost of this survey which would begin in January 1966 and take 6 months. Tentative agreement has been reached with the Government on the terms of reference and other important features of the study. We are presently reviewing proposals made by consulting firms on the execution of the study.

Survey of Power Resources in the Three Southern States

The Government has requested a UNSF grant for this purpose and asked that the Bank be executing agency. We have informed the Government that we would consider assuming this responsibility if the proposed scope of the survey were scaled down somewhat.

IV. TOPICS FOR DISCUSSION

- (a) To be raised by Bank at staff level:

None. No meeting is scheduled.

- (b) To be raised by Bank at meeting with President or Vice President:

None (should issues arise after this writing they will be covered by a supplemental memo).

- (c) Likely to be raised by the delegation:

- (1) The delegation may ask about the status of the proposed Bank loans totalling \$130-150 million for the three power projects. Bank missions working on these projects visited Brazil in August and September and issues arising from their visit may need to be discussed, in which case we will prepare a supplementary memorandum.
- (2) The delegation may ask about the Bank's lending program beyond the \$130-150 million for the three power projects.

Suggested reply: We have already discussed with the Brazilians the possibility of lending for livestock and storage projects. (In August-September two missions visited Brazil to define these projects. Issues may arise from these visits which may need to be discussed, in which case we will prepare a supplementary memorandum.) The projected transport survey includes feasibility studies for a number of high priority roads in the southern states. Some sizeable projects for financing may emerge from the steel study. The reorganization and reform of telecommunications may lead to projects in this sector. Whether the Bank would actually lend for these projects, and the extent of our commitments, would depend upon our continuing assessment of Brazil's economic performance and of Government's policies affecting economic development. An economic mission is scheduled for November.

- (3) The delegation may enquire about the Bank's views on the coffee diversification fund proposed at the recent meeting (August) of the International Coffee Council. The IBRD's representative told the meeting that we consider the proposal promising in principle and that we would be prepared to cooperate on a study of it if we are asked.

V. BACKGROUND INFORMATION

(a) Bank loans as of July 31, 1965:

(US \$ Millions)

<u>Year</u>	<u>Borrower</u>	<u>Purpose</u>	<u>Amount less Cancellations</u>	<u>Undisbursed Balance</u>
	Loans fully disbursed		194.0	00.0
1965	Usinas Eletricas Paranapanema	Power	22.5 ^{1/}	<u>1/</u>
1958	Central Eletrica de Furnas, S.A.	Power	73.0	00.7
1965	Central Eletrica de Furnas, S.A.	Power	<u>57.0</u>	<u>57.0</u>
	Total		346.5	57.7
	of which has been repaid		<u>89.8</u>	
	Total outstanding		256.7	
	Amount sold		6.3	
	of which has been repaid		5.4	<u>0.9</u>
	Net Amount held by Bank		<u>255.8</u>	

(b) IDA Credits as of July 31, 1965:

None.

(c) Technical Assistance Activities (see also III ii):

The Bank continues to be executing agency for the UN Special Fund financed power survey of South Central Brazil.

(d) Access to Private Capital Markets:

No prospects in foreseeable future.

(e) Bank 9% Capital Subscription (\$33.6 million):

None released.

(f) IDA Subscription (\$16.947 million):

None released.

^{1/} Not yet effective

(g) Holdings of Bank Bonds:

None.

(h) I.F.C.

Member (To be supplied by IFC)

Industrial Investments:

IFC (with other participants \$3,175,000) has made six investments in Brazil, three of which have been sold. The three remaining investments are automotive parts (\$450,000), motor vehicles (\$2,450,000), and pulp and paper (\$4,000,000). IFC has at present under active consideration two projects, one for the manufacturing and expansion of special steel (Villares) and the other for the expansion of a steel mill (Belgo Mineira); in addition, a number of other applications ranging from the production of pulp and paper, aluminum, automobiles, fertilizers, cement, hydraulic equipment, carbon electrodes and plywood to the mining of iron ore are being considered.

Development Banks:

IFC is advising the Banco Central on the preparation of regulations under a new law for investment banks. There have been preliminary talks with the owners of an acceptance company in Sao Paulo (FINASA) with a view to its possible re-organization into a long-term investment institution with IFC and other foreign participation.

VI. POLITICAL SITUATION

Presidential elections are scheduled for the fall of 1966. So far the only declared candidate is Governor Lacerda, a vocal critic of the Government's economic policies. Government has not put up a candidate so far. President Castelo Branco has repeatedly expressed his intention to retire next year. However, there is a growing feeling that he might be persuaded to run for Presidency in 1966 and the Constitution amended to make this possible.

At present there is little indication of the Government's popularity, or the lack of it. Government's score on the political front will depend very largely on the state of the economy in the months to come. On the inflation front tangible results are already visible (Section VII). However, there is hardship on account of layoffs in the industrial areas of the south.

Since the revolution, the Government has given ample evidence of capacity to take decisive action on difficult and unpopular issues of policy and institutional reform. Examples are raising the rates of public utilities, imposition of new taxes to reduce budgetary deficit, elimination of import subsidies, establishment of a central bank and budgetary reform.

VII. ECONOMIC SITUATION

Population:	80.25 million (1964)
GDP per capita:	US\$275
Foreign Exchange Reserves:	US\$464 million (end of June 1965)

The Government's stabilization program which got under way in the latter months of 1964 has produced a slowdown in the rate of price increases. (During the last four months the average rate of increase of cost of living has been 2½% per month. In June the increase was 1.6% and in July 2.8%. The recent figures are equivalent to an annual rate of increase of prices of 40% as against more than 80% a year ago. The program has also produced a slowdown in industrial production which has been concentrated in consumer durables and textiles, and to a lesser extent in the capital goods industries. The Government has taken a number of measures - selective credit expansion and tax incentives - to stimulate the production of consumer durables and capital goods.

The financial targets of the Government's 1965 program have largely been met so far. Tax receipts have been somewhat higher than expected and credit expansion to the private sector has been somewhat lower than the programmed level. But the greatest weakness in the financial picture is the large shortfall in the Coffee Account due mainly to abnormally low exports of coffee during the early months of 1965. Large proceeds from the coffee export tax together with a decline in bank credit for holding coffee stocks were expected to produce a substantial contractionary monetary effect, but it has fallen far short of the target. Moreover, the contractionary effect of the greater tax yield from higher coffee exports in the second half of the year will be counteracted by the very large coffee crop, which will require large purchases by the Coffee Institute and credit expansion to the private sector to finance the larger stocks. The Government has recently announced a new coffee policy which aims to curtail the expansionary effects of the large crop.

Brazil's foreign exchange position has improved considerably in recent months. The net gold and convertible exchange holdings of the monetary authorities rose from zero in December 1964 to more than \$450 million at the end of June 1965. Much of this improvement can be attributed to the depressed level of imports resulting from the stabilization program. But there have also been substantial capital inflows, mainly from public sources. Non-coffee exports have been rising in recent months partly as a result of the bumper crops.

The success of the stabilization program, the Government's selective measures to stimulate industrial production and housing, and the bumper crops are expected to lead to a recovery in industrial production and to induce a substantial increase in private investment, both foreign and domestic. This will produce a substantial increase in imports in 1966 which together with the

sizeable external debt obligations will require large capital inflows. According to the estimates of the Bank's economic mission, Brazil will need about \$300 million of non-project assistance in 1966. Most of this will have to come from AID and IMF. With a reasonably satisfactory economic policy performance, Brazil is expected to obtain assistance approaching \$300 million from these two agencies.

Creditworthiness

With regard to creditworthiness, the conclusions of the Bank's economic mission were as follows:

Brazil's past growth performance, present policies and programs, and future growth prospects provide a basis for substantial amounts of external assistance on suitable terms. The degree to which Brazil follows sound economic policies will influence the pattern and pace of Brazil's growth, the composition and level of investment and external financing requirements, as well as Brazil's ability to manage and service external debt.

Brazil's need for large external capital inflows arises mainly from the size and amortization schedule of existing external debt. The current account deficits are expected to be relatively small. Brazil will, therefore, need a relatively small net capital inflow, but a large gross inflow to meet its debt payments. Creditworthiness for new loans will thus, in part, depend on its ability to get external assistance in sufficient amounts and on appropriate terms which will have the effect of rolling over and stretching out its large external debt payments scheduled for the next five or six years. While Brazil is not now IDA-eligible under present criteria, she will need average terms somewhere between conventional IBRD and present IDA. Suitable grace periods will be especially important.

CHILE

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September 16, 1965

BRIEFING PAPER - 1965

CHILE

I. MEETING WITH DELEGATION

Meeting with Mr. Alter, Mr. Chaufourmier, Mr. Wright and Mr. Loftus to be arranged.

Mr. Knapp will meet with Finance Minister (not a member of Delegation) to discuss consultative group arrangements during week of CIAP review on Chile (probably week after Annual Meeting).

II. MEMBERS OF DELEGATION

Carlos Massad (B-F)

Vice President
Banco Central de Chile

Governor

Jorge Marshall (B-F)

Director
Department of Economic Studies
Banco Central de Chile

Alternate Governor

III. BANK/IDA PROSPECTIVE OPERATIONS

The following projects are under consideration:

<u>Purpose</u>	<u>Amount</u>	<u>Status</u>	<u>Tentative date for negotiations</u>
1. ENDESA electric power generation and transmission	\$50-150 million (very tentatively)	Appraisal mission scheduled for October/November	First half of 1966
2. Road construction and improvement	\$10-12 million (tentatively)	Appraisal scheduled after completion of studies financed by Bank Technical Assistance (see V c (iv))	Second quarter of 1966

In addition a possible project for financing the second stage of expansion of facilities of the Santa Maria Technical University is in a very preliminary stage of discussion. It will probably be financed by IDB which is financing the first phase.

IV. TOPICS FOR DISCUSSION

(a) To be raised by Bank at staff level:

- (i) Chilean Performance in 1965 in light of commitments to IMF and CIAP. While the performance on a cumulative basis has thus far been very encouraging the Government's reluctance to depreciate the exchange rate in line with actual domestic price increases is of concern to us and should be raised with the Chilean delegation.
- (ii) In connection with (i), Chilean delegation should be informed about planned review of economic performance at the end of this year. Bank should also raise with Chileans the question and possible timing of program review mission planned for 1966.
- (iii) Bank should indicate that, if our analysis of Chilean economic position and prospects is favorable, the Bank would actively consider financing of ENDESA and additional road construction and improvement. Bank should discuss in a general way the issues connected with financing ENDESA including possibility of joint financing and problems of local currency financing. In connection with roads, Bank should indicate possible sequence of future lending activities.
- (iv) Disbursement Problems. US\$19 million Livestock Development Loan and US\$5 million Loan for Meat and Milk Processing Plants, both of December 18, 1963 (Loans No. 366-CH and 367-CH). Unfavorable price conditions for meat and milk prevailing in 1964 as well as administrative difficulties have been largely responsible for the delays in the execution of these projects, although the Government has already taken corrective steps with respect to price policy and other incentives and some progress has been made in advancing the livestock program. The meat and milk plant project, however, continues to suffer from serious administrative deficiencies; indications are that the project is as much as three years behind schedule and that hardly any disbursements from the Loan will be made by the Closing Date (December 1966). The Bank has already expressed its serious concern to CORFO about the execution of both projects, and has informed CORFO that it will review them at the end of this year. Our intentions should be stated to the Chilean delegation, particularly regarding the meat and milk plant project, and the Bank should indicate that unless visible progress is made by the time of the review and prospects for advancing the projects have significantly improved, the Bank may have to consider serious measures including perhaps cancelling part of the loans.

September 21, 1965

(v) Central Bank and Other Government Agency purchases of 2-year Bonds for March 1966

We should inform the delegation of the Bank's plans for a 2-year bond issue of \$100 million in March 1966 and seek to obtain some idea of how much might be bought, and if none, why not.

(b) To be raised by Bank at meeting with Vice-President:

Establishment of Consultative Group. In April, Chilean position was negative as far as any immediate action is concerned on grounds that Chile could not have a Development Plan for presentation to Consultative Group until late in 1966. Recent conversations with the Government appear to indicate a certain change in this position. The Government has expressed some interest in the formation of a Consultative Group subject to clarification of (a) the Bank's conditions and requirements in terms of economic performance as well as with respect to the formulation of programs and preparation of projects, and (b) how and on what level the Bank would propose to set up a Consultative Group so as to make it more effective than already established Groups. Present staff thinking is that a Consultative Group might be formed on the basis of a short-term investment program and center round, though not be confined to, a nucleus of projects suitable for joint financing with prospective European or other lenders. In the absence of projects other than ENDESA's program which would be ready in the near future, it is thought that a Consultative Group could be initiated on the basis of joint financing of ENDESA's program and its scope widened subsequently as more projects suitable for joint financing are prepared.

(c) Likely to be raised by delegation:

The only issue on which the delegation might want to know the Bank's thinking would be the scope and magnitude of future Bank lending activity in Chile. We should reply along the lines noted in IV(a) (iii) above.

V. BACKGROUND INFORMATION(a) Bank Loans as of July 31, 1965

Year	Borrower	Purpose	Amount less Cancellations (in US\$ millions)	Undisbursed Balance
		Loans fully disbursed	51.85	0.00
1957	<u>Lota-Schwager</u> /CORFO	Coal mining	9.60	0.00
1957	<u>Lota-Schwager</u> /CORFO	Coal mining	12.20	3.58
1959	ENDESA/CORFO	Power	32.50	12.92
1961	Republic of Chile	Roads	6.00	2.62
1963	CORFO	Livestock	19.00	16.56
1963	CORFO	Meat and Milk Plants	5.00	5.00
1965	ENDESA/CORFO	Power	4.40	4.07
1965	CORFO	Vocational Training	2.75 ^{1/}	2.75
		TOTAL	143.30	47.50
		of which has been repaid	<u>30.88</u>	
		Total outstanding	112.42	
		Amount sold	5.29	
		of which has been repaid	4.48	<u>0.81</u>
		Net amount held by Bank	111.61	

^{1/} Not yet effective.

(b) IDA credits as of July 31, 1965

Date	Purpose	Amount less Cancellation (in US\$ millions)	Undisbursed Balance
June 28, 1961	Road Construction	19.0	13.2

(c) Technical Assistance Activities

- (i) 1962-64 resident mission (Havlik and Reitter). Reestablishment of the mission would depend on formation of Consultative Group.
- (ii) 1962-64 Capital Markets Study Mission (Thomas, Ewbank, Den Dunnen). The final report of the mission was transmitted to the Chilean Government in January of this year.
- (iii) A special technical representative (Parmeggiani) to assist on the Bank/IDA Highway Project has been stationed in Santiago since January 1963.
- (iv) In July 1965, the Bank approved a US\$210,000 technical assistance grant for a highway study to develop a coordinated highway program for the next 6 years which the Bank may in the future help to finance.
- (v) In July 1965 the Bank agreed to provide two experts to the Government and the Chilean Development Corporation (CORFO) for assistance in project preparation. One expert (Craig-Martin) has already assumed his duties.
- (vi) At the same time the Bank also agreed to provide two high level experts in railroad operation and management for a period of 2-3 months to advise the Government and the Chilean State Railroads on urgently needed operational and organizational reforms. The mission is expected to arrive in Santiago in November.

(d) Access to Private Capital Markets

None.

(e) Bank 9% Capital Subscription (\$8.4 million)

No release.

(f) IDA 90% Subscription (\$3.177 million)

No release.

(g) Holdings of World Bank Bonds

None.

(h) IFC

IFC (with other participants \$2,457,661) has made four investments in Chile; copper mining and smelting (\$4,337,500), food products (\$1,653,846), cement (\$1,300,000), and pulp and paper (\$3,000,000). No applications are under consideration.

Mr. Diamond had talks in Santiago in June with private groups interested in forming a broadly based private development finance company. IFC has offered to advise on the organization of the company and has kept in touch with the sponsors. IFC has also agreed to advise Corporacion de Fomento de la Produccion (CORFO) on the details of a proposed subsidiary to finance the private industrial sector, on the understanding that the subsidiary will be operated on economic lines and will not interfere with the proposed private development finance company.

VI. POLITICAL SITUATION

Eduardo Frei of the Christian Democratic Party - a left of center, non-Marxist, pro-clerical party - took office as President in November 1964 after he had won an impressive victory in the presidential elections in September 1964 over his most serious contender, Salvador Allende of the Popular Action Front which is backed by a Socialist-Communist coalition. The President constitutionally serves a 6-year term and cannot succeed himself for a second term. For this reason, former President Jorge Alessandri, an Independent supported by the Conservative and Liberal Parties, did not run for office again.

In the congressional elections in March 1965, President Frei's Christian Democratic Party won an absolute majority in the House of Deputies by gaining 82 seats out of 147 (formerly they held only 28), and a third of the seats in the Senate. The extent of the Frei victory was unexpected and heavy losers were primarily the right wing Conservative and Liberal Party as well as the Radical Party, an anti-clerical, middle of the road party.

The congressional victory has greatly strengthened the Government's position and it is expected that President Frei will obtain the necessary support by Congress to carry out fundamental economic and social programs and policies.

VII. ECONOMIC SITUATION

Total population:	8.4 million
GNP per capita:	US\$300-350 (adjusted exchange rate)
Foreign Exchange Reserves:	US\$111 million (gross): (-US\$178 million net) as of August 23, 1965

Despite continued expansion, the Chilean economy in 1964 continued to experience a sizeable balance of payments deficit and strong inflationary pressures with consumer prices rising by about 40 percent. Due to increased Government revenues and large external financial assistance, the overall fiscal situation improved and enabled the Government to finance its investment program without significant recourse to Central Bank credit. But while budgetary savings increased, earnings of the decentralized public agencies actually declined as a result of the Government's unrealistic rate policy in view of rising costs and prices. Thus, total public savings virtually stagnated in 1964 and covering of the public sector deficit required a net inflow of external loans and credits of about US\$150 million. This inflow of external assistance also helped to fill the balance of payments gap which was of the same order of magnitude.

The programs and policies to which the new Government committed itself in letters of intent to both the IMF and CIAP at the beginning of this year emphasized the Government's determination gradually to reduce the rate of inflation, to raise the level of public savings and to strengthen the balance of payments. The performance in the first half of 1965 has been encouraging and has met the tests applied by both IMF and CIAP. The Government has taken measures to restrict monetary and credit expansion and to limit wage and salary increases in 1965 strictly to the cost of living increase in 1964. As a result of the Government's efforts, the pace of inflation has slowed down compared to last year, and there are reasonably good prospects that price increases will not exceed 30 percent by the end of 1965. The balance of payments performance showed a marked improvement in the first half of 1965, largely on account of increased copper exports and the Government's deliberate policy to hold down imports. Thus, while the Government met the IMF balance of payments test, the exchange rate did not depreciate in line with domestic price increases.

On the fiscal side prospects for increasing public savings in 1965 over the level of past years have improved despite the fact that the outgoing Congress failed to approve the tax program submitted by the Government. Subsequently the Government has taken measures which will raise additional revenues, and has reduced expenditures.

Prospects for Congressional approval of the agreements reached between the Government and the copper companies to carry out sizeable investments which would result in substantial increases in export earnings, have greatly improved in view of the landslide victory of the Government's party in the Congressional elections in March. Legislation to authorize the President to finalize the agreements with the copper companies was introduced in the latter part of May and passage of the bill may come by October, but is by no means assured.

Despite the favorable long-run outlook for Chile's balance of payments on account of the copper investment, the balance of payments situation in 1965 and subsequent years presents Chile with a serious problem, mainly on account of the very heavy debt burden. At the request of the Chilean Government the principal creditor countries met in Paris in January and February of this year and agreed to reschedule a substantial part of Chile's obligations falling due in 1965 and 1966. But even with the debt relief obtained in the debt renegotiations, service requirements on Chile's external debt, both public and private, will remain very high in the next several years. Management of this high debt burden will require that Chile abstain from assuming additional sizeable external obligations on short and medium terms, and that a large scale inflow of external capital on soft terms will continue. Provided such assistance will be made available, for which there are reasonably good prospects, and provided the Government continues to make every effort to achieve monetary stability, to increase exports, and to raise public savings, Chile may be regarded as creditworthy for new Bank lending on conventional terms. To the extent possible, however, such new loans should be made available on extended maturities with extended periods of grace to meet Chile's balance of payments requirement.

COLOMBIA

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September 16, 1965

COLOMBIA

BRIEFING PAPER

I. MEETING WITH DELEGATION

Date: October 4, 1965

Time: 11:30 a.m. - 12:30 p.m.

Attended by:

Management: Mr. Knapp

Staff: Mr. Alter
Mr. Chaufournier
Mr. Weiner
Mr. Wiese
Mr. Mirza
Mr. Frost

II. MEMBERS OF DELEGATION

Joaquin Vallejo	(B)	Minister of Finance Governor
Ernesto Arango-Tavera	(B)	Director, Banco de la Republica
Eduardo Arias Robledo	(F)	General Manager, Banco de la Republica
Eduardo Soto-Pombo	(F)	President, Banco de Colombia
Jorge Mejia-Salazar		President, Banco de Bogota
Bernardo Restrepo Ochoa		Board Member, Banco de la Republica
Vincente Uribe Rendon		Board Member, Banco de la Republica

III. BANK/IDA PROSPECTIVE OPERATIONS

(i) Loans presently under consideration:

The following loans could be ready for signing before June 30, 1966:

Purpose	Amount (\$ million)		Tentative date for Negotiations
Financieras (PIF)	20 - 40	Appraisal report being prepared.	December 1965
Pilot Loan for Agricultural Credit	10 - 15	Appraisal mission scheduled for mid- October.	Early 1966
Power Inter- connection	25 - 30	Consultants' report being discussed by companies concerned.	First half 1966
Telecommuni- cations	23 - 25	Appraisal mission ten- tatively scheduled for October.	Early 1966
Irrigation (Atlantico Sur)	10 - 15	Project being pre- pared by consultants.	First half 1966
CVC/Yumbo IV	5	Awaiting further information	First half 1966

In addition, the following projects are in the early stages of discussion: Additional hydro capacity for the Inter-connected System (Colegio II and/or Canoas or alternative), further expansion of CVC facilities (Salvajina multi-purpose project), Paz del Rio (expansion program, possibly including a second blast furnace), Magangue thermal power station (Electraguas), secondary education in Antioquia, comprehensive high schools and agricultural education (Instituto Colombiano Agropecuario).

(ii) Consultative Group

No Consultative Group meetings were held in 1965 pending the outcome of our negotiations on measures to correct the deterioration in Colombia's economic situation. However, the U.S. Government, the Fund, and the Bank formulated joint positions for these negotiations in the framework of the Consultative Group. The Government is expected to take corrective measures shortly. A Consultative Group meeting would be held early next year. A mission is scheduled to go to Colombia in October/November to review the economic situation and the project list, and to prepare the material for such a meeting.

IV. TOPICS FOR DISCUSSION(a) To be raised by Bank at staff level:

None. No meeting scheduled at staff level.

(b) To be raised by Bank at meeting of delegation with President or Vice President:

(1) Economic Questions:

Any deficiencies in performance by the Government in executing the exchange rate and fiscal policies to be initiated in September. Assuming such deficiency as small or non-existent, we may wish to inform the Delegation of: (i) the Bank's own lending program and prospective project missions; (ii) of its intention to send a mission in October to draw up a project list for external financing, to be submitted to the Consultative Group early in January; and (iii) of the sector conditions to be attached to Bank loans in the above table: (1) formula for automatic rate adjustments (conditions for loans for Interconnection and Telecom), and (2) undertaking by government to obtain Bank approval for any future restrictions on meat exports (condition for livestock loan).

(2) Operational Questions:

Loan 295-CO and Credit 5-CO (Highways)

There are substantial delays in construction, mainly due to poor organization and administration in the Ministry of Public Works and lack of local funds for engineering. The project was scheduled for completion by the middle of 1965, but now it appears that it will take another four years to complete. The closing date of June 30, 1965, has been extended for only six months and the Government informed that further extensions would depend on its taking corrective measures to improve the administration of this project. We should reiterate our concern over the poor performance of this project.

Loan 343-CO (National Railroads)

Due to poor track maintenance, repeated derailments occur, causing serious damage to Bank-financed equipment. The situation has been repeatedly brought to the attention of the Government which agreed to make contributions to the railroads for track maintenance. The Government should continue making such payments until the track rehabilitation program is completed.

Loan 339-CO (CVC/Chidral)

There is a real danger of CVC/Chidral not being able to complete construction of Calima I. CVC/Chidral's financial position has become critical mainly because of the Government's postponement of necessary tariff increases. CVC/Chidral have asked USAID for counterpart funds and the Government for a cash contribution to solve their present problems. We should urge the Minister of Finance to make the cash contribution.

- (c) Likely to be raised by delegation (other than those raised by Bank/IDA):

None likely, in addition to points covered above.

V. BACKGROUND INFORMATION(a) Bank loans as of July 31, 1965:

(US \$ Millions)				
Year	Borrower	Purpose	Amount less Cancellations	Undisbursed Balance
		Loans fully disbursed	136.0	
1961	Republic of Colombia	Roads	19.5	6.2
1960	CVC and Chidral	Power	25.0	0.5
1963	CVC and Chidral	Power	8.8	0.2
1961	Empresas Publicas de Medellin	Power	22.0	5.3
1964	Empresas Publicas de Medellin	Power	45.0	42.5
1960	Emp. de Energia Electrica de Bogota	Power	17.6	00.0
1962	Emp. de Energia Electrica de Bogota	Power	50.0	14.0
1963	Electrificadora de Bolivar, S.A.	Power	5.0	2.7
1963	Ferrocarriles Nacionales	Railways	30.0	7.8
1963	Acerias Paz del Rio, S.A.	Steel	30.0	27.7
	Total		388.9	106.9
		of which has been repaid	69.3	
		Total outstanding	319.6	
	Amount sold	14.5		
		of which has been repaid	10.4	4.1
	Net Amount held by Bank		315.5	

(b) IDA Credits as of July 31, 1965:

(US \$ Millions)				
Date of Credit	Borrower	Purpose	Amount less Cancellations	Undisbursed Balance
Aug. 28 1961	Colombia	Highway Construction	19.5	10.0

(c) Technical Assistance Activities:

Executing Agent for the U.N. Special Fund Cauca Valley Coal Survey. The final reports of the consultants have now been published. Conger and Laurenti of DAS who were stationed in Cali in October 1963 to assist the Cauca Valley Corporation (CVC) in regional planning completed their assignments in March and September 1965, respectively.

Resident Mission in Bogota: Lacayo began his assignment in August 1964 to assist the Ministry of Public Works execute the Bank and IDA-financed road project. Iverson began his assignment in November 1964 to act as the Bank's representative in Colombia.

(d) Access to Private Capital Markets:

No prospects in foreseeable future.

(e) 9% Capital Subscription (US\$ 8.4 million):

The Government has agreed to release its subscription of US\$ 8.4 million in semi-annual installments to be completed by June 1967. On November 23, 1962, the Bank agreed to reschedule the July 1, 1962 installment to December 1, 1966, and on August 5, 1965, it agreed to reschedule the July 1, 1965 installment to June 1, 1967.

(f) IDA Subscription (90% Subscription): US\$ 3.2 million

No releases.

(g) Holdings of World Bank Bonds:

None.

(h) I. F. C.

Member

Industrial Investments

IFC (with other participants) has made nine industrial investments in Colombia, two of which have been sold or agreed to be sold. The seven remaining investments include fiberboard (\$500,000), food products (\$2,000,000), home furniture (\$170,000), cotton textiles (\$2,000,000), a forge plant (\$1,103,409), and a warehousing company (\$1,000,000). IFC is presently considering an investment in a livestock and slaughterhouse project (Indugan).

Development Banks

IFC has equity investments in three financieras, as follows:

<u>Company</u>	<u>Amount Invested</u>	<u>Date Approved</u>	<u>Portion Sold</u>
Corporacion Financiera Colombiana (Bogota)	\$ 2,023,216	August 29, 1961 and June 27, 1962	-
Corporacion Financiera Nacional (Medellin)	\$ 2,041,996	August 29, 1961 and June 3, 1964	\$843,807
Corporacion Financiera de Caldas	\$ 701,403	March 31, 1964	-

A mission led by Dr. G. W. Klein, consultant, reviewed the operations of all private Colombian financieras early in 1965. IFC is considering requests for participating in capital increases of the Bogota and Medellin financieras, and requests to make new investments in the financieras of Cali and Barranquilla. Also pending are requests that IFC accept seats on the Boards of the financieras at the time of the Annual Meeting to determine their interest in loans from IFC, to be made individually to each financiera, as a substitute for the proposed Bank loan to all the financieras through the Banco de la Republica (see Table on Page 2).

VI. POLITICAL SITUATION

President Guillermo Leon Valencia (Conservative) took office in August 1962 for a four-year term as President of the second coalition (National Front) administration. His administration is, in principle, dedicated to the National Front policies of economic development and social betterment within a framework of monetary stability. However, in practice, economic policy has been weakened by divisions within the coalition, particularly within the Conservative party and by divisions between the executive and legislative branches of government. These divisions have been accentuated by the President's reluctance to come to decisions. The Colombian public, which responds well to firm government, was losing confidence in the administration because of its tendency to vacillate. However, there is now evidence that the President is prepared to act early in September on the necessary economic measures, using, if necessary, the "state of siege" powers under the constitution.

VII. ECONOMIC SITUATION

Population: 15 million
Per capita income: US\$ 210
Foreign exchange reserves
(gross disposable in May 1965): US\$ 73 million

(a) Economic Growth:

Population is increasing at 2.2 percent annually, according to official estimates which probably underestimate the growth rate. Gross Domestic Product increased by 3.1 percent in 1963 and by an estimated 4.5 percent in 1964, compared with annual increases of 5.2 percent in the previous 4 years ended 1962. In 1965 growth is likely to have been affected adversely by the development of exchange and fiscal difficulties. However, new policies to be initiated in September (see paragraph (e) below) provide a basis for proceeding with the development program and reviving the pace of economic growth.

(b) External Debt Position:

External public debt outstanding at December 1964 was US\$ 825 million, including undisbursed, compared with US\$ 740 million at the end of 1963. Service on external debt is estimated at 14 percent of exchange earnings in 1964, declining to 6 percent in 1970. However, the normal roll-over of short-term external public debt owing to the IMF and foreign commercial banks presents a problem in 1965 and more particularly in 1966. The proposed improvements in Government economic policy are expected to restore Colombia's short-term creditworthiness.

