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FORM No. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/72-3
January 18, 1972

Minutes of Special Loan Meeting to consider "Argentina - SEGBA Power" (644-AR) held on January 12, 1972 in Conference Room B.

1. Present: Messrs. Knapp (Chairman), Cope, Williams, Aldewereld, Broches, Chadenet, Baum, Weiner, Howell, Rovani, Wiese, Cabezas, Cancio, Fajans, Greene, Ribi, Sheehan, van der Heijden and Wittusen (Secretary).

2. Issues: The meeting was called to consider Mr. Alter's memorandum of January 6, 1972 to Mr. Knapp entitled "SEGBA - Mission to Argentina". Since the previous Special Loan Meeting on December 13, 1971 (LM/M/71-53), SEGBA's tariffs had been raised by about 50% on the average and certain financial forecasts for 1972 had been made available to the Bank by SEGBA. Also, SEGBA's shareholders (i.e. the Government) had approved a motion by virtue of which SEGBA was no longer constituted under the Commercial Code but had been subsumed under Law 17318 relative to joint stock companies in which the State (and authorities and entities controlled by it) hold at least 51% of capital stock and have a majority voice in shareholders meetings. However, in response to a cable by the Bank, final action by the shareholders on the revision of SEGBA's Statutes was deferred until after a Bank mission to be sent shortly to Argentina had an opportunity to discuss the proposed reorganization of SEGBA with the Government. The meeting also had before it a memorandum of January 12, 1972 from Mr. Weiner to Mr. Knapp entitled "SEGBA: This afternoon's meeting on the proposed mission to Argentina."

3. Discussion. The meeting noted that:

(i) About $32 million of Loan 644-AR remained undisbursed; however, SEGBA had committed the entire amount of the loan ($60 million). The tariff increase of about 50%, put into effect on January 1, 1972, was unlikely to generate the prescribed 8% rate of return in 1972, mainly because it made no allowance for a simultaneous 15% increase in wages. Tariffs should, therefore, be raised again shortly and further adjustments might be called for in the course of the year. Even if the 8% return were assured for 1972, at least $20-25 million equivalent would be required

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to cover SEGBA's financing gap in 1972 and permit SEGBA to carry out an investment program compatible with its needs. This estimate was subject to review in Buenos Aires. It compared with an amount of about $48 million equivalent by which SEGBA's earnings in 1971 fell short of revenue standards laid down in SEGBA's Concession. Were the Government to agree to restore the entire $48 million to SEGBA, the Company's cash position would be more than adequate.

(ii) Guidance for the forthcoming mission was needed because of a divergence of views among the staff as to the nature of the assignment. Basically, there were two positions. The first, taken by the Public Utilities Projects Department, was to urge the Government to repeal the resolution of May 27, 1971 by the Secretary of Energy, requiring his prior approval for all tariff adjustments and thus preventing SEGBA from raising tariffs automatically (as provided in the Concession) to offset wage and fuel price increases. Such repeal would restore automaticity of tariff adjustments and signal the return to the regulatory regime in force until May 1971. The Government's refusal to implement the Concession should, in the view of the Projects Department, trigger off suspension of disbursements.

(iii) The second position, represented by the South America Department, was similar to the first one in its insistence on timely tariff adjustments to compensate for cost increases. It did not, however, necessarily require the return to the automatic regime. If necessary, it would accept a formal change in the regulatory regime and would admit the Government's right to approve each tariff increase, as long as tariffs were closely following wage and price movements and gave SEGBA the 8% return now provided for in the Concession. It would require, however, that the Government demonstrate its sincerity by deciding promptly on a next tariff increase and giving the mission an assurance as to its date and size. The South America Department was anxious to avoid a break for reasons of form and not of substance in Argentina's relations with the Bank. For the moment, the Minister of Finance might have persuaded the Government to try to reach accommodation with the Bank to avoid jeopardizing Argentina's current moves to borrow $500 million from US and European banks. On the other hand, President Lanusse wanted to become the elected President of the country and was trying to enlist support of political forces including the Peronistas, and this might preclude making significant concessions to outside parties.

(iv) A third approach was possible. It started from the premise that the positions of the Public Utilities and South America Departments coincided in substance. Both aimed at revenue from tariffs assuring SEGBA of an 8% return in 1972 and subsequent years; and both accepted the fact that the 1971 earnings deficiency would not be recovered from tariffs but by way of the Government meeting the financing gap. It was questionable whether any rate of return covenant was a durable proposition in the Argentine political circumstances. Consequently, the Bank might consider not to exercise its remedies as long as funds were available, irrespective of source, to carry out SEGBA's investment supported by the Bank. This was objected to on general economic grounds: the Bank should not accept a solution which could only imply recourse to the Central Bank and would thus associate the Bank with the wrong general financial policies at this time.

(v) SEGBA's Concession was a complex document providing, inter alia, for the tariff base being valued in US dollars and for certain other accounting procedures. These provisions may have been undermined by the recent decision of the shareholders (i.e. the Government) to reconstitute SEGBA under Law 17318. There was a danger that a departure from the automatic adjustment features of the Concession might upset the entire regulatory mechanism, which has been in existence since 1962, without prior agreement on a substitute system. The criticism of the Bank might be aggravated if it now became involved in a discussion of a new regulatory regime.

(vi) It would be difficult for the Bank to suspend disbursements mainly because of changes in the management set-up of SEGBA. Although past experience with SEGBA management regarding the necessary reduction of labor costs gave strong reasons for concern, it would be difficult to prove in advance that SEGBA could not be effectively managed under the proposed new Statutes. To determine the results of the management function passing from the Executive Committee to the Board might take six or more months of careful observation. A decision to suspend on financial grounds would have the advantage of being taken on the basis of already known facts.

(vii) The Executive Directors had not yet been informed of the issues under discussion and ought to be alerted to the problems and the Bank's response to them as soon as the mission had returned. Information about the present difficulties should be put before the Executive Directors prior to the circulation of the "Operations Evaluation Report: Electric Power," which included a section on SEGBA.

4. Decision. It was agreed that:

(i) The Bank at this time will neither consider amending the existing agreements nor insist that the letter of the agreements be respected. Rather, the Bank will reserve its right to exercise the sanctions available under the agreements should actual performance by Government and SEGBA depart from the underlying objectives of the agreements with respect to rate adjustments, provision of adequate funds for the project and efficient management.

(ii) The mission should tell the Government that the Bank considered them in default in contractual provisions concerning SEGBA's tariffs and Statutes, and that they are expected to show cause why the Bank should not suspend disbursements.

(iii) The Bank should insist on SEGBA earning an 8% return in US dollar terms in accordance with the Concession. This should preferably be accomplished by restoration of the automaticity of tariff adjustments provided for in the Concession. If the Government refused to accept this but was prepared to assure the Bank that it would cause rates to be adjusted as and when needed to achieve the 8% return now required by the Concession, and to indicate forthwith the amount and date of the next rate adjustment, the Bank should go along.

(iv) The Bank would not suspend disbursements in response to recent or proposed changes in the Estatutos before it has had an opportunity to confirm, by observing performance, that the reorganized management arrangement was not effective.

(v) Upon the return of the mission, the Executive Directors would be informed of the Government's failure to comply with its obligations as Guarantor of the Loans to SEGBA and of the Bank's response.

Dag F. Wittusen
Secretary

JFajans/DFWittusen/BChadenet/WCBaum/MWeiner/YRovani:ct

Cleared by: Messrs. Knapp
Broches
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Wiese

Form No. 60
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LM/M/72-1

January 10, 1972

Minutes of a Special Loan Meeting to consider "Philippines - First Livestock Project" held on December 29, 1971 in Conference Room B.

1. Present: Messrs. Knapp (Chairman), Cope, Williams, Baum, Fontein, Wapenhans, Gould, Hasan, Knobel, Loh, Sella, Stoops, Walshe and Wittusen (Secretary).

2. Issues: The meeting was called to consider the following three issues described in the East Asia and Pacific Department's memorandum to the Loan Committee of December 27, 1971 entitled "Philippines - First Livestock Project" (LC/O/71-140) and the appraisal report attached to it (PA-117):

(i) whether the maturity of the Bank loan should be increased from 13 to 20 years;

(ii) whether to provide for consultation on or approval of management appointments; and

(iii) whether to insist on international competitive bidding for feed grains and slaughterhouses.

3. Loan Terms. The meeting noted that:

(i) The appraisal report recommended on project grounds that the Bank loan have a term of 13 years including six years of grace, while the Area Memorandum proposed for country reasons that the Bank loan to the Government have a maturity of 20 years including six years of grace and be relent to

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Meeting Participants (minutes)
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the Development Bank of the Philippines (DBP) on the same terms as recommended by the appraisal report. The Area Department indicated that a longer term for the Bank loan was warranted because of the need to assist the Philippines in solving its difficult debt situation, to comply with the spirit of the IMF Standby Agreement which restricted foreign borrowing by the Philippines on terms of 15 years or less, and to encourage other members of the Philippine Consultative Group to provide assistance on more concessional terms.

(ii) It was agreed that there were no project grounds for extending the terms of the Bank loan given the terms of sub-loans and the project's cash flow. The Chairman indicated that he would be reluctant to propose to the Executive Directors to extend the terms of the Bank loan for country reasons as the arrangements proposed by the Area Department would generate local currency resources in the hands of the Government which would not be subject to Bank control. Moreover, the overall terms of the aggregate of Bank loans in the country were very favorable so that the relatively less favorable terms of a single livestock loan should not weaken the Bank's ability to persuade other donors to provide concessional assistance.

(iii) Also considered was the possibility of converting the livestock loan to an IDA credit by switching it with the Philippines-Fifth Power Project, which had recently been approved by the Loan Committee for an IDA credit.

4. Decision: For the reasons outlined in para. 3(ii) above, it was decided that the loan would have a term of 13 years as recommended in the appraisal report, but that Mr. Knapp and Mr. Fontein would subsequently consider whether the proposed loan for this project should be converted to an IDA credit. After the meeting it was agreed that IDA funds should not be transferred from the Power Project.

5. Management Appointees. The meeting noted that:

(i) The appraisal report recommended that the Bank reserve the right to approve the appointment of the technical director, two livestock production experts and two short-term consultants. Agriculture Projects Department considered that prior consultation with the Bank would not be sufficient to ensure qualified appointments as DBP was particularly vulnerable to political pressures. Since the project could be severely jeopardized should unsuitable persons be appointed, the Department considered that this was one of the difficult cases envisioned in O.M. 2.30 where prior approval of the Bank was required.

(ii) The Area Department noted that it was not the Bank's usual practice to insist on prior approval of management appointments as this was often unacceptable to the borrowing institution. Moreover, it was difficult in practice to ensure against unsuitable management even when prior approval was required and the Bank had seldom exercised its right to veto appointments submitted to it for approval.

(iii) The Legal Department said that a special situation was created, as in this case, when the Bank was financing the experts in question and that in such a case there was greater justification for requiring approval of appointments.

6. Decision: For the reasons indicated in para. 5(i) and (iii) above, it was decided that under this project the Bank should have the right to approve the appointments to the five management positions in question for the period during which the Bank financed their services. It was also agreed that the Technical Director would be appointed before the loan became effective and the other experts within a specified number of months after the loan was signed.

7. Procurement. The meeting noted that:

(i) The appraisal report recommended that the Government be required to procure under international competitive bidding procedures feed grains having a value of $2.3 million which would then be sold to private dealers for resale to the general public. An amount equivalent to the local currency generated by the sale of feed grains would be lent by the Government to DBP for relending to farmers under the project to help meet their incremental needs for working capital. Agriculture Projects Department considered that this arrangement would contribute to the supply of feed grains available in the Philippines at reasonable prices. The appraisal report also recommended international competitive bidding for the three small slaughterhouses to be constructed under the project.

(ii) The Area Department considered that the above procedure for procurement of feed grains would add administrative complications to an already difficult project without having a significant effect on feed grain prices as the amount of feed grains to be imported under the project was very small in relation to the total supply in the Philippines and the Government was already obtaining good prices for its imports. The Area Department was also reluctant to have the Bank associate itself with the Rice and Corn Administration (RCA), the agency responsible for procurement of feed grains, which it considered to be inefficient. The Area Department also considered that the case for international competitive bidding for slaughterhouses was marginal as the individual contracts of $225,000 would not be bulked. The Department therefore proposed that the Bank should be prepared to relax this requirement if this point was pressed during negotiations.

8. Decision: Taking into account the considerations noted in para. 7(ii) above, it was decided not to finance the import of feed grains under the loan, but rather to have the Bank finance directly some of the farmers' incremental requirements which would include their feed grain purchases in the local market. The percentage of each farm plan financed by the Bank would be correspondingly increased. It was also agreed that a covenant would be added to the loan agreement which would require the Government to ensure an adequate supply of feed grains for the project. With regard to the slaughterhouses, it was agreed that the Bank should press for international competitive bidding during negotiations. Finally it was agreed that the amount of the loan would be rounded to $7.5 rather than $7.6 million as originally recommended.

Dag F. Wittusen
Secretary

MAGould/DFWittusen:as

Cleared by: Messrs. Knapp
Baum
Fontein
Wapenhans
Sella

FORM No. 60
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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

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LM/M/72-2

January 11, 1972

Minutes of Special Loan Meeting to consider "India - Shipping Project" held on January 4, 1972 in Conference Room B.

1. Present: Messrs. Cope (Chairman), Williams, Baum, Knox, Jaycox, Votaw, Melmoth, Bain, Brandreth, Clevenger, Segal, Thomas and Wittusen (Secretary).

2. Issues: The meeting was called to consider the following issues contained in the South Asia Department's memorandum to the Loan Committee of December 28, 1971 entitled "India - Shipping Project" (LC/O/71-141):

(i) whether the Association should lend 80% or 100% of the foreign exchange cost of the ships;

(ii) relending terms from the government to the Shipping Development Fund Committee (SDFC), the financing intermediary, and from SDFC to the Shipping Corporation of India (SCI), the beneficiary; and

(iii) the foreign exchange risk.

3. Amount of credit. The meeting noted that:

(i) The Chairman questioned the necessity of the Association lending 100% of the foreign exchange cost of the ships when the government was to onlend only 80% of the credit. The remaining 20% of the credit could be considered a form of program lending, which he thought unnecessary for this project.

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(ii) In reply, it was pointed out that it was IDA policy to lend for the entire foreign exchange cost of projects in India. The credit was being made because India needed foreign exchange for the project. The project was unique in that it consisted almost entirely (98%) of foreign exchange costs. The credit could not be considered a program loan since all of it was tied to the purchase of the ships. Only some counterpart rupee funds were immediately available for uncontrolled use.