(c) Balance of Payments Position:

Serious balance of payments difficulties arose in 1965 on account of (1) the reduction in the coffee export quota; (2) requirements of refinancing US\$ 44 million of short-term foreign debt; (3) lack of confidence in the exchange rate level leading to private capital outflow; (4) the reluctance of the U.S. Government and the IMF to provide non-project assistance on the basis of existing fiscal, monetary and exchange rate policy; (5) the inability of the authorities to reduce import payments by the use of quantitative restrictions as long as the exchange rate is seriously overvalued. However, the devaluation of the import rate expected in September will provide a basis for more effective balance of payments management.

(d) Prices:

After four years of price stability, the average price level increased by 27 percent in 1963 and by 18 percent in 1964 as a consequence of the mismanagement of the devaluation imposed at the end of 1962. The price level in 1965 to date is only about 2 percent above the level prevailing in 1964.

(e) Main Economic Problems

A. Short-Term Problems:

In 1965 the economic situation was dominated by short-term balance of payments and fiscal problems. At this writing, the Government seemed resolved to take steps in September to deal with these as follows:

(1) Exchange Rate Adjustment:

The Government intends to shift initially 75 percent of imports from the former certificate rate of Ps 9 per US\$1 to a new intermediate rate of Ps 14, producing a depreciation of 42 percent in the average rate applicable to imports. Within a reasonable period, all imports would be shifted to the new intermediate rate, which would also be variable in accordance with the exigencies of the economic situation.

(2) Fiscal Measures:

The Government was faced in 1965 with a fiscal deficit of over Ps 1 billion. Revenue measures are proposed which will enable the Government to reduce the deficit to manageable proportions in 1965 and proceed with a substantial investment program in 1966 in circumstances of fiscal balance.

(3) Other Measures:

The Government has also indicated its intention of pursuing a conservative monetary policy and avoiding the promotion of general wage increases in the public and private sectors. These measures will provide a basis for proceeding with the development program, which has been hanging fire all year.

B. Medium-Term Problems

There remain problems which will have to be remedied over the next few years in order to accelerate the pace of the development program and increase the country's rate of economic growth:

(1) Balance of Payments:

Colombia has developed under protection a broad range of industries which are heavily dependent upon imported inputs, and this tendency will have to be corrected over the medium term by means of a reduction in the degree of protection. Exports are still dependent as to 65 percent upon coffee. Petroleum accounts for another 20 percent of exports, and petroleum investment was deterred in 1964-65 by official tax policy which the Government is now taking steps to correct. The balance of 15 percent of "minor" exports includes a number of items with a promising future. These minor exports have been increasing at an annual rate of 12 percent. The existing Colombian system of export incentives seems adequate to accelerate further the development of minor exports, provided protection would be reduced so as to make the domestic market more competitive. Finally, there remains the problem of disciplining external borrowing. Working in consultation with the Bank, the Government has restricted borrowing by means of medium-term supplier credits for the financing of its development program. However, a close watch needs to be maintained upon short-term commercial credit contracted as a means of balance of payments financing.

(2) Fiscal Problems:

Colombia has dealt with her fiscal problems over the past three years by a series of temporary measures. While this was to some extent inevitable, the Government should establish permanent sources of revenue for the public sector which are responsive to changes in money national income. Such sources should include taxes and also a flexible policy of permitting tariff increases by autonomous public enterprises. However, the Government seems to have decided already to put into effect an increase in the gasoline tax and to grant adequate rates for public utilities.

(3) Development Planning:

A deterioration in the quality of the Planning Office has had the unfortunate effect of preventing Colombia from taking full advantage of the quantity of external public assistance which is available from the Bank and other members of the Consultative Group. Development policy is also lacking in consistency and coordination of objectives in the sectors of agriculture and transportation. The Government intends to obtain power to reorganize the Planning Office.

(4) Efficiency in the Public Sector:

While many public agencies are highly efficient, development is hampered, particularly in the transportation sector, by organizational difficulties. With technical assistance from the Bank, the Government is working on the organization of highway construction.

(f) Creditworthiness

Given the adoption of the new exchange rate, fiscal, monetary and wage policies outlined in the preceding section, Colombia would become creditworthy for the full scale of external lending required by the Consultative Group project list, on which basis the Bank would be able to proceed with all projects presently under its own consideration. The Loan Committee agreed that in setting the grace periods on Colombian loans, "country problems" should be taken into account and the Bank should have a generous attitude in determining grace periods; however, a set formula should not be adopted and decisions should reflect the circumstances of each individual case.

(g) IDA-Worthiness

Given the present limitations on IDA funds and present eligibility criteria, Colombia is not considered eligible for IDA credits at this time.

COSTA RICA

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September 16, 1965

BRIEFING PAPER - 1965

COSTA RICA

I. MEETING WITH DELEGATION

Date: September 27, 1965

Time: 3:30 p.m.

Staff: Mr. Alter
Mr. Chaufournier
Mr. Weiner
Mr. Vignes
Mr. Kuczynski
Mr. Hawkins
Mr. Monsod
Mr. Schmitt

II. MEMBERS OF DELEGATION

Carlos M. Escalante	(B-F)	Member, Board of Directors Banco Central de Costa Rica
Felix Echeverria	(B-F)	Director, Foreign Exchange Department, Banco Central de Costa Rica

III. BANK/IDA PROSPECTIVE OPERATIONS

Projects presently under consideration:

<u>Purpose</u>	<u>Tentative Amount (\$ million)</u>	<u>Status</u>	<u>Tentative date for negotiations</u>
Agricultural credit	11-13.5	Appraisal report being prepared	Early 1966
New Port at Moin	To be de- termined. <u>1/</u>	Terms of reference for preliminary engineering is under discussion.	Late 1966
Power (2nd stage of Rio Macho and a thermal plant)	17-19	ICE is updating its studies for the re- view by consultants.	Mid-1966
Roads (Plan Vial II)	To be de- termined.	The Bank will be re- viewing the recently completed Plan.	Mid-1966

In addition projects may develop in the following fields:

Education - The UNESCO expert on the recent Bank mission is presently writing his report. There may be scope for a project along the lines of a technical-vocational school provided certain reforms are made in the educational system, particularly in the secondary-vocational level.

Industry - a third industrial equipment loan may materialize during the year.

1/ The total cost is about \$20 million of which \$7 million is in foreign exchange. In addition, financing is being requested for the access road to the port as an integral part of the project.

IV. TOPICS FOR DISCUSSIONa) To be raised by Bank at staff level(i) Financial position of the country:

The recent economic mission which visited Costa Rica has found that the fiscal position has deteriorated considerably in the current year. The mission discussed with President Orlich and others the type of measures which will be necessary to improve Costa Rica's internal financial performance and control its rising external debt, and thus make it possible for the Bank to move ahead with consideration of Loans for large and important infrastructure projects.

(ii) Delays in payments:

Consistent delays in payments were experienced in connection with our highway loan. In June we sent a letter expressing our concern; the Minister of Finance replied that he would take appropriate measures. We should emphasize that this is a very serious matter. The next installment is due in November 1965.

(iii) Regional Telecommunications:

We may congratulate the delegation for the attitude of Costa Rica in this respect. They were very active in preparing the Ministerial Meeting held in San Jose at the end of July and in trying to convince other countries to participate in the scheme. They also signed the Charter for the proposed regional company. What are their views about the future and any action the Bank could take?

(iv) New approach to operations in Central America:

A supplementary memorandum will be prepared after preliminary discussions with CABEI.

b) To be raised by Bank at meeting with President or Vice President

No meeting scheduled.

September 23, 1965

c) Likely to be raised by delegation

Although ICE has already agreed to raise its rates and employ consultants to review its 5 year power program, the delegation may cite the Bank's insistence on these two issues as indicative of a new rigidity in attitude. Secondly, the delegation may inquire about ICE's request for disbursement on local purchases made in connection with the Cachi Project.

We may reply that we are willing to continue our lending to the country, as evidenced by our sending a general economic mission in November 1964, the present economic mission to review the financing of Costa Rica's public investment program and the agricultural credit appraisal mission. But we are concerned by the financial situation of the Government and look forward to a timely improvement in this situation (see IV. a) (i) above).

As far as ICE is concerned, we insisted on the rate increase in accordance with ICE's obligations under our Loan Agreements which were undertaken in order to protect its financial position. We have been concerned over ICE's deteriorating financial condition and, in this respect, also with the difficulties we have sometimes encountered in securing consistent financial reports.

Regarding ICE's request for disbursements on local purchases, we have already requested revised estimates of foreign and local costs to determine the amounts that can reasonably be re-allocated.

V. BACKGROUND INFORMATIONa) Bank loans as of July 31, 1965

		(US \$ Millions)	
Year	Purpose	Amount less Cancellations	Undis- bursed Balance
1956	Banco Central de Costa Rica	3.0	nil*
1959	do.	3.5	nil
1960	do.	2.0	nil
1961	Instituto Costarricense de Electricidad (ICE)	8.8	nil
	Banco Central de Costa Rica	3.0	1.0
	Government of Costa Rica	5.5	3.2
1963	Instituto Costarricense de Electricidad	22.0	13.5
Total		47.8	
of which has been repaid		7.5	
Total outstanding		40.3	
Amount sold		3.2	
of which has been repaid		2.9	.3
Net amount held by the Bank		40.0	

b) IDA Credits as of July 31, 1965

(US \$ Millions)			
Date	Purpose	Amount less Cancellations	Undis- bursed Balance
October 13, 1961	Road	5.5	3.2

c) Technical Assistance Activities

UN Special Fund Port and Railway Study, for which the Bank acted as Executing Agency, was completed end of 1964. We are in touch with the Government for implementation of the recommendations.

None contemplated at present.

d) Access to Private Capital Markets

Not applicable

e) Bank 9% Capital Subscription: (\$.96 million)

Costa Rica increased its subscription by \$2.7 million in March 1965. \$360,000 have been released and lent in dollars.

f) IDA Subscription

90% subscription: \$180,000. No releases.

g) Holding of Bank Bonds

None

h) I.F.C.Industrial Investments

IFC (with participation \$89,848) made an investment of \$269,529 in a concrete products plant in 1962; an additional investment of \$320,000 (with participation: \$49,600) was made in 1965.

VI. POLITICAL SITUATION

Present Government's action has been inhibited because of its narrow majority (1 vote) in Congress. Elections will be held in February 1966. The present general opinion is now that Sr. Daniel Oduber, of the same party as the incumbent President, Francisco Orlich, may win it by a narrow margin. The period immediately before and after elections is likely to pass without concrete accomplishments.

VII. ECONOMIC SITUATION

Population: 1.4 million
GNP per capita: \$360
Foreign Exchange Reserves: \$1.4 million

The Costa Rican economy has shown signs of strength in recent years. Despite the volcanic eruption which began in March 1963, a moderate increase in exports and some growth in income was achieved in 1963 and 1964. The industrial sector has grown rapidly, encouraged by import-substitution opportunities at home and increased sales of manufactures to members of the Central American Common Market.

The volcanic eruption died down at the end of 1964, and the way now seems clear for a determined development effort. The chief problem which will have to be eradicated if this effort is to be successful is Costa Rica's large and continuing budget deficit. There is a more or less constant gap, amounting to 2-3 percent of GNP, between Government revenues and total expenditures. In the last four years, a substantial amount of short and medium term borrowing from U.S. banks has been undertaken to finance the budget deficit and the cash shortage of the power enterprise (ICE). If Costa Rica is to have the external debt-servicing capacity necessary to service the large amount of external borrowing (mostly from the IBRD) for the high-priority projects planned in the next few years, a determined effort will have to be made by the authorities to reduce or eliminate the budget deficit and raise public savings. Government revenues have on average barely kept up with the growth of the economy. They averaged 12.8 per cent of GNP in 1957-1959 and dropped to 11.7 per cent in 1961-1963. An IBRD mission is visiting (September) Costa Rica to attempt to work out a reasonable financing plan for the public investments being planned.

While Costa Rica's resource endowment is good, the extremely rapid rate of population growth in recent years (an unbelievable but census-proved 4.4% annually) is already posing problems, since it leads to an unduly high proportion of resources going into current expenditures for social services. The pressure of population is reflected in the budgetary problem, since the number of taxable wage-earners grows at a slower rate than the population of dependents requiring education. To overcome the problem of population, short of birth control education, Costa Rica will have to achieve high rates of economic growth which, in the context of its economy, are largely dependent on a substantial expansion of foreign exchange earnings.

Reasonable projections indicate that from a high point in 1964/1965 (13.5 per cent of estimated export earnings) estimated service on the external debt would likely decline \$12.9 million (or 9.5 per cent of forecast export earnings) in 1959. Thus the debt service burden appears to be manageable, assuming that very little or no new short term borrowing takes place. In addition, concrete measures are required if the Government is to increase its current account surplus to the level needed to adequately supplement external financing. Also, in view of the magnitude of justified capital requirements in relation to the present and prospective debt service burden, there is some justification for extending part of new external financing on extended terms.

DOMINICAN
REPUBLIC

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September 16, 1965

BRIEFING PAPER - 1965

DOMINICAN REPUBLIC

I. MEETING WITH DELEGATION

Date: September 29, 1965

Time: 9:30 - 10:00

Attended by: Mr. Alter
Mr. Chaufournier
Mr. Wright
Mr. Nelson
Mr. Bochenski
Mr. van der Heijden

No meeting scheduled with President or Vice-President.

II. MEMBERS OF DELEGATION

Not yet known.

III. BANK/IDA PROSPECTIVE OPERATIONS

No lending is considered in the near future and no projects suggested for possible Bank financing are close to being ready.

With a Provisional Government established the Bank will take the following actions:

Yaque Studies program (UNSF Project)

Provided satisfactory arrangements are made to solve organizational problems concerning the Dominican agency to be entrusted with the studies under the Plan of Operation (signed on February 25, 1965), the Bank will continue to act as Executing Agency for these studies.

Education

The report on "Educational priority projects for development" which has been prepared by the Project Identification Mission organized under the cooperative program between the Bank and UNESCO will be discussed with the Government.

IV. TOPICS FOR DISCUSSION

- (a) To be raised by Bank at staff level:

Economic Situation

Give delegates copies of last economic report emphasizing our concern about the deterioration of the country's economic situation over the last years and the necessity of remedial actions (as outlined in Section VII of the B.P.). In case the delegates should be already familiar with the economic report, copies of which were given to Mr. Pastoriza, personal representative of the Provisional President of the Republic, earlier in September, a discussion of the conclusions of the report might develop.

- (b) To be raised by Bank at meeting with President or Vice-President:

No meeting scheduled with President or Vice-President.

- (c) Likely to be raised by delegates.

- (i) Bridges:

Before the Civil War a project for a selective replacement of wooden road bridges by pre-stressed or post-stressed concrete structures was considered as a possibility for a future loan. A feasibility study was to be prepared by J.G. White and AID was to finance the study from a US\$1 million loan for feasibility studies. Delays in the signing of the contract between the Government and J.G. White developed because of various additional requirements of AID, which became known only after the Government, AID and the Bank had agreed to the terms of reference of J.G. White.

If the Government should inquire about the Bank's attitude to the project, the answer could be that the Bank has already made the expected contribution by drafting the terms of reference for J.G. White and that in the present circumstances we do not see any prospect for either Bank or IDA financing of the project for a while.

- (ii) Port of Santo Domingo

Previous governments have repeatedly approached the Bank for assistance in improving the operation of the port of Santo Domingo. A staff member of the Bank (Lowdon) visited the port twice and recommended (in March 1965) that (a) a firm of consultants be engaged to make recommendations for improvement of the port's administration, and (b) that the Government consider setting up an autonomous port authority.

To the best of our knowledge no firm of consultants was firmly contracted by the last Government (Mr. Lowdon had left with the Government the name of three firms experienced in that field). A commission for preparing an autonomous port authority was set up but never met.

September 8, 1965

If the Government should inquire about the Bank's attitude, we should (a) affirm that we are prepared to continue to provide advice on this matter but also (b) inquire whether the nature of the problem has not changed following the hostilities. (Mr. Lowdon did not see any need for large construction or reconstruction works in the port but this situation might have changed, since the port was the front line during the civil war. In fact, there are rumors that four out of the previously existing seven warehouses have been destroyed.)

V. BACKGROUND INFORMATION

(a) Bank Loans as of July 31, 1965

No loans have been made.

(b) IDA Credits as of July 31, 1965

No credits have been made.

(c) Technical Assistance Activities

The resident mission has been terminated as of June 30, 1965, as agreed with the Government early in 1965 although de facto there has been nobody in residence since April 17, (a week before the outbreak of hostilities).

Technical assistance in the preparation of projects (Yaque basins, education, bridges and port of Santo Domingo) has been mentioned above under III and IV.

(d) Access to Private Capital Markets

Banking connections:

Canada - Royal Bank of Canada, Bank of Nova Scotia)all have)branches in)the D.R.
U.S.A. - Chase Manhattan Bank, First National City Bank	

(e) Bank 9% Capital Subscription

Total 9%: US\$ 1.2 million

On March 16, 1964, the Board of Governors approved an increase in the capital subscription from \$8 million to \$13.3 million. The increase became effective on July 16, 1964. There has been no release of 9%.

(f) IDA Subscription

US\$ 360,000 No release.

(g) Holdings of Bank Bonds

None.

(h) IFC

IFC has made no investments in the Dominican Republic and there are no pending applications.

At the time of the political crisis in April, a Steering Committee of Dominican businessmen, with IFC assistance, were at an advanced stage in the formation of a private development finance company. This project is now in abeyance.

VI. POLITICAL SITUATION

On April 24, 1965, the de facto government - headed by Dr. Donald Reid Cabral, President of the Triumvirate (composed of himself and a second member) - was overthrown. Following severe fighting and other disturbances, an expeditionary force of U.S. troops, soon reinforced by troops from other OAS countries, landed and is still occupying parts of the country. An OAS peace mission, after many weeks of negotiations succeeded in bringing about an agreement between the two rival governments which consists briefly of (a) setting up a provisional government for 9 months with general elections thereafter; (b) disarming of the civilian combatants and political amnesty. The provisional President, Dr. Hector Garcia Godoy, formerly ambassador, foreign minister and industrialist, took power on September 3. He is well and favorably known to staff members of the Bank and IFC and was one of the candidates for a possible IFC sponsored private development finance company.

VII. ECONOMIC SITUATION

Population:	3.5 million
GNP per capita:	US\$ 245
Foreign Exchange Reserves:	US\$ 54.4 million

After the downfall of the Trujillo regime in 1961, the Dominican Republic experienced a period of political instability and rapid economic deterioration. Previously suppressed consumer demand increased substantially, stimulated by sharply higher wages, lower taxes and a large expansion in bank credit. Successive governments, in addition, proved unable to manage properly the large Trujillo enterprises which had been confiscated. The Sugar Corporation, in particular, incurred increasing deficits. The net result was a serious disruption of both the domestic and external finances. The de facto civil government which came to power in September 1963 was becoming increasingly aware of the country's pressing financial problems and initiated a stabilization program which aimed at improving the financial situation of the public sector. In August 1964, this government entered into a Standby Arrangement with the International Monetary Fund, designed to improve the balance of payments' situation by fiscal and monetary means. Steps were also taken to initiate important new development projects.

The improvement that was just beginning under the stabilization program was interrupted on April 24, 1965, when this Government was overthrown. The ensuing Civil War led to the well known intervention of US military forces, subsequently merged into the OAS Peace Force, and to serious economic dislocations which aggravated considerably the country's difficult economic problems. Economic activity declined rapidly and the GNP probably will drop by about 30 per cent in 1965. A sizeable amount of US grant assistance became available, however, which temporarily eased the balance of payments situation. Up to August 1965 it amounted to US \$47.5 million of which a large part went for meeting the April through June public payroll. July and August payments were not met, largely to bring about political pressures on the Imbert Government, which controlled the main part of the country.

When a Government is established in the Dominican Republic, it will have to undertake at the minimum a comprehensive program of measures to encourage exports (which at present show very poor prospects), to raise substantially public sector savings and to improve the planning and execution of public investments to restore momentum of the Dominican economy. In fact, unless these measures are taken, long-term growth may well decline below the high level of population increase. The public sector, especially the Sugar Corporation, must improve its financial position if the already very high debt burden is not to worsen further and if high priority investments are to be carried out. The Dominican Republic can no longer plan to supplement deficient savings by resort to heavy external borrowing as in the past. Debt service charges for 1965 were already so high (one-third to one-half of export proceeds) that default was only avoided by some difficult rescheduling. In addition, unless conditions of continuing reasonable political stability prevail in October 1965, and the country's economic prospects improve, the foreign banks which made a total of US\$24 million loans to the Sugar Corporation, may not be willing to make new finance

available to cover the Corporation's dead season expenditures. This would almost certainly bring about the financial collapse of the enterprise, unless some external aid on special terms is extended.

Urgent attention will have to be given to strengthening the balance of payments. In view of the internal cost increases of the last three years, such measures will in all probability now have to include an adjustment in the exchange rate. Such an adjustment would permit exports to grow faster, would tend to reduce the demand for foreign exchange for imports, foreign travel and investment income remittances, and would contribute to solving the financial problems of the Sugar Corporation.

The external lending agencies agree to the main part of these reforms. In fact, under the auspices of the OAS/CIAP, efforts will be made to induce the Provisional Government to carry out at least part of them; these efforts would then be supported by increased external assistance.

The country's serious outstanding problems including its heavy external debt burden, together with present uncertainties with respect to the extent by which the Provisional and/or subsequent Government will be willing and able to introduce the essential but far reaching economic reforms, are the main reasons why the Dominican Republic cannot be considered eligible for either Bank or IDA financing for the time being.

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September 22, 1965

BRIEFING PAPER - 1965

ECUADOR

I. MEETING WITH DELEGATION

Date: September 27, 1965

Time: 4:00 p.m. - 4:30 p.m.

Attended by:

Staff: Mr. Alter
Mr. Chaufournier
Mr. Wright
Mr. Wiese
Mr. Shibusawa

II. MEMBERS OF DELEGATION

Antonio MATA Martinez

(B)

Minister of Industry and
Commerce

Gustavo LARREA

(B)

Ambassador to the USA

Guillermo PEREZ Chiriboga

(F)

General Manager,
Central Bank del Ecuador

Alfonso ARCOS V.

(F)

Director of Research,
Central Bank del Ecuador

III. BANK/IDA PROSPECTIVE OPERATIONS

Loans presently under consideration:

<u>Purpose</u>	<u>Approximate Amount (\$ millions)</u>	<u>Status</u>	<u>Tentative date for Negotiations</u>
Second Guayaquil Port Project	3.0	Appraisal report being prepared	December 1965
Private Develop- ment Bank	3.0	Awaiting establish- ment of COFIEC and appointment of the General Manager	Early 1966
Guayas River Bridge	to be decided	Awaiting result of traffic and finan- cial studies, being carried out by Planning Office and Comite de Via- lidad (prospective borrower)	Mid-1966

IV. TOPICS FOR DISCUSSION

(a) To be raised by Bank at staff level:

(i) Economic Situation:

Express concern based on chapter VII below.

(ii) Guayas River Bridge:

We should remind the Government that we are unable to consider this project further until additional information on the financial and traffic aspects of the project is received by the Bank. The Comité de Vialidad de Guayaquil, prospective borrower, has not been too cooperative in this respect.

(iii) Central Bank and Other Government Agency purchases of 2-year Bonds for March 1966:

We should inform the delegation of the Bank's plans for a 2-year bond issue of \$100 million in March 1966, and seek to obtain some idea of how much might be bought, and if none, why not.

(b) To be raised by Bank at meeting with President or Vice-President:

No meeting scheduled.

(c) Likely to be raised by delegation:

(i) Possible Bank financing for Livestock:

Suggested response: Preliminary project identification mission scheduled for mid-October.

(ii) Possible Bank financing for the Pisayambo Hydroelectric Project (INECEL):

Suggested response: Bank is prepared to review the feasibility study as soon as it is ready.

(iii) Possible Bank financing for Jubones and Cola de San Pablo Hydroelectric Projects (INECEL):

Suggested response: Bank is prepared to review the feasibility studies as soon as they are available.

V. BACKGROUND INFORMATION(a) Bank Loans as of July 31, 1965

Year	Borrower	Purpose	Amount less cancellations	Undisbursed Balance
1954	Comite Ejecutivo de Vialidad del Guayas	Roads	7.5	0.0
1956	Empresa Electrica Quito, S.A.	Power	5.0	0.0
1957	Empresa Electrica Quito, S.A.	Power	5.0	0.0
1957	Republic of Ecuador	Roads	14.5	0.0
1958	Autoridad Portuaria de Guayaquil	Port Construction	13.0	0.0
1964	Republic of Ecuador	Roads	<u>9.0</u>	<u>6.8</u>
	Total		54.0	6.8
	of which has been repaid		<u>12.8</u>	
	Total outstanding		41.2	
	Amount sold	1.1		
	of which has been repaid	<u>0.4</u>	<u>0.7</u>	
	Net Amount held by Bank		40.5	====

(b) IDA Credits as of July 31, 1965

Date	Purpose	Amount (\$ millions)	Undisbursed Balance
May 26, 1964	Highway Construction	8.0	8.0

(c) Technical Assistance Activities

National Institute of Electrification (INECEL)

Bank advisory assistance to INECEL in preparing the basis for a national electrification plan was completed in October 1964.

(d) Access to Private Capital Markets

No prospects in foreseeable future.

(e) Bank 9% Capital Subscription (\$1.54 million)

Full amount released in dollars.

(f) IDA Subscription (\$0.585 million)

None released.

(g) Holdings of Bank Bonds

\$1.0 million.

(h) I.F.C.

Member.

(i) IFC management plans meetings at the Annual Meeting with the Ecuador delegation.

(ii) An investment of approximately \$2 million for the expansion of a cotton textile plant (la Internacional) will be presented to IFC's Board of Directors during the month of September 1965.

(iii) The sponsors of a new private development finance company in Ecuador, Corporacion Financiera Ecuatoriana (COFIEC), have been informed that IFC will not consider an investment in the share capital until the Company has had a year or so of successful operation, but they have been told that the Bank would consider a loan if COFIEC is set up on a satisfactory basis. The sponsors are now proceeding to organize the Company.

VI. POLITICAL SITUATION

The Military Junta, which assumed office in July 1963, proclaimed in early June 1965 to hold a presidential election on July 11, 1966. The elected president is expected to take office on September 1, 1966. Inasmuch as the Military Junta had originally announced that it would hold a presidential election in July 1965, this one-year postponement caused great dissatisfaction among political opposition leaders as well as the public, especially in Guayaquil. This resulted in a general manifestation on July 9, 1965. Consequently, the Military Junta reorganized the cabinet to include additional ministers from the Guayaquil area. The regime hopes that with this cabinet change the public will not press violently to have the date of the presidential election moved up from July 11, 1966. In the meantime, a number of political opposition leaders who were deported to Paraguay prior to or during the general demonstration of July 9, 1965, have been allowed to return to Ecuador.

VII. ECONOMIC SITUATION

Population	:	4.80 million (mid-1964)
GDP per capita	:	US\$ 195
Foreign Exchange Reserves:		US\$ 31.4 million.

The recent period of rapid growth in the Ecuadorian economy, based on an export boom in bananas, has now ended. The increase in GDP in 1965 will be small and there may well be an actual fall. This pattern has been determined by the recent decline in exports, which is the result of the loss of markets for bananas in the face of over-production throughout the world. While it may be possible to redress the position to some extent by internal cost reductions and changes in the organization of the industry, long-term prospects are much less optimistic than they were when the Ten Year Plan for Economic and Social Development was adopted in 1963. The first steps have now been taken to revise the plan, the execution of which is now more urgent than ever, because its main aim is to diversify the economy into other lines of production and end the dependence upon a narrow range of exports.

The external public debt outstanding at the end of 1964 was \$163 million, compared with \$116 million at the end of 1963. Interest and amortization payments were equal to 10.3% of current account exchange earnings in 1963 and are projected to decline to 6.4% in 1970.

The current account deficit was \$38 million in 1964, compared with a small surplus in 1963. The foreign exchange reserves continued to rise throughout most of 1964, reaching a peak of \$49 million in October; since then they have fallen continuously to about \$31 million. However, there has been little pressure on the rate of exchange and no evidence of capital flight.

After a long period of minor increases the cost of living rose by 4% in 1964, largely because of continued difficulties with food supplies affected by bad weather.

Further progress was made in 1964 with the fiscal reforms designed to strengthen the central government and prevent the dispersion of resources amongst many autonomous agencies. The overall deficit in 1964 was very small and was more than covered by internal savings and the proceeds of foreign loans. The fiscal performance in 1965 is expected to be rather poor because a large increase in expenditures was budgeted on the basis of over-optimistic revenue forecasts. The public deficit of the Central Government in 1965

may exceed \$28.0 million compared with \$21.0 million estimated by the CIAP Mission in May 1965. Political resistance has slowed up the completion of the recent drive for fiscal reforms and there are disturbing signs that some of the reforms will be rescinded in the face of regional/sectorial pressure groups.

Ecuador is eligible for a blend of IDA and Bank credits. It has limited creditworthiness, is among the poorer countries, and has had a satisfactory performance. The proposed Second Guayaquil Port project of \$3 million will probably be made an IDA credit (see III above).

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September 23, 1965

BRIEFING PAPER - 1965

EL SALVADOR

I. MEETING WITH DELEGATION

Date: September 29, 1965

Time: 3.00 p.m.

Staff: Mr. Alter
Mr. Chaufournier
Mr. Weiner
Mr. Vignes
Mr. Kuczynski
Mr. Schmitt

II. MEMBERS OF DELEGATION

Francisco AQUINO	(B-F) (Gov)	President, Banco Central de Reserva
Lucio PLATERO	(F)	Undersecretary of Finance
Guillermo BORJA NATHAN	(B)	Executive Secretary, Planning Council

III. BANK/IDA PROSPECTIVE OPERATIONS

<u>Purpose</u>	<u>Tentative Amount</u>	<u>Status</u>	<u>Tentative dates for negotiations</u>
Supplementary Highway Loan	2.8	Soon to be submitted to Loan Committee	December 1965
Irrigation	To be deter- mined	Feasibility study underway	Mid 1966
Highways	3.0	Feasibility study being prepared	Mid 1966
Education	To be deter- mined	Project preparation mission scheduled	Mid 1966

IV. TOPICS FOR DISCUSSIONa) To be raised by Bank at Staff level:(i) General

While we might express concern about delays in the execution of our Highways Development Credit underway and in the preparation of the next Highway program, we should welcome the diversification of our activities in El Salvador with the forthcoming irrigation and education projects. We should also congratulate El Salvador for their effort in working out a 4-year development program and enquire whether we can be of assistance in projects preparation.

(ii) Regional Telecommunications

Colonel Guerrero fought very hard against the regional telecommunications project on the grounds that (a) interconnection of the national telecommunications systems can be achieved more cheaply and more promptly by the national organizations themselves without establishing a regional company and (b) World Bank financing is cumbersome.