4. Decision: It was agreed that the Association would finance 100% of the foreign exchange costs of the ships, but that the government would use the rupee equivalent of the 20% of the credit that would not be onlent to SCI to subscribe to additional equity in SCI. At a later point in the meeting, the question of the increased dollar costs of the proposed ships as a result of recent exchange rate realignments was discussed. The amount of the increased costs would be clearer before Board presentation, but it was decided in principle that the credit would be increased to cover the full foreign exchange costs of the project.

5. Relending terms. The meeting noted that:

(i) The appraisal report recommended that the government relend to SDFC at 5 1/2% interest with the principal repayable in a lump sum after 15 years, and that SDFC in turn relend to SCI at 9% interest, repayable in 16 equal annual installments after one year of grace. The Chairman inquired why a financial intermediary (SDFC) was necessary, and how the lending terms recommended had been chosen.

(ii) The use of SDFC was proposed because it was a government channel established specifically to finance shipping and because it functioned effectively. Not to use this intermediary would cause administrative complications arising from the nature of ship charter and financing arrangements.

(iii) It was government policy to lend to SDFC at a current rate of interest of 5 1/2% repayable in a lump sum after 15 years; SDFC in turn lent to public and private shipping companies at an effective rate of 4 1/2% (receiving government grants to cover the negative spread and administrative expenses). The Projects Department maintained that given the nature of SDFC, an administrative channel and not a bank or financial agency, there was no financial or economic reason to object to the present arrangements between the government and

SDFC. On the other hand, the lending rate from SDFC to the shipping companies did have financial and economic consequences. Thus, with respect to the proposed project, the terms of SDFC lending to SCI were based, as far as the interest rate was concerned, on a long-standing Bank policy that the government raise interest rates to reflect the real cost of money, and, with regard to amortization, on technological considerations of the useful life of the ships.

6. Decision: The Chairman accepted as reasonable the proposed SDFC lending terms to SCI (9% repayable over 16 years after one year of grace). He also decided that the government's relending terms to SDFC should be the same as those of SDFC-to-SCI, allowing SDFC a margin to cover administrative expenses if requested by the government, so that IDA money would not be left in an organization which might use the funds to subsidize shipping and with which IDA did not wish to establish any particular institutional relationship. In addition, it was agreed that the sections of the appraisal report on SDFC be expanded and, if possible, information on SDFC's cash flow be included.

7. Exchange Risk. It was agreed that the exchange risk should be borne by SCI, the beneficiary, and that the mortgage should be denominated in convertible foreign exchange.

Dag F. Wittusen
Secretary

WClevenger/DFWittusen:as

Cleared by: Messrs. Cope
Baum
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Votaw

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LC/A/72-2

January 13, 1972

NOTICE OF MEETING

A meeting of the Loan Committee will be held on Monday, January 17, 1972 at 3:00 p.m. in the Board Room.

AGENDA

Colombia - Proposed Non-Project Loan

The Committee will consider the attached memorandum dated January 13, 1972 from the South America Department, entitled "Colombia - Proposed Non-Project Loan" (LC/O/72-7).

Dag F. Wittusen
Secretary
Loan Committee

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LC/O/72-7

January 13, 1972

LOAN COMMITTEE

Memorandum from South America Department

COLOMBIA: Proposed Non-Project Loan

1. As agreed during the Country Program Review on January 5, 1972, I submit the Colombian Government's request for a non-project loan together with the evaluation and counterproposal of the South America Department.

Request of Colombian Government

2. During the September 1971 Annual Meeting the Colombian Government asked the Bank to consider a US$100 million program loan to meet the special circumstances arising from the recent unexpected decline in Colombia's coffee revenues. The Colombian authorities feel that these circumstances make it necessary to increase and accelerate the flow of external resources beyond levels which could be achieved through project lending. They take the position that Colombia qualifies for a program loan under the criteria of Mr. McNamara's memorandum of December 15, 1970, to the Executive Directors. Colombia, they argue, has satisfactory economic and financial policies and a good development program, which has been disrupted because of circumstances beyond the Government's control. The Colombians point to the support of the Consultative Group for the Government's development plan and to the fulfillment of their recent commitments to mobilize Col$1,000 million in additional revenues per year. The Government is also considering a new series of measures which would produce about Col$800 million in 1973 and over Col$1,000 million in 1974, and a program loan would not be envisioned as a recurring source of financing.

3. The unexpected decline in coffee prices has clearly forced the Government to cut back on its public investment and overall growth targets for 1972. Although the average 1971 coffee price of 48 cents per pound is above levels of the late 1960's, it is below the 56-cent average assumed for 1971 and 1972 in Colombia's development plan and related public investment program, which called for an annual increase in investment of 8-9 percent in real terms. We have projected in our 1971 economic report that the average coffee price will continue at 48 cents for the next few years, which implies a shortfall of roughly US$100 million per year in foreign exchange receipts in 1971-72 compared to the plan projection. Because of the reduction in exchange earnings, it has been necessary to reduce the import budget. The authorities have also adopted stringent monetary measures to curtail demand. The Colombian authorities have informed the Bank that there will be a shortfall of about Col$1,500 million (US$70 million) in government revenues

in 1972 directly and indirectly related to the decline in the coffee price. They have also stated that about US$100 million in priority investments financed through the budget--some of which would be for rehabilitation required by recent severe rain damage--lack resources. The Government desires to use the peso proceeds of the proposed loan to finance some of these needs.

Evaluation and Counterproposal of South America Department

4. Colombia seems to fit the description of the case stated in Mr. McNamara's letter of May 4, 1971, to the Secretary General of UNCTAD on Supplementary Financial Measures: "...should a developing country member of the Bank, for reasons outside its control, experience an unexpected shortfall in its export earnings which threatens to disrupt the implementation of its development program, the Bank Group would examine the case on its merits with a view to determining whether and how it could shape or modify its lending and other operations for that country in such a way as to help the country to overcome the difficulties."

5. We have reviewed the Colombian request with AID, the IDB, and the IMF, and have concluded that there are no prospects that these institutions could make available extraordinary assistance at this time. Colombia is not eligible for Compensatory Financing through the IMF since current price levels of coffee, despite the 1971 decline, are still higher than the five-year average used for such assistance.

6. There seems to be a good a priori case for some form of extraordinary assistance to Colombia. First, coffee is vitally important not only to the country's balance of payments but also to the national budget because of the high marginal rate of taxation on coffee exports; thus coffee plays a crucial role in financing the Government's development effort. Second, Colombia has a satisfactory economic development program, including well prepared preinvestment studies--which has been reviewed by the Bank staff--and this program has been disrupted by the sharp fall in the price of coffee. Third, the proposed extraordinary assistance would not imply a departure from project financing, since Colombia has a good record of project preparation and has a sizable list of projects ready for submission to the Consultative Group for calendar year 1972. Fourth, Colombia has reasonable prospects for further increases in non-traditional exports, although several years will be required to raise their relative importance in the balance of payments to that of coffee.

7. The South America Department informed Bank management of its preliminary view, outlined above, and was authorized to explore the matter further during a mission to Colombia in early November in connection with discussions to review with the government authorities the findings of our 1971 economic mission. The mission's main conclusion pertaining to Colombia's medium-term development prospects was that, despite the Government's adoption of new revenue measures earlier this year, fiscal and balance of payments constraints have again become a deterrent to achieving high growth targets over the next several years. Concerning Colombia's external capital requirements over the medium-term, the mission questioned whether there would be sufficient domestic

resources, beginning in 1972, to support the annual levels of external borrowing discussed at the Paris meeting of the Consultative Group last February, as well as to meet the requirements of purely domestically-financed needs in the public sector.

8. Our main question concerning the Government's request for extraordinary assistance was whether or not the growth of public sector investment and the economy induced by a one-time program loan could be sustained after such a loan has been disbursed. We also questioned the size and purpose of the proposed loan. We felt it unlikely that total domestic investment in Colombia would fall short of earlier forecasts by the same magnitude as the estimated shortfall in coffee revenues from projected levels; and in view of the importance of private investment in the commodity producing sectors as a percentage of total investment in Colombia, we questioned whether it would be desirable for the increase in public investment made possible by a program loan to be equal in magnitude to such a loan.

9. A rapidly disbursing program loan in the order of US$100 million would undoubtedly ease Colombia's short-term budgetary difficulties, but such a large and rapid injection of resources in 1972, as requested by the Government, would create problems by requiring the authorities to adjust to sharply lower budgetary investment levels and foreign exchange availabilities after the program loan has been disbursed. The basis for this conclusion is our view that fiscal measures and export increases could not be achieved in sufficient magnitude to yield the resources needed in 1973 to replace, as it were, a program loan in the order of US$100 million.

10. In the light of the foregoing, representatives of the South America Department discussed with the Colombian Government an alternative approach designed to have a sustained effect on the balance of payments and on economic growth. It consists of a loan package totalling US$50-70 million, aimed at raising non-traditional exports, maintaining public investment spending at a satisfactory level, and meeting the import requirements of the productive sectors in Colombia which would be associated with a higher rate of economic growth. We propose that the exact amount of the loan be set at a later stage, when the details of the proposed loan are worked out and it is submitted to the Loan Committee for approval to invite negotiations, and that the loan amount be determined in the light of our evaluation of prospects for coffee prices at that time.

11. The two components of the proposed loan package would be: (a) finance for expanding the productive capacity of agriculture and industry serving the export market, covering the import content of investment and some local costs; and (b) finance for imports of intermediate products, raw materials, and capital equipment. The proposed uses of local currency generated under this component are described in paragraphs 12 and 13 below. The components and illustrative amounts for each are shown in the following table:

ILLUSTRATIVE ALLOCATION OF NON-PROJECT LOAN

(Millions US$)

	Foreign Exchange	Local Currency to be Available to: Industrial & Agricultural Enterprises	Government Investment Budget	Total
Export Projects Component				
Finance for expanding productive capacity of export agriculture and industry by providing credit to cover purchases of investment goods and some local costs -- to be channeled through suitable financial intermediaries	30 a/	30	...	30
Import Program Component				
Finance for imports of intermediate products, raw materials, and capital equipment	40 b/	10 c/	30	40
	70	40	30	70

a/ Including an estimated US$5 million for domestically produced goods; the foreign exchange associated with this amount would accrue to monetary authorities as free foreign exchange.

b/ This amount would accrue to the monetary authorities as free foreign exchange.

c/ This amount would be available to finance working capital of the export sector.

12. We discussed our counterproposal with the Colombian Government in early November but have modified it somewhat since the discussions were held. It has been formulated so as to reduce significantly the sharp adjustment for the balance of payments and public investment which a US$100 million program loan would imply. By linking the use of our proposed loan directly to performance targets for non-traditional exports, the adjustment process would be minimized. If non-traditional export targets are met, commitments from the loan would continue. If, on the other hand, the Colombians fail to meet the targets for non-traditional exports then commitments of loan proceeds would cease. Put another way, to the extent that sufficient demand for funds exists on the part of export industries, our loan would be utilized. The reverse would be true if such demand were not to materialize. An important additional feature of the proposal would be that it would facilitate the Bank becoming directly involved in non-traditional export policy, the success of which is of utmost importance for the future economic development of Colombia.

13. Under the export projects component (see table above) sub-loans would be made available, through suitable financial intermediaries, to goods producing enterprises serving the export sector. As in the case of our normal DFC projects the proceeds of the loan would finance mainly fixed investment in sub-projects, except that in this case they would be solely for export enterprises. Some portion of the loan could be designated to cover the costs of locally produced goods. Although there would inevitably be some potential competition for funds under this component and those from our regular loans to DFC's in Colombia, the aim would not be to substitute for our normal DFC loans but rather to make available additional resources in such a way as to contribute effectively to raising non-traditional exports. For this purpose we visualize the use of various existing financial intermediaries which re-lend to industry and agriculture in Colombia, such as the Private Investment Fund (PIF) in the central bank, the Caja Agraria, the Banco Ganadero, the government-owned DFC (IFI), commercial banks, as well as private DFC's. Under this arrangement we would not emphasize institution building of the financial intermediaries as in the case of our regular DFC loans, but would concentrate on increasing resources for expansion of the export sector. We would expect the disbursement period for this component of the loan package to be 24-30 months.

14. The second part of the proposed loan--shown as the import program component in the table above--would be used to finance essential imports, and would be disbursed in 12-18 months. The peso proceeds of this component would be made available for two purposes. One would be to provide finance for working capital in the private export sector, thus helping to ease the shortage for such funds. While in the past we had some doubts about the need for working capital, the shortage became evident--particularly for small and young firms with good potential for increasing exports--with the tightening of domestic credit following the decline in coffee prices. The working capital credits in pesos could be made through the Fondo Financiero Industrial (FFI), a special fund administered by the central bank for this purpose. The other use of peso proceeds from the import program component would be for increasing investment in the public sector for the types of activities normally

financed wholly from the government budget. We would limit peso releases for this purpose to the equivalent of US$30 million so as to minimize the danger of building into the budget a level of investments that would be difficult to sustain after disbursement ended. Disbursed over a period of about 18 months, US$30 million would represent about 5 percent of investments passing through the government budget. We have concluded from a review of the 1972 budget that at least the equivalent of this amount in high priority projects of the type described above lack financing. Unless extraordinary assistance can be found, expenditures on unassisted projects in 1972, in real terms, are likely to be about 15 percent below their 1971 level.

15. We estimate in our 1971 economic report a fiscal gap for the 1972-74 period of roughly Col$1,000 million per year. The Colombian authorities are in agreement with the need to take measures which will yield this amount of revenue, but prefer not to specify at this time the precise measures to be taken. This is a reasonable position, since it is difficult to predict the timing of Congressional deliberations concerning measures such as a proposed "presumptive" agricultural tax. As we proceed with our loan discussions we will move toward a clear understanding with the Colombian Government about the specifics of these needed fiscal measures.

16. Non-traditional export targets and a comprehensive program for achieving them should also be agreed upon during loan negotiations. We believe that a proper exchange rate policy is an essential component of any export promotion program. Since 1967 the Colombian authorities have adjusted the exchange rate at weekly intervals. There was a real depreciation vis-a-vis the U.S. dollar of about 16 percent through the end of 1969 (i.e., considering price movements in the U.S. as well as in Colombia), but only 5 percent since then. In this latter period, growth of non-traditional exports slowed appreciably.

17. The Colombian authorities have indicated a willingness, however, to depreciate at a faster pace in the future. When pressed for a more precise definition of intent they are unwilling to link exchange rate policy to domestic and foreign price movements, preferring to use non-traditional export growth as an indicator of performance. While we would rather have a quantitative policy statement relating depreciation to price movements at home and abroad, we would be prepared to accept a suitably ambitious target rate of growth for non-traditional exports during the next several years. Our view is that an increase of 15 percent per year would constitute an acceptable target for these exports, a growth rate slightly above that used for the balance of payments projection in our 1971 economic report. Should the Colombians fail to achieve this target we would analyze the export record with them and try to determine whether exchange rate depreciation should be accelerated even further. We would also review progress on the Government's efforts to simplify export and import procedures, to improve port administration, to expand credit programs for export-oriented activities, and to promote private trading companies. These measures, along with those designed to improve access of the private sector--particularly small and new firms--to foreign exchange would be agreed upon during loan negotiations.

18. As stated earlier, the exact amount of the proposed extraordinary loan--somewhere between US$50 and US$70 million--would be determined just prior to the invitation to negotiate and will depend on our evaluation of the price prospects of Colombian coffee at that time. We propose a two-stage loan, with the second stage dependent on the coffee price prevailing at the time of review. Although we have projected a constant 48-cent price per pound for the next few years (the same price as the average in 1971), experience has taught us to prepare for great volatility in the world coffee market. In an apparent reaction to labor problems at major U.S. ports, the price of Colombian coffee rose to 52 cents per pound in early December. Should prices continue to rise during 1972, Colombia's need for extraordinary foreign assistance would be reduced, and our mid-loan review might lead to cancellation of part of the original commitment.

19. Bank disbursements of foreign exchange under the import program component and approvals to commit funds under sub-loans for export projects would also depend on Colombia's progress toward meeting minor export goals. In addition, the release of counterpart pesos for the government investment budget would be made only if all local currency requirements for the public sector projects financed by the Consultative Group are being met in full. A series of periodic reviews would ensure that mutually agreed targets are being met, and that Consultative Group projects are receiving the local financing that they require.

Gunter K. Wiese
Deputy Director

Attachment

POPULATION: 20.5M

P PER CAP: $ 290

IVA COLOMBIA - 5 YEAR OPERATIONS AND LENDING PROGRAMS
(BY FISCAL YEAR - AMOUNTS IN $ MILLIONS)

OPERATIONS PROGRAM			1972	1973	1974	1975	1976
2-CLM-AC-02	AGRICULTURE CREDIT	IBRD			20.0		
2-CLM-AD-02	LAND COLONIZATION II	IBRD			10.0		
2-CLM-AB-03	LAND SETTLEMENT III	IBRD					20.0
2-CLM-AF-01	FISHERIES I	IBRD				15.0	
2-CLM-AI-02	ATLANTICO IRRIGATION II	IBRD	5.0				
2-CLM-AI-04	CESAR IRRIGATION II	IBRD				15.0	
2-CLM-AL-03	LIVESTOCK III	IBRD			15.0		
2-CLM-AL-04	LIVESTOCK IV	IBRD				15.0	
2-CLM-AT-01	FORESTRY	IBRD					30.0
2-CLM-DD-04	DFC-(IFI)	IBRD		15.0			
2-CLM-DD-06	DFC V	IBRD		35.0			
2-CLM-DD-07	DFC VI	IBRD				30.0	
2-CLM-DD-08	DFC VIII IFC	IBRD				20.0	
2-CLM-EE-03	EDUCATION III	IBRD		10.0			
2-CLM-EE-04	EDUCATION IV	IBRD				10.0	
2-CLM-GG-01	EXTRORDINARY LOAN	IBRD	60.0				
2-CLM-IF-02	INDUSTRY-POZ DEL RIO II	IBRD			25.0		
2-CLM-IM-01	NICKEL CERRO MATOSO	IBRD			25.0		
2-CLM-PH-17	POWER(GUATAPE)	IBRD		30.0			
2-CLM-QU-01	TOURISM	IBRD			15.0		
2-CLM-TH-07	HIGHWAYS VII	IBRD		27.0			
2-CLM-TH-09	HIGHWAYS IX	IBRD				20.0	
2-CLM-TR-06	RAILWAYS VI	IBRD	16.0				
2-CLM-UT-01	BOGOTA URBAN TRANSPORT	IBRD				20.0	
2-CLM-WW-04	BUCARAMANGA SEWERAGE	IBRD		3.0			
2-CLM-WW-05	MEDIUM CITIES W/SUPPLY	IBRD	12.0				
2-CLM-WW-07	WATER SUPPLY	IBRD			15.0		
2-CLM-WW-08	WATER SUPPLY INSFOPAL	IBRD					25.0

POPULATION: 20.5M

GNP PER CAP: $ 290

IVA COLOMBIA - 5 YEAR OPERATIONS AND LENDING PROGRAMS
(BY FISCAL YEAR - AMOUNTS IN $ MILLIONS)

OPERATIONS PROGRAM

	1964-68	1969-73	1972-76		1972	1973	1974	1975	1976
IBRD	161.2	596.8	558.0	IBRD	93.0	120.0	125.0	145.0	75.0
IDA				IDA					
TOTAL	161.2	596.8	558.0	TOTAL	93.0	120.0	125.0	145.0	75.0
NO	9	26	28	NO	4	6	7	8	3

LENDING PROGRAM (9/2/71)

IBRD	161.2	583.3	480.0	IBRD	75.0	125.0	100.0	90.0	90.0
IDA				IDA					
TOTAL	161.2	583.8	480.0	TOTAL	75.0	125.0	100.0	90.0	90.0
NO	9	29	23	NO	4	6	5	5	3

P & B 12/29/71

FORM No. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

January 17, 1972

MEMORANDUM TO THE LOAN COMMITTEE

Mexico - Ports Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated January 17, 1972 from the Central America and Caribbean Department, entitled "Mexico - Proposed Loan for a Ports Project" (LC/0/72-10).

2. Comments, if any, should be sent to reach Mr. Meier (ext. 2632) by 3:00 p.m. on Thursday, January 20.

3. It is planned then, if the Committee approves, to inform the Government and representatives of Nacional Financiera, the Secretariat of the Navy and the National Ports Coordinating Commission that the Bank is prepared to begin negotiations for the proposed loan on the terms and conditions referred to in the attached memorandum.

Dag F. Wittusen
Secretary
Loan Committee

DISTRIBUTION

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
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Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
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Special Adviser to the President
Mr. J.H. Williams
Directors, Other Departments and EDI
Meeting Participants (minutes)
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Vice President (IFC)

CONFIDENTIAL

LC/O/72-10
January 17, 1972

LOAN COMMITTEE

Memorandum from Central America and Caribbean Department

MEXICO - Proposed Loan for a Ports Project

1. Attached is the Appraisal Report "Appraisal of a Ports Project", dated January 12, 1972 (No. PTR-104), recommending a loan of $20 million to finance the foreign exchange cost of the Bank's first port project in Mexico. Following past practice the loan would be made to Nacional Financiera S.A.

2. The Bank has made 26 loans to Mexico, mostly for power, roads and agriculture, totalling $1,096.1 million. Our lending program is characterized by a sharp increase in volume and diversification into new fields, which will be helped by the new Administration's stress on planning and the inclusion in the Federal Budget of allocations for financing the study of new projects. The first operation of this fiscal year was the $22 million loan for the Zihuatanejo Tourism Project which was approved by the Board on December 21, 1971. Within this fiscal year we expect to submit loans for the National Railways, power and a new industrial fund to finance equipment mainly for export-oriented industries. As the attached five-year lending program shows, we plan to extend our lending operations to such new fields as steel, forest industries, education, water supply and small scale agriculture.

The Economy

3. A report entitled "Current Economic Position and Prospects of Mexico" (CA-14a) was distributed to the Board on November 15, 1971. The first year of President Echeverría's Administration has been marked by a distinct improvement in economic management. Two significant fiscal packages have been introduced, the first in December 1970, and the second in December 1971 and the Government is considering further important revenue measures in the fields of electric power, railroad, water services and petroleum products. Decisions in respect of electric power and water rates are expected to be made within the next six months, while increased rates for railroad and port services are foreseen in connection with the respective Bank projects. In the field of foreign trade the Administration has succeeded during 1971 in bringing rapidly

increasing imports under control - though at some cost to growth - and in introducing important institutional and fiscal incentive measures to promote exports. The past year has also witnessed a marked improvement in external debt management, with a move towards centralized control over external borrowing by public agencies and a sharp reduction in borrowing for periods of less than 5 years. Also in its first year in office the new Administration, in cooperation with the Bank, has begun to study seriously some of the country's long-term economic problems, notably the optimum allocation of water and energy resources. More vigorous action is still, however, required to extend education and other social services, to improve income distribution and to tackle the problems of population, growth and unemployment, if stability and fast economic growth are to be maintained.

The Sector and the Project

4. This is the first project which has been developed following the recommendations of the 1970 Bank Transport Sector Report. Another operation which has grown out of this Report - a loan proposal for the National Railways - will be presented to the Loan Committee in the next few weeks. These projects reflect a fundamental change in the Government's attitude towards the transport sector; in future investment planning and coordination for all transport modes will be centralized by a Sectoral Planning Office within the Transport and Communications Secretariat and the Government has established targets for making both the ports and the railways financially viable.

5. This port project has two main objectives: a) to improve efficiency of operations in the five major ports (the project ports) by the provision of high priority installations and equipment; and b) to establish an institutional basis for dealing with ports efficiently. A Department of Port Operations will be set up within the Secretariat of the Navy and provided with clear operational responsibilities and objectives. Autonomous agencies are not envisaged, but the signing by the President of Mexico of a decree establishing this Department is proposed as a condition of negotiation. In each major port an overall port administration will be established responsible for day-to-day operations. The National Ports Coordinating Commission which is responsible for coordinating the various port operations including shipping, railways, trucking, storage, etc., and the design of the country's long-term port development program, was established by decree of December 23, 1970, and has already hired its staff.

6. The project cost is estimated at Ps. 347 million (US$ 27.8 million equivalent) with a foreign exchange element of US$ 20 million, for which Bank financing is requested. The Bank loan

would help finance in the five project ports a grain handling installation, a tanker berth, warehouses and a transit shed, firefighting and port telecommunication equipment, mobile cargo-handling equipment, and - benefiting all ports - two dredgers and dredging equipment, consulting services and staff training. The possibility of financing consulting services through UNDP was explored and the Government expressed preference for inclusion of the cost of these services in the proposed Loan. Part of the amount reserved for consulting services will cover the cost of a National Port Development Study which is expected to serve as the basis for our next ports loan.

7. All equipment would be procured and construction contracts awarded under international competitive bidding procedures. Domestic manufacturers will have a margin of preference of 15 percent, or customs duties, whichever is lower. The foreign exchange content of civil works has been estimated at 27 percent for purposes of disbursement.

8. Responsibility for the execution of the project will be shared by three agencies. All work connected with construction of facilities and improvement of ports will be executed by the Ministry of the Navy, and the mobile cargo handling equipment, which is to be rented or sold to port concessionaires, will be administered by a financially self-supporting trust fund already established for this purpose within Nacional Financiera. The consulting services for operations and accounting and the national port study will be the responsibility of the National Ports Coordinating Commission, a unique institution designed to fit specific Mexican circumstances. The Bank's Transport Sector Report had recommended the establishment of a National Ports Council with executive powers, but the Government of Mexico did not consider this to be politically feasible. Although legally the Commission has no executive power, the arrangements made are considered adequate, and the Commission - through its chairman, the Secretary of the Presidency - has the strong political stature to make it an effective body.

9. Until now Mexican ports have been operated without regard to financial results. Revenues and expenditures have been accounted for under various headings in the Federal Budget. Accounting consultants to be financed retroactively from the Loan (maximum US$ 120,000) are now studying an accounting system in each port and reviewing the tariff structure. At present the overall level of tariffs is low and unrelated to costs. For example, in the five project ports, one-third of the tonnage handled pays some 90 percent of all port charges, and the surplus of the port of Veracruz covers the deficits of the other four ports. The largest single beneficiary of the present tariff exemptions is the National oil company Pemex.

10. The Appraisal Report recommends that port charges levied by the Secretariat of the Navy in the five project ports be reasonably related to fully distributed costs except in those cases where economic loss, e.g. through under-utilization of existing capacity, might result from applying such a pricing policy. National income accounts for the project ports indicate that this policy could be implemented without undue stress on port users, and that it would make the project ports financially viable with internally-generated funds sufficient to cover a) working expenses, b) debt service resulting from future port investments, and c) a contribution to finance a reasonable portion of capital expenditure. Agreement on these objectives to be attained as from 1973 should be reached during negotiations. However, since existing fixed assets have not yet been adequately valued and future capital requirements (outside the project) are not known, it is not possible to define now the financial rate of return required to achieve the above financial objectives, nor is it possible to assess the contribution to capital requirements deemed reasonable. These matters will have to be determined in consultation with the Bank when sufficient data will become available around the end of 1972 as a result of the consulting services included in the project. The Appraisal Report also provides for consultation between the Government and the Bank on a Plan of Action for application of the policies defined above to major ports other than the project ports.

11. A similar tariff policy is also recommended for cargo-handling which is a major item of the cost of port services and performed by concessionnaires at rates approved by the Transport and Communications Secretariat. Since the concessionnaires are independent workers' cooperatives or unions, we expect some reluctance on the Government's part to accept commitments for readjusting tariffs, and this may be a difficult point during negotiations.

Economic Justification

12. The proposed project is an integral part of Mexico's efforts to increase efficiency in its transport sector and an important element in the policy for the promotion of exports. It shows high rates of return for all of its main components ranging from 28 percent for the grain handling installation to 14 percent for mobile cargo-handling equipment. These returns are not sensitive to varying traffic forecasts.

Term of Loan

13. The Appraisal Report recommends a term of 25 years including a grace period of four years on the basis of the average economic life of the equipment and an expected disbursement period of four years.

A term of 25 years is also warranted on economic grounds to support the present Administration's efforts to improve the external debt profile.

Recommendation

14. Subject to the condition mentioned in paragraph 5, I recommend that representatives of the Mexican Government, Nacional Financiera, the Secretariat of the Navy and the National Ports Coordinating Commission be invited to negotiate a loan of about $ 20 million for a ports project to Nacional Financiera, with the guarantee of the Mexican Government on the terms and conditions proposed in the Appraisal Report.