We should express our surprise that El Salvador, usually the leader for the Central American integration movement, has been the main opponent of this first and important integration project. We also should express surprise at the judgment passed by Colonel Guerrero on the Bank's action and enquire about specific facts on which this judgment is based. Finally, we might point out that execution of the project on the one hand and selection of the lending agency on the other are two entirely different questions. With regard to the concept that interconnection of the national systems would be best achieved by the various national telecommunications organizations, the delegation's attention might be drawn to the fact that action by these organizations would likely be subject to considerations of national priorities for the allocation of the national resources and would likely result in considerable delays in the construction and the development of proper interconnection over the whole area. This, in fact, was a major argument in favor of the proposed regional company.

September 23, 1965

(iii) New Approach to operation in Central America:

A supplementary memorandum will be prepared after preliminary discussions with CABEI.

(iv) 9% Capital Subscription:

We should enquire about the status of the unreleased portion of El Salvador's capital subscription, and press for its release over say a four-year period. (The original \$180,000 was released several years ago.) The delegation may explain that the decision was deferred out of concern that the Bank would use it as a precedent in requesting similar releases from other Central American countries. We should reply that we consider the case of each country on its own merit (example Costa Rica) and that Nicaragua, for example, had already agreed to release its 9% subscription. Also the delegation may explain that El Salvador would be willing to release the remaining portion (\$780,000 equivalent) of its 9% subscription on condition that purchases be limited to those from Central America and Mexico. We then should indicate that a release with such a limitation would be of very little value to the Bank. Finally, we might observe that at the last Annual Meeting, the Salvadorian delegation promised that the matter would be given full consideration. Apparently, however, no progress has been made in this respect.

(v) Bond Issue on External Markets

We might enquire about any action taken as a follow-up to Mr. van Zelm's mission to El Salvador last February at Mr. Aquino's request. The purpose of the mission was to advise the Banco de Reserva on the possibility of issuing public sector bonds abroad. We might enquire about any follow-up to this mission on the Salvadorian part.

(vi) Central Bank and Other Government Agency purchases of 2-year Bonds for March 1966

We should inform the delegation of the Bank's plans for a 2-year bond issue of \$100 million in March 1966 and seek to obtain some idea of how much might be bought, and if none, why not.

September 2, 1965

- b) To be raised by Bank at meeting with President or Vice President:

No meeting scheduled.

- c) Likely to be raised by Delegation:

(i) In connection with the proposed supplementary Highway loan, the delegation might complain about (a) the delays in the official decision and (b) financing the additional cost of the projects through a Bank loan, whereas original financing was through an IDA Credit.

On the first point, we should point out that we did not receive until August the information requested about the increase in costs and revised economic justification of the feeder roads part of the project. On the second point, we would have just to explain IDA's eligibility criteria. The earthquake which affected San Salvador mid-1965 has not changed El Salvador's position in this respect.

(ii) In connection with assistance in the education field, the delegation may ask about the status of the Bank/UNESCO project preparation mission. We can indicate that the mission is scheduled to arrive in El Salvador in mid October.

V. BACKGROUND INFORMATION(a) Bank Loans as of July 31, 1965

Year	Borrower	Purpose	(US \$ Millions)	
			Amount less cancellations	Undis- bursed Balance
1949	Comision del Rio Lempa	Power	12.5	nil
1954	Republic of El Salvador	Roads	11.1	nil
1959	Republic of El Salvador	Roads	5.0	nil
1959	Comision del Rio Lempa	Power	2.7	nil
1960	Comision del Rio Lempa	Power	3.4	nil
1963	Comision del Rio Lempa	Power	6.0	1.9
1963	Administracion Nacional de Telecomunicaciones	Tele- communications	9.5	8.2
Total			<u>50.2</u>	<u>10.1</u>
of which has been repaid			15.0	
Total outstanding			<u>35.2</u>	
Amount sold			3.1	
of which has been repaid			1.6	1.5
Net amount held by the Bank				<u>33.7</u>

(b) IDA Credits as of July 31, 1965

Date	Purpose	(US \$ Millions)	
		Amount less cancellations	Undis- bursed Balance
Nov. 2, 1962	Highways	8.0	5.4

(c) Technical Assistance Activities

- (i) 1963-1964 Executing Agency for UN Special Fund Central American Study. The part of the report concerning El Salvador formed the basis for our Telecommunications loan.
- (ii) None contemplated at present

(d) Access to Private Capital Markets

Not applicable

(e) Bank 9% Capital Subscription

US \$ 0.96 million; 0.18 Released and lent in dollars.

(f) IDA subscription

90% subscription: US \$ 270,000. No releases.

(g) Holding of Bank Bonds

\$600,000

(h) I.F.C.

Industrial Investments

IFC made an investment in a textile plant (\$140,000) which has been sold. There are no pending applications.

VI. POLITICAL SITUATION

President Julio Rivera of the Partido de Conciliacion Nacional (National Conciliation Party) assumed office on July 1, 1962, for a term of five years. The President holds middle-of-the-road views and advocates moderate social and economic reforms. Elections scheduled end of 1966.

VII. ECONOMIC SITUATION

Population: 2.9 million
Per capita GNP: About US \$260
Foreign exchange reserves: US \$65.9 million

El Salvador's good economic performance continued in 1964. Exports, spurred by the rise in coffee prices, increased cotton production, and increase in the substantial trade with the Central American Common Market, reached a record level of \$178 million, compared to \$154 million in 1963 and \$119 million in 1961. Exports to Central America, mostly of manufactures, reached \$35 million in 1964, or 20% of total exports. The performance of the domestic agricultural sector has not been on a level with the efficient and highly-organized export sector. Nevertheless, from 1962 to 1964 GNP in real terms rose by about 8% annually.

The period of rapid economic growth has been accompanied by fiscal stability and a rapid increase in public investment, although public investment has fallen short of the ambitious targets set for it. In the last few months, a very rapid expansion in commercial bank credit led to an unduly large increase in imports, but the Central Bank has taken remedial measures which should rapidly ease the pressure on the balance of payments. On May 3, 1965, the city of San Salvador was hit by a severe earthquake, which will require fairly substantial reconstruction expenditures for housing and industrial buildings. Some of the reconstruction has already been completed, and El Salvador should be able to provide a major portion of the remaining needs out of domestic resources.

With its able entrepreneurial class, El Salvador should be able in the next few years to achieve a satisfactory rate of growth, especially if economic management continues to be of the high standards of the last 3-4 years. El Salvador should be able to finance most of its public sector external capital requirements on conventional terms.

El Salvador's favorable growth prospects, sound economic management, and low external debt service in relation to projected export receipts make it creditworthy for additional external loans on conventional terms to finance its probable external capital requirements over the next few years.

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September 23, 1965

BRIEFING PAPER - 1965

GUATEMALA

I. MEETING WITH DELEGATION

Date: September 27, 1965

Time: 4:30 - 5:00 p.m.

Staff: Mr. Alter
Mr. Chaufournier
Mr. Weiner
Mr. Vignes
Mr. Steuber
Mr. Kuczynski
Mr. Schmitt

II. MEMBERS OF DELEGATION

Carlos Enrique PERALTA MENDEZ (B)

Minister of Economy

Arturo PEREZ-GALLIANO (F)

Governor
President, Banco de Guatemala

Jorge Lucas CABALLEROS MAZARIEGOS (B)

Minister of Finance and
Public Credit

J. Francisco FERNANDEZ RIVAS (F)

Alt. Governor
Manager, Banco de Guatemala

Jorge Alberto PAPADOPOLO

Adviser, Ministry of Finance
and Public Credit

Mario R. GOMEZ-VALENCIA

Adviser, Sub-Gerente
Banco de Guatemala

Manuel MENDEZ

Adviser
Banco de Guatemala

III. BANK/IDA PROSPECTIVE OPERATIONS

The following projects are presently under consideration:

<u>Purpose</u>	<u>Tentative Amount</u>	<u>Status</u>	<u>Tentative Date For Negotiations 1)</u>
Power	\$15 million	Appraisal report being prepared	Early 1966
.....
Roads	\$25 million	Feasibility study to commence soon	Mid-1966
Pacific Port	\$12 million	Feasibility study underway	Mid-1966

¹⁾ Assuming early settlement of sterling debt issue.

IV. TOPICS FOR DISCUSSION(a) To be raised by Bank at staff level:1. Status of Sterling Debt Settlement

2. Economic Mission: What are the Government's intentions with regard to increasing their tax revenues as recommended in our economic report?

3. Power

The Bank is prepared to make a loan of about \$15 million for the financing of the power program discussed with the Bank mission last June. Our letter of August 4 indicated steps to be taken by INDE before a loan can be made:

- (i) Purchase of land for the Jurun-Marinala project as well as purchase - suggested by INDE - of El Salto and San Luis facilities;
- (ii) INDE to engage consultants for the planning and engineering of expansion program;
- (iii) Agreement in principle between INDE and Empresa Electrica on bulk power sales.

So far no answer has been received. We should inquire about the difficulties which may be encountered either within the Government or in the relations with Empresa Electrica.

4. Roads

The Bank is prepared to assist Guatemala in financing the roads El Estor-San Felips (200 km.) and Morales-Puerto Mendez (69 km.) and is also considering assistance in the preparation of the project for which consultants should be used in view of the lack of transport economists in the Highway Department. We should make it clear to the Delegation that we regard the acquisition of highway maintenance equipment through an Ex-Im Bank loan (not yet signed) as a prerequisite for Bank lending.

5. Pacific Port

The (favorable) conclusions of the recent FAO mission as to the justification of the fisheries part of the combined commercial/fisheries port were recently transmitted to the Government. The special Guatemalan committee established to study the port project has been slow in responding to the Bank's questionnaire. The major question is the location of the port (San José or Champerico). Are there indications that it will be resolved soon?

6. Education: If Unesco mission report is available, preliminary discussions on further steps.

7. Bank 9% subscription: If sterling debt is settled, we should request release of the remaining \$360,000 of unreleased 9% subscription.

8. IDA 90% subscription

We should explore, provided sterling debt is resolved, possibility of releasing the 90% subscription (\$360,000).

9. Regional Telecommunications

Guatemala did not attend the ministerial meeting held in San Jose (Costa Rica) on July 30 and 31, but sent an excuse cable. Previously the Minister of Communications and Public Works had indicated strong reservations about the proposed regional company. The reasons advanced were:

- a) Excessive multiplication of autonomous regional organizations which easily get out of governmental control;
- b) Legal procedure for establishing the proposed company would take time and would result in delays in construction of the regional network which is urgently needed;
- c) More studies would be necessary to make a convincing case that the proposed company would be a more efficient way to operate the regional network rather than to use the existing national telecommunications organization.

Counter arguments are:

- a) An autonomous regional organization in this case is justified by the necessity to make sure that proper and timely construction, maintenance and extension of the regional network would proceed in an orderly fashion all over Central America;
- b) Each government would have a director on the Board of the proposed company and, therefore, would be able to keep things under control;
- c) The Central American Telecommunications Committee, when preparing the draft charter of the proposed company, made clear that this company would use services existing in national organizations whenever feasible;
- d) CABEI indicated that, with a view to not delaying the execution of the project, they would be prepared to make financing available so that work can begin even before the proposed company is legally established and can contract for a loan from the Bank.

September 23, 1965

10. New Bank approach towards Central American Integration

A separate paper will be prepared in time for the Annual Meeting.

11. Central Bank and Other Government Agency Purchases of 2-Year Bonds for March 1966

We should inform the delegation of the Bank's plans for a 2-year bond issue of \$100 million in March 1966 and seek to obtain some idea of how much might be bought, and if none, why not.

(b) To be raised by Bank at meeting with President or Vice-President:

No meeting scheduled.

(c) Likely to be raised by delegation:

None.

V. BACKGROUND INFORMATION(a) Bank Loans as of July 31, 1965

(U.S. \$ Million)

Year	Borrower	Purpose	Amount less Cancellations	Undisbursed Balance
1955	Republic of Guatemala	Roads	<u>18.2</u>	<u>00.0</u>
	Total		18.2	00.0
	of which has been repaid		<u>8.6</u>	
	Total outstanding		9.6	
	Amount sold	2.1		
	of which has been repaid	<u>0.6</u>	<u>1.5</u>	
	Net amount held by Bank		<u>8.1</u>	

(b) IDA Credits as of July 31, 1965

None.

(c) Technical Assistance Activities

Possible technical assistance for preparation of highway project in Izabal and Alta Verapaz Departments.

(d) Access to Private Capital Markets

Not applicable.

(e) Bank 9% Capital Subscription: \$720,000

\$360,000 has been released and lent in dollars.

(f) IDA 90% Subscription: US\$360,000

No release.

(g) Holdings of Bank Bonds

None.

(h) I. F. C.

IFC made an investment (\$200,000) in a flour milling project, which has been sold. There are no pending applications.

VI. POLITICAL SITUATION

The present military Government headed by Col. Enrique Peralta Azurdia seized power on March 31, 1963. The Government, which has been recognized by most foreign Governments, provides more stability and better administration to the country than the previous one.

A Constituent Assembly was convened in July 1964 to:

- (a) Elect the present Chief of Government President of the transitional Government,
- (b) review and validate legislation passed on a decree basis by the present Government,
- (c) draft a new constitution.

The draft constitution is expected to be completed by the end of 1965. Elections would then take place in March 1966.

VII. ECONOMIC SITUATION

Population: 4.3 million
GNP per capita: About US\$280
(possible over-estimate)
Foreign exchange reserves (net):
US\$58 million

Since 1963, Guatemala has experienced rapid economic growth, largely spurred by a growth of exports from \$119 million in 1962 to \$167 million in 1964. The increase in exports was the result of a rapid expansion of cotton production, and of various minor products, including manufactures for sale in the Central American Common Market. Exports to the Common Market totalled almost \$30 million in 1964, compared to \$9 million in 1961.

The Government which assumed power in March 1963, has taken advantage of the bonanza period to introduce some badly-needed tax measures to raise public revenue. Even so, Guatemala's tax effort (8-9% of GNP) remains very low, particularly in relation to the substantial increase in public savings which will have to take place if various high-priority projects in transportation, power and education are to be carried out. An economic mission which visited Guatemala in December 1964 recommended a few specific steps to achieve a minimum increase in public revenue. The public sector will also have to direct a higher proportion of public revenues to the underprivileged Indian sector - which comprises half the population - if the country's long-term political stability is not to be jeopardized.

The maintenance of political stability is particularly important in Guatemala; in the fifties and early sixties, continued instability had a markedly depressing effect on economic activity. With a modicum of political stability, Guatemala's growth prospects are encouraging, and with a probably rapid growth of export earnings, it should be able to service comfortably on conventional terms the largest part of the external capital requirements of the public sector.

HAITI

CONFIDENTIAL
September 16, 1965

BRIEFING PAPER - 1965

HAITI

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I. MEETING WITH DELEGATION

Date: September 29, 1965

Time: 4:30 - 5:00

Attended by:

Staff: Mr. Alter
Mr. Chaufournier
Mr. Wright
Mr. Nelson
Mr. Bochenski
Mr. van der Heijden

No meeting scheduled with President or Vice-President.

II. MEMBERS OF DELEGATION

Not known yet

III. BANK PERSPECTIVE OPERATIONS

The Delegation will be told that for the time being neither the Bank nor IDA are prepared to start any operations in Haiti.

If the Delegation should ask for explanations, the following reasons could be given:

- (a) Haiti's current financial position and immediate prospects, jointly with its considerable indebtedness, do not permit further loans on conventional terms.
- (b) The great demand for IDA's limited funds imposes certain strict criteria for IDA eligibility, which consist not only of poverty of the country but also of general performance, in which Haiti has been deficient, particularly:
 - (i) Poor administration and inadequate cooperation in the execution of previous Bank/IDA activities, without evidence of improved prospects in this respect.
 - (ii) Growth of conditions under which the effectiveness of investment is limited by inefficiencies and waste in administration of economic activities.
 - (iii) Failure to direct effectively public policy to the promotion of economic development and the inability or unwillingness of the Government to give sufficient priority to economic goals as compared to other goals of public policy.
 - (iv) Conditions which have led to a discouragement of private investment and the exodus of substantial numbers of professional and skilled personnel with resulting economic impact.

IV. TOPICS FOR DISCUSSION

- (a) To be raised by Bank at staff level:

There will be no point in raising any matters.

- (b) To be raised by Bank at meeting with President or Vice President:

No meeting scheduled with President or Vice President.

- (c) Likely to be raised by delegation:

None foreseen other than the basic matters of Bank/IDA assistance, already discussed.

V. BACKGROUND INFORMATION(a) Bank Loans as of July 31, 1965

(US \$ millions)

Year	Borrower	Purpose	Amount less Cancellations	Undisbursed Balance
1956	Republic of Haiti	Highway maintenance and rehabilitation	2.6	0.0
		Total	<u>2.6</u>	
		of which has been repaid	<u>1.2</u>	
		Total outstanding	1.4	
		Amount sold	0.386	
		of which has been repaid	0.386	<u>0.0</u>
		Net amount held by Bank	1.4	

(b) IDA credits as of July 31, 1965

(US \$ millions)

Date	Purpose	Amount less Cancellations	Undisbursed Balance
November 2, 1962	Interim Highway Project	0.35	0.0
	Total	<u>0.35</u>	

(c) Technical Assistance Activities

A technical assistance grant was made in 1961 for study of reconstruction and reorganization of the port of Port-au-Prince. The report was sent to Haiti on September 30, 1963. No action has been taken yet on the report but the Haitians continue to be interested in a port project.

(d) Access to Private Capital Markets

Banking connections:

Canada	Royal Bank of Canada (has branch in Haiti)
USA	First National City Bank (main correspondent of Haiti's central bank)

(e) Bank 9% Capital Subscription (US\$ 1.35 million)

No release.

(f) IDA Subscription (US\$ 0.684 million)

No release.

(g) Holding of Bank Bonds

None.

(h) IFC

IFC has made no investments in Haiti and there are no pending applications.

VI. POLITICAL SITUATION

In May 1963 President Duvalier, after having made use of an ingenious electoral procedure, began his second six-year term, assuming the title of "Chief of the Revolution".

On May 27, 1964, the National Assembly ratified the decree providing a life-term for Dr. Duvalier. This was subsequently confirmed by a popular referendum.

The Duvalier regime is likely to stay in power for the foreseeable future. Most policies are subordinated to the self-preservation of the regime.

Political conditions in Haiti, although particularly deplorable in recent years, have been hardly ever satisfactory throughout the history of that unhappy nation. They are largely an outcome of excessive poverty with too few jobs and with jobs in government coveted by too many people; hence a continuous pressure towards changes and an almost irresistible temptation for illicit gains during the short periods of tenure of office. The relative stability of the Duvalier administration was achieved not only at the price of violating the constitution and electoral laws but, even more, by ruthless elimination of any potential opposition. This, jointly with the lack of opportunities for gainful employment within the country, led to large-scale emigration of the population both among agricultural workers, thousands of whom moved as cane-cutters to the Dominican Republic, and among the educated classes who settled, at least temporarily, in Africa, in the USA, in neighboring Puerto Rico and other countries.

VII. ECONOMIC SITUATION

Population:	4.4 million
GNP per capita:	US\$ 60-70
Foreign Exchange Reserves:	US\$ 4.0 million

Haiti is one of the poorest countries in the world, with a per capita GNP of about US\$ 60-70. Income per head has probably fallen in the past decade and certainly fell in the last 2-3 years. The recent deterioration is in part the result of two severe hurricanes in 1963 and 1964 which damaged the coffee crop, the country's chief export product. As a consequence, Haiti was unable to take advantage of the higher international coffee prices and in 1965 it has suffered a very drastic fall in export earnings.

The Haitian authorities have in recent years made some progress toward conservative fiscal and monetary policies suited to the country's scant means. A small amount of domestically financed public investment has been realized. In addition, the authorities have resumed service on all pending foreign debts: an agreement was signed in July 1965 with the Export-Import Bank, Haiti's largest creditor, and the first payment under the new schedule has been duly made. With the recent signing of a similar agreement with AID, Haiti has completed arrangements with all its foreign creditors. Furthermore, Haiti's export structure has in the last few years become more diversified, so that it is less dependent on coffee.

Notwithstanding these improvements, the nature of the present governing regime is such that the benefits of any assistance which might be provided at the present time is likely to be nullified by policies and actions which give higher priority to goals of the regime other than economic growth. These policies of the harsh dictatorship have contributed to the worsening economic situation and have resulted in the interruption of most US assistance and the rapid decline of tourism. In addition, as a result of oppression and falling income levels, a substantial amount of professionals are emigrating limiting further the country's ability to resume economic growth.

Taking the above considerations into account it is not considered appropriate for IDA to make additional commitments to Haiti at this time.

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CONFIDENTIAL

September 16, 1965

1-Rev.

BRIEFING PAPER - 1965

HONDURAS

I. MEETING WITH DELEGATION

Date: September 29, 1965

Time: 11.30 a.m.

Staff: Mr. Alter
Mr. Chaufournier
Mr. Weiner
Mr. Vignes
Mr. Zenick
Mr. Kuczynski
Mr. Schmitt

II. MEMBERS OF DELEGATION

Manuel ACOSTA BONILLA	(B) (Gov.)	Minister of Economy and Finance
Roberto RAMIREZ	(F) (Gov.)	President, Banco Central de Honduras
Guillermo BUESO	(F)	Chief, Research Department, Banco Central de Honduras
Gabriel A. MEJIA		Adviser Director, Banco Central de Honduras

III. BANK/IDA PROSPECTIVE OPERATIONS

Purpose	Tentative Amount (US \$ millions)	Status	Tentative dates for negotiations
Expansion and improvement of the Port of Puerto Cortes	4.1	Legislation establishing Port Authority now before Congress	End 1965 ^{1/}
Power Development	To be determined	Bank's mission scheduled mid-September to discuss scope of program	

^{1/} if legislation on Port Authority adopted in September.

IV. TOPICS FOR DISCUSSIONa) To be raised by Bank at Staff level:(i) Arrears due to the Empresa Nacional de Energia Electrica (ENEE)

The problem of arrears in Government payments due to the financially weak ENEE is a long-standing one. Despite many assurances that in accordance with the commitments undertaken by the Government in connection with our \$8.8 million (Canaveral hydroelectric project/loan of June 1960) payments would be kept current, the last of which was contained in a letter from the Minister of Economy and Finance dated November 25, 1964, arrears have mounted again. The issue was again raised by a Bank mission with the Minister of the Presidency, Ricardo Zuniga on May 26 and a subsequent letter was written to the new Minister of Economy and Finance on the subject. Nothing apparently has been done so far, but in a recent cable the Minister of Economy and Finance stated once more that he would settle the problem as soon as possible.

The Bank should reiterate to the delegation its serious concern about this matter and strongly press for a permanent and satisfactory solution thereof.

(ii) Regional Telecommunications

We should enquire about the position of Honduras vis a vis the proposed regional telecommunications company.

At the Ministerial Meeting held in San Jose (Costa Rica) end July, the Honduran delegation accepted the proposed scheme "ad referendum" and indicated that the President's decision could be expected within the next few days. So far no decision has been notified.

At the San Jose meeting, the Honduran delegation indicated that their Government had considered as an alternative to proceed with a proposed interconnection of the Honduran and Salvadorian telecommunications system. Financing was expected from suppliers credits. Did the Government take any steps further along this line?

September 23, 1965

We should observe that such an alternative would (a) leave without solution the problem of regional telecommunications, and (b) impose on Honduras itself the burden of financing the equipment which, otherwise, would be born by the proposed regional company.

Also, we have been told that Honduras objected to the proposed regional company on the grounds that more equipment would be located in Costa Rica than in any other country and that, consequently, equal distribution of the construction costs would not be fair. We should draw the attention of the delegation to the fact that the construction costs would be born by the company and not by any individual countries, which are only required to equally subscribe to the capital of the regional company, so as to have equal rights of vote in the Board.

(iii) Port of Puerto Cortes

We should express our concern in the long delay in establishing the Port Authority agreed upon mid-1964. The latest information is that the legislation required is now before Congress. We should enquire about the prospects for a decision.

(iv) Northern Road Project

The loan for this project was signed on February 1965. We should enquire about the status of the procedure to make it effective.

(v) Education

It is tentatively planned that the chief of the UNESCO mission, which is scheduled to be in El Salvador in October - November, will visit Honduras for several days to observe the educational system in the country. We are suggesting this visit to see whether we can be of assistance to Honduras within the framework of the Bank/UNESCO cooperative agreement.

The purposes and activities of the Bank/UNESCO in this field should be described to the delegation and we should offer to send Mr. Emerson to Tegucigalpa during the time period mentioned.

(vi) Central Bank and Other Government Agency purchases of 2-year Bonds for March 1966

We should inform the delegation of the Bank's plans for a 2-year bond issue of \$100 million in March 1966 and seek to obtain some idea of how much might be bought, and if none, why not.

b) To be raised by Bank at meetings with President or Vice President:

No meeting scheduled

c) Likely to be raised by Delegation:

The Government recently requested the Bank to waive the provision of the Loan Agreement for financing the North Road whereby the Government would have to provide L500,000 in 1965 as its contribution to the project. The reason for this request was that construction would not begin before January 1966.

Our position is that we would be willing to consider a reduction of the contribution agreed upon (down to L 100,000 needed to cover local contribution to various consulting services to be performed in 1965) provided we receive satisfactory assurances from the Government that settlement of the arrears to ENEE is underway. The Minister of Finance has cabled that payment would be made the week of September 13. We are now awaiting confirmation from ENEE of its receipt before acting on the Government's request.

V. BACKGROUND INFORMATION(a) Bank Loans as of July 31, 1965

			(US \$ millions)	
Year	Borrower	Purpose	Amount less cancellations	Undis- bursed Balance
1955	Republic of Honduras	Highway maintenance	4.2	nil
1958	Republic of Honduras	Highway construction	5.5	nil
1959	Empresa Nacional de Energia Electrica (ENEE)	Power	1.4	nil
1960	Empresa Nacional de Energia Electrica (ENEE)	Power	8.8	nil
1965	Republic of Honduras	Highway construction	6.0 ^{1/}	6.0
Total			25.9	6.0
of which has been repaid			5.7	
Total outstanding			20.2	
Amount sold		1.6		
of which has been repaid		1.4	.2	
Net amount held by the Bank			20.0	

^{1/} not yet effective(b) IDA credits as of July 31, 1965.

		(US \$ millions)	
Date	Purpose	Amount less cancellations	Undis- bursed Balance
May 12, 1961	Highway construction and improvement	9.0	3.3
Feb. 2, 1965	Highway construction	3.5 ^{2/}	3.5
Total		12.5	6.8

^{2/} not yet effective

(c) Technical Assistance Activities

1963-1964 Economic Adviser (Mr. C. J. Thomas)

1963-1964 Executive Agency for the UN Special Funds Central American Telecommunications. Report circulated in March 1964. No reaction from the Government.

(d) Access to Private Capital Markets

Not applicable

(e) Bank 9% Capital Subscription

\$720,000; \$540,000 released (original 9%) and lent in dollars.

(f) IDA Subscription

90% subscription; \$270,000. No release

(g) Holding of Bank Bonds

None

(h) I.F.C.

Industrial Investments

IFC (with participation: \$100,750) has made an investment of \$350,000 in a leather tanning project. There are no pending applications.

VI. POLITICAL SITUATION

Gen. Oswaldo Lopez Arellano who had been chief of Government since the military coup of October 1963 was elected President in March 1965 by the recently elected National Party dominated Constitutional Assembly. The angry charges of election fraud have since subsided and Liberal Party members of the Congress have taken their seats. General Lopez was inaugurated as President on June 6, 1965.

Virtually the entire cabinet was changed just prior to the inauguration and new appointments have been made in governmental institutions. Some of the new appointees, including the Minister of Foreign Relations, are Liberal Party members. This might be taken as an indication of some political stability in the future. The central decision making authority, however, is in the hands of the Minister of the Presidency, Ricardo Zuniga.

VII. ECONOMIC SITUATION

Population: 2.1 million
GNP Per capita: About US \$210
Foreign exchange reserves: US\$ 24.5 million

After several years of virtual stagnation, economic growth was resumed in 1962, under the stimulus of a continued period of political stability and of the coming into operation of essential infrastructure investments in roads and power. Since 1962, the Honduran economy has been growing at a brisk rate, although a slower one than Nicaragua, El Salvador and Guatemala. The stimulus for this growth has come from an increase in exports, particularly minor products other than bananas, and from a fairly rapid expansion of manufacturing for the domestic market.

The new administration which assumed power in the fall of 1963 introduced a number of tax measures which have made revenues more responsive to trends in the economy and are likely to help the public sector raise its very low level of savings. In view of the large needs for basic infrastructure investments in the next few years in relation to the low level of domestic savings and the uncertainties of export prospects in view of their still heavy dependence on bananas, Honduras was considered eligible for additional IDA assistance at the beginning of 1965. A \$3.5 million Development Credit was then made, together with a \$6 million Loan to finance highway construction. With this IDA credit, however, Honduras has received \$6.25 per head and is therefore in the "enough for the time being" category.

Honduras prospects for economic growth in the next few years should be good. Large investments in banana expansion should begin to pay off in the next couple of years, and the manufacturing sector should continue to expand. However, with a history of recurrent political instability and a new cabinet which includes appointees untested in economic management, there is need to observe carefully how ensuing events might affect economic expansion.

In view of its low debt-service ratio and favorable growth prospects, Honduras should be able to finance a substantial portion of its external capital requirements on conventional terms.

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September 16, 1965

BRIEFING PAPER - 1965

JAMAICA

I. MEETING WITH DELEGATION

Date: September 29, 1965

Time: 10:00 a.m. - 10:30 a.m.

Staff: Mr. Alter
Mr. Chaufournier
Mr. Weiner
Mr. Nelson
Mr. Kuriyama
Mr. van der Heijden

No meeting scheduled with President or Vice-President.

II. MEMBERS OF DELEGATION

D. B. Sangster (B-F)

Acting Prime Minister and
Minister of Finance

G. A. Brown (B)

Financial Secretary

R.T.P. Hall (F)

Acting Governor, Bank of Jamaica

Advisers

D. R. Clarke

Acting Under Secretary
Ministry of Finance

S. J. Stephens

Executive Assistant
Bank of Jamaica

JAMAICA

September 1, 1965

III. BANK PROSPECTIVE OPERATIONS

Projects presently under consideration:

Purpose	Amount (\$ million)	Status	Tentative Date for negotiations
Electric power	20.0	Feasibility study expected to be received late September 1965.	open
Education	3.0 - 5.0	Feasibility report expected to be received in October 1965.	open

The aforementioned projects have not yet been considered by the Loan Committee and the Government's requests for Bank assistance in them are so far on an unofficial basis. However, the Bank has been in close contact on the power project, for several years, with the Government and the power company.