Edgar Gutiérrez
Director

Attachment

Population: 52.4 million
GDP Per Capita: $654

MEXICO: ACTUAL AND PROPOSED LENDING THROUGH FY-1977
(US$ million)

Attachment

		Through					Fiscal Years										Total	Total	Total
		1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1964-68	1969-73	1973-77
Agriculture/Livestock Credit I	IBRD				25.0														
Agriculture/Livestock Credit II	IBRD							65.0											
Agriculture/Livestock Credit III	IBRD									75.0									
Agriculture/Livestock Credit IV*	IBRD											95.0							
Agriculture/Livestock Credit V	IBRD													75.0					
Agriculture/Livestock Credit VI	IBRD															75.0			
Small Scale Agriculture I	IBRD													40.0					
Small Scale Agriculture II	IBRD															40.0			
Irrigation I and II	IBRD	27.5																	
Irrigation III	IBRD				19.0														
Irrigation IV	IBRD						25.0												
Forestry I	IBRD											15.0							
Forestry II	IBRD														20.0				
Education I	IBRD												15.0						
Education II	IBRD															25.0			
Industry I	IBRD	0.5																	
Industry II	IBRD										35.0								
Industry III	IBRD												40.0						
Industry IV	IBRD														50.0				
Steel (Las Truchas) I	IBRD											60.0							
Steel (Las Truchas) II	IBRD															60.0			
Power I to VI	IBRD	254.8																	
Power VII	IBRD				93.4														
Power VIII	IBRD				16.6														
Power IX	IBRD						90.0												
Power X	IBRD								125.0										
Power XI	IBRD										125.0								
Power XII	IBRD												100.0						
Power XIII	IBRD														75.0				
Panuco Multi-purpose Project	IBRD													40.0					
Tourism I	IBRD										20.0								
Tourism II - Unidentified	IBRD													20.0					
Tourism III - Unidentified	IBRD															20.0			
Highways I - III	IBRD	55.4																	
Highways IV	IBRD		39.3																
Highways V	IBRD			32.0															
Highways VI	IBRD						27.5												
Highways VII	IBRD								21.8										
Highways VIII	IBRD												20.0						
Highways IX	IBRD														20.0				
Highways X	IBRD																		
Highways XI	IBRD																		
Ports I	IBRD										20.0								
Ports II	IBRD												20.0						
Railways I	IBRD	61.0																	
Railways II	IBRD										70.0								
Railways III	IBRD												50.0						
Tehuantepec Isthmus (Transp.)	IBRD													35.0					
Water Supply I	IBRD											35.0							
Water Supply II	IBRD														35.0				
Unallocated	IBRD												25.0		50.0				
Operations Program	IBRD										270.0	205.0	245.0	210.0	200.0	220.0			1080.0
	No.										5	5	6	5	5	6			27
Lending Program	IBRD	399.2	39.2	32.0	154.0	-	142.5	65.0	146.8	75.0	235.0	185.0	195.0	225.0	200.0	180.0	367.8	706.8	985.0
	No.	12	1	1	4	-	3	1	2	1	4	3	5	5	4	5	9	11	22
IDB - gross commitments					53.2	28.0	66.0	32.0	97.4	100.0	110.0	110.0	110.0	110.0	110.0	110.0	-	449.4	550.0
IBRD o/s inc. undisbursed		369.3	451.6	525.2	513.5	560.8	637.2	717.5	836.6	884.8	1087.5	1185.5	1322.8	1528.0	1681.5	1827.6			
exc. undisbursed		203.2	308.8	350.4	404.7	444.8	484.5	543.9	599.3	707.1	819.3	975.3	1117.6	1257.8	1387.3	1524.4			
IBRD - gross disbursements		235.5	54.7	60.9	75.4	63.6	66.8	85.0	83.1	134.6	142.0	188.0	180.0	180.0	176.0	195.0	321.5	632.7	919.0
- net disbursements		192.0	39.1	41.5	54.3	40.1	39.8	59.4	55.4	107.8	112.2	156.0	142.3	140.2	129.5	141.1	214.8	490.8	709.1
- net transfer		129.7	24.3	24.8	36.0	19.4	16.9	32.2	27.7	69.5	72.7	110.6	90.8	78.2	56.8	58.6	121.4	312.7	395.0

*including provision for small scale agriculture credit

Central America and Caribbean Department
January 13, 1972

Form No. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

January 17, 1972

MEMORANDUM TO THE LOAN COMMITTEE

Indonesia - Population Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated January 17, 1972 from the East Asia and Pacific Department, entitled "Indonesia - Population Project" (LC/0/72-9).

2. Comments, if any, should be sent to reach Mr. Alisbah (ext. 4704) by 3:00 p.m. on Thursday, January 20.

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

Dag F. Wittusen
Secretary
Loan Committee

DISTRIBUTION

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director, Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
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Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Economic Adviser to the President
Special Adviser to the President
Mr. J.H. Williams
Directors, Other Departments and EDI
Meeting Participants (minutes)
Overseas Offices and Missions
General and Loan Committee Files
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/0/72-9

January 17, 1972

LOAN COMMITTEE

Memorandum from East Asia and Pacific Department

INDONESIA: Population Project

Introduction

1. Attached for the consideration of the Loan Committee is an Appraisal Report entitled "Appraisal of a Joint IDA-UNFPA Population Project" (No. PP8) dated January 7, 1972 which recommends an IDA credit of $13.2 million to the Government of Indonesia to help finance a major expansion of the national family planning program. The project would be jointly financed with the United Nations Fund for Population Activities (UNFPA) from which a grant of $13.2 million would be made available.

The Lending Program

2. Since the Association started lending to Indonesia in 1968, seventeen credits for a total amount of $231.4 million have been made - $51 million in FY 1969, $80.5 million in FY 1970, $95.9 million in FY 1971 and $4 million thus far in FY 1972. In addition to the present project, eight more are expected to be ready for consideration by the Executive Directors in the current fiscal year. These include further lending for irrigation rehabilitation, agricultural estates, education, highways and power distribution, as well as lending in such new fields as development finance, smallholder rubber and oil palm, and marine transport, which should be more than sufficient to absorb Indonesia's current IDA allocation of $115 million.

The Economy

3. The latest Bank economic reports on Indonesia are those of March 25, 1971 (EAP-22) on longer-term development perspectives, and of November 30, 1971 (EAP-27a) on the aid requirements of the economy for FY 1972/73. The latter report focuses on recent economic performance, particularly in 1971, and the prospects for 1972.

The Population Sector

4. Indonesia's population of about 120 million ranks among the world's largest (fifth), is growing at a relatively high annual rate (2.6%), and is one of the world's poorest (annual per capita income of less than $100). Nearly two-thirds of this population live on the islands of Java and Bali, two of the most heavily populated regions of the world with a combined density of about 575 persons per square km.

It is unlikely that living standards can be significantly raised unless the rate of population growth is slowed. The Government is aware of this problem and has given strong policy support to a national family planning program. In 1970 it established a National Family Planning Coordinating Board (NFPCB) to take over and expand a program which had been initiated by a voluntary organization. Progress to date has been encouraging, but much higher numbers of continuing acceptors are necessary before any significant effect on the birth rate can be expected.

5. The Government's current family planning program is primarily confined to Java and Bali and calls for a total outlay of about US$85 million during 1972-1977. The program is based on the recommendations of a UN - WHO - IBRD mission which visited Indonesia in 1969 in response to a Government request for assistance in drawing up a national program. Over 80% of family planning services is now delivered by the facilities and staff of the health services; other implementing units, such as voluntary organizations and the military, account for the remainder. To support the family planning effort, an extensive motivation program has been started which uses non-medical field workers and a variety of communications media. For the implementation of the national program, Indonesia is also receiving financial and technical assistance from USAID, Japan, Sweden, UNICEF, WHO, UNFPA, IPPF, the Population Council, and the Ford Foundation. In 1970 such external assistance amounted to about US$3 million.

The Project

6. Having established an organization and a program, the Government must now strengthen and greatly expand the scale of its efforts. This will involve a sizeable construction program, an expansion of health services personnel, a major training effort, the building up of demographic research, and the further improvement of the statistical reporting system. All this calls for large increases in budgetary allocations, and considerable help from abroad in the form of capital and technical assistance. The proposed project, which forms an important part of the national program, is designed to provide such assistance and will be the Bank Group's first fully integrated population project.

7. The main elements of the project are: (i) a ten-fold increase of non-medical field workers, (ii) construction and staffing of schools for the training of all categories of existing staff in the national program as well as for the training of additional paramedical staff, (iii) introduction of population education in and out of school, (iv) strengthening and expansion of the research capability of NFPCB, (v) rehabilitation and expansion of family planning centers, (vi) construction of administrative centers for NFPCB in Djakarta and in the provinces, and (vii)provision of vehicles to meet the transport requirements arising from the expansion of staff. To assist the Government with implementation, the project also includes a sizeable component of technical assistance. The construction

element of the project involves over three hundred widely dispersed structures of which more than 270 are small family planning centers. The construction and service elements of the project are concentrated in East Java, Bali and Djakarta, while the institution-building aspects and the training, research, evaluation and technical assistance components will benefit the entire national program.

8. The objective of the project is to improve living standards through a lowering of the birth rate. It is estimated that as a result of the project the number of new acceptors of family planning would increase to a level more than three times higher than would be reached without the project. The current level is about 270,000 acceptors per year. Without the project, this might rise to around 500,000 per year by 1975; with the project, a target of 1.6 million is probable. While it is difficult to measure the economic impact of a population project, the appraisal report contains certain calculations based on conservative assumptions which indicate that as a consequence of the project per capita incomes would be 1.8% and 5% higher by 1980 and 1985 respectively. To achieve similar increases in per capita incomes through other means would require gigantic investments as compared with the total cost of this project (see Annex 39 of the Appraisal Report). Other benefits of the project include the reduction of unemployment and improvement of health conditions.

9. The total cost of the project is estimated to be $33 million, of which $12.6 million (38%) represents foreign exchange, and $20.4 million (62%) local costs. Of the total cost, about 36% is for civil works, 28% for incremental operating costs, 17% for technical assistance (including advisory services, consultants' fees, fellowships and research funds), 10% for vehicles and spares, and 9% for equipment and furniture.

10. The Association would finance 40% ($13.2 million), UNFPA, on a grant basis, 40% ($13.2 million), and the Government 20% ($6.6 million) of the cost of the project. The UNFPA, however, can provide unconditionally only $9.3 million for the project, and the balance of its contribution can only be pledged subject to the availability of funds (see paragraph 18). The Association and UNFPA would share equally the full capital costs (including indirect taxes) of the project except 5% of any items procured locally to avoid payment of direct Indonesian taxes, as well as a portion of the incremental operating costs (on a declining scale, meeting 80%, 60%, 40% and 20% of such costs in the first through the fourth years respectively). In the case of the advisory team for which UNFPA has already advanced $400,000, IDA funds would be used after effectiveness to finance retroactively half of all expenditures incurred to that date by UNFPA. The Association would have the right to cancel savings from the proposed credit resulting from procurement inconsistent with the Association's procedures. Other savings would be made available, subject to the Association's approval, to finance additional expenditures related to the purposes of the project.

The Government's contribution would be limited to financing on an increasing scale the remainder of the incremental operating costs (reaching 100% in the fifth year). The Association would administer as executing agency the UNFPA grant.

11. With the exception of the NFPCB Headquarters building in Djakarta, the construction included in the project consists of small and scattered units unsuitable for international tendering. Contracts for these, therefore, would be awarded on a competitive basis after bidding by pre-qualified local contractors. Contracts for the NFPCB headquarters and for equipment and furniture - totalling about US$5.4 million - would be awarded on the basis of international competitive bidding. Domestic manufacturers of furniture and equipment would be accorded a preferential margin equal to 15% of the c.i.f. costs of competing imports or to the existing rate of duty, whichever is the lower. Vehicles would be procured by UNICEF on the basis of international competitive bidding except in those cases where the Association agrees that, for purposes of fleet standardization, vehicles should be procured by UNICEF under its long-term bulk purchasing arrangements with manufacturers. The case for standardization is currently being reviewed by a member of the Resident Staff, in conjunction with UNICEF's regional transport advisor.

12. The Ministries of Health, of Education, of Information and of Public Works, a number of Provincial governments, and certain international organizations and agencies will participate in the project. The NFPCB will be responsible for the overall administration and coordination of project activities. Because of the complexity of the project and the relative inexperience of NFPCB, implementation will be difficult. To ease the burden of management, the project includes a number of provisions for strengthening NFPCB. These include: (i) the setting up of a three-man team of international experts to advise NFPCB on programming, training, and communications aspects of the national program (as indicated in paragraph 10, UNFPA has already advanced funds for this purpose and the advisors are being recruited); (ii) the establishment and staffing of a Project Implementation Unit (PIU) within the NFPCB; (iii) the retention of a consulting firm to assist the PIU; (iv) the establishment under the auspices of the PIU of a coordinating committee on which senior staff of other Ministries involved in project implementation as well as international agencies and foundations participating in the project would be represented; (v) the appointment of the School of Architecture of the Institute of Technology at Bandung for the design of the facilities included in the project.

13. In addition, the Government would associate other agencies with the implementation of specific project components, and funds for the expertise and services to be provided by these agencies would be jointly financed by IDA and UNFPA. WHO is expected to assist the Government with the hospital postpartum program, UNESCO with the communications and population education components, UNICEF with vehicle procurement and maintenance, and the Population Council with the demonstration field postpartum program. No single one of these services to be provided by these agencies is crucial to the success

of the project. Moreover, the agencies involved are not the only ones who could provide the services, since the experts needed could also be recruited from private foundations or other sources. An association with these agencies is, however, regarded as crucial to the long-term development of the national program, particularly in view of the influence of WHO and UNESCO with the Ministries of Health and of Education respectively. There are also two other important reasons for the proposed participation of these agencies in the project. Firstly, the cooperation of WHO is particularly important for the future work of the Bank Group in the population field. Secondly, on the basis of their past experience, the other UN agencies regard UNFPA primarily as a source of funds for themselves and therefore their inclusion in the project is partly a by-product of having a joint project with UNFPA. As initially conceived, the Association, as executing agency, was to enter into direct contractual relationships with these agencies and was to have coordinated their work in the project. At discussions held between the Association and these agencies it became apparent that they, particularly WHO, resented the proposed supervisory role of the Association. They have, however, indicated their readiness to assist with the above components if called upon by the Government. This, therefore, is the procedure to be followed; we would look to the Government through its arrangements with these agencies to carry out the project and there would be no direct contractual relationship between the Association and these agencies. Originally it had been hoped that the UN Population Division would assist the Government with two of the evaluation and research components covering the Institute of Demography and the Population Study Center. At this time, however, participation of the UN Population Division in the project appears unlikely, and if it does not, the Government will seek expertise acceptable to the Association either from private foundations or from other sources.

14. The assurances to be sought from the Government in connection with the project are listed in Section 7.01 of the Appraisal Report. As conditions of effectiveness, (i) the Government would restructure the NFPCB along the lines set out in the Appraisal Report, including the setting up and staffing of a Project Implementation Unit and the appointment of consultants, and (ii) NFPCB would enter into an agreement with the School of Architecture of the Institute of Technology at Bandung for the design of project facilities. The simultaneous effectiveness of the UNFPA grant would also be a condition of credit effectiveness.

15. In view of the complexity of the project, before inviting negotiators we will seek to reach final agreement with UNFPA on the content of the project, the assurances to be sought from the Government, the proposed financing and disbursement arrangements, and the preliminary drafts of the legal documents (including the Credit Agreement and the tripartite agreement between the Association-UNFPA-and the Government).

Issues

16. There are three issues which should be considered by the Committee. Is the project manageable? Is the Government making an adequate financial contribution to the project? Should the Association help to finance incremental operating costs as proposed?

17. In view of NFPCB's and our own relative inexperience in this field, and the number of international agencies and government departments involved in the project, its implementation and administration are likely to be difficult. To the extent possible, measures to ensure proper management have been included in the project (see paragraph 12). Whether these will prove sufficient can only be determined during implementation. In any case, we will have to supervise this project extremely closely, and this will call for considerable staff time. At present, the project is being handled without additional staffing, but the Population Projects Department expects that as it moves into the implementation phase additional staffing at headquarters and/or in Djakarta will become necessary and will have to be provided.

18. The relatively small contribution of the Government to the project (i.e. 20%) should be viewed in light of the fact that the project is part of the national family planning program which calls for an outlay of $85 million (including the project) and to which the Government has a financial commitment far in excess of its contribution to this project. In this context, it is also relevant that $3.9 million of UNFPA's $13.2 million contribution can only be pledged subject to the availability of funds (see paragraph 10). In accordance with our standard provisions, the Government would assume this burden in the unlikely event that UNFPA were unable to provide the conditional portion of its pledge and no other external financing were found.

19. The incremental salaries and maintenance costs involved in the project represent a permanent build-up in the level of operating costs as a result of the project. IDA and UNFPA participation, on a declining scale, is intended to give the Government time to build up its resources to the level necessary to finance these costs after the project is completed. It might have been possible to devise an arrangement whereby UNFPA would have financed a larger proportion of operating costs while the IDA credit would be used for capital costs only. The discussions with UNFPA, however, were sufficiently complicated without an argument on who should finance what. Vis-a-vis UNFPA, therefore, the Association has consistently maintained that the simplist arrangement would be for both organizations to finance jointly an equal share of all project items. UNFPA has accepted this view, and it would be difficult to reopen the subject now. It should also be noted

that, while IDA funds would be disbursed against all items, the size of the proposed credit is roughly equivalent to the foreign exchange cost of the project.

Recommendation

20. I agree with the recommendation of the appraisal report that the project forms a suitable basis for an IDA credit of $13.2 million, and recommend that, upon reaching final agreement with UNFPA on the basis of the green cover report and the preliminary drafts of the legal documents, the Government of Indonesia be invited to send representatives to negotiate such agreements.

Raymond J. Goodman
Director
East Asia and Pacific Department

FORM No. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

January 17, 1972

MEMORANDUM TO THE LOAN COMMITTEE

Kenya - Nairobi Airport Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated January 17, 1972 from the Eastern Africa Department, entitled "Kenya - Nairobi Airport Project" (LC/0/72-8).

2. Comments, if any, should be sent to reach Mr. Kaji (ext. 4915) by 3:00 p.m. on Thursday, January 20.

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

Dag F. Wittusen
Secretary
Loan Committee

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LC/0/72-8

January 17, 1972

LOAN COMMITTEE

Memorandum from the Eastern Africa Department

KENYA: Nairobi Airport Project

I. INTRODUCTION

1. The Loan Committee is asked to consider proposals for a Bank loan of \$27.7 million to Kenya, with a term of 20 years, including five years of grace, for the Nairobi Airport project.

2. While the Bank Group has actively participated in the development of the transportation sector in Kenya through eight loans and credits for road construction and maintenance and four loans to the common service organizations of the East African Community (EAC) for the development of railways and harbors, the proposed loan will be the first for aviation in Kenya and indeed for the whole of Africa.

3. The Bank's involvement with the formulation of the proposed project dates back to 1969 when we, at the request of the Government, reviewed the Master Plan for airport development at Nairobi prepared by consultants. Our review resulted in recommendations for a total revision of the Master Plan to take into account the longer term technical and ecological implications of the proposed second runway location and consequently that of the terminal complex. The Government accepted the Bank's recommendations and the revision of the Master Plan and subsequent design and engineering of the proposed project was carried out in close consultation with the Bank.

4. An IDA Credit of \$22 million for the Fourth Highway Project was approved by the Board on December 21, 1971. Except for the proposed loan, there are no other operations in Kenya scheduled for FY72. A Phase II Smallholder Agricultural Credit Project is expected to be appraised in early 1972 and projects for tourism, development finance company and Second Phase Livestock Development are under active preparation with Bank Group assistance. The FY71-75 Operations Program is attached.

II. THE ECONOMY

5. An economic mission visited Kenya in August/September 1971 and its draft report has been distributed to the Economic Committee. The mission found that Kenya had made good progress in implementing its current

1970-74 Development Plan, despite two poor agricultural seasons in 1969 and 1970. GDP has continued to grow at a high rate (over 6 percent a year in real terms), and in 1970 gross fixed capital formation was equivalent to nearly 25 percent of monetary GDP. The central government has pushed development expenditure at a faster rate than projected in the Plan, and has financed an increasing proportion by raising loan capital from the local market. The high level of economic activity, and particularly the high investment ratio, has recently exerted strain on Kenya's balance of payments for the first time in some years, and reserves have been reduced during 1971 to a level equivalent to about four months' imports.

6. If Kenya is to continue her development program at the present pace, a larger net inflow of external capital will be required in the future to finance her balance of payments gap. On the basis of its generally sound policies and plan implementation, Kenya will continue to merit a substantial amount of assistance from external donors. While much of the assistance received in the early post-Independence period was on conventional terms, and the blend of Bank Group lending has also been relatively hard, Kenya's debt burden is still not very heavy (some 6 percent of foreign exchange earnings) and the economy is able to absorb reasonable amounts of aid on conventional terms.

III. THE PROJECT

7. The proposed project forms the first phase of the Master Plan for the development of the Nairobi Airport and, when completed in 1975, will provide capacity to meet the needs up to 1982.

8. Attached is a report entitled "Appraisal of Nairobi Airport Project" which recommends a loan of $27.7 million with a term of 20 years, including a five year period of grace, for financing a project comprising:

(a) construction of a new terminal building for international and domestic traffic, a freight building, taxiways, aprons, control tower, other ancillary buildings and access roads;

(b) installation of airfield and approach lighting, a fire hydrant system, water, electrical and sewerage systems; and

(c) provision of technical assistance and training, including consultants' services.

The total cost of the project is estimated at $45 million equivalent, of which $27.7 million (62%) is the estimated foreign exchange component.

Economic Justification

9. The existing airport facilities at Nairobi for passenger and freight aircraft are rapidly approaching their saturation points and the project will ensure unrestricted flow of passenger and cargo traffic.

Nairobi is a major international airport, serving not only Kenya, which derives 12 percent of its foreign exchange earnings from tourists, but also to an extent all of East Africa. The scheme adopted for the development of the necessary facilities is the optimum solution taking into account long range technical and ecological implications of alternatives.

10. The project would yield a rate of return of 14 percent to the economy of Kenya. About 86 percent of the benefits to the Kenyan economy would result from foregone costs to aircraft operators, expected to be captured by Kenya through airport charges. The remaining 14 percent would be net revenues to Kenya from the increase in the number of foreign visitors as a result of improvements in the Nairobi airport. The bulk of the projected benefits, savings in cost to aircraft operators, are based on fairly reliable data. The calculations relating to benefits from the incremental foreign passenger traffic is based on studies made in other parts of the world and the factor used to estimate the impact of delays, in the absence of improvements, on future tourist traffic appears to be plausible.

11. User charges would be an important vehicle for capturing the benefits of the project for the Kenyan economy. Nairobi airport has been, and is expected to continue to be, financially viable. The airport operations have contributed significantly to the Government revenues in the past and are expected to continue doing so. During negotiations we would seek assurances that the Government shall take all necessary action to ensure that the airport will generate revenues sufficient to yield a minimum rate of return on net fixed assets in operation of 6 percent through 1978 and 10 percent thereafter. Our projections indicate that the airport will in later years generate revenues far greater than that required to meet the stipulated minimum rates of return. It is possible that such a surfeit of revenues may induce some laxity on the part of the airport management towards cost control, the end result of which would be a reduction in the contribution the airport would otherwise make to the Government budget. To ensure adequate cost control, the appraisal report recommends that we seek assurance from the Government that the operating ratio (ratio of operating expenses to operating revenues) would be kept as low as possible and would not exceed 72 percent through 1978 and 60 percent thereafter.

12. Assurances would be sought during negotiations that a commercial accounting system will be introduced in the Aerodromes Department and that this would be the basis for the introduction of user charges based on costs. Accounting consultants would be appointed for this purpose and on the job training would be provided for the accounting staff. During negotiations, assurances would be sought that accounting consultants would be retained no later than December 31, 1972 so that a new tariff structure would be available for consideration before the commissioning of new facilities. Assurances would also be sought that proposals for the new user charges would be developed in consultation with the Bank and that agreed new scales would be instituted in time for the commissioning of new facilities.

Organization

13. Hitherto, responsibilities for airport operations were dispersed amongst various ministries, resulting in a lack of adequate control, coordination and accounting of these operations. The Government has now established an Aerodromes Department, which will be responsible for the construction and management of airports.

14. The four key positions in the new Department: the Director; the Deputy Director; the Airport Engineer; and the Financial Manager, are not filled at present. It is expected that suitably qualified local personnel will be available, possibly from amongst the senior civil servants, to fill the positions of Director and Deputy Director. During negotiations we would seek assurance that these two positions would be filled by persons selected in consultation with the Bank; the appointment of the Director would be a condition of effectiveness of the loan. Suitably qualified local personnel are not available for the positions of Airport Engineer and Financial Manager. The Government has already located two overseas candidates, whose qualifications and experience are acceptable to the Bank, for filling these positions. The UNDP has agreed to "top up" the salary of the person filling the position of Airport Engineer, but as yet no arrangements have been concluded for obtaining similar financing for the position of Financial Manager. Funds have been provided under the proposed loan for financing such costs. It is our experience that Kenya is generally reluctant to use such funds, at least until it has exhausted all possibilities of obtaining "topping up" assistance from bilateral or other multilateral sources. This has on several occasions led to major delays in making necessary appointments and hence in the execution of the project. Before presenting the loan to the Board, we would like to be assured that suitable candidates have in fact been selected and firm financing arrangements have been made in case Kenya does not wish to utilize the funds provided in the loan. The actual appointment of these two experts would be a condition of effectiveness.

15. The staffing needs of the Department, adequate to operate the new facilities in 1975, will be worked out by the Director and his senior officers. During negotiations we shall seek assurances that a staffing plan will be prepared and submitted to the Bank for review by January 1, 1973 and would subsequently be implemented in accordance with an agreed timetable. In addition, during negotiations we shall discuss the general content and the timing for preparation of a training program for the staff of the Department and seek assurances that a program will be prepared in consultation with the Bank and implemented in accordance with an agreed timetable.

Procurement and Disbursements

16. Procurement of equipment and the letting of construction contracts will be in accordance with the Bank guidelines for international competitive bidding. Disbursements would be made against the actual foreign exchange costs or the estimated foreign exchange component of the goods and services procured.

17. The Government expects to incur a total expenditure of about \$4 million in respect of consultants' services for architectural and engineering design and supervision of project construction. Of this, approximately \$1.9 million will be paid prior to April/May 1972, when we expect the proposed loan to be signed. The loan would include financing of the eligible portion of such costs retroactively from April 1, 1970, which was roughly the date when the consultants commenced work on the revision of the Master Plan, as recommended by the Bank. This would be about \$1.3 million.

Nairobi-Airport Road

18. The airport access road would be linked up with a section of the Mombasa-Nairobi road which provides the main road into the city. Since the existing Airport-Nairobi section is overtaxed and does not lend itself to improvements, the Government has decided to reconstruct this section on a new alignment. This section was to be reconstructed as a part of the package put up by the Government under the Fourth Highway Project. However, this section had to be subsequently deleted from the Project, as detailed engineering was not available at the time of appraisal. The Appraisal Report (paragraph 7.01(g)) recommends that we obtain assurances from the Government that the section of the Nairobi-Mombasa road from the airport to Nairobi be reconstructed by 1975 on an alignment and geometry satisfactory to the Bank. While I quite accept the desirability of having the new section ready by 1975 to be linked up with the airport access road to be constructed under this project, I believe that we should be prepared to accept satisfactory temporary arrangements whereby the access roads would be linked up with the existing road should the Government expect difficulty in lining up satisfactory financing arrangements in time to permit start of construction by late 1972. The Transportation Projects Department accepts this recommendation.

V. RECOMMENDATION

19. I recommend that the Bank invite representatives of the Republic of Kenya to negotiate a loan of \$27.7 million, substantially on the terms and conditions set forth in paragraphs 7.01 to 7.03 of the Appraisal Report subject to paragraph 18 of this memorandum.

Michael L. Lejeune
Director

Attachment: Five-Year Operations Program

Attachment

POPULATION: 10.9M

iP PER CAP: $ 130

IVA KENYA - 5 YEAR OPERATIONS AND LENDING PROGRAMS
(BY FISCAL YEAR - AMOUNTS IN $ MILLIONS)

OPERATIONS PROGRAM

			1972	1973	1974	1975	1976
8-KEN-AC-02	AGRICULTURAL CREDIT	IDA		3.0			
8-KEN-AC-03	AGRIC. CREDIT	IDA					6.0
8-KEN-AD-02	COTTON	IDA			3.0		
8-KEN-AI-01	KANO PLAIN IRRIGATION	IDA					10.0
8-KEN-AL-02	LIVESTOCK II	IDA			8.0		
8-KEN-AP-03	HORTICULTURE DEVT	IDA			3.0		
8-KEN-AX-01	AGRIC UNIDENTIFIED	IDA				4.0	
8-KEN-AX-02	AGRIC.UNIDENT	IDA					5.0
8-KEN-DD-01	DFC	IBRD		2.0			
8-KEN-DD-02	DFC	IBRD				3.0	
8-KEN-EE-03	EDUCATION III	IDA			7.0		
8-KEN-EE-04	EDUCATION III	IDA					10.0
8-KEN-PH-02	POWER KAMBURU EXPANSION	IBRD			5.0		
8-KEN-PH-03	GTARU POWER	IBRD					35.0
8-KEN-QQ-01	TOURISM	IBRD		7.0			
8-KEN-TA-01	NAIROBI AIRPORT	IBRD	27.7				
8-KEN-TH-06	HIGHWAYS IV	IDA	22.0				
8-KEN-TH-07	HIGHWAYS V	IBRD/I				25.0	
8-KEN-UU-01	NAIROBI URBAN DEVT.	IDA			5.0		
8-KEN-WW-02	WATER SUPPLY	IBRD					10.0

	1964-68	1969-73	1972-76
IBRD		94.1	99.7
IDA	39.0	47.3	101.0
TOTAL	39.0	141.4	200.7
NO	8	12	20

	1972	1973	1974	1975	1976
IBRD	27.7	9.0	5.0	13.0	45.0
IDA	22.0	3.0	26.0	19.0	31.0
TOTAL	49.7	12.0	31.0	32.0	76.0
NO	2	3	6	3	6

LENDING PROGRAM (3/10/71)

	1964-68	1969-73	1972-76
IBRD		84.4	67.0
IDA	39.0	46.3	73.0
TOTAL	39.0	130.7	140.0
J	8	12	15

	1972	1973	1974	1975	1976
IBRD	20.0	7.0	5.0	10.0	25.0
IDA	20.0	4.0	15.0	12.0	22.0
TOTAL	40.0	11.0	20.0	22.0	47.0
NO	2	3	3	3	4

P & B 12/29/71

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/72-3
January 18, 1972

Minutes of Special Loan Meeting to consider "Argentina - SEGBA Power" (644-AR) held on January 12, 1972 in Conference Room B.