Apart from the above listed projects, the following projects may eventually be presented to the Bank for consideration:

(a) Kingston Expressway project: A feasibility study for this project is to be undertaken shortly with the assistance of a Bank technical assistance grant. The study is expected to be completed in the course of 1966.

(b) Private Development Finance Company: Good progress is being made in the establishment, with IFC assistance, of a private development finance company in Jamaica. If established, it is possible that the company would seek part of its fund requirements from the Bank.

(c) Water Supply and Flood Control Project: The Government is now studying a water supply and flood control project at Harker's Hall, for which it may, in due course, seek Bank assistance.

IV. TOPICS FOR DISCUSSION

(a) To be raised by Bank at staff level:

(1) Economic situation: With reference to the recent economic mission to Jamaica, we might compliment the Jamaican Government for what is an imaginative and sound approach to economic development. This approach includes the creation of a healthy investment climate for the already strong and dynamic private sector, the sound Governmental financial policies, its increased level of public investment expenditures in education and agriculture in particular, and its efforts to develop further the local capital market.

We might also inquire about the Government's present thinking with respect to the financing of the increased level of public investment expenditures in the years 1967 and 1968, especially in the light of the limited prospective possibilities to raise external finance in the private capital markets abroad.

(2) % Release: Jamaica joined the Bank in February 1963 but has not released its 9 per cent capital subscription (\$2.4 million). The possibility of its release over a period of, say, five years has been discussed on previous occasions with the Government but no progress has been made to date. We should ask for a release on a convertible currency basis along the lines already discussed, stressing the following considerations: i) the 9 per cent capital released on a convertible basis would constitute a valuable addition to the Bank's resources at a time when the Bank is endeavouring to enlarge its operations and enter new fields of activities; ii) the release would provide tangible evidence of the desire of Jamaica to cooperate for the success of the Bank and to meet fully the obligation of membership, particularly at a time when the first Bank loan for highway development was made, technical assistance in project preparation, education and the Kingston Expressway study is being provided and further substantial Bank lending in Jamaica is expected to materialize in the near future; iii) while recognizing difficulties in the external payments position of Jamaica, it should be noted that, for instance, the five Central American countries with evidently similar or more serious difficulties and lower per capita income have already all agreed to release all or part of their 9 per cent capital subscriptions on a convertible basis; and iv) assuming a release spread over five years the annual impact would be relatively minor.

(3) IDA membership: Jamaica applied for IDA membership in September 1963 but has not proceeded to fulfill the requirements for membership. We should urge Jamaica's membership pointing out the importance we attach to international cooperation in this field and expressing our view that IDA will eventually be able to extend credits to Jamaica.

JAMAICA

September 21, 1965

(4) Central Bank and Other Government Agency purchases of 2-year Bonds for March 1966: We should inform the delegation of the Bank's plans for a 2-year bond issue of \$100 million in March 1966 and seek to obtain some idea of how much might be bought, and if none, why not.

(5) Power Project: We might inquire about the status of the signing of the new franchise for the Jamaica Public Service Company and the enactment of the Public Utility Commission Bill, both of which are necessary in our consideration of a loan for the proposed power project.

(6) Water Supply and Flood Control Project: We might inquire whether the Government has taken any decision on the proposed Harker's Hall water supply and flood control project, and if so, what decision.

(7) Packaging of Small Projects: During the visit of the recent economic mission to Jamaica, the possibility of packaging small projects in feeder road construction, agricultural credit, extension services, land settlement, marketing and storage facilities, etc. into packages sufficiently large for presentation to the Bank was discussed with the Government. The Government has since been working on this possibility; we might inquire about the status of its work on this matter.

(b) To be raised by Bank at meeting with President or Vice-President:

No meeting scheduled with President or Vice-President.

(c) Likely to be raised by delegation:

None

JAMAICA

September 22, 1965

V. BACKGROUND INFORMATION

(a) Bank Loans as of July 31, 1965

(US \$ millions)

Year	Borrower	Purpose	Amount less Cancellation	Undisbursed balance
1965	Jamaica	Highways	<u>5.5</u>	<u>5.5</u>
	Total		5.5	5.5
	of which has been repaid		<u>-</u>	
	Total outstanding		5.5	
	Amount sold	0.3		
	of which has been repaid	-	<u>0.3</u>	
	Net Amount held by Bank		<u>5.2</u>	

(b) IDA Credits as of July 31, 1965

Not yet member of IDA.

(c) Technical Assistance Activities

(1) Since January, 1965, Mr. Henry Wiens, consultant, has been seconded by the Bank to the Government of Jamaica to assist in the identification and preparation of projects. His assignment, which was to end in June, 1965, was extended to December, 1965, by request of the Government.

(2) A technical assistance grant of up to \$200,000 was approved by the Executive Directors in May, 1965 to assist in a feasibility study for the proposed Kingston Urban Expressway project. The Terms of Reference for the study have been agreed upon by the Bank and the Government and offers are being invited from consultants on the basis of said Terms of Reference.

JAMAICA

September 21, 1965

(3) Assistance is presently being provided the Government under the Bank/UNESCO cooperative arrangement in the preparation of a feasibility report for an education project. The report is expected to be completed in November 1965.

(d) Access to Private Capital Markets

Banking connections:

U.K. - Barclays Bank D.C.O.
Canada, U.S.A. - Bank of Nova Scotia

Investment

U.K. - Crown Agents
U.S.A. - Kuhn, Loeb and Co.
Canada - Annett and Co.

Bond Issues

£ 3.2 million, London, June 1964, 6-3/4%, 12 years.
Can. \$ 4.5 million, Toronto, June 1964, 7%, 22 years.
£ 3.15 million, London, June 1965, 7%, 13½ years.

(e) Bank 9% Capital Subscription

\$2.4 million. No release.

(f) IDA Subscription

Not yet member of IDA.

(g) Holdings of Bank Bonds

None

(h) I.F.C.

Industrial Investments

IFC has made an investment of \$224,000 in a pre-mixed concrete company in Jamaica. There are presently no new applications.

At the request of the Government, IFC sent a consultant, Mr. A.N.H. James, to Jamaica in August to assess the need for a development finance company. The consultant's report, endorsed by IFC, was transmitted to the Government on August 10. It recommended the establishment of a new private institution. The Government has agreed with principal recommendations, and in August a Steering Committee was established (with Mr. James' assistance) to set up the new company. Mr. Mathew is visiting Jamaica September 6-10 to advise the Steering Committee. An IFC investment and a Bank loan will probably be requested if the company is organized.

JAMAICA

September 1, 1965

VI. POLITICAL SITUATION

Jamaica became an independent member of the British Commonwealth on August 6, 1962. Political power rests with the elected House of Representatives with 45 members. The Senate consists of 21 members, 13 nominated from the Government party and 8 from the opposition party.

Since the elections held in April, 1962, Sir Alexander Bustamante of the Jamaica Labour Party (JLP) has held the Premiership. He has been ill since early this year (81 years old) and his deputy, Mr. Donald Sangster, is serving as Acting Prime Minister. The Government follows a moderate policy and the political and social situation is stable.

The next elections are due in 1967. The People's National Party (PNP), led by Mr. Norman Manley, a lawyer, constitutes an active opposition party.

JAMAICA

September 1, 1965

VII. ECONOMIC SITUATION

Population	: 1.8 million
GNP per capita	: US\$ 445
Foreign Exchange Reserves	: US\$ 85.2 million

In the past decade, the Jamaican economy, once substantially dependent upon tropical agriculture, achieved a remarkably high rate of growth: real GDP advanced by an annual 6.8 per cent and per capita real GDP rose by 60 per cent in this period. At the same time the economy experienced a major transformation, principally caused by the discovery of bauxite, the rapid rise in industrial activity, the development of its promising tourist potential and the upsurge in the building industry. The increased activity stimulated the other sectors except agriculture, the growth of which lagged considerably behind the overall growth of the economy, mainly because of its serious structural problems. Indeed, the lagging agricultural sector constitutes Jamaica's fundamental development problem: it has been largely responsible for the high level of unemployment in the country (about 16 per cent of the labor force), which has not been substantially reduced through massive emigration, and for the rapidly rising level of food-imports which causes serious balance of payments pressures.

In 1962, upon reaching independence, the Jamaican Government prepared a Five-Year Independence Plan 1963-1968 mainly designed to raise the level of economic growth which had fallen steadily since 1959, largely because of the reduced rate of increase in foreign investment. The targets included a 5.6 per cent rate of economic growth. To a large extent, the Jamaican Government has so far succeeded in its aims. Although the economy only experienced a 2.5 per cent rate of growth in 1963, this was primarily due to uncertainties incident to Jamaica's transition to independence and to political unsettlement in the Caribbean area. In the latter half of 1963, government policies did lead to the restoration of confidence in the private sector, investment increased rapidly and the rate of growth in real GDP accelerated to 7.8 per cent in 1964. The traditionally lagging domestic agricultural sector experienced an 11 per cent growth rate in 1964. But despite the upturn in economic activity, unemployment has probably not been reduced mainly because of substantial hindrances to emigration which the country experienced since 1963.

JAMAICA

September 1, 1965

In 1964, the increased level of economic activity, stimulated by a substantial expansion of bank credit (mainly channelled to the private sector) led to a 20 per cent rise in imports of goods and services. The rapidly rising level of imports caused serious concern and led to import restrictions, largely introduced to induce the private sector to undertake import substituting activities.

Current revenues increased by 18 per cent in 1964, permitting the Jamaican Government to raise its current account surplus by 50 per cent to £ 6.6 million, which financed 45 per cent of the rapidly rising investment expenditures. The remainder was financed mainly by domestic and external long-term borrowing.

The Jamaican Government is showing an imaginative and sound approach to the country's development problems. Up to 1968 it plans to execute a public investment program aimed at providing Jamaica with an expansion of economic and social infrastructure facilities and at developing the rural agricultural economy in a determined effort to raise agricultural productivity and incomes, thereby reducing migration to already overcrowded cities. Although part of these investment expenditures can be financed by budgetary savings and internal borrowing, the remainder of these will have to be financed through external borrowing. However, due to balance of payments difficulties in the US as well as in the United Kingdom, the Jamaican Government - which used to cover the main part of its external finance requirements through bond issues in the private capital markets abroad - is now facing a serious limitation to its ability to raise capital in these countries, and may have to curtail expenditures in the years 1967 and 1968. The Government is facing up to this possibility by increasing its project preparation effort to make a larger part of its investment program eligible for financing by external official lending agencies.

Jamaica's external debt service burden is low (less than 3 per cent of prospective annual foreign exchange earnings through 1970) and exports promise to grow at a satisfactory rate. Jamaica is clearly creditworthy for substantial new external borrowing at conventional terms.

MEXICO

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CONFIDENTIAL

September 22, 1965

BRIEFING PAPER - 1965

MEXICO

I. MEETING WITH DELEGATION

Date: October 1, 1965 Time: 10:30 a.m. - 11:00 a.m.

Attended by: Management:

Mr. Woods

Staff

Mr. Alter
Mr. Weiner
Mr. Nelson
Mr. Lerda

II. MEMBERS OF DELEGATION

Antonio Ortiz Mena
Governor

Secretary of Finance and
Public Credit

Jesus Robles Martinez
Adviser

Director General,
Banco Nacional Hipotecario
Urbano y de Obras Publicas, S.A.

Alfredo Navarrete
Adviser

Director,
Nacional Financiera, S.A.

Juan Gallardo Moreno
Adviser

Coordinator for the Alianza
para el Progreso in Mexico

Francisco Ruiz de la Pena
Adviser

Chief, Department of Enter-
prises and Industrial Relations,
Nacional Financiera, S.A.

III. BANK/IDA PROSPECTIVE OPERATIONS

Purpose	Amount (\$ million)	Status	Tentative Date for Negotiations
Farm Credit	25	Loan approved by ED's on September 16, to be signed on September 29.	Completed
Electric Power	up to 150	Negotiations to begin in mid-September	
Irrigation*	20	Appraisal report in preparation.	November 1965
Irrigation*	45	Preliminary review has been made of two components by Bank staff; submissions of other three components are expected by end of 1965.	Second quarter of 1966
Federal Highways	25-40	Project proposal expected in next spring.	Third quarter of 1966
Mexico City Water and Sewerage	55	Submission delayed because of need for additional technical studies.	Open
Total	up to <u>335</u>		

* Submissions relating to two irrigation districts now being appraised are included in the first irrigation project listed. Submissions for five additional districts now at varying stages of preparation are included in the second irrigation project listed.

IV. TOPICS FOR DISCUSSION

(a) To be raised by Bank at staff level:

(i) Public Investment Plan

To review with Mexican officials the status of work in preparing a public investment program for the next three years, particularly financial aspects, and to discuss plans for a Bank mission late this year to study it. This discussion will go into more specifics than will be feasible in the meeting with the President (see (b) (ii), below).

(ii) Lending Program

To review the status of the current lending program, with particular attention to outstanding problems, and to discuss with the Mexicans appropriate steps to be taken with regard to our taking a preliminary look at projects which they consider of priority importance for inclusion in a further lending program, such as Monterrey water supply and telecommunications.

(iii) Central Bank and Other Government Agency Purchases of Two-Year Bonds for March 1966

We should inform the delegation of the Bank's plans for a 2-year bond issue of \$100 million in March 1966 and seek to obtain some idea of how much might be bought, and if none, why not.

(b) To be raised by Bank at meeting with President:

(i) Power Loan Negotiations

These negotiations are now scheduled to be held next week. The major outstanding problem centers around joint financing. The Government still needs to be convinced regarding its merits. Mr. Woods might emphasize the importance which the Bank attaches to obtaining partial financing by others of large projects receiving Bank loans and to comment specifically on the desirability of working out arrangements for participation by others in financing the Mexican Power Sector Project. Discussions are now being held with representatives of several governments and of private banks regarding the interest in such participation. A summary of these discussions will be presented prior to the meeting with the Mexican Delegation.

(ii) Mexican Economic Policies

Mr. Woods should comment favorably on the progress of the Government in following sound economic policies during its first year in office as well as on the letter which we expect to receive during the Annual Meeting outlining the Government's economic policies relating to the development program and its

financing. (Bank staff have reviewed a draft of the letter with Mexican officials. As soon as the letter is received copies will be made available, together with any staff comment which may be appropriate.) Mr. Woods should also refer to the work now under way to prepare quickly a public investment program for the next three years and the hope that arrangements can be worked out for a Bank mission to study it toward the end of the year. He might emphasize the importance the Bank attaches to the formulation of a comprehensive public investment program, in combination with a sound plan for its financing, as a basis for future Bank lending to Mexico. He might also suggest that, with the development of such an investment program and financial plan and continuing effective application of strong general economic policies by Mexico, the Bank would be willing to consider working out with Mexico a formal "time-phased" lending program for the next two-three years. Final decisions regarding the loans for various projects would, of course, continue to depend on their meeting our usual project tests and on Mexico's credit-worthiness.

(iii) IDA Contribution

Mr. Woods might express appreciation to the Mexicans for their agreement to release a part of their IDA subscription (equivalent to US\$76 thousand) for purchases in Mexico under an IDA Credit to India. It would be useful to urge the Mexicans to consider further release of their IDA subscription on a convertible basis, stressing the importance of Mexican leadership in this field. It would also help to demonstrate Mexico's progress in economic development in that, while she is continuing to receive World Bank loans, she is now at the stage where she can simultaneously help other countries in their development. The Mexicans may reply that they would wish to have their IDA funds used for materials in more processed form than in the case of the recent release. The reply should be that this must necessarily depend on the results of international competitive bidding under IDA projects and that Mexico's progress in reducing costs and expanding exports of processed commodities are of major importance in determining the types of products for which the Mexican IDA release would be used. The Mexicans may also suggest, as they have in the past, that they are agreeable to a further IDA release, provided it is used to help finance projects in other Latin American countries. Our reply might be that we appreciate Mexico's willingness to follow this pattern but we hope that she will see her way clear to permit the IDA release to be used on a world-wide basis.

V. BACKGROUND INFORMATION(a) Bank Loans as of July 31, 1965

(US\$ million)

<u>Year</u>	<u>Borrower</u>	<u>Purpose</u>	<u>Amount less cancellations</u>	<u>Undisbursed balance</u>
Loans fully disbursed			316.3	
1960	Nacional Financiera	Roads	25.0	3.8
1961	Nacional Financiera	Irrigation	15.0	3.2
1962	Nacional Financiera and Caminos y Puentes Federales	Toll roads	30.5	4.2
1963	Nacional Financiera	Irrigation	12.5	11.0
1963	Nacional Financiera	Roads	40.0	35.0
1965	Nacional Financiera and Caminos y Puentes Federales	Toll roads	<u>32.0</u>	<u>32.0</u>
	Total		471.3	89.2
	of which has been repaid		<u>72.9</u>	
	Total outstanding		<u>398.4</u>	
Amount sold		38.6		
of which has been repaid		<u>23.5</u>	<u>15.1</u>	
Net amount held by Bank			<u>383.3</u>	

(b) IDA Credits as of July 31, 1965

None

(c) Technical Assistance Activities

None

(d) Access to Private Capital MarketsBanking Connections:

Government and Governmental banking agencies have close connections with leading banks in the U.S. and other countries.

Bond Issues:

Bond issues totalling \$100 million were floated in the U.S. in 1963 and 1964 (consisting of \$40 million in July 1963, \$25 million in April 1964 and \$35 million in October 1964). A further issue in the U.S. market had been planned for this spring but is being delayed because of the current situation in the market. Underwriters of issues in the U.S. market have been the First Boston Corporation and Kuhn, Loeb and Company.

(e) Bank 9% Capital Subscription

Total 9% capital: US\$15.6 million.
All released, convertible into any currency.

(f) IDA Subscription

9% subscription: US\$7.886 million.
US\$0.076 million released for purchases
in Mexico.

(g) Holdings of Bank Bonds

US\$49.47 million

(h) I.F.C.Industrial Investments:

IFC (with other participants: \$11,485,784) has made seven investments in Mexico, two of which have been sold. The other five include an aircraft engine overhaul plant (\$520,000), a steel mill (\$1,473,552 purchase of shares and underwriting commitments of \$9,044,856 equivalent of shares), a sodium sulphate plant (\$750,000), a steel pipe plant (\$250,000 purchase of debentures and a standby commitment of \$750,000 of debentures) and a construction and industrial equipment plant (\$1,601,281). Plans for an additional financing of about \$5 million for the expansion of the steel mill project (Fundidora) are being presently discussed.

VI. POLITICAL SITUATION

President Diaz Ordaz of the ruling Institutional Revolutionary Party (PRI), started his six-year term of office on December 1, 1964. He stands practically at the middle of the political spectrum and, as expected, is supporting the basic economic policies and the gradual social reforms under which Mexico has shown such steady progress.

VII. ECONOMIC SITUATION

Population: about 40 million at the end of 1964

GNP per capita: US\$440 equivalent

Foreign exchange reserves: US\$480 million

Gross domestic product increased about 10% in real terms in 1964. This unusually large increase resulted mainly from a very favorable agricultural year and a substantial rise in both public and private investment. The additional public investment was financed largely by domestic credit and by heavy foreign borrowing on relatively short terms. The 1964 pattern could not be continued without impairing price and exchange stability.

To attack the budgetary problem, the Government is curtailing public sector investment, in particular by new measures to control the budgets and the borrowing of the decentralized public sector and state enterprises. At the same time, current revenues of the Federal Government have risen by more than 20 per cent during the first half of 1965 while current expenditures rose by only 6 per cent.

While the public sector has retrenched in the first half of 1965, the investment boom of the private sector continued and helped to maintain an over-all high level of activity. Real GNP in the current year is now expected to rise by at least 6.5 per cent.

At the end of 1964, Mexico's external public debt totalled about \$2.0 billion, including about \$250 million still undisbursed. Service on this debt totals \$468 million in 1965, equivalent to about 24 per cent of estimated total current account foreign exchange receipts. Debt service subsequently declines to about 17 per cent in 1966 and to about 6 per cent by 1970. The declining debt service ratio provides a margin for additional long-term borrowing with adequate grace periods. The extent of Mexico's further credit-worthiness will depend to a considerable degree on the effectiveness of the Government's declared and partly already initiated policies of restraining domestic credit expansion and curbing external borrowing on short terms.

NICARAGUA

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September 16, 1965

BRIEFING PAPER - 1965

NICARAGUA

I. MEETING WITH DELEGATION

Date: September 29, 1965

Time: 4 - 4:30 p.m.

Staff: Mr. Alter
Mr. Chaufournier
Mr. Weiner
Mr. Vignes
Mr. Steuber
Mr. Kuczynski
Mr. Schmitt

II. MEMBERS OF DELEGATION

III. BANK/IDA PROSPECTIVE OPERATIONS

Projects presently under consideration:

<u>Purpose</u>	<u>Tentative Amount</u>	<u>Status</u>	<u>Tentative Date For Negotiations</u>
Rio Tuma II hydroelectric power	\$3-4 million	Completion of feasibility study expected soon	Late 1965
.....			
Port of Corinto	To be determined	Feasibility study to begin soon	Mid-1966

IV. TOPICS FOR DISCUSSION(a) To be raised by Bank at staff level:1. Lack of projects

The \$2.6 million Rivas irrigation loan made in 1963 was the last Bank loan to Nicaragua. The period of intense Bank activity ended already in 1956. While the Bank, with total lending of \$38 million to date, still tops all other financing institutions (AID \$18 million, ExImBank \$15 million, IDB ordinary resources \$9 million) the prospects for an intensification of Bank lending are not encouraging. Between 1963 and 1965, other institutions have lent modest amounts only (IDB \$7 million for livestock and small industries; AID \$6 million for education, airports, development banks; ExImBank \$1 million for grain storage). We should contrast this situation with the extremely favorable conclusions of our economic report (1964) as to Nicaragua's creditworthiness. How does the Delegation explain this paradox? How do they view the present efforts of the planning office (assisted by an AID planning team) with regard to sector programming; will they result in an increased scope and speed of project preparation? How could the Bank step in with assistance?

2. Lack of Government cooperation

A certain uneasiness still prevails in our relations with Nicaragua. While the causes are difficult to determine, there is evidence of a definite lack of good will and cooperation on the Government's part. Two examples:

(i) Despite our urging in March that ENALUF do not reduce power rates pending the appraisal of Rio Tuma II, selective rate reductions were decided and made public subsequently

(ii) In May we sent to the Corinto Port Authority terms of reference for the expansion of the port with a request for comments and suggestions as to the consultants. No reply has been received yet, but in the meantime we learnt from another source that consultants had already been hired.

We should insist on better consultation and cooperation.

3. Rivas Irrigation Project

What is the Government's position with regard to the proposed cancellation of the existing loan?

Our position is that, while we would be prepared to weigh carefully the Government's arguments against cancellation, what we know now suggests that the loan should be cancelled. Due to a significant upward revision of cost estimates, the project is not economically justified unless bananas and other high value crops can be produced within the whole area and marketed. Experiments are necessary which would require at least 18 months. This applies especially to bananas where wind conditions could be a limiting factor. Standard Fruit is willing to proceed with banana experiments and, if warranted, grow this crop on a large scale (6,000 acres and more). Under present circumstances water charges for the 2/3 of the farmers not growing bananas would be an intolerable burden; only high-value tropical crops would economically justify these charges. While we are in favor of cancellation now, we should make it clear that if the necessary crop experiments and marketing arrangements confirm the economic feasibility of the project, the Bank would be prepared to make a new loan taking into account the higher project cost.

4. Other irrigation projects

A Bank agricultural mission which visited Nicaragua in May 1964 identified several possible irrigation projects of which one (Tuma Viejo) appears promising. We should inquire about the Government's intentions with regard to these projects, and offer to explore possibilities for Bank technical assistance to carry out feasibility studies. In Tuma Viejo there is a heavy concentration of land ownership in relatively few hands. The Delegation is likely to ask about Bank policy with respect to land reform. Our position should be that the Bank has no rigid rules, and that the economic size of holdings under irrigation will be the foremost consideration. This can only be determined after studies of soils, cropping patterns, etc.

5. UN Special Fund study on Atlantic Port

If by the time of the meeting with the Delegation we have not received the Government's comments on our draft terms of reference - promised for mid-September, we should press for this.

6. Education

The report of the Unesco project identification mission should be ready by mid-September. If we have the report at the time of the Annual Meeting we should offer to explore further steps including, if appropriate, financing possibilities for educational projects.

September 23, 1965

7. Central American Telecommunications

We should congratulate the Nicaraguans for their support of this regional project.

8. New Bank approach to Central American Integration

A separate paper will be prepared in time for the Annual Meeting after preliminary discussions with CABEI.

9. IDA 90% subscription

We should press for the release of the 90% subscription amounting to \$270,000.

10. Central Bank and Other Government Agency Purchases of 2-Year Bonds for March 1966

We should inform the delegation of the Bank's plans for a 2-year bond issue of \$100 million in March 1966 and seek to obtain some idea of how much might be bought, and if none, why not.

(b) To be raised by Bank at meeting with President or Vice-President:

No meeting scheduled.

(c) Likely to be raised by delegation:

None.

V. BACKGROUND INFORMATION(a) Bank Loans as of July 31, 1965

		(U.S. \$ Million)		
Year	Borrower	Purpose	Amount less Cancellations	Undisbursed Balance
		Loans fully disbursed	23.0	00.0
1960	Empresa Nac. Luz y Fuerza	Power	12.5	1.0
1963	Republic of Nicaragua	Irrigation	<u>2.6</u>	<u>2.5</u>
	Total		38.1	3.5
	of which has been repaid		<u>14.5</u>	
	Total outstanding		23.6	
	Amount sold	2.4		
	of which has been repaid	<u>1.8</u>	<u>0.6</u>	
	Net amount held by Bank		<u>23.0</u>	

(b) IDA Credits as of July 31, 1965

		(U.S. \$ Million)	
Date	Purpose	Amount less Cancellations	Undisbursed Balance
Sept. 7, 1962	Managua water supply	3.0	0.5

(c) Technical Assistance Activities

The Bank is Executing Agency for a United Nations Special Fund Highway and Ports Survey on the Southern Atlantic Coast. Terms of reference have not yet been finally agreed upon with the government.

(d) Access to Private Capital Markets

Not applicable.

(e) Bank 9% Capital Subscription: \$540,000

Beginning October 1, 1964, Nicaragua had started releasing its 9% subscription in 12 semi-annual instalments of \$45,000.

(f) IDA 90% Subscription: US\$270,000

No release.

(g) Holdings of Bank Bonds

No holdings.

(h) I. F. C.

A proposed IFC investment in the Corporación Nicaragüense de Inversiones (CNI) was turned down in December 1963 because of uncertain profitability prospects in the absence of quasi-equity. IFC expressed willingness to reconsider later on if CNI had a satisfactory record of operations.

IFC has received a \$2 million request for the financing of a metal structure and pipe project (Metales y Estructuras).

VI. POLITICAL SITUATION

Dr. Rene Schick of the Liberal (Somoza) Party, a former Minister of Education, was inaugurated President in May 1963 for a four-year term. He is generally respected, and there is a sizeable segment of the population willing to cooperate with him who avoided any cooperation with the Somozas, who continue to have a large following. Recently President Schick has shown an increasing measure of independence towards the Somoza family, especially Senator (and former President) Luiz Somoza.

The Government is generally pursuing moderately liberal policies, especially in the social field.

VII. ECONOMIC SITUATION

Population: 1.6 million
GNP per capita: About US\$275
Foreign exchange reserves (net):
US\$57 million

Nicaragua's economic performance in recent years has been highly satisfactory. From 1961 to 1964, GDP grew at an average rate of about 8% in real terms. Much of this growth is the result of a very rapid growth of exports, which rose from \$64 million in 1960 to about \$123 million in 1964 - largely due to a very rapid expansion of cotton production and to a lesser extent due to the increasing importance of various minor exports.

The authorities have taken advantage of this bonanza period to raise taxes and increase expenditures, particularly for education and various infrastructure and public works projects. The task ahead is to prepare sufficient high-priority projects to diversify and strengthen the economy, particularly by improving its human resources. A beginning has been made in this direction with the assistance of a planning team sponsored by AID.

Nicaragua's growth prospects are good. In view of its low debt service burden, it should be able to meet most of its external capital requirements for the public sector in the next few years on conventional terms.

PANAMA

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September 16, 1965

BRIEFING PAPER - 1965

PANAMA

I. MEETING WITH DELEGATION

Date: September 29, 1965

Time: 10:30 - 11:00 a.m.

Staff: Mr. Alter
Mr. Chaufournier
Mr. Weiner
Mr. Vignes
Mr. Steuber
Mr. Kuczynski

II. MEMBERS OF DELEGATION

Jorge T. VELASQUEZ (F)

General Manager, Banco
Nacional de Panama

Jose Guillermo AIZPU

Adviser, Assistant for Economic
Affairs, Banco Nacional de
Panama

III. BANK/IDA PROSPECTIVE OPERATIONS

The following projects are under consideration:

<u>Purpose</u>		<u>Status</u>	<u>Tentative Date for Negotiations</u>
Road rehabilitation, maintenance and new construction	\$5.8 million	Appraisal report being prepared	late. 1965
Bayano hydro-electric project	\$28 million	Awaiting clarification of prospect for power sales	Mid-1966

IV. TOPICS FOR DISCUSSION(a) To be raised by Bank at staff level.1. General

The Bank is very much concerned with the performances of CAM and IRHE regarding our loans for highways and power. Definite improvements are expected. Appropriate changes in the organization of both organizations would be conditions for the loans now under consideration (new highway and Bayano).

2. New Highway Loan

Our recent letter to the Minister of Public Works indicated that, subject to confirmation by the Government of the agreement to the points discussed with the Bank mission last July, the Bank is prepared to make a loan of about \$5.8 million to finance

- a) construction of the two roads Volcan-Sereno and San Francisco-Santa Fe,
- b) engineering of a 1,000 kms rehabilitation program,
- c) rehabilitation work on a first tranche of 250 kms and
- d) maintenance equipment.

Another loan would be considered in 1967, in the light of CAM's performances, for the completion of the rehabilitation program. We expect to make the \$5.8 million loan by the end of 1965, if we receive by the end of September the information and documents requested in our recent letter.

3. Bayano Hydroelectric Project

We should express our satisfaction that IRHE finally engaged management consultants as agreed upon in January, 1965. Our letter of September 3 indicated the measures to be taken by IRHE before the appraisal of the project can be completed. We should urge the government and IRHE to expedite action and to take the best advantage of the assistance of the management consultants to enter into discussions about a power sales contract with Fuerza y Luz and the Panama Canal Company and to review IRHE's organization. We also should urge them to keep in close touch with us at every step so as not to delay the final decision on the requested loan.

September 23, 1965

4. Chiriqui railroad

The proposed road loan of \$5.8 million includes funds for a study of road alternatives to the existing railroad which is now operating at a loss. It is highly likely that the road alternative study will show a good economic justification. In that case, what are the prospects of discontinuing railway operations?

5. Bank 9% subscription

In March 1965 Panama's capital subscription was raised from \$400,000 to \$9 million. We should ask for the release of the 9% (\$774,000) corresponding to the capital increase (\$8.6 million).

6. IDA 90% Subscription

\$14,000 out of the \$18,000 corresponding to the 90% subscription has been released. We should press for the release of the remaining \$4,000.

7. Central Bank and Other Government Agency Purchases of 2-Year Bonds for March 1966

We should inform the delegation of the Bank's plans for a 2-year bond issue of \$100 million in March 1966 and seek to obtain some idea of how much might be bought, and if none, why not.

(b) To be raised by Bank at Meeting with President or Vice-President:

No meeting scheduled.

(c) Likely to be raised by delegation:1. Local currency financing for Bayano hydroelectric project

The Delegation is likely to question the position taken in our letter of September 3 to IRHE that the Bank is not willing to finance substantially more than the foreign exchange component (about 60% of total cost). Maximum local currency contribution envisaged by Government is \$10 million. Current estimates call for a local currency portion of about \$18 million; the precise amount can only be determined once the amount of power to be generated has been ascertained. The Government should seriously explore possibilities of raising the local currency required.

2. Education

If the Delegation should ask why the Unesco project identification mission under the co-operative program requested by the Government early this year had not been sent, we should explain that Unesco had agreed with us that in the

PANAMA

-5-

Rev.

September 23, 1965

absence of even an outline for the development of the educational sector and in view of present and past heavy U.S. involvement in educational financing, a small Unesco mission (outside the co-operative program) should further explore the situation. The problem is not primarily financial but one of long-term programming for which Unesco intends to provide technical assistance.

V. BACKGROUND INFORMATION(a) Bank Loans as of July 31, 1965

(U S \$ Million)				
Year	Borrower	Purpose	Amount less Cancell.	Undisbursed Balance
1953	Instituto de Fomento Economico	Agriculture	0.66	00.0
1953	Instituto de Fomento Economico	Grain silos	0.29	00.0
1955	Republic of Panama	Roads	5.90	00.0
1960	Republic of Panama	Roads	7.20	1.0
1962	Instituto de Recursos Hidraulicos y Electri- ficacion	Power	4.00	2.1
	Total		<u>18.05</u>	<u>3.1</u>
	of which has been repaid		<u>7.55</u>	
	Total outstanding		10.50	
	Amount sold	2.5		
	of which has been repaid	2.2	<u>0.30</u>	
	Net Amount held by Bank		<u>10.20</u>	

(b) IDA Credits as of July 31, 1965

None.

(c) Technical Assistance Activities

The assignment (1961-1965) of the Bank resident adviser (Habib) was terminated in June 1965.

(d) Access to Private Capital Markets

Panama has frequently placed long-term bonds in the New York Market. Its access to the U.S. capital market was based entirely on the fact that service on these debts was secured by the U.S. Canal annuity payment of \$1.93 million.

(e) Bank 9% Capital Subscription: US\$810,000

\$36,000 corresponding to original total subscription of \$400,000 released and lent in dollars.

(f) IDA 90% Subscription: US\$18,000

US\$14,000 released.

(g) Holdings of Bank Bonds

None,

(h) I. F. C.

An application is presently under study for an I. F. C. investment of about \$1 million in a palm oil extraction plant (Compania Agricola). There are no other applications.

VI. POLITICAL SITUATION

President Marco A. Robles, who was the candidate of the previous administration of President Chiari of the Liberal Party, was elected in May and inaugurated in October 1964. Mr. Robles is known for his integrity, strength of character and pro-U.S. sentiments. The new administration is likely to continue moderate economic and social reforms.

Relations with the U.S. have returned to normal after the January 1964 disturbances. Negotiations for a new Canal Zone treaty are under way. Labor relations with the United Fruit Company were normalized early in 1965 after a 3-month strike.

VII. ECONOMIC SITUATION

Population: 1.2 million
GNP per capita: US\$415
Foreign exchange reserves (net):
US\$6.5 million

Panama has in the last decade achieved a rapid rate of growth (averaging 6.5% annually), particularly in the period of 1960-1963 (an average of 9.5% annually). During the last period, the main stimulants to growth were increased transactions with the Canal Zone, a rapid expansion of foreign private investment in commerce and industry, of construction and of public sector expenditures. The economy received a jolt as a result of the political disturbances of January 1964 and the temporary break of relations with the United States. Recovery was quick, however, particularly after the Presidential elections of May 1964.

While Panama's economic prospects in the next few years are good, a number of problems have to be attacked with determination. The main one is to make the economy less dependent on the Canal Zone and the area of Panama City. The administration has a fairly well-conceived development program partly directed to this aim, but the program will seriously lag unless a major effort is made to raise public savings. The efforts to diversify the economy are increasingly assuming urgency, since a new sea-level canal will be required by 1980-85. Its location (various sites in Panama and other countries are under consideration) and the timing of its construction could have very profound implications for the long-term future of Panama and its economy.

On the basis of its past growth performance, its present policies and programs, and its future growth prospects, Panama is creditworthy for new external borrowing on conventional terms.

PARAGUAY

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September 16, 1965

BRIEFING PAPER - 1965

PARAGUAY

I. MEETING WITH DELEGATION

Date: September 29, 1965

Time: 11:00 a.m.

Attended by:

Staff: Mr. Alter
Mr. Chaufournier
Mr. Wright
Mr. Loftus
Mr. Ross
Mr. Duran Ballen

II. MEMBERS OF DELEGATION

Dr. Cesar Romeo Acosta

(B) President
Banco Central del
Paraguay

Dr. Oscar Stark Rivarola

(B) Manager, Banco Central
del Paraguay

General Cesar Barrientos

(F) Minister of Finance

Edgar F. Taboada

(F) Undersecretary of
Finance

III. BANK/IDA PROSPECTIVE OPERATIONS

The following projects are presently under consideration:

Purpose	Amount	Status	Tentative Date for Negotiations
Port Improvement	\$2.75 million	Government invited to negotiate	October 1965
Second cattle project	\$5 to 7 million	Appraisal report being prepared	December 1965
Roads	\$2 million	Appraisal mission scheduled for late 1965	First quarter of 1966

IV. TOPICS FOR DISCUSSION

- (a) To be raised by Bank at staff level:

Release of 9%. As the foreign exchange reserves of Paraguay have improved we should stress the need of Paraguay releasing in dollars its 9% capital subscription. We could suggest that this be done in five annual payments.

Report of the Ross Mission: The preparation of the economic report based on the information gathered by the mission - May/June 1965 is near completion. The Bank would want to discuss the conclusions of the report with the government and for this purpose it will send a mission to Paraguay sometime in the latter part of this year. The Ross mission believes that the present economic and financial position is favorable but a number of problems loom large on the horizon:

- (a) The utilization of the very substantial pipeline of external credits and loans will necessitate an increasing provision of public sector savings if the external assistance is to be effectively utilized under conditions of internal and external stability.
- (b) The debt service burden is becoming heavy both in relation to foreign exchange earnings and to domestic savings. Additional external borrowing should therefore be carefully coordinated and limited to high priority productive projects. In this connection, investments in livestock, in agriculture, and in the processing of agricultural produce for export as well as for the domestic market should be encouraged. This will require not only diligent preparation of appropriate projects but also a great deal of emphasis will have to be placed on organizational and institutional arrangements for channeling financial assistance.
- (c) New infrastructural investments should be only of the most essential projects and should be assured of their local currency financing from non-inflationary sources.

September 22, 1965

- (d) Additional external borrowing should concentrate on long-term loans with extended grace periods and the public sector should refrain from taking on suppliers' credits in excess of annual repayments on previously contracted supplier's credits.
- (e) Central Bank and Other Government Agency purchases of 2-year Bonds for March 1966

We should inform the delegation of the Bank's plans for a 2-year bond issue of \$100 million in March 1966 and seek to obtain some idea of how much might be bought, and if none, why not.

Consequently, in anticipation of the mission the Government should investigate what measures it can put into effect to overcome these problems, and in particular point (a).

- (b) Likely to be raised by delegation:

Second Cattle Project. The delegation might ask when a decision will be made regarding a) the timing of the negotiations for this project; and b) whether it will be financed by the Bank and/or IDA. We should answer that regarding a) that appraisal report is near completion and should permit the Management to arrive at a decision on the project's merits within a few weeks; regarding b) due to the scarcity of IDA resources it will not be possible to determine until later in the year whether or not IDA will be able to lend to Paraguay.

V. BACKGROUND INFORMATION(a) Bank loans as of July 31, 1965

Year	Borrower	Purpose	Amount less cancellations	Undisbursed balance
1951	Republic of Paraguay	Agriculture and Transport	4.5	0.0
1964	Republic of Paraguay	Roads	<u>2.2</u> 1/	<u>2.2</u>
Total (net of cancellations and refundings)			6.7	2.2
of which has been repaid			4.5	
Total now outstanding			2.2	
Amount sold		.1		
of which has been repaid		.1		
Net amount held by Bank			2.2	

1/ Not effective as of July 31, 1965 (Declared effective on September, 1965)

(b) IDA Credits as of July 31, 1965

Date		Amount less cancellations	Undisbursed balance
Oct. 26/61	Highways	6.0	5.4
Dec. 26/63	Cattle Project	<u>3.6</u>	<u>2.5</u>
		9.6	7.9

(c) Technical Assistance Activities

1964-65 Executing Agency for UNSF Road Survey. Phase (I) (Aerial photography) was expected to be finished by October, 1964, but due to weather and equipment problems it will only be finished in October 1965. Phase II started in August 1965 and is expected to be completed in December 1965. Phase III is dependent upon UNSF making available additional funds (\$205,000) due to under-estimation of costs. UNSF has reacted favorably to this request.

(d) Access to Private Capital Markets

None.

(e) Bank 9% Capital Subscription (\$0.54 million)

\$126,000 released for purchases in Paraguay.
See III (a).

(f) IDA 90% Subscription (\$0.27 million)

No release.

(g) Holdings of World Bank Bonds

The Central Bank of Paraguay has bought \$250,000 worth of two-year bonds issued in September 1965.

(h) IFC

Member.

IFC has no investments in Paraguay and no applications are pending.

VI. POLITICAL SITUATION

President Stroessner has been in office 11 years. His popularity in Paraguay has increased through a program of public works and economic stabilization, which has both fostered agricultural production and held the cost of living down. During the last years greater freedom of expression has been permitted and in slow steps an opposition party is being strengthened. The respect for the Stroessner regime has also increased abroad and prominent people have made complimentary statements about it. Stroessner's term will expire in August, 1968. Political stability should continue to be firm.

VII. ECONOMIC SITUATION

Population:	1.9 million
GNP per capita:	US\$165 to US\$195
Net Foreign Exchange Reserves:	US\$8.4 million

The economy experienced a satisfactory rate of growth during 1964. It is estimated that gross national product increased by approximately 5%. According to preliminary indications, this growth rate is continuing into 1965. With the help of an increasing inflow of external development assistance, an adequate level of investment has been maintained.

The monetary authorities continued to pursue a policy of relative stability throughout 1964 and up to the present time. The cost of living rose by some 4% during 1964 (largely because of increases in meat prices) and wages were increased by about 6%, or largely in line with increasing productivity. This policy of maintaining monetary and price stability remains the cornerstone of the economic and financial program of the country.

In spite of the pressures to meet rising current and development expenditures, public finances have on the whole been managed soundly. The budget cash deficit in 1964 amounted to some \$375 million, or about 7% of expenditures. Because of a number of offsetting financial operations within the public sector, the actual expansionary effect of the deficit was considerably smaller. During the period January-April 1965, a seasonal budgetary surplus was achieved as revenues were some 25% more than during the same period of 1964, while expenditures increased by only 12%. Public investment activity was maintained at a satisfactory level in 1964 and is increasing substantially this year. The fiscal authorities have declared their intention of managing the budget in a manner consistent with the maintenance of a policy of monetary stability and economic development.

Among the most favorable developments of 1964 was a 23% increase in export earnings. About one-third of this increase resulted from higher prices while export volume registered an increase of approximately 14% during 1964. The value of imports increased by only some 9% during 1964. A current account deficit of US\$10.5 million was more than covered by the net capital inflow on private and

public accounts in the amount of about US\$13 million. As a result of these movements as well as of a number of subsidiary developments, the net foreign exchange reserves of the Central Bank increased by US\$3.3 million during 1964 and reached the level of \$8.4 million by the end of April, 1965. In the opinion of leading Paraguayan exporters, the prospects for a continuing growth in exports this year are good. Likewise, the existence of a very substantial pipeline of external loans and credits gives assurance of substantial capital inflows during 1965 which should more than cover the current account deficit.

The outstanding external public debt repayable in foreign exchange stood at the equivalent of US\$61 million at the end of 1964. In addition, there was external public indebtedness repayable in guaraníes in the amount equivalent to US\$23 million. Service payments in foreign exchange on the public debt amount to between US\$4 million and US\$5 million and represent between 8% and 9% of recent export earnings. In addition, there are service payments in guaraníes which amount to the equivalent of between US\$2 million to US\$3 million annually during 1965-66. These represent approximately 50% of total annual public sector gross savings. The external debt of the private sector repayable in foreign exchange is estimated at the equivalent of US\$5 million and that repayable in guaraníes at the equivalent of about US\$1 million.

Bank Creditworthiness and IDA/worthiness

Although the external debt service burden is heavy, the substantial increases in exports in the past two years and the promise of continuation of this trend should enable Paraguay to manage a somewhat higher level of external indebtedness on Bank terms. However, both for balance of payments reasons, and especially because of the heavy burden external debt service imposes on public sector savings, Bank loans should preferably carry extended grace periods.

Paraguay also meets the present tests of eligibility for IDA assistance. It is a low income per head country, its recent performance in managing its financial affairs has been reasonably satisfactory and its policies affecting the livestock industry have been on the whole constructive. Lastly, it experiences a serious shortage of domestic savings in relation to its capital requirements for sound economic growth. The Department has recommended a new IDA commitment to Paraguay during the first half of 1966. However, until a decision on this recommendation is made, Paraguay is an "enough for the time being" country.

PERU

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September 1, 1965

BRIEFING PAPER - 1965

PERU

I. MEETING WITH DELEGATION

Date:

Time:

Attended by:

Staff: Mr. Alter
Mr. Chaufournier
Mr. Weiner
Mr. Knox
Mr. Havlik
Mr. Masoni

II. MEMBERS OF DELEGATION

Sandro Mariategui

Finance Minister,
(September 27 and 28 only)

Celso Pastor

Ambassador to Washington
(Governor of IBRD)

Tulio de Andrea

General Manager of Banco
Industrial del Peru
(Alternate Governor of IBRD)

ADVISERS

Carlos Gibson

Financial Minister,
Peruvian Embassy, Washington

III. BANK/IDA PROSPECTIVE OPERATIONS

The following projects are under consideration:

Purpose	Amount (\$ million)	Status	Tentative date of negotiations
Port of Pisco	7	Draft appraisal report under consideration.	December 1965
Power (Lima Light: Matucana Project)	20	Feasibility Study being prepared.	Early 1966
.....			
Roads	13	Feasibility Studies being prepared.	Mid-1966
Livestock (Huallaga Project)	Open	Project Identification mission scheduled for October 1965.	Open

A number of other projects may come under consideration in the next few months; but the precise list will depend on the findings of the Development Program Appraisal Mission.

IV. TOPICS FOR DISCUSSION(a) To be raised by Bank at staff level

The director of the San Lorenzo Project (Loan No. 418-PE) has resigned and we are awaiting the nomination of a successor for our approval. We fear that this change may indicate the beginnings of political interference in the management of the Project and not simply a change of director. Thus, regardless of whether we have received a new nomination by the time of the Annual Meeting, we should express our concern and emphasize the need for strong and consistent leadership in carrying out the Project, particularly since its past history shows the problems which arise if such leadership is lacking.

This loan should have been declared effective on August 18. But the necessary legal documents arrived shortly after that date and were not wholly satisfactory. Whether we shall declare it effective by the Annual Meeting depends on some changes in these documents. To have a satisfactory nomination for the directorship would be a condition for actual initiation of disbursements.

We shall wish to raise various general matters, but their precise content will depend on the discussions of the Havlik mission in Lima. A separate memorandum will be prepared on the mission's return. We expect the topics for discussion to fall under these heads:

- (i) An understanding on domestic economic policies, particularly fiscal;
- (ii) Bank lending program;
- (iii) the formation of a consultative group. In connection with the last point, we should stress the difficulties of arranging a satisfactory consultative group if the dispute with the International Petroleum Company is not settled.

Finally we should raise two other matters. The first is to express concern at the report that Peru has been seeking to raise external finance by means of letters of credit on the New York market (see V(d)). The second is to raise the question of releases from Peru's 90% IDA contribution. In May 1965 we asked for a small release to finance an Indian purchase, under IDA Credit No. 52 to India, of pig-lead from Peru. The Peruvian Government refused, but indicated a willingness to make releases where they helped the consolidation of the Latin American regional market. In a letter of July 1, 1965 we welcomed this latter willingness; but, in view of the strength of Peru's external position, we should now

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ask for releases on a broad international basis for the purchase of Peruvian exports. Whether we should seek fully convertible releases is much more problematical, but on balance the negative case prevails. We expect that for the next few years export earnings will not rise as rapidly as in the recent past whereas imports are expected to grow in line with a rate of growth of GDP of about 5% per annum. As a result, the present current account surplus is expected to give way to deficits.

We should inform the delegation of the Bank's plans for a 2-year bond issue of \$100 million in March 1966 and seek to obtain some idea of how much might be bought, and if none, why not.

- (b) No meeting scheduled with President or Vice President
- (c) Likely to be raised by the delegation

The delegation may raise the Peruvian Corporation issue (Loan No. 334-PE), since the Bank agreed to a much smaller concession than the Corporation, with Government support, had requested. We should reply that our agreement to capitalize some more interest during construction should materially help the Corporation during the next three critical years. The Corporation's other requests (namely, longer grace and amortization periods) would help it in 1968 and in the following years whereas the years of severe cash shortage are 1965 through 1968.

V. BACKGROUND INFORMATION(a) Bank Loans as of July 31, 1965

Year	Borrower	Purpose	Amount less cancellations	Un- disbursed Balance
Loans fully disbursed			69.9	
1958	Autoridad Portuaria del Callao	Port	6.6	2.2
1960	Republic of Peru	Roads	5.5	2.2
1961	Republic of Peru	Roads	10.0	0.7
1963	Peruvian Corporation Ltd.	Railways	13.3	3.2
1963	Lima Light & Power Company	Power	15.0	6.4
1964	Republic of Peru	Port	3.1	2.1
1965	Republic of Peru	Irrigation ^{1/}	11.0	11.0
1965	Banco de Fomento Agropecuario	Agriculture	<u>15.0</u>	<u>15.0</u>
Total			149.4	42.8
of which has been repaid			<u>28.5</u>	
Total outstanding			120.9	
Amount sold		12.5		
of which has been repaid		<u>8.0</u>	<u>4.5</u>	
Net amount held by Bank			116.4	

^{1/} Not yet effective.

(b) IDA Credits as of July 31, 1965

None.

(c) Technical Assistance Activities

	<u>Approved</u>	<u>Completed</u>	<u>Allocation</u>	<u>Revised Est. Cost</u>
Highway Program Studies	May 1961	Oct. 1961	\$175,000	\$134,268
Roads	Oct. 1964	-	\$300,000	In progress

Because of delays by the Peruvian authorities in signing the Agreement and in meeting legal requirements for effectiveness, the grant for roads became effective only in August 1965.

(d) Access to Private Capital Markets

The Peruvian Government has contacted certain New York investment companies to arrange the flotation of a long-term bond issue - possibly 15 years - in the amount of US\$ 10-15 million. A prospectus is now in preparation, and it is expected that the issue will be made late in 1965 or early in 1966.

The Peruvian Government borrowed US\$ 40 million from a group of U.S. commercial banks at the end of 1964. The loan is payable in three years at a rate of 6-1/2% per annum. Its proceeds are not tied to any specific purpose but it is generally understood that they would be available for the Government's investment program.

We have been told informally by New York financial sources that the Peruvian Government has made a contract with the Inter-American Capital Corporation (IACC) of Long Island to borrow US\$ 68 million. According to the agreement, IACC, at a fee of \$340,000 will undertake to market 10 year letters of credit of a total amount of \$40 million, letters of undertakings for purchase of equipment of a total amount of \$23 million, plus \$5 million for unspecified uses, at a rate of 6-1/4% and commission of 3/4%. The Peruvian representative in these negotiations is reported to be having second thoughts about the wisdom of this financing and to be trying to break the contract with IACC.

(e) Bank 9% Capital Subscription

U.S. \$3.15 million. Entire amount paid and lent in dollars.

(f) IDA Subscriptions

U.S. \$1.593 million. No release.

(g) Holdings of Bank Bonds

None

(h) IFC

IFC (with other participants: \$3,572,000) has made six investments in Peru: metal products and household appliances (\$250,000), brick manufacturer (\$280,000), building materials (\$300,000), ammonia and fertilizers (\$4,083,290), and two cement plants (\$2,400,000 and \$1,600,000). The investment of \$300,000 in the building materials plant has been written off by IFC because of losses incurred by the company, which resulted in its subsequent liquidation. IFC is considering a proposal to assist in the financing of a new ammonia fertilizer plant (Quimica del Norte) and is also considering participation in an underwriting of an issue of common shares in a utility project (Lima Light).

A proposed IFC equity participation in Inversiones Abancay, S.A. is in abeyance pending the reorganization of the company. IFC has expressed willingness to study any new proposal which the sponsors wish to put forward.

VI. POLITICAL SITUATION

Broadly speaking, the Belaunde Administration has had some success in infusing a greater sense of unity and purpose into an extremely unhomogenous country. In recent months, however, guerrilla activity has broken out in the Sierra. Such disorders have occurred before and have been firmly dealt with, as indeed appears to be happening this time. The Government lacks a majority in Congress, but it has succeeded in securing the passage of an Agrarian Reform Law. It is pursuing a vigorous public works program (see also section VII). The Government has still not resolved its dispute with the International Petroleum Company but there have been some recent signs of greater flexibility on both sides. Despite this continuing dispute, the Government evidently wishes to encourage private investment, including foreign private investment.

VII. ECONOMIC SITUATION

Population:	11.3 million
GNP per capita:	US\$ 280
Foreign Exchange Reserves:	(April 1965) US\$ 202 million

Since 1959 GDP has expanded at 6.4% per annum or by 3.5% on a per capita basis, population growing at 2.9%. Exports have provided the key to fast economic growth by more than doubling - primarily in fish meal and minerals - between 1959 and 1964. In the early 1960's investments - a greatly increased share of them going into new industries - have been of the order of 22% of GDP while national savings have been practically sufficient to finance the large-scale investments. Some 70% of total investment is attributable to private enterprise.

In 1964 and early 1965, economic growth has been associated with increasing inflationary pressures. Although government revenues in 1964 increased by 20% above 1963 levels, current outlays moved ahead even more, thus leaving a smaller source of non-inflationary financing for public investments which had risen by probably one-fourth above 1963 outlays. In spite of increased foreign financing, substantial Government recourse to Central Bank borrowing took place at the end of 1964. This, together with further accumulations of foreign exchange reserves, led to a 17% rise in money supply during 1964, while at the same time raising the liquidity of the banking system. The cost of living index at the end of 1964 was 11% above that of the year before, and the rise of prices accelerated further in early 1965, and is currently at an adjusted annual rate of about 18%. Under the 1965 IMF Stand-by Arrangement the Government has committed itself to reduce its reliance on Central Bank financing and to redirect its efforts toward drawings on external funds.

In spite of generally favorable economic developments in recent years, the underlying problems of uneven income and even more of unequal property distribution have remained. Results from the recently enacted Agrarian Reform Law are likely to be felt only slowly. Colonization of new lands on the eastern slopes of the Andes and in the tropical forest areas will also take time, despite the vigorous support given by the present Government to programs attacking these basic problems. The Government is likely to be faced with severe limitations arising from the prospect of declining export prices in the next few years and a much reduced buoyancy in export earnings as compared to the recent performance. However, the prospects for further substantial economic growth (considerably above population growth) are good if the Government pursues its announced investment program and related policies

while maintaining its efforts to attract private capital - particularly in the mining and industrial sectors - and keeping the nation's finances on an even keel. This will require a substantial increase in the public savings effort.

Service payments on external public (and publicly guaranteed private) debt amounted to nearly 11% of export earnings in 1964. Substantial new borrowing, estimated at some US\$ 150 million per annum during the next two years, will be required to maintain a generally well directed public investment effort. If this borrowing is on appropriate terms, this would be within Peru's margin of external borrowing capacity. However, it is unlikely that Peru will obtain sufficient foreign commitments to assure the adequate financing of its investment program unless a satisfactory solution is found regarding the conflict between the Peruvian Government and the International Petroleum Company (IPC); this conflict has been preventing AID from committing new loans. Should this prove to be the case, a curtailment of public investment would be necessary which would not permit the public sector fully to contribute to the growth of the Peruvian Economy.

Subject to Peru's carrying out satisfactory investment program and economic policies, the order of magnitude of the possible Bank lending to Peru in the next 2-3 years is \$200 million. IDA lending is not recommended as Peru appears to be creditworthy for such amount on Bank's conventional terms.

TRINIDAD
& TOBAGO

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September 16, 1965

BRIEFING PAPER - 1965

TRINIDAD AND TOBAGO

I. MEETING WITH DELEGATION

Date: September 27, 1965

Time: 5:00 p.m. - 5:30 p.m.

Staff: Mr. Alter
Mr. Chaufournier
Mr. Wright
Mr. Nelson
Mr. Kuriyama
Mr. van der Heijden
Mr. Ronday

No meeting scheduled with President or Vice-President.

II. MEMBERS OF DELEGATION

A.N.R. Robinson (B-F)

Minister of Finance

William Demas (B)

Head, Economic Planning Division
Prime Minister's Office

Winston Fung (F)

Permanent Secretary
Ministry of Finance

Adviser

Leonard Williams

Senior Economist
Ministry of Finance

III. BANK PROSPECTIVE OPERATIONS

The following projects are presently under consideration:

Purpose	Amount (\$ million)	Status	Tentative date for negotiation
Highway	8.5 - 10.0	Additional information awaited for appraisal mission possibly in November 1965.	open
Port develop- ment	3.0	Further information awaited to complete appraisal report. Govt. considering necessary improvements in port management, operations and finances.	open
Crown lands development	unknown	Feasibility study expected towards end September under Bank/FAO cooperative program.	open
Power develop- ment	unknown; see below	Investment plan awaited from Trinidad and Tobago Electricity Commission.	open

The Loan Committee agreed in March 1965 (i) to consider Bank loans for the highway (about \$7.5 million) and power (about \$19 million, in 1966/67) projects; (ii) to assist in the project preparation for the Crown lands project; and (iii) to defer a decision on the port project until after further study.

TRINIDAD AND TOBAGO

September 1, 1965

It now appears that the power project will be reduced in scope and/or postponed.

A Bank mission appraised the port project in June 1965 and concluded that it may be economically justified, provided necessary improvements were made in port management, operations and finances.

Apart from the above, it is possible that the Government may seek Bank assistance in an education project, based on a UNESCO mission report completed in August 1964.

September 22, 1965

IV. TOPICS FOR DISCUSSION

(a) To be raised by Bank at staff level:

1. Economic matters: Mr. Demas stated during his visit to the Bank in August that the Government was reviewing the 1964-68 development program to take account of subsequent developments. We might inquire about the status of this review and confirm our plan to have an economic mission visit Trinidad and Tobago after the review is completed.

Mr. Demas also stated that the Government was exploring the possibility of making market issues in the U.K. and/or U.S. We might inquire about the status of such exploration and further inquire about local revenue measures contemplated for the financing of public sector investments, taking into consideration the results of the above-mentioned exploration.

2. 9% Release: Trinidad and Tobago joined the Bank in September 1963 but has not released its 9 per cent capital subscription (\$2.4 million). We should ask for a release on a convertible currency basis, perhaps over a period of, say, five years stressing the following considerations: i) the 9 per cent capital released on a convertible basis would constitute a valuable addition to the Bank's resources at a time when the Bank is endeavoring to enlarge its operations and enter new fields of activities; ii) the release would provide tangible evidence of the desire of Trinidad and Tobago to cooperate for the success of the Bank and to meet fully the obligation of membership, at a time when substantial Bank lending in Trinidad and Tobago is expected to materialize in the near future; iii) while recognizing difficulties in the external payments position of Trinidad and Tobago, it should be noted that, for instance, the five Central American republics with evidently similar or more serious difficulties and lower per capita income have already all agreed to release all or part of their 9 per cent capital subscriptions on a convertible basis; and iv) assuming a release spread over five years the annual impact would be relatively minor.

3. IDA membership: Trinidad and Tobago applied for membership in IDA in June 1964 but has recently indicated that it is not interested in joining at present. We should urge its membership pointing out the importance we attach to international cooperation in this field and expressing our view that IDA will eventually be able to extend credits to Trinidad and Tobago.

September 22, 1965

4. Central Bank and Other Government Agency purchases of 2-year Bonds for March 1966: We should inform the delegation of the Bank's plans for a 2-year bond issue of \$100 million in March 1966 and seek to obtain some idea of how much might be bought (it should be borne in mind however that the Central Bank was established only in January 1965 and may not yet have developed a clearly defined policy on such operations).

5. Southern Highway Project: In a letter dated July 15, 1965, to the Government the Bank indicated the need for additional information on traffic, economic benefits, etc. before an appraisal mission could go down, possibly in November. We might inquire about the status of this project.

6. Port Development Project: A letter was also sent on the same date on the port project at Port-of-Spain. This letter pointed out the need for improvement in port management, operations and finances in order that the Bank could proceed with the consideration of the project. We might inquire about the status of such improvement.

7. Education Project: An education project based on the recommendations of a UNESCO mission has been under consideration by the Government. We might inquire about the status of this project.

(b) To be raised by Bank at meeting with President or Vice-President:

No meeting scheduled with President or Vice-President.