1. Present: Messrs. Knapp (Chairman), Cope, Williams, Aldewereld, Broches, Chadenet, Baum, Weiner, Howell, Rovani, Wiese, Cabezas, Cancio, Fajans, Greene, Ribi, Sheehan, van der Heijden and Wittusen (Secretary).

2. Issues: The meeting was called to consider Mr. Alter's memorandum of January 6, 1972 to Mr. Knapp entitled "SEGBA - Mission to Argentina". Since the previous Special Loan Meeting on December 13, 1971 (LM/M/71-53), SEGBA's tariffs had been raised by about 50% on the average and certain financial forecasts for 1972 had been made available to the Bank by SEGBA. Also, SEGBA's shareholders (i.e. the Government) had approved a motion by virtue of which SEGBA was no longer constituted under the Commercial Code but had been subsumed under Law 17318 relative to joint stock companies in which the State (and authorities and entities controlled by it) hold at least 51% of capital stock and have a majority voice in shareholders meetings. However, in response to a cable by the Bank, final action by the shareholders on the revision of SEGBA's Statutes was deferred until after a Bank mission to be sent shortly to Argentina had an opportunity to discuss the proposed reorganization of SEGBA with the Government. The meeting also had before it a memorandum of January 12, 1972 from Mr. Weiner to Mr. Knapp entitled "SEGBA: This afternoon's meeting on the proposed mission to Argentina."

3. Discussion. The meeting noted that:

(i) About $32 million of Loan 644-AR remained undisbursed; however, SEGBA had committed the entire amount of the loan ($60 million). The tariff increase of about 50%, put into effect on January 1, 1972, was unlikely to generate the prescribed 8% rate of return in 1972, mainly because it made no allowance for a simultaneous 15% increase in wages. Tariffs should, therefore, be raised again shortly and further adjustments might be called for in the course of the year. Even if the 8% return were assured for 1972, at least $20-25 million equivalent would be required

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Meeting Participants (minutes)
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Executive Vice President (IFC)
Vice President (IFC)

to cover SEGBA's financing gap in 1972 and permit SEGBA to carry out an investment program compatible with its needs. This estimate was subject to review in Buenos Aires. It compared with an amount of about \$48 million equivalent by which SEGBA's earnings in 1971 fell short of revenue standards laid down in SEGBA's Concession. Were the Government to agree to restore the entire \$48 million to SEGBA, the Company's cash position would be more than adequate.

(ii) Guidance for the forthcoming mission was needed because of a divergence of views among the staff as to the nature of the assignment. Basically, there were two positions. The first, taken by the Public Utilities Projects Department, was to urge the Government to repeal the resolution of May 27, 1971 by the Secretary of Energy, requiring his prior approval for all tariff adjustments and thus preventing SEGBA from raising tariffs automatically (as provided in the Concession) to offset wage and fuel price increases. Such repeal would restore automaticity of tariff adjustments and signal the return to the regulatory regime in force until May 1971. The Government's refusal to implement the Concession should, in the view of the Projects Department, trigger off suspension of disbursements.

(iii) The second position, represented by the South America Department, was similar to the first one in its insistence on timely tariff adjustments to compensate for cost increases. It did not, however, necessarily require the return to the automatic regime. If necessary, it would accept a formal change in the regulatory regime and would admit the Government's right to approve each tariff increase, as long as tariffs were closely following wage and price movements and gave SEGBA the 8% return now provided for in the Concession. It would require, however, that the Government demonstrate its sincerity by deciding promptly on a next tariff increase and giving the mission an assurance as to its date and size. The South America Department was anxious to avoid a break for reasons of form and not of substance in Argentina's relations with the Bank. For the moment, the Minister of Finance might have persuaded the Government to try to reach accommodation with the Bank to avoid jeopardizing Argentina's current moves to borrow \$500 million from US and European banks. On the other hand, President Lanusse wanted to become the elected President of the country and was trying to enlist support of political forces including the Peronistas, and this might preclude making significant concessions to outside parties.

(iv) A third approach was possible. It started from the premise that the positions of the Public Utilities and South America Departments coincided in substance. Both aimed at revenue from tariffs assuring SEGBA of an 8% return in 1972 and subsequent years; and both accepted the fact that the 1971 earnings deficiency would not be recovered from tariffs but by way of the Government meeting the financing gap. It was questionable whether any rate of return covenant was a durable proposition in the Argentine political circumstances. Consequently, the Bank might consider not to exercise its remedies as long as funds were available, irrespective of source, to carry out SEGBA's investment supported by the Bank. This was objected to on general economic grounds: the Bank should not accept a solution which could only imply recourse to the Central Bank and would thus associate the Bank with the wrong general financial policies at this time.

(v) SEGBA's Concession was a complex document providing, *inter alia*, for the tariff base being valued in US dollars and for certain other accounting procedures. These provisions may have been undermined by the recent decision of the shareholders (i.e. the Government) to reconstitute SEGBA under Law 17318. There was a danger that a departure from the automatic adjustment features of the Concession might upset the entire regulatory mechanism, which has been in existence since 1962, without prior agreement on a substitute system. The criticism of the Bank might be aggravated if it now became involved in a discussion of a new regulatory regime.

(vi) It would be difficult for the Bank to suspend disbursements mainly because of changes in the management set-up of SEGBA. Although past experience with SEGBA management regarding the necessary reduction of labor costs gave strong reasons for concern, it would be difficult to prove in advance that SEGBA could not be effectively managed under the proposed new Statutes. To determine the results of the management function passing from the Executive Committee to the Board might take six or more months of careful observation. A decision to suspend on financial grounds would have the advantage of being taken on the basis of already known facts.

(vii) The Executive Directors had not yet been informed of the issues under discussion and ought to be alerted to the problems and the Bank's response to them as soon as the mission had returned. Information about the present difficulties should be put before the Executive Directors prior to the circulation of the "Operations Evaluation Report: Electric Power," which included a section on SEGBA.

4. Decision. It was agreed that:

(i) The Bank at this time will neither consider amending the existing agreements nor insist that the letter of the agreements be respected. Rather, the Bank will reserve its right to exercise the sanctions available under the agreements should actual performance by Government and SEGBA depart from the underlying objectives of the agreements with respect to rate adjustments, provision of adequate funds for the project and efficient management.

(ii) The mission should tell the Government that the Bank considered them in default in contractual provisions concerning SEGBA's tariffs and Statutes, and that they are expected to show cause why the Bank should not suspend disbursements.

(iii) The Bank should insist on SEGBA earning an 8% return in US dollar terms in accordance with the Concession. This should preferably be accomplished by restoration of the automaticity of tariff adjustments provided for in the Concession. If the Government refused to accept this but was prepared to assure the Bank that it would cause rates to be adjusted as and when needed to achieve the 8% return now required by the Concession, and to indicate forthwith the amount and date of the next rate adjustment, the Bank should go along.

(iv) The Bank would not suspend disbursements in response to recent or proposed changes in the Estatutos before it has had an opportunity to confirm, by observing performance, that the reorganized management arrangement was not effective.

(v) Upon the return of the mission, the Executive Directors would be informed of the Government's failure to comply with its obligations as Guarantor of the Loans to SEGBA and of the Bank's response.

Dag F. Wittusen
Secretary

JFajans/DFWittusen/BChadenet/WCBaum/MWeiner/YRovani:ct

Cleared by: Messrs. Knapp
Broches
Chadenet/Baum
Weiner
Wiese

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Members of the Loan Committee

DATE: January 7, 1972

FROM: Dag F. Wittusen

SUBJECT: Bolivia - Mining Sector Paper
Rescheduling of Loan Committee Meeting

Please note that the Loan Committee meeting to discuss the Bolivia - Mining Sector Paper, previously scheduled for Monday, January 10, 1972 at 3:00 p.m. in the Board Room, has been rescheduled for Tuesday, January 11, 1972 at 4:30 p.m. and will be held in Room C1006.

FORM No. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

January 6, 1972

MEMORANDUM TO THE LOAN COMMITTEE

India - Maharashtra Agricultural Credit Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated January 6, 1972 from the South Asia Department, entitled "India - Maharashtra Agricultural Credit Project" (LC/O/72-5).

2. Comments, if any, should be sent to reach Mr. Thomas (ext. 2294) by 12:00 noon on Wednesday, January 12.

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

Dag F. Wittusen
Secretary
Loan Committee

DISTRIBUTION

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Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
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Deputy Director, Projects
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Copies for Information:

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Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Economic Adviser to the President
Special Adviser to the President
Mr. J.H. Williams
Directors, Other Departments and EDI
Meeting Participants (minutes)
Overseas Offices and Missions
General and Loan Committee Files
Executive Vice President (IFC)
Vice President (IFC)

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CONFIDENTIAL

LC/O/72-5

January 6, 1972

LOAN COMMITTEE

Memorandum from South Asia Department

INDIA - Maharashtra Agricultural Credit Project

1. I attach a draft appraisal report entitled "Appraisal of Maharashtra Agricultural Credit Project" recommending that the Association make a credit to India of US$30.0 million equivalent for this project.

Background

2. The Maharashtra project, which was appraised in March and April 1971, would be the seventh in a series of agricultural credit projects in India; six others in the States of Gujarat, Punjab, Andhra Pradesh, Tamil Nadu, Haryana and Mysore have been approved by the Association since June 1970. Consideration is being given to the possibility of appraising one other such project in the State of Madhya Pradesh later this financial year. All these projects are aimed at increasing the range and amount of institutional credit available to farmers wishing to take fuller advantage of modern agricultural technology; they were identified in 1968 by an IDA mission which, with the assistance of the FAO/IBRD Cooperative Program, reviewed agricultural credit institutions and farm investment requirements in selected areas of India.

Bank/IDA Lending Program

3. During the current fiscal year, five credits to India totalling US$114.0 million (Pochampad Irrigation, Cochin and Gorakhpur Fertilizers, Grain Storage and Mysore Agricultural Credit) have already been approved. In addition to the present project, a US$75.0 million credit for railways is expected to be presented shortly, bringing the total to US$189.0 million so far this year. A Bank loan of US$60.0 million for ICICI was presented to Executive Directors on October 26. In keeping with the Government of India's (GOI) emphasis on improvements in agriculture, the IDA lending program for the balance of the year includes US$91.5 million in this and related sectors; US$13.5 million for wholesale markets in Bihar, US$43.0 million for Tawa irrigation, US$20.0 million for Nangal and US$15.0 million for Trombay fertilizer plants. Other projects envisaged are for family planning (US$12.0 million), industrial

imports (US$75.0 million), shipping (US$80.0 million), a first credit to the Industrial Development Bank of India (US$20.0 million) and power transmission (US$60.0 million). A copy of the current edition of the Five-Year lending program is attached.

4. The April 1971 economic report on India (SA-25a dated May 11, 1971) described the continuation of many of the encouraging trends observed in the previous year's report - in particular the further growth of exports and agricultural production. It notes, however, the decline in net aid receipts. Net aid has diminished in the past five years from levels of over US$1 billion a year (of which half was food aid) to US$452 million in 1970/71 of which US$216 million was food aid. Net aid was equal to about 20 percent of net domestic investment in the mid-sixties, it now equals about 8 percent. This fact represents an important potential constraint on future growth and, already, the resulting shortage of resources has been reflected in a shortfall of investment compared to the planned level, which seems to be the bare minimum required if India is to achieve a tolerable rate of growth. Since the economic report was written, problems have arisen which have affected the availability of financial resources for economic development in India. The budgetary cost of caring for the refugees from East Pakistan was estimated at approximately US$700 million through the end of the current fiscal year. Toward this figure the international community had committed a total of about US$250 million equivalent by the time the armed conflict between India and Pakistan broke out on December 3, 1971. A final assessment of the refugee cost, as well as a judgment of the financial and economic implications of the recent conflict, will only be possible further in the future, but there is no doubt that the need for rapidly disbursing development assistance has become more urgent than was indicated in the economic report.

Project Description

5. Most of the proceeds of the credit would be lent to farmers for on-farm investments in minor irrigation and land levelling through the Agricultural Refinance Corporation (ARC), the Maharashtra State Cooperative Land Development Bank (LDB) and its federated Primary Land Development Banks (PLDB) as well as through selected commercial banks. (As in earlier credits, the participating commercial banks would be required to accept the same terms and conditions of lending to farmers as the LDB). In addition, the project would include financing for well-drilling and earthmoving equipment and for consultancy services (advisers to the State Groundwater Department to set up and assist in the implementation of detailed geologic and hydrologic studies). As in the other agricultural credit projects in India, ARC would assume the main responsibility for supervision. The Borrower would be GOI, which would relend the credit to ARC, which would repay about 70 percent after nine years at an interest rate of 5-1/4 percent per annum and the balance after fifteen years at an interest rate of 5-3/4 percent per annum. ARC would refinance at 6-1/2 percent per annum the loan operations of agreed

participating banks. Loans to individual borrowers would be at 9-1/2 percent interest, repayable generally over a period of up to ten years but extending to fifteen years in the case of loans to small farmers for land reclamation. These rates are 1/2 percent higher than those applicable to earlier credits (see paragraphs 16-20).

6. The appraisal report estimates the total cost of the project at US$50.3 million equivalent. The proposed Association credit would finance the total estimated foreign exchange cost of US$8.9 million and approximately 50 percent of local expenditures, the balance being contributed by ARC, the lending banks and farmers.

Benefits

7. The project would benefit at least 45,000 farmers and their dependents in Maharashtra through investment in minor irrigation and land levelling. Tubewell, dugwell and lift irrigation development would irrigate about 106,000 ha. Investments in land development would lead to the levelling and grading of some 33,000 ha, the bunding of 47,000 ha and the provision of water courses and field drains on 115,000 ha. The resulting intensification of cropping would lead at full development to increases in production of 247,000 tons of foodgrains, 50,000 tons of seed cotton, 23,000 tons of groundnuts, 400,000 tons of sugarcane and 215,000 tons of bananas. The annual value of this increased production, at current prices, is estimated at about US$22 million equivalent. The estimated economic rates of return on incremental investment at projected world market prices range from 35 to 55 percent for minor irrigation and 39 percent for land development. At present prices and costs, the financial rates of return to farmers vary between 40 to 73 percent for minor irrigation and 60 percent for land development.