(c) Topics likely to be raised by delegation:

Crown Lands Development Project: The delegation may inquire about how soon Bank financing could be arranged for this project. We might state that this would largely depend on how well formulated the feasibility study of the FAO team turns out to be. In any event we would communicate with the Government promptly upon receipt and review of the FAO report.

TRINIDAD AND TOBAGO

September 1, 1965

V. BACKGROUND INFORMATION

(a) Bank Loans as of July 31, 1965

(U.S. \$ millions)

Year	Borrower	Purpose	Amount less Cancellations	Undisbursed Balance
1961	Trinidad and Tobago	Electric Power	<u>23.5</u>	<u>7.7</u>
	Total		23.5	
	of which has been repaid		<u>-</u>	
	Total outstanding		23.5	
	Amount sold	15.3		
	of which has been repaid -		<u>15.3</u>	
	Net amount held by Bank		<u>8.2</u>	

(b) IDA Credits as of July 31, 1965

Not yet member of IDA.

(c) Technical Assistance Activities

Assistance is being provided to the Government under the Bank/FAO cooperative arrangement in the preparation of a feasibility report on a project for the development of Crown lands. The report is tentatively expected to be completed towards the end of September 1965.

(d) Access to Private Capital Markets

Banking Connections:

U.K.	-	Barclays Bank D.C.O.
Canada	-	Royal Bank of Canada Bank of Nova Scotia Canadian Imperial Bank of Commerce
U.S.	-	Chase Manhattan First National Bank of Boston

TRINIDAD AND TOBAGO

September 1, 1965

Investment

U.K.	-	Crown Agents
U.S.	-	Paribas Corporation

Bond Issues

U.S. \$10.0 million, New York, May 1964;
15 years, 6-5/8%. No issue in London since 1954.

(e) Bank % of Capital Subscription

U.S. \$2.4 million. No release.

(f) IDA Subscription

Not yet member of IDA.

(g) Holdings of Bank Bonds

None.

(h) I.F.C.

The Board of Governors has approved the membership application of the Government of Trinidad and Tobago.

In response to the Government's request for comments on a feasibility study regarding a proposed Industrial Development Bank, prepared by Mr. B. Berkoff of the Commonwealth Development Finance Company Limited, IFC informed the Minister of Finance in March 1965 that the small size of the proposed institution raised serious doubt as to its viability. Our comments were simply acknowledged.

TRINIDAD AND TOBAGO

September 1, 1965

VI. POLITICAL SITUATION

Dr. Eric Williams assumed his office of Prime Minister after the elections of December, 1961. He belongs to the People's National Movement (PNM), which derives its support mainly from the urban population of negro and mixed origins. The Democratic Labour Party (DLP), the opposition, derives its support principally from the rural East Indian population. The Government follows moderate policies and the political and social conditions under the present Government have been calm. Next elections are due towards the end of 1966.

TRINIDAD AND TOBAGO

September 1, 1965

VII. ECONOMIC SITUATION

Population	:	950,000
GNP per capita	:	US\$ 580
Foreign Exchange Reserves:		US\$ 78.7 million

Although in 1964 Trinidad and Tobago's economic growth performance fell considerably short of the country's annual 10 per cent rate of growth, experienced in the 1955-1962 period, the economy showed some signs of recovery. Real GDP in that year rose by over 3 per cent as compared to 1.9 per cent in 1963, largely determined by the 5 per cent rate of growth in output of the country's chief industry, petroleum extraction and refining. In addition manufacturing advanced by about 5 per cent. However, agricultural production did not change appreciably and still remained under the 1961 level, causing serious concern in the country.

In 1964, the economy continued to be dominated by the oil industry. It accounts for roughly 30 per cent of GDP, 40 per cent of total gross investment and generates about two-thirds of the country's export earnings. At the same time the industry provides about 40 per cent of the Government revenues. Since 1962 the rate of growth of investment in the petroleum sector, however, has levelled off, largely because of the drop off in the rate of discovery of new oil fields of commercial significance. As a result, output of refineries only rose slightly largely based on increased crude oil imports and payments to the Government on account of income taxes and royalties hardly changed from the 1962 level.

Exports of fuels and lubricants rose by 8 per cent, which together with increased exports of mainly chemicals and manufactures led to an overall growth of exports of 8 per cent. But import demand grew faster as a result of a 10 per cent rise in non-agricultural wages, stimulated by a 20 per cent rise in bank credit (mainly channelled to the private sector). Foreign exchange reserves fell by 22 per cent to US\$ 78.7 million, roughly 2 months of imports.

Despite the near stagnation in revenues originating from the petroleum industry, current revenues in 1964 rose by 12 per cent, largely because of increased collections of income taxes and import duties. Current account savings decreased somewhat but continued to finance about 40 per cent of the Government's investment expenditures. The remainder was financed mainly by increased internal borrowing as the amount of external borrowing rapidly dropped.

TRINIDAD AND TOBAGO

September 1, 1965

The Government of Trinidad and Tobago is presently executing a Five-Year Plan (1964-1968), largely to reduce the economy's dependence on the petroleum industry. Total public investment expenditures are planned to average about TT\$ 64 million per annum, roughly the same level of the 1962-1964 period. The main part of these expenditures would cover investments in power, telephone and sewerage. In the light of prospective smaller current surpluses resulting from the stagnation in petroleum revenues and a relatively high rate of growth in current expenditures, to some extent caused by the sharp increase in expenditures on education, the Government expects to encounter problems in the financing of these investments. It, therefore, is undertaking a revision of the Plan which should be completed in November 1965.

Up to 1970 Trinidad and Tobago's debt-service payments account for less than 5 per cent of prospective foreign exchange earnings. Although there are some uncertainties with respect to the future balance of payments performance, the amount of prospective external financing now under consideration by Trinidad and Tobago should be well within its margin of creditworthiness.

URUGUAY

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September 16, 1965

BRIEFING PAPER - 1965

URUGUAY

I. MEETING WITH DELEGATION

Date: September 29, 1965 Time: 3:30 p.m.
Attended by: Staff: Mr. Alter
Mr. Chaufournier
Mr. Weiner
Mr. Loftus
Mr. Duran-Ballen
Mr. Wyss

II. MEMBERS OF DELEGATION

Mr. Daniel Hugo Martins, Governor	(B)	Minister of Finance
Alternate Governor	(B)	
Mr. Julio Solsona Flores, Governor	(F)	President, Banco de la Republica
Mr. Raul Ybarra San Martin, Alternate Governor	(F)	General Comptroller Ministry of Finance

III. BANK/IDA PROSPECTIVE OPERATIONS

Purpose	Amount (\$ million)	Status	Tentative Date for Negotiations
Power	\$ 25 - 50	Project appraisal initiated in mid-June. Awaiting appraisal of Uruguayan economy. Economic mission in the field.	First quarter 1966.

IV. TOPICS FOR DISCUSSION

(a) To be raised by Bank at staff level:

Capital Subscription. In April 1965 the Chamber of Representatives passed a bill approving the small quota increase and the 100% increase. In July 1965 the Senate approved this bill, thus completing all legislative requirements. The Government can now proceed to make the corresponding payments to the capital of the Bank. We should stress the need of prompt action, if it has not already been done.

9% Capital Subscription on original quota: (\$1,890,000). In September 1962 the Government agreed to release in dollars beginning March 1963 its 9% in 10 semi-annual payments. The Government, however, has not fully complied with the agreement. \$756,000 has been released. \$189,000 is in arrears and an equal amount is due September 30, 1965.

In view of Uruguay's financial position the Bank is willing to postpone additional releases in dollars. (This can be arranged by an exchange of letters before the delegation departs).

Livestock Loan 407-UR of March 30, 1965. Parliament has not yet ratified this loan the proceeds of which are urgently needed to continue the program of livestock development. We should stress the importance of prompt parliamentary action.

Negative Pledge. As evidence of the Bank's desire to help Uruguay the Bank has accepted (or will accept) to waive the negative pledge so that the Banco de la República may refinance credits from New York, Canadian and European banks for about \$75 million giving as collateral a pledge of a similar amount in gold. We should stress that our waiver would not in itself solve Uruguay's immediate financial problem unless the Government also adopts a workable stabilization program and a realistic long-term development plan.

Delays in Starting Highway Survey Financed by Loan 324-UR. In spite of constant urging the Government has not hired the firm to be put in charge of the Survey. This action has been postponed due to "political problems", meaning possible criticisms for hiring foreign consulting engineers. Almost 3 years have elapsed since the Loan was signed (about 2 years since the loan became effective). Unless the firm is definitely selected by December 31, 1965 and hired and working by March 1, 1966, the Bank might contemplate cancelling the \$200,000 allocated for this purpose in the loan account. However, and what is more important, the Bank would be unable to consider further lending to Uruguay for highways in the absence of

such a survey, as the priorities are unknown. The Bank would regret having to cancel the funds allocated for this survey because it believes that such a study is very much in Uruguay's interest and would be most helpful to itself and other financing institutions.

(b) Likely to be raised by delegation:

Power Project. The delegation might ask when the Bank will arrive at a decision regarding UTE's request for financial assistance. We should answer that an economic mission is presently in Uruguay appraising the Uruguayan economy. The Bank has already informed UTE that it will not be able to arrive at a decision until Uruguay's creditworthiness is examined. This we hope to determine in late October at which time we should continue with our appraisal of UTE's program. In this regard the Bank is concerned with UTE's financial position and its ability to carry out its projects due to the decline in the rate of return on the revalued assets. UTE has agreed to bring up its rate level so that it will render an 8% return on its fixed investments. The Government should support UTE as the Bank will not be able to lend unless such a rate of return is achieved. If on creditworthiness grounds it is at all possible to proceed with a loan to UTE, the Bank will have to consider an appropriate set of terms for amortization and grace period in the light of Uruguay's financial position.

V. BACKGROUND INFORMATION(a) Bank loans as of July 31, 1965:

(US\$ millions)

Year	Borrower	Purpose	Amount less cancellations	Undisburs Balance
1950	UTE	Power development and telephones	33.0	00.0
1955	UTE	Power development	5.5	00.0
1956	UTE	Power development	25.5	00.0
1959	República Oriental del Uruguay	Livestock improvement	7.0	00.0
1962	República Oriental del Uruguay	Highways	18.5	17.3
1965	República Oriental del Uruguay	Livestock development <u>1/</u>	<u>12.7</u>	<u>12.7</u>
Total			102.2	30.0
of which has been repaid			<u>20.4</u>	
Total outstanding			81.8	
Amount sold		3.2		
of which has been re- paid		<u>2.8</u>	<u>.4</u>	
Net amount held by Bank			<u>81.4</u>	

1/ Not yet effective.(b) IDA credits as of July 31, 1965:

None. Uruguay is not a member.

(c) Technical Assistance Activities:

None.

(d) Access to Private Capital Markets:

None.

- (e) Bank 9% Capital Subscription. (\$1.89 million).

\$756,000 released in dollars [see IV (a)]

- (f) IDA Subscription

Not a member. The Executive Power sent to Parliament a bill which included the request for Parliamentary authorization for IDA membership. Parliament deleted the pertinent clause from the proposed bill.

- (g) Holdings of Bank bonds.

None.

- (h) IFC

Not a member. The Executive Power sent to Parliament a bill which included the request for Parliamentary authorization for IFC membership. Parliament deleted the pertinent clause from the proposed bill.

VI. POLITICAL SITUATION

After 14 years of experimenting with the system of government by council, the majority of Uruguayans have come to realize that this system is inoperable. Most leaders, including the last three presidents of the National Council of Government, have publicly expressed the need to return to the single presidential system. Washington Beltran, the present president, has indicated that he will propose a plebiscite on this issue before the elections of November 1966. It is uncertain whether the plebiscite will be held, due to the cumbersome constitutional requirements. However, if the plebiscite is approved it should confirm the desire of the people of Uruguay to change the system of Government.

VII. ECONOMIC SITUATION

Population: 2.6 million

GNP per capita: US\$550

Net foreign exchange reserves: [to be furnished as soon as
IMF mission returns]

The stagnation of Uruguay's economy since the mid-1950's has continued into 1964 and early 1965. In 1964 GDP recovered by one percent - not enough to maintain per capita income, given the 1.4 percent population growth.

The country's financial situation during 1964 and in early 1965 has seriously deteriorated. The Bank of the Republic (central bank) and even more the private banks expanded credits by a combined total of 55 percent during 1964 with the private sector sharing more than the public sector in this increase. As a result money supply rose by over 50 percent in the face of a stagnating GDP. Price controls and lagging adjustments in the official exchange rate retarded the increase in the cost of living index during 1964 to 40 percent; a further acceleration in the first half of 1965 points toward price increases of perhaps more than 50 percent during this year. Public finances have probably deteriorated more severely than indicated by the government's reliance on central bank credit as it has reportedly built up substantial unpaid balances to domestic suppliers and to government employees as well as to recipients of social security payments.

Export prices in 1964 averaged some 12 percent above the level reached in 1963 (or 25 percent above 1961 levels). But as a consequence of unrestrained credit expansion and expectations of devaluation exporters withheld their products, particularly wool, and export earnings increased only little, while domestic inflation greatly stimulated imports. The most serious factor affecting the balance of payments, however, was a sharp deterioration of confidence in the nation's finances leading to substantial capital flights. Thus the central bank increased, during 1964, its debt to foreigners by US\$21 million and its foreign exchange commitments to Uruguayans, mostly foreign exchange cover for future import payments, rose by US\$102 million. Two devaluations of the official exchange rate (in November 1964 and March 1965) adding up to close to 60 percent belatedly and temporarily closed the gap between external and internal price levels; but unchecked inflation makes the present rate, prevailing since March, again unrealistic. Only temporary

closings of the official import market since early 1965 prevented a further deterioration in the central bank's position during the first half of 1965. The crisis of confidence indicated by the 1964 capital flights was further accentuated by the bankruptcy (related to mismanagement) of the second largest private bank in Montevideo in April 1965.

Uruguay's social and economic structure has come under a severe test by these recent financial strains at the end of nearly ten years of stagnation. Decisions required to improve the immediate economic situation depend on a solution of the political dilemma referred to in Section VI. The long-run prospects for Uruguay to resume economic growth, in turn, are related closely to the continued success of the Bank-initiated and financed livestock improvement program which is increasingly covering the whole country. Uruguay should remain a low cost producer of quality beef with excellent demand prospects and of high-grade wool with a fairly good future. The government has become increasingly aware that improvements in the livestock sector, the economy's backbone, is in need to be supplemented by more employment creating activities related to other exports by selected industries and services if the public sector is to discontinue its role of channelling income from low cost livestock producers to unemployed city dwellers. The government has prepared a set of measures designed to deal with the present financial crisis (although these measures are still stated in abstract and general terms). The preparation of a longer-term development program is apparently complete and our mission is now in the field examining this program. The government hopes that such a development program can be put into effect in order to mitigate employment effects likely to result from a stabilization program.

Uruguay's external public debt has been of a long-term character until recent years, and includes only small amounts of suppliers' credits. But the Bank of the Republic since 1962 consolidated some US\$50 million of bilateral balances (with Brazil and Argentina) and some US\$40 million from US banks into medium- and long-term loans. As a result of the consolidation of existing commercial debts to foreign private banks and of new debts arranged by the Bank of the Republic - discussed in Section IV (a) - Uruguay's external public debt, with maturities of more than one year, reported to amount to close to US\$ 240 million as of December 31, 1964, would increase by some US\$70 million or by one-third. As a consequence of the additional consolidated debt, debt service would rise in the next five to ten years from around 11 percent of current account receipts to probably not less than 20 percent of current account receipts. As far as we can now tell the debt service burden would be uniformly high during the next five years and somewhat lower during the following five years.

VENEZIA

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CONFIDENTIAL

September 16, 1965

BRIEFING PAPER - 1965

VENEZUELA

I. MEETING WITH DELEGATION

Date: September 27, 1965

Time: 1:00 p.m. (lunch)

Staff: Mr. Wilson
Mr. Chaufournier
Mr. Vignes
Mr. Wright
Mr. Zinman
Mr. Lerdau

II. MEMBERS OF DELEGATION

General Rafael Alfonzo Ravard (B)

Governor of Bank for Venezuela; President, Corporación Venezolana de Guayana

Mr. Eloy Anzola Montauban (B)

Alternate Governor of Bank for Venezuela; President, Corporación Venezolana de Fomento

Mr. Alfredo Machado Gomez (F)

Governor of the Fund for Venezuela; President, Banco Central de Venezuela

Mr. Benito Raúl Losada (F)

Alternate Governor of the Fund for Venezuela; Director, Banco Central de Venezuela

Mr. Ernesto Peltzer (F)

Economic Adviser, Banco Central de Venezuela

Mr. Samuel Rieber Wolf (F)

Chief, International Organizations Section, Banco Central de Venezuela

Mr. Marcos Sandoval (F)

Assistant to the Director, Economic Research Department, Banco Central de Venezuela

III. BANK/IDA PROSPECTIVE OPERATIONS

Loans presently under consideration:

Purpose	Amount (\$ Million)	Status	Tentative Date for Negotiators
Telecommunica- tions	40.0	Negotiators invited	September 1965
Caracas Water Supply	21.3	Negotiators invited	October 1965
Port Expansion and Improvement (Puerto Cabello)	5.0	Appraisal mission scheduled October 1965	Early 1966
Third Highway Loan	45.0	Appraisal mission scheduled January 1966	mid-1966

In addition, the Bank has been asked to consider the Zulia Agricultural Development Project and the Guayana Agriculture Project, on which we are awaiting further information.

IV. TOPICS FOR DISCUSSION(a) To be raised by Bank at staff level(1) Possible Bank lending program:

We should inform the Venezuelan delegation that, depending on the degree to which the Venezuelan Government undertakes revenue measures recommended by the recent Bank program mission to help complete the financing of the 1965-1968 development program, the Bank would be willing to prepare a lending program for priority projects in such development program. The status of reported Government initiatives in this field should be requested. With respect to loans under consideration, appraisal missions are tentatively scheduled in October 1965 for the Puerto Cabello project and in January 1966 for the highway project.

(ii) IDA Membership

We should take this opportunity to discuss Venezuela's membership in IDA. In the past the Government has been reluctant to consider participating in IDA on the grounds that it would not qualify for IDA lending. Given the country's good economic condition and the Bank's large lending program the Government may well be more receptive now to become a member of IDA (Venezuela's total contribution to IDA would be \$7.06 million including \$706,000 in gold and foreign exchange).

(iii) Slow Disbursements

Submittal of Withdrawal Applications has been slow relative to physical progress on the road projects (Loans 306-VE and 390-VE). We should reiterate our earlier request that the Ministry of Finance take up this matter with appropriate Government agencies with a view toward speeding up the procedures so that disbursements from the Loan Accounts will more accurately reflect the progress in execution of the projects.

(iv) Joint Financing

During discussions of the proposed loan to CANTV (Telecommunication project), the Bank staff attempted to interest the Venezuelan Government in joint financing of some of the equipment to be purchased. The then Minister of Finance was strongly opposed to such arrangements, partly because the interest cost would be higher than in the case of a straight Bank loan. The Venezuelan representatives also pointed out that the legislation authorizing a Government guarantee for the proposed CANTV loan was limited to a loan with an interest rate of 6% per annum, and that the legislative intent precluded the use

September 23, 1965

of supplier credits or similar financing, as it authorized a Government guarantee of a "credito exterior," i.e., from an official foreign financing institution. We should, therefore, reiterate the purposes of joint financing, and urge the Venezuelan delegation to request the Government to take the necessary measures to permit the possibility of joint financing in future Bank loans to Venezuela.

(v) Unsatisfactory Performance of CADAFE (Loan 391-VE)

CADAFE's financial position, as reflected in its statements for 1964, is unsatisfactory. The company's actual rate of return for 1964 was 1.9% as compared with a forecast, when the loan was made in August 1964, of 5.5%. The main problem seems to be lack of control over personnel expenses, and collections. We have not yet received a response to our letter of August 5, 1965, to the President of CADAFE, in which we enquired about his plans for improving the company's performance. We should, therefore, ask the Venezuelan delegation to raise this matter with CADAFE.

(vi) Central Bank and Other Government Agency Purchases of 2-Year Bonds for March 1966

We should inform the delegation of the Bank's plans for a 2-year bond issue of \$100 million in March 1966 and seek to obtain some idea of how much might be bought, and if none, why not.

(b) To be raised by Bank at meeting with President or Vice-President:

(No meeting scheduled)

(c) Likely to be raised by delegation:

(i) Proposed loan request for 400 KV power transmission line

The Governor of the Bank for Venezuela will probably wish to discuss the proposed request of the Corporacion Venezolana de Guayana (of which he is President) for a loan to assist in financing a new power transmission line to complement the Bank-financed Guri Hydroelectric project.

We should reiterate to the delegation that Bank consideration of this project would depend on the undertaking of a frequency unification agreement between the CVG and Electricidad de Caracas, a privately-owned electric power company.

We should also discuss the above-mentioned agreement in the context of the Government's commitment, in its letter of September 12, 1963, to the Bank in connection with the Guri Hydroelectric Project (Loan 353-VE), to take measures so that the frequency conversion of the Caracas area would be effected at the start of operations of the Guri Project (1968).

V. BACKGROUND INFORMATION(a) Bank Loans as of July 31, 1965

			(US\$ Millions)	
Year	Borrower	Purpose	Amount less Cancellations	Undis- bursed Balance
1961	Republic of Venezuela	Express Highways	45.0	14.9
1963	EDELCA	Electric Power	85.0	64.0
1964	Republic of Venezuela	Highways	30.0	30.0
1964	CADAFE	Power Transmission	<u>14.0</u>	<u>6.1</u>
Total			174.0	115.0
of which has been repaid			<u>-</u>	
Total now outstanding			174.0	
Amount sold		9.0		
of which has been repaid		<u>-</u>	<u>9.0</u>	
Net Amount now held by Bank			<u>165.0</u>	

(b) IDA Credits as of July 31, 1965

None.

(c) Technical Assistance Activities

None pending at present.

(d) Access to Private Capital Markets

Venezuela has successfully raised \$15 million by the sale of government bonds in April, 1965, through a syndicate headed by the First Boston Corporation and Kuhn, Loeb and Company. About 18% of this issue was placed in Europe.

(e) 9% Capital Subscription: \$12,600,000

The Venezuelan Government has agreed to release all of the 9% capital subscription in U. S. dollars. The amount corresponding to the 1961 special increase (\$10,710,000) is being released over five years. The remaining amount (equivalent of \$1,890,000) outstanding on Bank loans will be released, in U.S. dollars, upon repayment by borrowers.

(f) IDA Subscription

Not a member. See IV (a) (ii), above.

(g) Holdings of World Bank Bonds

None.

(h) I. F. C.Industrial Investments

IFC has made two investments in Venezuela and both of them have been sold. IFC is presently considering three projects consisting of the manufacturing of pulp and paper (Guayana pulp), tin containers (Tin Plate) and concentrated cattle feed (Protinal).

In 1963 I. F. C. invested the equivalent of \$1.34 million in the share capital of C. A. Venezolana de Desarrollo (CAVENDES). A mission visited CAVENDES in August, 1965, in connection with its application for a loan from I. F. C. This is now under consideration.

VI. POLITICAL SITUATION

The political situation has been relatively stable since President Raul Leoni, of the Accion Democratica (AD), took office in March, 1964, for a five-year term, succeeding Romulo Betancourt, the first elected President in Venezuela's history to serve out his full term of office. Since November 1964, a coalition known as the Amplia Base, which consists of Leoni's AD party, the Union Democratico Republicano (URD) and the Uslar parties, has formed the majority in the Congress. The present Government is continuing Betancourt's policies of raising the country's rate of growth and reducing unemployment. President Leoni has also invited private enterprise to participate with the Government in investing in the petrochemical and other industries.

VENEZUELA

September 1, 1965

VII. ECONOMIC SITUATION

Population (mid-1964):	8.4 million
GNP per capita (1964):	US\$830
Foreign Exchange Reserves (June 1965):	US\$822 million

From 1962 to 1964 the economy expanded at the high average rate of almost 7 per cent annually, after several years of recession. This high level of activity was accomplished in spite of a slowdown in the rate of growth of the hitherto leading oil sector. The upswing has been supported by some increase in public works, especially road-building, by a revival of private construction, and by good agricultural crops. Because of the large excess capacity in the manufacturing industry, production in this field has been able to expand by about 10% per year without the support of major new investments. Private consumption and savings, both private and public, have increased substantially, and unemployment has diminished.

During the next few years, economic growth will proceed in a setting significantly different from that of recent years. Additional capacity in manufacturing and construction has greatly diminished and the scarcity of skilled manpower is making itself more progressively felt.

The sharp recovery of production since 1962 has proceeded simultaneously with the continued strengthening of the balance of payments, and until recently, in the absence of internal price increases. Foreign exchange reserves have increased substantially and were at the high level of \$822 million at the end of June, 1965. Short-term foreign debts have largely been paid up, while the utilization of long-term foreign credits has remained at a low level. Venezuela's external public debt, as of December 31, 1964, amounted to \$414 million (including undisbursed). The Bank development program appraisal mission estimated that even with substantial amounts of increased borrowing, the debt service ratio would remain below 4% of exchange earnings at the end of 1968, as compared with a present debt service ratio of less than 2%. Venezuela is therefore creditworthy for a considerable amount of new foreign borrowing.

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September 20, 1965

BRIEFING PAPER - 1965

I N D I A

I. MEETING WITH DELEGATION

Due to the war it is almost certain that the Minister of Finance will not attend the Annual Meeting.

On September 10 Mr. Woods met briefly with Messrs. Bhattacharyya, Bhoothalingam, de Lattre and Bell to discuss the findings and implications of the economic mission.

Messrs. Stevenson and Votaw met with Mr. C. S. Krishna Moorthi on September 9 and 10 to discuss various aspects of the lending program.

The delegation returned to New Delhi September 10 and no further meetings have been scheduled as of this writing.

II. MEMBERS OF DELEGATION

T. T. Krishnamachari	Governor (IBRD/IMF) Minister of Finance
S. Bhoothalingam	Alternate Governor (IBRD) Secretary, Ministry of Finance
P. C. Bhattacharyya	Alternate Governor (IMF) Governor, Reserve Bank of India

Advisers

K. S. Sundara Rajan	Executive Director (IBRD)
J. J. Anjaria	Executive Director (IMF)
S. Guhan	Alternate Executive Director (IBRD)
A. K. Ghosh	Alternate Executive Director (IMF)
I. G. Patel	Chief Economic Adviser Ministry of Finance
C. S. Krishna Moorthi	Joint Secretary, Ministry of Finance
M. G. Kaul	Minister, Embassy of India
R. V. Krishnan	Additional Private Secretary to Finance Minister

III. BANK/IDA PROSPECTIVE OPERATIONS

(Listed in order of expected presentation to Executive Directors).

1. Koyna - III (\$18.5 million, Bank): Appraisal Report ready for Loan Committee; as far as the Bank is concerned, negotiations could begin as soon as conditions on the subcontinent return to normal. The project need not be delayed even if loan negotiations are deferred for a month or two. No special problems of negotiation or implementation are anticipated.
2. Punjab Flood Control and Drainage - II (about \$15 million, Bank): Appraisal Report cannot be completed until further data are received from India. Loan would be negotiated after (or concurrently with) proposed technical assistance project for resource studies (item 17 below).
3. Bangalore Water Supply and Sewage (\$25 million, probably IDA): Reappraisal mission is visiting Bangalore September 13-25 to up-date 1964 report. If consultants' team is working effectively and the 1964 law has been amended in accordance with our previous understandings, negotiations could proceed in November/December. Implementation of the project need not be delayed, even if negotiations should not occur until early 1966.
4. IISCO (\$20-30 million, Bank): July/August IFC appraisal mission found that ore supply to the Company, in view of increasing share of fines, presented formidable problem and that suitable facilities for beneficiation and agglomeration have to be selected as soon as possible. Bank/IFC therefore discussing feasibility review with the Company. The earlier loan proposal may be expanded by the Company to include substantial financing of ore-mining and ore-preparing facilities, maintenance equipment, and spares. A broader project along these lines would probably help strengthen the Company but might delay negotiations until early 1966.
5. Indus Equipment (\$23 million, Bank but outside consortium pledge): This loan to help purchase equipment for the giant Beas project has been delayed more than two years, pending agreement between India and US-AID; there is still no sign of when such agreement may be reached although the Indian Government recently appealed to Ambassador Bowles to help expedite approval.
6. Railways (\$50-70 million, probably IDA): The Government has requested \$68 million, but the exact amount will be determined after the appraisal. There is some concern that railway investment is running ahead of the rail transport needs of the economy; it is certainly excessive compared to the starved road transport program. A pre-appraisal questionnaire has been forwarded to India; if answered promptly, the appraisal mission would go to India late in October.

7. Hindustan Allied Fertilizer (about \$20 million, Bank): This project at Kothagudem has been under discussion with Allied Chemicals and their Indian partners for several years. Formal negotiations were recessed in February. The project has since been redesigned to process naphtha (instead of coal) and will have to be reappraised when there is satisfactory evidence that the principals are prepared to go ahead. Project viability may also depend on Government price policy, which is still uncertain.
8. TISCO (probably \$60 million, Bank): Negotiations on financing needs for the next stage of development have been held off pending agreement between the Company and Government regarding repayment of government advances and the public trustee issue; negotiations on these points are in progress and may be concluded soon. The project was appraised both in 1963 and in 1964, but a new mission will be required after TISCO settles with Government. Given Bank experience with other projects in India, it is entirely possible that some redefinition of the project or other delays may occur before a lending proposal is firmed up.
9. Haldia Port (\$20-32 million, probably Bank): Information requested a year ago has been prepared by a study group under Transport Ministry economist Dr. Bhatia. Originally, the group was expected to report in February 1965, but this target was subsequently postponed until August. The report, which has just arrived, will be reviewed by the Bank staff and, if found satisfactory, would provide the basis for an October/November appraisal mission. The Calcutta Port Trust has also requested further assistance; this can be considered only after having come to a judgment about the probable level of traffic through Haldia and its effect on the older port.
10. Goa Port (\$12-15 million, probably Bank): The project would assist primarily in the improvement of ore-handling facilities. A formal request and revised project report are overdue and may arrive in the next few weeks. The appraisal mission would probably be organized in two stages. First, an IFC mission to determine ore export prospects and ore-handling requirements; and second, a transport mission to review port improvements necessary to meet those requirements. In addition to a revised project report, Government has also been asked to provide the Bank with a copy of the Battelle Institute study of ore export prospects (first draft due in October), siltation tests (to be completed at Poona toward the end of the year), and Canadian consultant C. D. Howe's review of Rendell, Palmer and Tutton port design.
11. Uttar Pradesh Tubewells - II (amount uncertain): In a report received last month, FAO recommended a project substantially different from that which the State requested. It is not clear whether FAO's recommendations would go far enough to meet the Bank's criteria of viability. Once the minimum conditions for considering a second tubewell project in Uttar Pradesh have been agreed within the Bank, it will be necessary to consult with State and Union governments to determine whether or not such a project would be acceptable to them. The government has indicated that it would welcome discussions in October/November in order to try to define a more productive project.