8. Well-drilling equipment (including bits) and earthmoving equipment (with spare parts) would be procured through international competitive bidding. Some of this equipment is manufactured in India, but the Government acknowledges that the supply is inadequate for current needs. Procurement arrangements will be on the usual basis of a "preference" for domestic suppliers at the level of 15 percent or the level of custom duties, whichever is the less. The duty on these items is presently 30 percent, which is the basic rate applied to most imports. I do not expect the GOI to ask that these items be reserved for procurement from domestic suppliers, but if any item were to be so reserved, we would reduce the amount of the credit accordingly.

Rehabilitation of Lending Institutions

9. The first five earlier agricultural credit projects were in States with comparatively strong cooperative lending institutions, the financial viability of which was never in doubt. Such institutions in Maharashtra, as indeed was the case in Mysore, although organizationally well structured, suffer from a history of consistently poor collection

records, as indeed do the cooperative banks in most of the other four States of India in which similar projects are now contemplated. It was clear during appraisal that a new approach had to be formulated (concentrating on the rehabilitation of the lending institutions) and that considerable improvement in collection performance and in financial strength would be necessary, if the project was to proceed.

10. The appraisal report outlines a number of recommendations to this end, which do not differ substantially from the formula evolved in the Mysore project for rehabilitation of the lending institutions. These recommendations were discussed with the Maharashtra authorities by a follow-up mission last September and a number of satisfactory assurances and commitments have since been received from the State government. The Agriculture Projects Department and I are agreed on the tactics outlined and the degree to which the various recommendations should be pursued during negotiations.

11. The appraisal report recommends as a prerequisite to negotiations, that a program for the reorganization of the LDB acceptable to IDA, be drawn up and necessary measures be taken to establish the financial viability of the LDB and of a sufficient number of PLDBs to ensure adequate project implementation. A detailed plan for the LDB reorganization is being finalized and the State government has confirmed its support of the program and the provision of the necessary funds.

12. The rehabilitation program, which is already being initiated, consists of three inter-related parts, the essential details of which are:

(a) Part I - The determination of PLDBs to be eligible under the Scheme: The appraisal report recommends that all project banks should be viable and no bank with a collection rate of less than 75 percent be allowed to participate in the project. The first step, therefore, was to determine the number of PLDBs which would be eligible or which could be rehabilitated within a reasonable period and whether these would be adequate for project implementation. An analysis by ARC and the LDB shows that of a total of 26 PLDBs (of which 21 are in the project areas), all have overdues of 25 percent or more. The overall average of overdues as at June 30, 1971 was 54 percent; however, a substantial proportion of these overdues is of very recent origin and results from severe drought which affected repayment in 1970/71 in the project areas. The rehabilitation program would initially be limited to the 21 project area PLDBs all of which would be expected to be financially and managerially reorganized by September 30, 1972, the proposed deadline for credit effectiveness.

(b) Part II - The Rehabilitation Program: In order to bring the PLDBs within the proposed criteria of acceptability for project participation, "chronic" overdues (i.e. those deemed irrecoverable, outstanding for three or more years, resulting from non-productive lending such as debt redemption and certain other general lending categories) will be taken out of the balance sheet and transferred to a 'below the line' suspense account. Where such restructuring affects the viability of the Primary Banks, a capital injection in the form of redeemable equity will be provided by the State government. Sufficient evidence is forthcoming from the analysis of overdues already undertaken to offer assurances that such treatment will result in virtually all the banks achieving an overdue level of 25 percent or less. The overdues so treated will remain collectable and, as recovered, will be used to "retire" the share capital contributed by the State government. The sum involved is calculated at about US$5 million, which the State government has undertaken to provide from funds already budgeted and from funds to be provided in the next financial year beginning April 1, 1972. Of this sum, US$1 million is being provided immediately. In addition, there are overdues attributable to the drought amounting as at June 30, 1971 to US$5.6 million which would not be a part of the rehabilitation program since it has been agreed that a new schedule of repayments should be introduced (having the effect of extending due dates), their realization being specifically guaranteed by the State government. Formal assurances on this point would be sought during negotiations. Financial assistance to be provided will be contingent upon the agreement of the banks to appoint managerial and other staff found necessary by a Reserve Bank of India survey, such staff to be under the control of the LDB.

(c) Part III - Measures to avoid recurrence of the overdues position: Plans have also been formulated to improve the overdues position overall, over and above the 25 percent level, which is regarded as only a first, interim benchmark. Coercive action regarding overdues is being taken on a State-wide basis and, to ensure a continuation of this effort at the proper level, it is proposed that any rehabilitated PLDB which, during the life of the project, falls below the requisite collection level of 75 percent should be disqualified from further refinancing under the project. Such action would be taken on the advice of the ARC in consultation with the Association.

13. The success of such a program clearly depends very largely on the ability of the LDB to provide the necessary staffing. Arrangements are being made to train 40 key staff at the RBI Training School in Poona, in project planning and appraisal techniques who, in turn, will train supervisory staff in their field responsibilities. These arrangements appear to be satisfactory and should ensure that adequate staff are available in time for project implementation.

14. The delay in making the project effective inherent in these arrangements (up to 6 months) is unusual, but there are several reasons why it is important that the Association enters into a firm commitment in the fairly near future. The measures taken by the State authorities to meet conditions of negotiations have induced a momentum in the progress of rehabilitation of the banking structure which will be encouraged and accelerated if the project proceeds to Board approval without undue delay. Such a commitment on the part of the Association will also allow project authorities to commence at least partial implementation of aspects of the project which should have the effect of expediting the processing and issuing of loans to farmers once Effectiveness is declared.

Issues

15. Consultancy services: In view of the need of the State Groundwater Directorate, which is to be established, for assistance in the general implementation of the groundwater development including specialist studies, a recommended condition of effectiveness is the appointment of three consultants - a hydrologist, a geophysicist and an expert in water management. In three earlier projects in Southern India (Andhra Pradesh, Tamil Nadu and Mysore) where similar problems concerning groundwater exploitation occur, the Association is financing the recruitment of eight consultants in disciplines related to the exploitation of groundwater resources. During the negotiations held on the Tamil Nadu project, discussions centered on the possibility of pooling consultancy expertise to concentrate on the problems of hard-rock areas of the four central/southern States of Andhra Pradesh, Tamil Nadu, Mysore, and Maharashtra. There are geographical and geological similarities, which make a single integrated consultancy team an economical and desirable proposition. In the event, nothing concrete emerged from these discussions. During the Mysore negotiations, we further explored the possibility of creating such a team, and we should continue to do so. We should need to be satisfied thatsufficient additional necessary expertise was available to the team, possibly from the Central Groundwater Board, which is now in the process of being established, to ensure that farmers' investments in groundwater are protected by proper evaluation and technical assistance. Unless acceptable arrangements for a pool of consultants can be agreed without unduly depleting expertise elsewhere, we would press for the employment of the proposed consultants specifically for the project, as we did in the case of the Mysore project, leaving pooling arrangements to be worked out at a later date, if appropriate.

Interest Rates

16. The appraisal report makes two, not necessarily related, recommendations concerning the interest rate structure:

> (a) The interest rate at which GOI relends the proceeds of the Credit to the ARC should be increased from 4-3/4 percent to 5-1/4 percent for 9 year money and from 5-1/4 percent to 5-3/4 percent in respect of ARC refinancing for 10 years and above but not exceeding 15 years (in each case after deducting 1/2 percent for prompt payment).
>
> (b) The on-lending rate from LDB to the ultimate beneficiaries should be increased by 1/2 percent (from 9 to 9-1/2 percent), independently of any increase which might be passed on as a result of the proposed increase in the lending rate from GOI to ARC.

17. The justification for the first recommendation stems from a recent similar increase in GOI's on-lending rate to ARC for other than IDA funds, and it is felt that such a differentiation in interest rates as between IDA funds and those from the Borrower's own resources is unacceptable. The justification for the second recommendation is based on a judgment that higher interest rates to farmers would help encourage a more rapid mobilization of rural savings. Furthermore, there is some evidence that low interest rates stimulate borrowing by larger producers with more immediate access to institutional credit in preference to lending to smaller producers. It is, therefore, a major constraint to the development of those producers who traditionally have had less easy access to institutional credit facilities. There is also some doubt whether the 2-1/2 percent margin which a 9 percent interest rate allows the LDB is adequate to meet the LDB's increasing costs of appraisal, supervision and collection and, in particular, in the case of Maharashtra, to permit an increased appropriation to reserves. As lending is increasingly extended to smaller holdings, such costs are likely to rise.

18. It may well be that a general upward revision of interest rates under agricultural credit projects at some future date is desirable, but I do not think it appropriate to raise the rate at this juncture and in the context of this project. The ARC refinancing rate was increased only 18 months ago to 6-1/2 percent, and under the five current agricultural credit schemes, downpayments, repayments and interest rates to the ultimate beneficiaries are stiffer than those previously imposed by LDBs. Partly, as a result, the resistance to ARC lending disciplines and more stringent lending terms is increasing and the initial reluctance of farmers to borrow on these new terms may be a factor in the slow disbursement of these earlier credits. This resistance is particularly strong in States so far excluded from IDA

support, where investment conditions are not so favorable. I believe that it is essential to strengthen the banking mechanism and improve the quality of lending in such States where ARC's influence has so far been small, and that these higher priorities should not be prejudiced by the introduction of a higher interest rate at this time.

19. The Maharashtra project, in particular, is the last of a series of four in Southern India and the last in our lending program until FY 73. The State will be having elections to its legislature in the near future and the practicalities of the situation are such that I do not think the present State government could commit itself or its possible successor to a higher rate of interest in this project than that already negotiated in three neighbouring States.

20. It seems to me that the question of the interest rate structure in the agricultural sector is one which should be discussed in a wider context than this specific project. We, or ARC, should examine in some detail the projected cash flows and profitability of selected LDBs to establish what margins are desirable between ARC's refinance rate, that for LDBs, their primaries and the rate to the ultimate beneficiary. In the light of such discussion and research, a considered and agreed attitude towards interest rates could be evolved with the cooperation of the Borrower on a basis which could legitimately be applied for the future to all similar lending. I, therefore, believe, and Agriculture Projects Department concurs, that while the forthcoming negotiations would provide a suitable opportunity to raise the issue, we should not press for an increase in the margins for this particular project, provided that GOI, ARC and other interested parties agree at negotiations to submit a written review of the whole question of the interest rate structure in the agricultural sector by June 30, 1972.

Tractors

21. The appraisal report recommends that the 1,000 tractors requested, mainly for haulage in the sugar cooperatives, should not be financed. The economic case against these tractors seems fairly conclusive. No request for general purpose tractors was included in the original submission by the Maharashtra State government but I suspect that a request for such a component may be made during negotiations. The appraisal report analyses the supply and demand position for tractors in the State and concludes that demand is being met by indigenous supplies and by imports under bilateral arrangements. To some extent, however, in States such as Maharashtra where farm mechanization is in its early stages, demand is a function of the availability of credit and also of the supply position. I would be sympathetic to a request for a small number of tractors if one were to be made during negotiations and if convincing evidence of insufficient availability of tractors were to be produced. This would also avoid a disparity of treatment between Maharashtra and Mysore (in which we have agreed to finance 2,000 tractors). The Agriculture Projects Department has no objection to this proposal.

LDB Loan Limits

22. The appraisal report recommends that the LDB increasesits loan limit from 50 percent to 75 percent of the developed value of land required as security, since it is felt that the present limit could be an unreasonable constraint in the case of farmers with small landholdings.

23. The concept of the "developed value of land" is of fairly recent origin in the lending operations of most LDB's in India. The system which pre-dated it, and which still obtains in some States, was to calculate the collateral value of land after a very conservative and complicated process, involving multiples of land assessment for tax purposes, which usually provided at least 200 percent protection for any loan granted. The shift to the developed value concept was a progressive one and appears to be satisfactory in other States at the 50 percent level.

24. ARC and LDB may argue that 75 percent is unnecessarily high and that the present level does not, in fact, impose constraints on lending. In this event, I should be prepared to consider their arguments, provided that the lower limit based on developed land values does not lead to a reduction in lending in any particular case below the level necessary to finance an investment in its entirety.

Recommendations

25. Subject to the views of the Committee and with the reservations expressed above, I recommend that the Borrower be invited to negotiate the proposed Credit of US$30 million on the basis of the recommendations set out in paragraphs 7.01, 7.02 and 7.03 of the appraisal report.

I. P. M. Cargill
Director
South Asia Department

Attachments

Population: 547 m. (1971 Census - preliminary)
GNP (1970/71) Per Capita: $90

INDIA - FIVE-YEAR LENDING PROGRAM

($ millions)

		Fiscal Year 1972	1973	1974	1975	1976	1977	Total 1964-68	Total 1969-73	Total 1974-77
Agric. Credit - Mysore	IDA	40.0								
Agric. Credit - Maharashtra	IDA	30.0								
Agric. Credit - Bihar	IDA		30.0							
Agric. Credit - Punjab II	IDA		30.0							
Agric. Credit - Madhya Pradesh	IDA		30.0							
Agric. Credit - Uttar Pradesh	IDA			25.0						
Irrigation - Pochampad	IDA	39.0								
Irrigation - Tawa	IDA	43.0								
Irrigation - Jayakwadi	IDA		20.0							
Irrigation - Pamba	IDA		15.0							
Irrigation - Krishna	IDA			30.0						
Irrigation - Kuttiyadi	IDA			5.0						
Grain Storage	IDA	5.0								
Bihar Marketing	IDA	13.5								
Lake Chilka Fisheries	IDA		10.0							
Mysore Marketing	IDA			20.0						
Mysore Fisheries	IDA			40.0						
Uttar Pradesh Forestry	IDA			7.0						
Apple Processing & Marketing	IDA			9.0						
	IDA									
Agric. Unidentified	IDA			25.0						
Agric. Unidentified (10 projects)	IDA				270.0					
Agric. Unidentified (10 projects)	IDA					270.0				
Agric. Unidentified (10 projects)	IDA						270.0			
Telecommunications V	IDA		40.0							
Telecommunications VI	IDA			50.0						
Telecommunications VII	IDA				40.0					
Telecommunications VIII	IDA					40.0				
Telecommunications IX	IDA						40.0			

INDIA - FIVE-YEAR LENDING PROGRAM

($ millions)