12. Sone Irrigation - II (amount uncertain): Supervision mission this winter will consider whether or not Stage II, for which a sketchy project report has just been received, would be ready for appraisal early in 1966.

13. Hooghly River Bridge (amount uncertain): No formal request to consider this project has been received, although the Bank helped finance the cost of preliminary engineering. The Government has decided that the bridge should be a high-level crossing, but this judgment will have to be reviewed as soon as future port developments are more clearly defined (item 9 above). The Government favors a combined contract for detailed engineering design and construction, but would not object to a small, relatively short-term loan for the engineering stage and later consideration of a second loan for construction.

14. Bombay-Poona Road (amount uncertain): The Bank has expressed interest. The Government has undertaken engineering studies that are unlikely to be completed before the first months of 1966. We have indicated to Government that highway projects would receive priority consideration by the Bank but as yet the Government has not prepared the Bombay-Poona project or any other proposals in sufficient detail to be appraised.

15. Forestry and Fisheries: Exploratory FAO missions scheduled for fall.

16. Birla-Armour Fertilizer: Government has endorsed the project for Bank and/or IFC consideration. Principals have discussed the project with IFC but seem reluctant to seek Bank financing, because Government interference in company affairs might be increased if the Government were to guarantee its foreign exchange financing.

Technical Assistance

17. Bombay Water Supply (\$500,000): Loan Committee approval expected before Annual Meeting. Consultants' proposals should be available early in November; work could begin by the end of the year.

18. Punjab Agriculture and Water Resources (\$1.5 - 2.5 million): Loan Committee approval expected before Annual Meeting. During October, Bank staff would visit India to discuss detailed arrangements for the study with representatives of State and Union governments and the proposed consultants (U.S. Bureau of Reclamation).

19. Bombay Expressways (\$400,000): Assistance discussed in India by transport mission in February 1965. However, as of this writing no formal request had been received from Government.

IV. TOPICS FOR DISCUSSION

(a) To be raised by Bank at staff level.

1. The proposed lending program will be reviewed in an effort to expedite action necessary before appraisals can be scheduled (or completed), as indicated in section III above. Virtually all projects are being delayed at the Indian end, primarily by inadequate preparation of project details and indecisiveness on relevant policy issues.

2. It may be useful to ask if India plans to present any other projects for Bank/IDA financing during the next four months. Most of the proposals so far submitted by India (and listed in section III above) involve major expansion of capital assets, will be constructed over the next several years, and can yield returns only toward the end of (or even after) the Fourth Plan period. In total amount they may not even absorb the remaining \$290.5 million (\$205.5 million from the Bank and \$85 million from IDA) already pledged for the period ending March 31, 1966.

3. Against the present list of projects it will be hard to commit the full amount of Bank/IDA pledges before the end of the Third Plan period; and even if committed to these projects, Bank (and to a lesser extent IDA) funds would disburse slowly (i.e., must be considered Fourth Plan aid in disbursement terms). The only really fast disburser would be the proposed new railway credit, and there is almost nothing on the present list to support maintenance import requirements. Therefore, if there is agreement between Mr. Woods and the Minister on economic policy issues, it would probably be desirable to revise the entire lending program to provide more support for maintenance imports in the next year or two. Most of the projects now listed could be covered easily by a Bank commitment of \$50 million per year during the Fourth Plan. (This would approximately equal scheduled repayments on Bank loans during those years.)

4. Projects which have experienced serious delays in implementation will be reviewed in an effort to expedite completion (e.g. Bombay port, Calcutta port, national highways, Salandi irrigation and power transmission). These problems are already well covered in various memoranda to India.

(b) To be raised by Bank at meeting with President.

1. Understanding with IMF: Unless there are joint meetings we should ask the delegation for its version of recent discussions with the Fund.

2. Economic policies: Beyond what may have been discussed with the Fund, it was hoped that the Minister would indicate his reaction to all points emphasized in June by Messrs. de Lattre and Bell: including decontrol of maintenance imports, stimuli to exports,

priority for agriculture, population control, obstacles to private foreign investment and competition for development resources from the defense sector.

(i) The Government has been asked to summarize in writing what policies it intends to follow in future (and what outside aid might be required to support such policies). The Bank should continue to insist on a (conditional but) written undertaking regarding India's future economic policies.

(ii) It should be made clear that there can be no increase in assistance to India for "Maintenance imports" -- and there may very well be a decrease in aid -- unless the Government gives a firm undertaking on economic policy issues.

(c) Likely to be raised by delegation.

1. Aid to underwrite relaxation of import controls: The Minister will almost certainly ask what additional foreign assistance might be available during the Fourth Plan to cover the increase in imports expected to follow decontrol. He may also ask what additional aid would be available earlier if decontrol measures were adopted prior to April 1, 1966.

(i) There are various estimates of the amount of additional non-project aid that might be required to cover the increase in imports following decontrol. These estimates are in the range of \$300-500 million per annum for three to five years plus \$250-350 million in IMF-type facilities to deal with sharp speculative increases in imports immediately following decontrol. Total aid (including assistance for project financing) might not need to increase by the same amount. The Government has promised to give its own estimates of additional aid requirements expected to arise from various decontrol measures, but these have not yet been received.

(ii) It will be of considerable importance in these discussions to make sure that the Minister realizes that there is a real possibility of increasing what he calls "non-project" aid, provided policy-changes in India justify exceptional measures by IDA, IMF, US-AID and similar agencies. In India it has been argued that such aid would not be available no matter what policy changes the Government adopted; uncertainty on this point has been effective in discouraging or delaying reforms which might have been adopted otherwise.

(iii) Given correct policies in India, there is quite a bit that Bank/IDA could do to provide additional maintenance import support. For example, a substantial development credit might be negotiated to cover the foreign exchange cost of imported

fertilizers currently being distributed in markets to be served by fertilizer factories already under construction (or for which firm contracts have been signed); such a credit might also include provision for sulphur, phosphate and other imported materials required to sustain production in existing fertilizer plants. An agricultural credit project might be devised; such a credit could give considerable balance of payments' relief by disbursing foreign currencies against a larger portion of credits provided in rupees than the portion required to cover imported inputs, and it would help underline the importance we attach to agriculture. Additional industrial imports credits could be devised -- e.g. to cover materials and/or industries which are decontrolled. Foreign exchange could also be disbursed against a substantial percentage of local currency costs of projects; however, most proposals presently in the project pipeline will require several years to complete and are therefore slow disbursing; moreover, several are for private companies for whom this procedure would not be appropriate.

(iv) If the Government were to give an undertaking on economic policy quickly, we could also move quickly. Specifically, IDA during the next six months, could commit the \$85 million from outstanding pledges for disbursement against 1966/67 maintenance imports. (These funds are presently earmarked for railway and Bangalore water projects, which could as well be handled by the Bank.)

(v) Outside the IMF and IDA, the U.K. and Germany are "friendly", but the only other source of immediate assistance in substantial amounts to support decontrol measures is likely to be the U.S. Given appropriate policy measures in India, the Bank would be prepared to recommend that the U.S. consider further non-project assistance, and we have reason to believe that it would not be impossible for substantial additional non-project aid to be made available from the U.S. almost immediately (i.e., provided out of existing authorizations).

(vi) In the longer run the Bank would expect all members of the consortium to permit a larger portion of whatever aid they give to be used for maintenance imports.

(vii) Provided that conditional agreement is reached on economic policies, the Bank is prepared immediately to explore the possibility of additional aid for maintenance imports with all members of the consortium.

2. Fourth Plan appraisal: The delegation may ask what schedule we have in mind for reviewing the Fourth Plan. For our own administrative purposes we would like to firm up a schedule for this appraisal. However, the Plan draft expected during the summer has still not been published -- and may not be until the international situation is clarified. Moreover, it will be virtually impossible to prepare a

meaningful appraisal of the Plan for presentation to the consortium without knowing what changes in policy the Government proposes.

(i) The Minister should be told that the Bank would find it difficult to organize a Fourth Plan appraisal until it has not only the draft Plan but also the Government's written statement regarding its proposed economic policies.

(ii) However, the Bank is prepared to examine Fourth Plan investment programs for individual sectors (e.g., transport and agriculture) beginning late in October and using reports prepared by the Bell mission as the starting point for such discussions.

(iii) The longer Fourth Plan decisions are delayed, the longer Bank appraisal and consortium consideration of Fourth Plan aid requirements will have to be deferred.

3. Debt rescheduling: The Minister may ask what the Bank can do to assist in reducing India's projected 1966/71 debt service burden.

(i) We should reply that the Bank believes this subject can be handled best in the context of discussions on the level of aid for the Fourth Plan, i.e. only after the Bank's Fourth Plan appraisal has been submitted to consortium members. The Bank should reiterate its intention to have debt rescheduling considered by the consortium at an appropriate time, as one means of providing additional financial assistance to India.

(ii) We might ask what plans there are to reschedule payments to East Bloc creditors.

4. Fourth Plan Aid: It is clearly too early for a meaningful discussion of details. Unless present economic policies are changed, aid from the consortium will probably be less than before; conversely, consortium aid might well be increased if new policies are put into effect. The Bank is thinking of new commitments in the range of \$50-100 million per annum, depending on Indian policy and performance; but it may be best to mention no figure at this time. IDA lending clearly depends on further replenishment.

V. BACKGROUND INFORMATION

(a) Bank Loans as of August 31, 1965

			(US \$ million)	
Date signed	Borrower	Purpose	Amount less cancellations	Undisbursed balance
Loans fully disbursed			625.0	
Nov. 19/54	Tata Power Co.	Trombay power	13.9	0.1
May 29/57	Tata Power Co.	Trombay power II	9.7	0.1
June 25/58	Madras Port	Port improvements	11.0	1.5
June 25/58	Calcutta Port	Port improvements	29.0	0.9
July 15/59	ICICI - II	Private industry	10.0	0.3
Oct. 28/60	ICICI - III	Private industry	20.0	2.1
Aug. 9/61	India	Private coal mining	35.0	14.5 ^{a/}
Aug. 17/61	Calcutta Port II	Port improvements	21.0	14.3
Dec. 22/61	IISCO - III	Coal development	19.5	16.2
Feb. 28/62	ICICI - IV	Private industry	20.0	6.1
June 5/63	ICICI - V	Private industry	30.0	20.2
May 28/65	ICICI - VI	Private industry	50.0	50.0
June 11/65	India	Power transmission	70.0 ^{b/}	70.0
June 11/65	India	Kothagudem power II	14.0	12.4
Total			978.1	208.6
of which has been repaid			223.8	
Total outstanding			754.3	
Amount sold			97.3	
of which has been repaid			78.4	18.9
Net amount held by Bank			735.4	

^{a/} Up to \$8 million may be cancelled after December 31, 1965.

^{b/} Effective in part; additional tranches will be made effective upon review of undertakings from individual Boards and agencies, most of which have been received.

(b) IDA Credits as of August 31, 1965 ^{a/}

(US \$ million)			
Date signed	Purpose	Amount less cancellations	Undisbursed balance
June 21/61	Highway construction and improvement	60.0	11.2
Sept. 6/61	Tubewell irrigation	6.0	--
Nov. 22/61	Shetrunji irrigation	4.5	1.8
Nov. 22/61	Salandi irrigation	8.0	6.6
Nov. 22/61	Punjab flood protection and drainage	10.0	0.9
Feb. 14/62	Durgapur power extension	18.5	8.9
June 29/62	Sone irrigation	15.0	5.5
July 18/62	Purna irrigation	13.0	4.3
Aug. 8/62	Koyna power - II	17.5	11.9
Sept. 14/62	Bombay port	18.0	15.0
Sept. 14/62	Telecommunications	42.0	14.7
Mar. 22/63	Railway improvements - VII	67.5	--
May 24/63	Kothagudem power	20.0	12.7
June 9/64	Industrial imports	90.0	31.1
July 6/64	Telecommunications - II	33.0	21.0
Oct. 24/64	Railway improvements - VIII	62.0	21.9
Aug. 11/65	Industrial imports - II	100.0 ^{a/}	100.0
	Total	<u>585.0</u>	<u>267.5</u>

^{a/} Became effective September 10, 1965.

(c) Technical Assistance Activities

Two technical assistance projects have so far been completed -- the Coal Transport Study in August 1964 (\$862,273) and the Hooghly River Crossing in June 1965 (\$87,500). On July 8, 1965 the Executive Directors approved an allocation of \$285,000 to the Eastern Region Transport Survey; the consultant team is already in Calcutta. Besides the Bell mission studies during the last year, various smaller surveys have been carried out by the Bank staff members in Delhi.

(d) Access to Private Capital Markets

No IBRD bond issue has been raised nor is any contemplated.

(e) Bank 9% Capital Subscription

Entire 9% (\$72.0 million) is released. \$21.6 million convertible into any currency is already on loan; of \$50.4 million available for purchases in India, \$1.6 million has been used.

(f) IDA Subscription

Part II member. Use of India's 90% (\$36.3 million) subscription for purchases of goods in India to supply IDA projects outside India has so far not been found. However, the Indian Government has agreed in principle to release rupees against 50 percent of the value of such purchases, subject to India's approval of individual cases.

(g) Holdings of Bank Bonds

Position unchanged from last year. \$1 million of IBRD bonds, \$10.04 million of borrower's obligations.

(h) International Finance Corporation

<u>Existing Investments</u>		(U.S. dollars)
Assam Sillimanite, Ltd.	Refractory materials	886,276
K.S.B. Pumps, Ltd.	Submersible water pumps	210,000
Precision Bearings India, Ltd.	Ball and roller bearings	1,029,250
Fort Gloster Industries, Ltd.	Electrical power cables	1,210,883
Mahindra UGINE Steel Co. Ltd.	Alloy steel	3,450,001
Lakshmi Machine Works, Ltd.	Textile machinery	<u>1,380,000</u>
Total		8,166,410

<u>Active Applications and Future Prospects</u>		(\$ million)
AEG India NGEF	Motors, transformers, switches	1.3
Modern Mills	Acetate filament yarn	3.4
Ratnagiri Pig Iron	300,000 tons pig iron	to be discussed
Struthers Wells Corporation	Chemical equipment	1.4
Zenith Steel Pipes, Ltd.	75,000 tons seamless tubes	9.7

A number of other inquiries have been received and are under examination (e.g. Birla Pig Iron \$1.3 million, Madras Aluminium \$6 million, Sikkim Jewel Bearings \$300,000, McNally-Bird Machine Tool Project, Kerala Tire Manufacturing Plant).

Subjects to be discussed

- (i) The effect of the recent increase in import duties for capital goods and raw materials on our projects.
- (ii) The insecurity caused by rumors about increases in income and other taxes.
- (iii) Foreign exchange funds from IFC investments not needed for imported equipment should be made available for additional raw material imports.
- (iv) Review of understanding reached with the Government in 1962 re IFC terms.

VI. POLITICAL SITUATION

The war with Pakistan overshadows all other considerations and makes much of what has been said above about economic development policies and lending programs seem irrelevant. Even if arrangements are made quickly to halt hostilities, the last few weeks' experience is likely to have a profound effect on political and economic thinking in India. It is too early to say whether the shock will bring a new spirit of decisiveness to government; however, similar hopes, expressed three years ago during the Chinese crisis, have so far been frustrated.

During the year Mr. Shastri has consolidated his political power. The war will probably add to his strength -- at least in the next few months. In spite of domestic disenchantment and violent criticism over inflation and the food crisis, the Prime Minister survived his first sorties into the international arena and achieved a major domestic political victory at the Congress Party conference at Bangalore in July. Mr. Morarji Desai, the Prime Minister's most outspoken opponent within the Congress, was decisively defeated; and Mr. Kamaraj, whose political support led to the selection of Mr. Shastri as Prime Minister a year ago, was put in the position of requiring the Prime Minister's support to win reelection as President of the Party.

VII. ECONOMIC SITUATION

- (a) Population (1965) approximately 480 million
GNP per capita \$90 (current prices at the official rate of exchange)
Foreign exchange reserves, including gold, were very low (\$440 million) at the end of May.

- (b) The Indian economy is still struggling to keep up with the increase in population. Sluggishness in agriculture continues; good harvests in the 1964/65 season have merely brought the growth in output back to the 2-1/2 percent trend line, which is lower than requirements. An erratic monsoon threatens to push agricultural production in 1965/66 below last year's level. A continued food crisis is expected.

In regard to industry there is a growing awareness among Indian authorities of the need to provide increased maintenance imports and to take other steps which would permit better utilization of existing capacity. However, the level of foreign exchange reserves is lower than ever before and the export position continues to be disappointing.

On August 19 the Finance Minister presented a supplementary budget for 1965/66. It appears that the new budget involves mainly a revision of existing import duties, primarily for the purpose of rationalization; additional revenue of Rs. 170 crores per annum is expected from duties at the new level, indicating an average increase of around 12 percent. No new stimulus to exports was included in the announcement. These measures have pleased no one and angered many; they do not represent -- and were not intended to represent -- a significant change in economic policy.

ANNEX A

LIST OF THE INDIAN CABINET

<u>Name</u>	<u>Portfolio</u>	<u>State to which belongs</u>
Shri Lal Bahadur Shastri	Prime Minister, and Minister of Atomic Energy	Uttar Pradesh
Shri Gulzarilal Nanda	Minister of Home Affairs	Gujarat
Shri T.T. Krishnamachari	Minister of Finance	Madras
Smt. Indira Gandhi	Minister of Information and Broadcasting	Uttar Pradesh
Shri Swaran Singh	Minister of External Affairs	Punjab
Shri S.K. Patil	Minister of Railways	Maharashtra
Shri Asoke K. Sen	Minister of Law and Social Security	West Bengal
Shri Y.B. Chavan	Minister of Defence	Maharashtra
Shri N. Sanjeeva Reddy	Minister of Steel and Mines	Andhra Pradesh
Shri C. Subramaniam	Minister of Food and Agriculture	Madras
Shri Humayun Kabir	Minister of Petroleum and Chemicals	West Bengal
Shri Satya Narayan Sinha	Minister of Communications and Parliamentary Affairs	Bihar
Shri M.C. Chagla	Minister of Education	Maharashtra
Shri D. Sanjivayya	Minister of Labour and Employment	Andhra Pradesh
Shri Mahavir Tyagi	Minister of Rehabilitation	Uttar Pradesh

Source: Indian Executive Director's office.

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September 14, 1965

BRIEFING PAPER - 1965

IRAN

I. MEETING WITH DELEGATION

Staff: Monday, September 27, at 3 p.m.

Management: Saturday, October 2, at 10 a.m. (Mr. Knapp)

II. MEMBERS OF DELEGATION

Jamshid Amuzegar	Governor (IBRD) Minister of Finance
Mehdi Samii	Governor (IMF) Governor, Bank Markazi Iran
Jahangir Amuzegar	Alternate Governor (IBRD) Ambassador-at-Large Chief of the Iranian Economic Mission Washington, D.C.
Ali Hezareh	Temporary Alternate Governor (IMF) Senior Economist Research Department Bank Markazi Iran
Nader Akrami	Adviser Head, International Organizations Section, Research Department Bank Markazi Iran

III. BANK/IDA PROSPECTIVE OPERATIONS

An FAO mission visited Iran in October/November 1964 to identify agricultural projects which might be suitable for Bank financing. The mission's report was submitted to the Government in May 1965. In June 1965 we informed the Government of our reactions to the report, and offered to send a mission this fall to appraise the Ghazvin project, involving groundwater irrigation plus farm development. We

suggested that the Government seek FAO's assistance or engage private consultants in the preparation of some of the other agricultural projects and the Bank would be prepared to consider such projects when adequate feasibility studies had been completed. No reply has yet been received from the Government.

The Bank proposes to send a mission of five or six persons to Iran either later in 1965 or early in 1966 for the purpose of making a comprehensive study of the agricultural sector in view of the relatively poor performance in that sector and the possibility of greater Bank involvement in agricultural projects in the future.

The Bank has agreed in principle to consider the financing of the Greater Dez irrigation project prior to the expiration of the three-year test period stipulated in the Dez Loan Agreement. KWPA is proceeding with planning and design studies and expects to approach us some time in 1966 for initial consideration of the project.

A UNESCO/FAO mission visited Iran in June 1965 to identify educational projects for possible Bank financing. The mission's draft report suggests priority needs in teacher training, technical and agricultural education, but we are not satisfied that a convincing case is made for the new facilities envisaged. UNESCO has agreed to revise the report in the light of our comments. In any event, substantial additional work would be required to prepare specific projects.

Additional Iranian requests are likely for assistance in highway and feeder road construction - especially the latter, since our loan last April for this purpose was to finance a pilot project to guide future feeder road construction - but we do not expect these before next year.

IV. TOPICS FOR DISCUSSION

(a) To be raised by Bank at staff level

- (i) Release of capital subscription: Iran has not yet released the 9% of the 1960 special increase in its capital subscription to the Bank. In an exchange of letters between Mr. Stevenson and the Ministry of Finance in May and June of this year, it was agreed that the release of this remaining portion, amounting to \$2.052 million, would be discussed at the time of the Annual Meeting. When the Bank 9% has

been released, the Area Department will take up the matter of the release of the 90% IDA subscription.

- (ii) Agricultural projects: If not received by that time, we should ask about Government's reactions to our letter of June 1965 on the report of the FAO agricultural project identification mission. Area Department will also discuss with delegation the proposed timing and arrangements for the forthcoming missions for the agricultural sector study and the Ghazvin project appraisal, in the light of the findings of the McDiarmid mission which visited Iran August 26 - September 11 (Mr. McDiarmid's memorandum of September 14, 1965, attached).
- (iii) Steel mill: We should ask the delegation for whatever details are available on the agreement with the U.S.S.R. for the establishment in Iran of a steel mill and other industries in exchange for natural gas from Iran.
- (iv) SID Convention: If action is not completed by that time, we will wish to ask delegation about status of Iran's adherence to the SID Convention.
- (v) Debt consultation: Following our representations to the Government last fall about its failure to notify us of the \$200 million military credit arranged with U.S. banks, the Central Bank for several months gave us fairly full details of new credits entered into by Iran. We should point out to the delegation, however, that this information came to us after the fact and did not constitute advance consultation, which our loan agreements provide for. Moreover, the flow of such information appears to have stopped since press reports indicate that additional credits are being entered into or considered. Specifically, we should ask about recent press reports of new suppliers' credits and raise the question of Iran's using this type of financing for its development program.

(b) Likely to be raised by Delegation

- (i) Agricultural projects: Delegation may ask about Bank assistance for other agricultural projects besides Ghazvin; our position is set forth in our letter to Mr. Asfia of June 18 giving Bank's reactions to FAO report (attached).

- (ii) Education: Delegation may ask about status of UNESCO project identification mission report and Bank's reactions to it. We should state that UNESCO report is still being put into final form, but that we understand all of the projects reviewed require a considerable amount of preparatory work before they will be ready for consideration.
- (iii) Consultative group: Delegation may raise question of a consortium or consultative group for Iran, in view of the recent decision within the Bank to organize more such groups. If the Government appears to attach real importance to this request, we should say that the establishment of a consultative group for Iran is a possibility, though the Bank must satisfy itself that better coordination of aid would help to make the country's development effort more effective. Several factors would have to be examined closely by the Bank: that the aid-givers representing the bulk of external financing to Iran agree that the Bank should organize some coordinating machinery; that a sufficient volume of projects can be expected to be forthcoming to provide an adequate vehicle for external assistance; and that the Government's own performance offers reasonable prospects that the coordination effort can have constructive results. The Bank would have to consider the findings of Mr. McDiarmid's mission and of the forthcoming agricultural sector study.

V. BACKGROUND INFORMATION

(a) Bank loans as of July 31, 1965

			(US \$ Millions)	
Year	Borrower	Purpose	Amount less cancellations	Undisbursed Balance
1957	Iran	General development	75.0	-
1959	Iran	Road construction	72.0	-
1959	IMDBI	Assist private industry	5.2	2.7
1960	Iran	Dez multipurpose project	42.0	-
1964	Iran	Road construction	18.5	16.8
1965	Iran	Road construction	32.0 ^{1/}	32.0
1965	Iran	Feeder roads	8.5 ^{1/}	8.5
1965	IMDBI	Assist private industry	10.0 ^{1/}	10.0
Total			263.2	70.0
of which has been repaid			93.9	
Total outstanding			169.3	
Amount sold			21.3	
of which has been repaid			17.5	
Net amount held by Bank			165.5	

^{1/} Not yet effective.

(b) IDA credits as of July 31, 1965

None.

(c) Technical Assistance Activities

- (i) Port study: In April 1965 the Bank agreed to cover the foreign exchange costs, estimated at \$39,000, of a study of port administration in Iran to be carried out by Arthur D. Little Inc. The consultants' team visited Iran in May/June and the report is expected to be ready in late September or early October. The report will indicate steps required on the part of the Iranian authorities to transfer cargo handling operations from the Customs administration to a strengthened port authority. If these steps are completed, we may be approached by the Iranians to help organize and possibly to finance the implementation stage; we have made clear, however, that we have no commitment to help in financing that stage.
- (ii) Iran Electricity Authority: In June the Bank terminated its technical assistance, originally estimated to amount to \$750,000, for establishment and initial operation of the Iran Electricity Authority. The initial work of the consultants (Stone & Webster Service Corporation) in preparing uniform codes, standards of service and accounting procedures was completed some months ago. In the meantime the Authority, which was to be primarily a licensing and regulatory agency, was absorbed into a newly created Ministry of Water and Power charged with various activities in the power field, including operation and management of local electric utilities. After long efforts to obtain an understanding of the Ministry's intentions it became clear that the consultants' services would not be used as originally envisaged, and the project was terminated. The Bank continued to cover the foreign exchange costs of the consultants' services through July 31, 1965; total expenditures are estimated at about \$283,000.

(d) Access to Private Capital Markets

Not applicable.

(e) Bank 9% Capital Subscription

\$8.1 million of which \$6.0 million, corresponding to original 18% subscription, has been released and is convertible

into any currency. \$2.1 million, representing 9% of the special increase taken up in February 1960, has not been released. Initiative for release suggested under IV(a) above.

(f) IDA Subscription

Part II member. 90% subscription amounts to \$4.09 million, of which none has been released. Initiative for release suggested under IV(a) above.

(g) Holdings of Bank Bonds

\$5.0 million.

(h) I. F. C.

Investment Outstanding: Sherkat Sahami Kahkashan \$300,000 approved on June 2, 1959.

Future Prospects for I.F.C.: No active applications. There seems to be little industrial activity of sufficient size to warrant direct participation by I.F.C. The demand for financing from IMDBI has increased, but the funds presently available to IMDBI appear sufficient to meet the current demand.

VI. POLITICAL SITUATION

The political situation remains quiet despite the assassination of Prime Minister Hassan Ali Mansour last January and an attempt to assassinate the Shah in April. These incidents serve as a reminder of political undercurrents of opposition to the Shah's regime, made up of disparate elements including some who wish to strengthen representative institutions in Iran and various groups opposing the Shah's social and economic reform measures.

The new Prime Minister is Amir Abbas Hoveida (43), formerly the Finance Minister, who received an overwhelming vote of confidence in the Majlis after his appointment last January. He continues his predecessor's policy of implementing the Shah's program. Succeeding the late Mr. Mansour as head of the Shah's New Iran Party is Mr. Ata-Olah Khosrovani, Minister of Labor and brother of the Iranian Ambassador to the United States. The party controls two-thirds of the Majlis elected in September 1963.

Although a member of CENTO, Iran has recently improved its

relations with the U.S.S.R. In July 1965 the Shah paid a visit to Moscow, during which it was announced that the U.S.S.R. had offered to assist in developing heavy industry in Iran in return for Iranian natural gas. The offer includes a steel mill with a capacity of 600,000 tons a year, a machine tool plant for manufacturing textile and sugar refining equipment, and a factory to produce agricultural equipment. The U.S.S.R. has also agreed to assist in financing a hydroelectric and irrigation complex on the Araks river bordering the U.S.S.R.

VII. ECONOMIC SITUATION

(a) <u>Population</u> (1965):	22 million, growing at 2-2.5 per cent per annum.
<u>Per capita GNP</u> (1964):	Between \$180 and \$200.
<u>Exchange Reserves</u> (June 1965):	\$300 million (six months' imports).
<u>Average Annual Growth:</u>	
Gross national product (1962-1964)	About 3-4 per cent.
Industrial production (1956-1962/63)	8 per cent.
Agricultural production (1952/54-1960/62)	2 per cent.
Crude oil production (1956-1964)	16 per cent.

- (b) In 1960 inflation, generated by excess credit expansion to the private sector, culminated in severe pressure on the balance of payments, requiring the adoption of a stabilization program. Unfortunately fiscal and monetary retrenchment coincided with a two-year falling off in development expenditures and in the adoption of a far-reaching land reform and other measures which had a protracted dampening effect on private investment. The economy went into a recession which persisted until late 1963. The Third Plan, initiated in September 1962, got off to a slow start because too few projects were ready for execution. During the first 2½ years of the 5½ Year Plan, development expenditures amounted to only Rls. 56 billion or 28 per cent of the Rls. 200 billion Plan.

Early in 1964 a measure of confidence had been restored in the private sector so that the easy money policy adopted in 1962 brought increased private investment. This was combined with a step-up in investment expenditures by the Government, and recovery set in. By the third quarter of that year, however, the economy had passed into another inflationary phase with renewed pressure on the balance of payments and the price level. The money supply rose by about 23 per cent in the two years ending March 21, 1965. This credit expansion financed a sharp increase in imports which rose in 1964/65 by about 45 per cent. The effects of inflation were compounded by crop failures owing to the particularly harsh winter of 1963/64. But for the receipt of non-recurrent bonuses paid for new oil concessions totalling about \$185 million there would have been a substantial loss of foreign exchange reserves in 1964/65. As it was, reserves increased by about \$90 million in that year and in June 1965 amounted to about \$300 million or about six months' imports.

Despite the recovery, Iran's overall economic growth was modest last year because of the set back in agricultural production. The Third Plan aims at an annual growth of 6 per cent but only 3-4 per cent per annum has been achieved thus far. However, with good crop prospects this year GNP may increase by close to the target percentage.

Oil remains Iran's major economic asset, accounting for 17 per cent of GNP, 50 per cent of Government revenues and about 75 per cent of foreign exchange earnings. In 1964 crude production increased about 16 per cent and the Government's oil revenues, even excluding the more than \$200 million of special bonuses and other non-recurring payments, amounted to \$445 million, an increase of nearly 14 per cent over the previous year.

The outlook at present is uncertain (see attached memorandum by Mr. McDiarmid). In September 1964 and again recently the Central Bank took action to curtail the liquidity of the commercial banks; however, prospects for this year still indicate that excessive monetary expansion is likely to occur and some reduction in the Central Bank's proposed financing of the development program seems necessary. Additional measures also may be required to limit the increase in credit to the private sector.

Thanks largely to the expected continued growth of oil revenues, albeit possibly at a lower rate than in 1964/65, Iran should have no difficulty in servicing such conventional borrowing as will be required. If oil revenues increase by 10 per cent per annum, the debt service ratio would still remain below 14 per cent in 1970, even if as much as \$200 million is

borrowed each year (which compares with annual net foreign borrowing of only \$20.5 million during the first two years of the Third Plan). Such a burden should be easily borne, assuming of course reasonable monetary and fiscal performance.

Attachments: Letter of June 18, 1965 to Mr. Asfia on agricultural projects.

Letter of April 30, 1965 to Minister Rouhani, and his reply of June 6, on the Greater Dez project.

Letter from the Finance Minister of June 1, 1965, on release of Bank capital subscription.

Mr. McDiarmid's memorandum, "Iran Mission, August 26 - September 11, 1965," dated September 14, 1965.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

1818 H Street, N.W., Washington, D. C. 20433, U.S.A.

Area Code 202 • Telephone - Executive 3-6360 • Cable Address - INTBAFRAD

June 18, 1965

Mr. Safi Asfia
Managing Director
Plan Organization
Khataban Daneshkadeh
Tehran, Iran

Dear Mr. Asfia:

1. We understand that the report of the FAO mission which visited Iran in October/November 1964 to identify agricultural projects which might be suitable for Bank financing was submitted last month to your Government for consideration. We look forward to receiving the Government's views on the report in due course. In the meantime, as agreed with Dr. Kazemzadeh during his recent visit, I would like to give you the Bank's reactions to the report and an indication of possible courses of action we would be prepared to take, if desired by the Government.

Ghazvin Development Project

2. The Ghazvin project appears likely to be ready soon for appraisal by the Bank. In order to assess its economic and technical feasibility, we would want in our appraisal to investigate particularly: (a) the data from the pilot project and the basic surveys; (b) detailed plans for well drilling and for associated farm development; and (c) the organizational status and responsibilities of the Ghazvin Development Authority. The best time for such appraisal would be September or October 1965, by which time two seasons' results from part of the pilot project would have become available. Accordingly, if the Government should so request, we would be prepared to send a mission to appraise this project with a view to determining its suitability for Bank financing.

3. In the meantime, however, we are concerned that the economic justification of the project might be jeopardized if water development is allowed to proceed uncontrolled, particularly before the results of the pilot project have become available. We suggest that the Government may wish to take steps to ensure that water development work already undertaken or planned in the area would be coordinated with the progress of all other aspects of the project, so as not to prejudice the ultimate comprehensive planning and execution of the Ghazvin project. In our opinion this would imply that no new public well drilling schemes be launched until the results of the pilot project have been thoroughly studied, and that the Government and the Ghazvin Development Authority should take effective measures to regulate the drilling of wells and the use of water in the area by both public authorities and private initiative.

June 18, 1965

4. In this connection - if the Government wishes the Bank to proceed with consideration of the project - we would appreciate being informed of: (a) the present status of legislation for the control of water use and development in the area; (b) the number of new wells developed since September 1964; and (c) the immediate future prospects, say until September of this year, for additional wells and the extent of use being made of the new wells and the area thus irrigated. It would be helpful if the information under (b) and (c) could be given for governmental and private activities separately.

Seed Production and Distribution

5. This would be a new activity for Bank financing, but we recognize that it could contribute significantly to the improvement of agricultural production in Iran. Because it is new, we are not sure how a project in this field could be devised to make it suitable for Bank financing. It might be possible to focus upon the work in one or more specific regions, or tie this activity into a more comprehensive specific project, such as Ghazvin. The success of a program of seed production and distribution would depend very largely on the organization and satisfactory working of seed distribution cooperatives. This and other points raised by the FAO mission's report would require further discussion before we could determine whether and if so how soon a project could be made ready for appraisal. If you wish us to pursue this matter, we would be glad to have further discussions with FAO with a view to sending a mission to assist with the preparation of a project.

Agricultural Credit

6. We promised Dr. Zahedi during his visit to Washington last January that we would communicate further with him regarding the possibility of Bank assistance to the proposed Agricultural Development Fund for large-scale commercialized agriculture. You will note that the FAO mission's report raises a number of questions about the project for "development of idle lands" and concludes that whereas it might be worthwhile if properly designed and managed, there is not now sufficient information on the purposes and feasibility of the project to enable an appraisal to be made. The mission report also raises a question regarding the setting up of new institutions alongside the Agricultural Bank to carry out agricultural credit operations. This, as you know, is a matter that we have been thinking about for some time. We recognize that the Agricultural Bank has many problems, and if we were to go into the field of agricultural credit in Iran we would have to examine not only the proposed lending operations but also the proposed organization of such new credit activities, including the relative merits of a new institution or of a thorough-going reform of existing institutions, so as to determine whether the proposed arrangements are feasible. As things are, the FAO mission has not found a project in this field which the Bank could appraise at this stage, and we will await the Government's suggestions regarding the development of a project and any way in which we--or FAO-- might be of assistance.

June 18, 1965

Other Projects

7. As you will have seen from the mission's report, the other projects considered by the mission are not at this time ready for consideration for one reason or another. On the basis of the mission's report, we should like to suggest that the Government expedite the preparation, with assistance from FAO or consultants, of the irrigation projects examined by the mission. The Bank would be prepared to consider such projects when adequate feasibility studies have been completed, which should be the case reasonably soon for those projects on which the consultants are already engaged, such as Sefid Rud, Zayendeh Rud, etc. The Government may consider it useful to call upon FAO to review with the consultants the preparation of these projects so as to ensure that the feasibility studies when completed will answer the questions likely to be raised during financial appraisal.

8. Of the other projects considered by the mission, most will require a great deal more preparatory work. I should note, moreover, that some of these appear to involve primarily technical assistance, which could more appropriately be obtained from sources other than the Bank, while certain others of the projects represent activities which might, as the report suggests, be taken up as part of a broader project--possibly as part of an integrated agricultural development based on one of the irrigation projects mentioned above.

9. We look forward to receiving your reactions to the foregoing at your convenience. We will of course be most happy to discuss further with you and with FAO any aspect of their report. Meantime, we are tentatively scheduling an appraisal mission for the Ghazvin project for late September.

10. I am taking the liberty of sending a copy of this letter to Dr. Zahedi for his information.

Sincerely yours,

Alexander Stevenson
Director
South Asia Department

cc: Dr. H. Zahedi
Director of
Agricultural Credit and Rural Development Bank of Iran

Dr. J. Amuzegar
Chief of
Iranian Economic Mission

Mr. I. H. Ergas
Director,
FAO/IBRD Cooperative Program

Mr. P. Reid
World Bank Liaison Representative
FAO, Rome

April 30, 1965

His Excellency
Mansour Rouhani
Minister of Water and Power
Government of Iran
Teheran, Iran

Excellency:

1. This is with reference to the point raised in your letter of March 10, 1965, relating to the Greater Dez irrigation project; I am writing you separately on the matter of assistance to the Iran Electricity Authority which was the main subject of that letter.
2. After his visit to the Dez project last fall, Mr. Evans reported favorably on the progress of the project, especially the agricultural development work being done there, and we recognize that some shortening of the three-year period referred to in Section 5.11 of the Dez Loan Agreement may in the event turn out to be justified. In the meantime I want to reiterate what I said to you, and also to Mr. Asfia and Mr. Ansari, that the Bank firmly supports the view that planning of the Greater Dez project should proceed with all possible speed so as to make sure that construction can be taken up smoothly at the appropriate time. It has been our understanding that planning and design studies would require perhaps a year and what information we have received from the Plan Organization on allocations to the project (Fund Requirements - DIAP - 1344, Schedule B, Chapter 1, Section B) during your financial years 1343-44 led us to the conclusion that, apart from certain roads, construction works were not expected to start before next year. Your letter, however, indicates that some work on the extension of the irrigated area might be put in hand as early as the summer of 1965. It would be helpful to us to have from the Government what it believes to be a feasible construction schedule for the various parts of the Greater Dez project so that we may know precisely what is being proposed and be able to reach full accord with the Government on its plans in this regard.

His Excellency
Mansour Rouhani

- 2 -

April 30, 1965

3. I am taking the liberty of sending copies of this letter to Mr. Asfia and Mr. Ansari.

With kindest personal regards,

Sincerely yours,

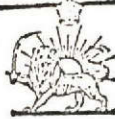
J. Burke Knapp
Vice President

cc: Mr. S. Asfia
Managing Director
Plan Organization

Mr. A. R. Ansari
Managing Director
Khuzestan Water and Power Authority

AStevenson/SMTolbert:bl
IBRD:lh
April 30, 1965

cc: Messrs. Evans
Piccagli
Cancio
Rigby

MINISTRY OF WATER AND POWER
TEHRAN - IRAN

No 1561/462/100

Date June 6, 1965

Mr. J. Burke Knapp
Vice President
International Bank for Reconstruction
and Development
1818 H. Street, N. W.
Washington, D.C. 20433
U. S. A.

Handwritten notes:
New Table
Please inform
Judge on my
island

Dear Mr. Knapp:

Thank you for your letter of April 30, 1965.

Regarding your query on the Greater Dez Project we would like to make the following comments:

At the present, our Consulting Engineer is in the process of gathering the information necessary for the preparation of the designs and construction of the Diversion Dam, West Main Canal and other activities stated in Chapter I, Schedule B of KWPA Table III.

Specifically, at the present, the following goals have been established:

1. Completion of Project Studies - End of 1965.
2. Award of Construction Contract for Diversion Dam and West Main Canal - Summer 1966.
3. Completion and delivery of regulated flow to 20,000 hectares of land, to remainder of west side of project and to Karkheh river - End of 1968.
4. Remainder of Project to be fully and intensively developed over ensuing five years.
5. We are considering the possibility of undertaking minor construction of access roads to the Project sites during 1965.

Furthermore, we would like to state that no construction on the extension of the irrigation system in the Greater Dez is scheduled for 1965.

With kindest personal regards,

Sincerely yours,


Mansur Rohani
Minister of Water and Power

REGISTERED
MAIL NUMBER

718



MINISTRY OF FINANCE

TEHRAN 1st June, 1965.

No. 2938

Dear Mr. Stevenson,

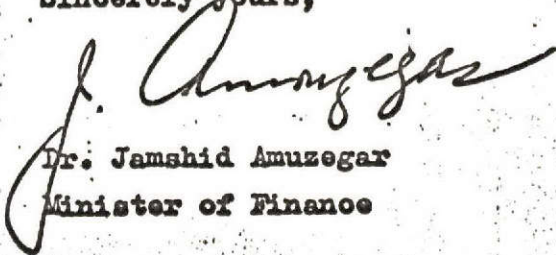
Thank you very much for your letter of May 10, 1965 concerning the release of the 9 per cent local currency portion of the 1960 special increase in Iran's subscription to the capital of the International Bank for Reconstruction and Development.

It is our intention to discuss the above question with you during the Annual Meeting to be held in Washington next September and I have no doubt that we will be able to find a solution which will be agreeable to the Bank and the Government of Iran.

I wish to express my gratitude for your kind words regarding my new position and look forward to close cooperation with the Bank in furthering the development of Iran.

With kindest regards,

Sincerely yours,


Dr. Jamshid Amuzegar
Minister of Finance

Mr. Alexander Stevenson,
Director,
South Asia Department,
International Bank for
Reconstruction and Development,
Washington, D. C. 20433

Mr. Alexander Stevenson

September 14, 1965

O. J. McDiarmid

Iran Mission, August 26 - September 11, 1965

The following covers the more important points we discussed with the Iranian authorities, together with a short sketch of the status of the Third Plan and the condition of the Iranian economy.

1. Agricultural Sector Study: The proposal is to send a Bank/FAO mission of five to six persons to Iran, either late in 1965 or early in 1966, for the purpose of making a comprehensive examination of the agricultural sector to produce recommendations on agricultural policy and public investment in the agricultural sector during the Fourth Plan. I discussed this with the Ministers of Agriculture and Finance, with Mr. Asfia, the Agricultural and Planning Divisions of the Plan Organization, and the Chairman of the Agricultural Bank. All felt that such a study would be very useful to provide a master plan for future investment. Now that the land reform program is approaching completion and a new structure of Iranian agriculture established, a study of the relationships between agriculture, transportation and industry as well as the internal relationships within the agricultural sector itself need to be examined. The Minister of Agriculture emphasized the need for examining the relation between agricultural production and industrial utilization of agricultural products and suggested that a specialist on this subject be attached to the mission. Mr. Asfia said that in a forthcoming communication to the Bank on the Ghazvin project they would request the Bank to arrange a comprehensive agricultural study. I believe that this mission might be more productive if it were dispatched after we have an understanding with the Government on preparations for the Fourth Plan. Also it would probably be desirable that the second phase of the land reform program be substantially completed and the revision of the Third Plan which is now underway be finished. These considerations suggest the timing for early 1966. It would also be desirable to have the agricultural mission roughly coincide with a more comprehensive study of the Iranian economy which, I think, will be required in the first half of 1966.

2. Assistance in Preparing the Fourth Plan: Messrs. Kazemzadeh and Majidi, Mr. Asfia's deputies in the Plan Organization, and Mr. Oskoui, Chief of the Planning Division, raised with me the question of technical assistance in the preparation of the Fourth Plan. This problem has to be considered in the light of the present condition of the Plan Organization and particularly its staffing for planning purposes. With the inception of the Third Plan, it was intended that the Plan Organization would direct its attention to planning and overall program supervision.

However, the planning unit in the Plan Organization is quite small, and the technical sections of the Plan Organization spend their time checking on the progress of the projects being executed by the various agencies of the Government. At this stage the Plan Organization has neither the staff nor the organization to prepare the Fourth Plan. The only serious economic and statistical work being turned out is in the Bank Markazi and (hopefully) the new Central Statistical Office. However, the Bank Markazi economists have no close working relationship with the Plan Organization. Obviously, a pre-condition for any outside assistance in preparing the Fourth Plan would be the vitalization of the planning function in the Plan Organization itself. This should include raising the Chief of the Planning Division to the rank of deputy director. Messrs. Kazemsadeh and Majidi told me that they personally felt that the IERD should be asked to provide a team to prepare the Fourth Plan. Other alternatives of lesser appeal were: (a) to ask a university (presumably not Harvard) to do the job; or (b) to request a distinguished development economist (Mr. Tinbergen, of course) to organize a team. I remarked that this would be a new problem for the Bank and felt that there might be some difficulty for us to assume so much responsibility for a program which we might be asked to assist in financing. The situation would be different if the Plan Organization were now as well equipped as it was at the beginning of the Third Plan. However, I think that the Bank should try to work out an arrangement to meet the basic needs of the situation.

3. SID Convention: This matter is now in the hands of the Minister of Finance, who told me that he proposed to take it up soon with the Council of Ministers. He is recommending approval but was not sure that Iran would be among the first twenty adherents. There is no substantive difficulty, and the Minister understands that the oil agreements can be excluded. I suggested that action be expedited as much as possible, and the Minister promised to do so.

4. The Ghazvin Project: I believe that the Bank should send a mission to appraise this project as soon as possible, since considerable work is being done and commitments are being made in connection with it. For example, a deal is under discussion with Peerless to manufacture pumps in Iran, and though I have no details, I imagine a good deal of well-digging activity is in progress. Mr. Asfia assured me that international competitive bidding was being used, but this may require attention.

5. Agricultural Reform Expert: Dr. Valian, the Chief of the Agricultural Reform Organization (a subsidiary of the Ministry of Agriculture) asked me if the Bank could provide Iran with an expert on agrarian reform. I expressed some surprise at this request, since the agricultural reform program in Iran is substantially completed. He said that they wanted someone to advise them on solving the residual

problems connected with agricultural reform, such as agricultural cooperatives, credits, etc. I discussed this request with Mr. Hopkinson, the U.N. Resident Representative, and with Mr. Asfia. Mr. Hopkinson said that a similar request had been made to the U.N. some time ago and he felt that it was motivated by the desire to pin some of the onus for the shortcomings of the program on a foreign adviser. The U.N. had bowed out. Mr. Asfia said he would look into the matter but did not think that the request was at the stage when it could be properly considered by the Bank. I agreed.

6. Status of the Third Plan: As of September 21, three years of the $5\frac{1}{2}$ -year Plan will have been completed. Up to August 21, total development expenditures were about Rls. 52 billion, with about Rls. 15 billion additional having been spent on the recurrent cost of maintaining and operating development projects. Administration of the Plan Organization, debt service, etc. involved a further Rls. 10 billion. Thus total Plan Organization expenditures have been roughly Rls. 77 billion or, say, 38 per cent of the Rls. 200 billion program during roughly 55 per cent of the Plan period. In terms of real investment, the accomplishment was considerably less, since a large portion of "development" expenditures have been for agricultural credit and other purposes which have enhanced consumption rather than the economy's stock of productive assets. The Plan Law provided for up to Rls. 50 billion (about \$650 million) of new gross foreign and domestic borrowings. However, only about Rls. 4.8 billion (roughly 64 million) of gross foreign capital has been utilized thus far. At the same time, over Rls. 16 billion of domestic credits have been used, mostly from the Central Bank.

At present, the Plan Organization is preparing new projections of the financial requirements for the rest of the Plan period. These indicate that, if oil exports increased at the rate they have in the recent past (about 12 per cent a year) and the full Rls. 50 billion of loans are obtained, a Plan of Rls. 200 billion (including Rls. 32 $\frac{1}{2}$ billion of recurrent expenditures) can be financed. However, the utilisation of the full amount of oil revenues provided in the Plan Law will result in a deficit for the ordinary budget of about Rls. 18-20 billion during the remaining years of the Plan. If, as seems likely, the full Rls. 200 billion of Plan expenditures is not achieved, this overall public sector deficit may be reduced, although offsetting factors would be a shortfall in the proposed drawings on foreign loans, many of which are for projects which are not likely to be carried very far during the Third Plan, and a slower increase in oil revenues which also seems likely.

The basis for an acceleration in Plan expenditures is largely the expectation that a number of large industrial projects will get started during the next year or so. These include the long-planned steel mill, a petrochemical complex, oil and gas pipelines from the Khuzestan area to Tehran and the Tehran refinery. Only the pipeline

and refinery projects seem like early starters (the oil pipeline is already under construction). The steel mill project is now under negotiation with the Russians. It will probably be paid for on somewhat the same basis as the U.A.R. is paying for the Aswan Dam (in local currency to purchase exports), and the means of payment will not be confined to the natural gas as was reported in the press. I mentioned to Mr. Asfia the requirement for a consultation with the Bank on this credit and he said that the Government would do so in due course.

If the Third Plan costs about Rs. 170 billion as seems likely, resources now in prospect should be adequate for its financing. This coincides with the original estimates we made in 1961-62.

7. General Economic Situation: The general economic situation remains pretty much as described in the briefing paper. New credit control measures were taken in early September, with a view to absorbing the excess liquidity of the commercial banks. However, substantial drawdowns of government balances during the first quarter of 1965/66 (March to June) provided the banks with a large amount of additional liquid assets, thus substantially nullifying the effect of these monetary measures. It seems clear that further action will be required on the monetary front. Furthermore, while this year's government budget is only slightly in deficit, the Finance Minister thinks that expenditures may have been under-estimated and that an extraordinary effort will be required to keep the fiscal situation in reasonable balance. Large new credits were provided to the Plan Organization during the first quarter to finance the refinery-pipeline complex. Thus, there is likely to be substantial pressure on the balance of payments at least during the remainder of this year. While reserves continue at a high level (at about five-months payments for goods and services), they fell by about \$60 million (about 14 per cent during the first quarter of this fiscal year). Ordinary (non-bonus) oil revenues increased only 6 per cent during the first half of this year as compared with over twice that percentage last year, but the oil consortium feels that an 8 per cent increase will probably be achieved for the year as a whole. Unofficial estimates indicate that reserves may decline by as much as \$170 million or about 40 per cent in 1965/66, however, this is a highly tentative estimate. The 45 per cent increase in imports last year was due largely to the restocking of inventories, both industrial and commercial; increased food imports because of the poor crop; and a rise in both public and private imports of capital equipment. This year, imports of industrial raw materials appear to be the most important factor in the further rise of imports.

As might be expected, following three years of stagnation, construction is increasing very sharply and industrial investment seems to have entered a period of boom. For example, loans approved by IMDBI increased

over 160 per cent in the first five months of this year, as compared with the similar increase last year. Fortunately, agricultural production this year should achieve a record in contrast with the poor harvest of the last three years. Despite this, however, Iran expects to import about one-half million tons of food grains this year.

OJMcDiarmid:ke

September 14, 1965

DECLASSIFIED

JUL 11 2016

BRIEFING PAPER - 1965

WBG ARCHIVES

NEPAL

I. MEETING WITH DELEGATION

Staff: Tuesday, September 28, 5 p.m.

Management: No meeting planned.

II. MEMBERS OF DELEGATION

Sailendra Kumar Upadhya	Governor (IBRD) Minister without Portfolio
Pradumna Lal Rajbhandari	Governor (IMF) Governor, Nepal Rastra Bank
Yadav Prasad Pant	Alternate Governor (IBRD) Secretary, Ministry of Finance
Pushkar Nath Pant	Alternate Governor (IMF) Joint Secretary, Ministry of Economic Planning

III. BANK/IDA PROSPECTIVE OPERATIONS

Nepal joined IDA in March 1963, and an exploratory Bank/IDA mission visited the country in November 1963. While the mission concluded that Nepal should be considered eligible for IDA assistance, the scope for IDA operations is sharply limited on the one side by the lack of suitable projects and of organizations capable of implementing them, on the other by the amount of aid already available from other sources. Transport and irrigation appear the most promising areas for possible IDA assistance (see also reference to Karnali hydroelectric project under IV(b) below).

The Bank organized and assisted in financing a mission which visited Nepal in October/November 1964 to make a transport survey. It was envisaged that the mission's report would form the basis of

a transport program to be included in Nepal's Third Five-Year Plan (1965-70). In April 1965 the mission's draft report was discussed with the Government, and at that time it was learned that Nepal had received an offer of substantial additional assistance for road construction and that, contrary to earlier expectations, there appeared no need for an IDA operation in this field at present. Government officials expressed to the mission an interest in IDA assistance in the field of civil aviation, but we have heard nothing further on this matter. The final report on the transport survey was transmitted to the Government in July 1965.

IV. TOPICS FOR DISCUSSION

(a) To be raised by Bank at staff level

- (i) Transport survey: If not received by that time, we should ask about Government's reactions to transport survey report, proposed next steps, and ways in which we may be of further assistance. Specifically, we should ask about the needs for external assistance in air transport, noting that further development of air services is an essential part of the transport plan drawn up by the survey mission.
- (ii) SID Convention: We should also ask about status of Nepal's adherence to SID Convention.

(b) Likely to be raised by Delegation

- (i) Possible IDA projects: The delegation may enquire about general possibilities of IDA financing of projects in Nepal. Our reply should emphasize the question of follow-up of the transport survey findings; we should also be encouraging as regards other projects generally, but should stress the importance of sound project preparation.
- (ii) Karnali project: It is just possible that the delegation may ask about our interest in the Karnali hydroelectric project, which is the subject of a feasibility study financed by the UN Special Fund, expected to be available around the end of this year. If this project is eventually undertaken, it will be a very large one with an estimated capacity in the initial stage of about 1,000,000 kilowatts. Nepal could not possibly finance the project out of its own resources, and the main market for the power to be produced would be in India, so that an agreement between the two countries would be

a necessary pre-condition of the project going forward. It will in any case be several years before major investments in this project can be undertaken. We can say, therefore, that we continue to follow the project studies with interest and would not rule out the possibility of Bank or IDA assistance in due course if and when a sound project is prepared that is acceptable to both countries. We should, however, make clear to the delegation that Nepal should not "save up" possible IDA help for an eventual Karnali project, but that it should try to get a more modest IDA project underway and develop working relationships with us as soon as possible.

- (iii) Consultative group: Prior to last year's Annual Meeting the Nepal Government requested an appointment with Mr. Woods to discuss a consortium for Nepal. This was taken up with the Nepalese delegation by the Area Department. We explained that Nepal at this stage of its development would not qualify for a consortium or consultative group sponsored by the Bank, since; (a) the Bank Group had not so far lent to the country and did not expect any sizeable operations in the near future; and (b) such a consultative group could serve a purpose only if greater maturity had been achieved in planning and project preparation than is the case in Nepal. The Karnali hydro project could be treated as an individual case of collaboration among aid sources at the appropriate time. The delegation appeared to accept these arguments, and no meeting was arranged with Mr. Woods; it is conceivable, however, that the delegation could raise this question again, and the answer should be the same.

V. BACKGROUND INFORMATION

- (a) Bank loans as of July 31, 1965

None.

- (b) IDA credits as of July 31, 1965

None.

- (c) Technical Assistance Activities

Transport survey mission (see III above).

(d) Access to Private Capital Markets

None.

(e) Bank 9% Capital Subscription

\$0.9 million. No release. It is not intended to press for a release; Nepal has to date received no financial assistance from the Bank group.

(f) IDA Subscription

Part II member. No approach for release of 90% local currency subscription is planned.

(g) Holdings of Bank Bonds

None.

(h) I. F. C.

Nepal applied for membership in August 1963. The period in which it could complete membership requirements was extended, at the Government's request, to March 31, 1965. We then informed the Government that we had again extended the period, to September 30, 1965; no reply has been received to this communication.

VI. POLITICAL SITUATION

Effective political power in Nepal still rests in the hands of King Mahendra, who appoints and dismisses his Ministers at will. Under the new Constitution promulgated by the King in December 1962 a system of Panchayat democracy has been established in place of the parliamentary system which was dissolved at the end of 1960. Panchayat democracy is organized in tiers with village, city, district and zonal councils (panchayats) and at the top the National Panchayat of 125 members which is convened from time to time by the King to review the policies of the Government and to enact legislation.

Nepal now has friendly relations with its two giant neighbors - India and China - as well as with the U.S. and the U.S.S.R. It receives aid from all these countries, predominantly the U.S. and India, and from a number of others as well. In so doing, Nepal has tried to maintain a delicate balance in its relations with these countries. In December 1964, a major road link with China, built with Chinese aid, was opened between Kathmandu and Kodari on

the northern border with Tibet, and in August 1965 a new Chinese loan equivalent to \$28 million was announced for the construction of a 140-mile highway from Kathmandu to Pokhara in the central region of Nepal. In March 1965 it was announced that India had agreed to build a major portion of the 600-mile East-West highway from the eastern to the western border, and the U.S. has agreed to make available some of the construction equipment for this road. Partly as an offset to Indian influence, Nepal has recently gone out of its way to develop closer relations with Pakistan.

In November 1964, the King approved a land reform bill fixing a ceiling of 25 bighas of land (a bigha equals about 1.6 acres) per family of five members and providing for the redistribution of surplus land among landless peasants. It is stated officially that the program is to be completed in three years, but the prospects for prompt or effective implementation are very dim.

VII. ECONOMIC SITUATION

(a) Population (1965): 10 million, growing at about 1.5 per cent per annum.

Per capita GNP (1962): About \$50 (direct observation and comparison with neighboring countries tends to indicate that this is an underestimate).

Exchange Reserves (mid-1964): \$47 million equivalent (6 months' imports).

(b) There are no reliable economic statistics and it is impossible to say with any precision what the trend of national income has been, although direct observation seems to indicate some growth in the recent past. Living conditions have improved in Kathmandu, thanks largely to foreign aid, and also to the opening of the road linking the valley to India. The biggest gain in welfare in the rural areas has probably been due to the eradication of malaria from a substantial part of the country. Agriculture is the mainstay of the economy; about 97 per cent of the total population is rural. The only industries are those connected with forestry and timber and with processing agricultural produce. A major expansion in sugar mill capacity is being completed; about half of Nepal's jute production is processed in the country, and a large cigarette factory has just been opened. Land reform is being actively implemented in a pilot area, with plans for

extending it soon to 16 other districts.

The Government is actively trying to modernize the country. Budgetary procedures were introduced about five years ago. The planning of development is still in a very primitive stage. To raise domestic resources for investment, taxes have been increased in recent years, notably land taxes, and new taxes such as an income tax, an urban property tax, a tax on travel abroad, etc. have been introduced. From a negligible amount in 1962/63, public savings increased to about NRs. 56 million in 1964/65 (about 2 per cent of national income). Local efforts have also been mobilized for local improvements. Estimates of total development expenditures indicate an increase from NRs. 172 million in 1962/63 to NRs. 258 million in 1964/65, including projects carried out directly by foreign aid agencies.

The major obstacle to development is still the lack of qualified personnel to work out and implement plans and programs. However, this obstacle and that of traditional attitudes may be gradually breaking down as more and more young people go to school and universities and travel abroad. Nepal's natural resource base, in particular its mineral resources, are not well known. There is, however, a large hydroelectric potential. The scope for developing tourism is also great.

Nepal's external public debt is very low. Its foreign reserves amounted to NRs. 380 million in mid-1964 (about six months' imports), including NRs. 200 million equivalent in non-convertible Indian rupees. Some conventional borrowing may be possible in the future, but for the time being the country's low level of income, uncertain development prospects, unfavorable position for exports, and heavy reliance on foreign aid, which finances more than three-quarters of public development expenditures, make it appropriate for a first Bank/IDA operation to be an IDA credit. Nepal is eligible for IDA on grounds of performance and poverty.

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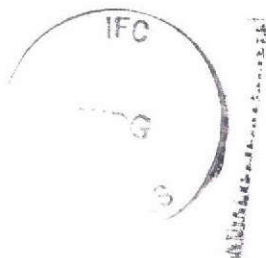
INTERNATIONAL DEVELOPMENT
ASSOCIATION

INTERNATIONAL FINANCE
CORPORATION

OFFICE OF THE PRESIDENT

G. D. WOODS - WESTERN HEMISPHERE

- ✓ Argentina - Fri. Oct. 1 - 9:15 (45 min)
- ✓ Brazil - Fri. Oct. 1 - 10:00 (30 min)
- ✓ Mexico - Fri. Oct. 1 - 10:30 (immed. follow
loan signing)
- ✓ *L. Amer Caucus -*
Tues, Sep. 28 - 5:00 - 6:00



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