(Continued)		1972	1973	Fiscal Year 1974	1975	1976	1977	Total 1964-68	Total 1969-73	Total 1974-77
Education - Agric. Universities	IDA		20.0							
Education Unidentified	IDA				20.0					
DFC - ICICI IX	IBRD	60.0								
DFC - ICICI X	IBRD			55.0						
DFC - ICICI XI	IBRD					50.0				
DFC - IDBI	IDA	25.0								
Fertilizer - Cochin	IDA	20.0								
Fertilizer - Nangal	IDA	20.0								
Fertilizer - Gorakhpur	IDA	10.0								
Fertilizer - Trombay	IDA	15.0								
Fertilizer - Tata	IBRD			25.0						
Iron Ore- Marcona	IDA		40.0							
Industrial Imports VII	IDA	75.0								
Industrial Imports VIII	IDA		75.0							
Industrial Imports IX	IDA			75.0						
Industrial Imports X	IDA				100.0					
Industrial Imports XI	IDA					100.0				
Industrial Imports XII	IDA						100.0			
Small Scale Industry	IDA		20.0							
Industry - Unidentified	IDA			20.0						
Industry - Unidentified	IDA				20.0					
Industry - Unidentified	IDA					20.0				
Industry - Unidentified	IDA						20.0			
Family Planning	IDA	12.0								
Power Transmission III	IDA	60.0								
Power - Unidentified	IDA			50.0						
Power - Unidentified	IDA				60.0					
Power - Unidentified	IDA					60.0				
Power - Unidentified	IDA						60.0			

INDIA - FIVE-YEAR LENDING PROGRAM

($ millions)

(Continued)		1972	1973	Fiscal Year 1974	1975	1976	1977	Total 1964-68	Total 1969073	Total 1974-77
Water Supply - Bombay	IDA		30.0							
Water Supply - Unidentified	IDA			15.0						
Water Supply - Unidentified	IDA				15.0					
Shipping I	IDA	80.0								
Shipping II	IDA		80.0							
Highways II	IDA		30.0							
Railways XI	IDA	75.0								
Railways XII	IDA			45.0						
Transportation - Unidentified	IDA					55.0				
Tourism - Unidentified	IDA				10.0					
Tourism - Unidentified	IDA					10.0				
Unallocated	IDA				20.0		50.0			
	IBRD	60.0		80.0		50.0		159.0	140.5	125.0
	IDA	562.5	470.0	416.0	555.0	555.0	540.0	591.0	1,727.9	2,025.0
	Total	622.5	470.0	496.0	555.0	605.0	540.0	750.0	1,868.4	2,150.0
	No.	17	14	16	18	17	15			
Note: the IDA lending program is to be adjusted to --		420.0	375.0	375.0	540.0	540.0	540.0		1,373.4	1,995.0

FORM No. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

January 6, 1972

MEMORANDUM TO THE LOAN COMMITTEE

India - Bihar Agricultural Markets Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated January 6, 1972 from the South Asia Department, entitled "India - Bihar Agricultural Markets Project" (LC/O/72-6)

2. Comments, if any, should be sent to reach Mr. Thomas (ext. 2294) by 12:00 noon on Wednesday, January 12.

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

Dag F. Wittusen
Secretary
Loan Committee

DISTRIBUTION

Committee:

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

President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Economic Adviser to the President
Special Adviser to the President
Mr. J.H. Williams
Directors, Other Departments and EDI
Meeting Participants (minutes)
Overseas Offices and Missions
General and Loan Committee Files
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/0/72-6

January 6, 1972

LOAN COMMITTEE

Memorandum from South Asia Department

India - Bihar Agricultural Markets Project

1. I attach a draft appraisal report entitled "Appraisal of Bihar Agricultural Markets Project", recommending that the Association make a Credit to India of US$13.5 million equivalent for this project.

Background

2. This project, which was appraised in June-July 1971, would be the Bank Group's first operation in the development of agricultural market centers. Although Bihar is one of the poorest States in India, ongoing programs for extensive irrigation, increased use of fertilizers and high yielding variety seeds, and the expansion of agricultural credit are already resulting in considerable increases in agricultural production. Lack of suitable market facilities and antiquated market systems, however, continue to be constraints to this development, and the present project is an important component in the overall strategy for the improvement of agricultural practices in the State. This opportunity for lending was identified by an IDA mission in February 1971, which assisted agencies responsible in the Government of India (GOI) and in Bihar, in preparation of a proposal.

Bank/IDA Lending Program

3. During the current fiscal year, five Credits to India, totalling US$114.0 million (Pochampad Irrigation, Cochin and Gorakhpur Fertilizers, Wheat Storage and Mysore Agricultural Credit) have already been approved. One other Credit has been negotiated and will be presented to the Executive Directors in the near future (Railway XI US$75.0 million) bringing the total to US$189 million. A Bank loan of US$60.0 million for ICICI was presented to the Executive Directors on October 26, 1971. In addition to the present project, other agricultural or agriculture related projects in this year's IDA lending program are Tawa Irrigation (US$45.0 million), Maharashtra Agricultural Credit (US$30.0 million) and Trombay (US$15.0 million) and Nangal (US$20.0 million) Fertilizer Plants. The lending program also contains proposed projects in Family Planning (US$12.0 million), Shipping

(US$80.0 million), Power Transmission (US$60.0 million), a first credit to the Industrial Bank of India (US$20.0 million) and Industrial Imports (US$75.0 million). A copy of the current edition of the Five-Year lending program is attached.

4. (This paragraph is identical to paragraph 4 of the Area Memorandum on the Maharashtra Agricultural Credit Project LC/O/72-5 of January 6, 1972). The April 1971 economic report on India (SA-25a dated May 11, 1971) described the continuation of many of the encouraging trends observed in the previous year's report - in particular, the further growth of exports and agricultural production. It notes, however, the decline in net aid receipts. Net aid has diminished in the past five years from levels of over US$1 billion a year (of which half was food aid) to US$452 million in 1970/71, of which US$216 million was food aid. Net aid was equal to about 20 percent of net domestic investment in the mid-sixties; it now equals about 8 percent. This fact represents an important potential restraint on future growth and, already, the resulting shortage of resources has been reflected in a shortfall of investment compared to the planned level which seems to be the bare minimum required if India is to achieve a tolerable rate of growth. Since the economic report was written, problems have arisen which have affected the availability of financial resources for economic development in India. The budgetary cost of caring for the refugees from East Pakistan was estimated at approximately US$700 million through the end of the current fiscal year. Towards this figure, the international community has committed a total of about US$250 million equivalent by the time armed conflict between India and Pakistan broke out on December 3, 1971. A final assessment of the refugee cost as well as a judgment of the financial and economic implications of the recent conflict will only be possible further in the future. No doubt, the need for rapidly disbursing development assistance has become more urgent than was indicated in the economic report.

Project Description

5. The proposed project would form part of a GOI program to develop regulated agricultural markets throughout India. It would provide in 50 market towns in Bihar State such facilities as land, entrance roads, office buildings, auction platforms, storage godowns, traders' shops and equipment. The objective would be to reduce market losses; the project would also be instrumental in assisting the Bihar government in the implementation of its Marketing Act. This Act, passed in 1960, so far has not produced significant improvements in agricultural marketing since there is a lack of organizational assistance and physical facilities in which the marketing function could be concentrated.

6. The principal responsibilities for the project would be with a State Marketing Board (SMB), the establishment of which would be a condition of effectiveness. The SMB would have general supervisory powers over the Regulated Market Committees (RMCs) and would be empowered to fix market fees. A further condition of effectiveness would be that the SMB had set the market fee for all regulated markets at 1 percent of produce handled (presently 0.25 percent), in order to generate sufficient income to ensure the viability of the RMCs. The SMB would be the key management agency in planning the development of the markets and their proper operation, and it would have power to take over the operations of any RMC in default or failing to regulate market operations properly.

7. Land would be provided by the State government as its contribution to the project. RMCs would borrow up to 95 percent of the cost of improvements from the State Bank of India (SBI) which would obtain up to 85 percent refinancing from the Agricultural Refinance Corporation (ARC), the channel for IDA assistance. IDA funds would be disbursed to GOI on the basis of 75 percent of the amounts refinanced by ARC under the project. GOI would onlend the IDA funds to ARC at 5-3/4 percent interest repayable over 20 years, (i.e. GOI's standard lending rate to ARC, recently increased by 1/2 percent to the 5-3/4 percent level after the appraisal report was written). ARC would refinance SBI loans at 6-1/2 percent interest, and SBI would lend to RMCs at 9 percent repayable on terms up to 15 years with a two-year grace period.

8. Finance would also be provided for project evaluation by an appropriate institution (such as a university) which would evaluate the marketing function in a sample of towns selected for market development. There would also be provision for training the staff of the SMB at GOI's school at Nagpur operated by the Directorate of Marketing and Inspection.

9. The appraisal report estimates the total cost of the project at US$22.6 million. The proposed Association credit of US$13.5 million would finance about 60 percent of project cost; i.e. the foreign exchange cost of US$5.8 million, (including the cost of construction steel, roofing materials, bitumen, fuel and machinery), and about 50 percent of the local costs, excluding land. This figure may subsequently be rounded out to take into account the recent international currency adjustments.

Benefits

10. Because this project is the Bank Group's first project in the field of agricultural wholesale markets, a new methodology had to be evolved for the assessment of benefits which, for lack of precise data, were difficult to quantify. A complete evaluation must await the information to be produced by the proposed valuation study, but a first analysis shows that of all the possible benefits the following four are probably the most important:

(a) grain quality improvement due to cleaning (estimated at US$3.2 million per annum at full development),

(b) reduction of grain losses from excessive handling and lack of storage and covered auction platforms (US$1.7 million per annum at full development),

(c) savings in municipal budgets through reduction in maintenance and administrative costs following reduced traffic congestion (US$0.12 million per annum), and

(d) induced agricultural production due to the incentive of increased prices realized by farmers.

11. The economic rate of return has been based on the first three of these considerations only, since the fourth is particularly difficult to quantify without information on supply elasticities and possible price increases. The estimated return of 29 percent should be regarded as a minimum; if agricultural production were to increase by 1 percent only, the rate of return would rise to 39 percent.

12. Income distribution effects are also difficult to estimate. Most of the grain quality benefits and a substantial part of the reduction in handling losses should be realized directly by farmers who, as a result would enjoy enhanced incomes. On the other hand, gross receipts of traders would be reduced by their having to give up part of the market fee they now collect; but since their operating costs would be lower and better quality produce would attract higher prices, their profits should increase. The net effect should be to their advantange, as experience elsewhere in India has demonstrated.

13. Another benefit of significance to be derived from the project would be the stimulation of employment by market construction (estimated at 7,500 man-years), plus the secondary employment effects generated by the development of secondary business activities.

Procurement

14. Construction of the market facilities would be phased over five years in some 50 market towns, and each market would be designed in accordance with its unique needs. Because of this diversity over area and time, and because each facility, consisting of simple brick and concrete structures would differ in design, each market sub-project would require a separate contract. Their construction would not, therefore, be suitable for international competitive bidding. Adequate local contractors are available in Bihar.

Issues

15. There are no divergencies of opinion between myself and the Agriculture Projects Department on the project objectives to be achieved or on any other matters of substance. The following issues are raised because they may present problems during negotiations. We are, however, in accord on the extent to which these issues should be pursued in negotiations.

Amendment of the State Marketing Act

16. Amendment of the Bihar Agricultural Produce Markets Act is necessary to permit the creation of a SMB, and the raising of the marketing fee to a minimum of 1 percent of the value of produce marketed. We propose that such amendment should be a condition of Board presentation. State officials expressed a willingness to proceed with such amendments during appraisal, and to ensure that there may be no undue delay, the State government was informed of these requirements by letter on November 29, 1971, and asked to initiate the necessary action. We do not anticipate any problems in this regard, but if the legislative procedures prove to be protracted, and we are satisfied by evidence and assurances produced during negotiations that there are only temporary procedural obstacles to early ratification of the necessary legislation, we might contemplate making the amendment of the Act a condition of effectiveness.

Local Contribution

17. Land acquisition, which is to be the responsibility of the State government, represents about 6 percent of project cost. Some of it is already owned by the State, and in addition, the State has some US$0.2 million available for market development which could be used for this purpose. Local contributions would, however, also be made: 5 percent by Market Committee sub-borrowers, 9 percent by SBI and 20 percent by ARC. Some of these institutions may argue for lesser percentages of contribution, but all of them are capable of generating these resources, and we do not consider that there is a need for any flexibility in our approach to this matter during negotiation, unless we are convinced that, within the overall level, minor adjustments as between contributors are desirable.

Default Risk

18. Some officials in SBI have indicated a desire to have a guarantee of all sub-loans from the State government. We do not recommend such a guarantee, since the SBI should, clearly, carry the default risk as a proper incentive to good appraisal and supervision,

since the projected SBI cash flow is more than adequate to cover the risk, and since there is a need for the bank to develop its role in such agriculturally related schemes without direct reliance on government. We should not, therefore, be prepared to deviate during negotiations from the recommendation of the appraisal team unless new and strong reasons are produced for any change.

Recommendation

19. Subject to the views of the Committee, I recommend that the Borrower be invited to negotiate the proposed Credit of US$13.5 million on the basis of the recommendations set out in paragraphs 7.01, 7.02, 7.03, 7.04 and 7.05 of the appraisal report.

I. P. M. Cargill
Director
South Asia Department

Attachments

Population: 547 m. (1971 Census - preliminary)
GNP (1970/71) Per Capita: $90

INDIA - FIVE-YEAR LENDING PROGRAM

($ millions)

		Fiscal Year						Total	Total	Total
		1972	1973	1974	1975	1976	1977	1964-68	1969-73	1974-77
Agric. Credit - Mysore	IDA	40.0								
Agric. Credit - Maharashtra	IDA	30.0								
Agric. Credit - Bihar	IDA		30.0							
Agric. Credit - Punjab II	IDA		30.0							
Agric. Credit - Madhya Pradesh	IDA		30.0							
Agric. Credit - Uttar Pradesh	IDA			25.0						
Irrigation - Pochampad	IDA	39.0								
Irrigation - Tawa	IDA	43.0								
Irrigation - Jayakwadi	IDA		20.0							
Irrigation - Pamba	IDA		15.0							
Irrigation - Krishna	IDA			30.0						
Irrigation - Kuttiyadi	IDA			5.0						
Grain Storage	IDA	5.0								
Bihar Marketing	IDA	13.5								
Lake Chilka Fisheries	IDA		10.0							
Mysore Marketing	IDA			20.0						
Mysore Fisheries	IDA			40.0						
Uttar Pradesh Forestry	IDA			7.0						
Apple Processing & Marketing	IDA			9.0						
	IDA									
Agric. Unidentified	IDA			25.0						
Agric. Unidentified (10 projects)	IDA				270.0					
Agric. Unidentified (10 projects)	IDA					270.0				
Agric. Unidentified (10 projects)	IDA						270.0			
Telecommunications V	IDA		40.0							
Telecommunications VI	IDA			50.0						
Telecommunications VII	IDA				40.0					
Telecommunications VIII	IDA					40.0				
Telecommunications IX	IDA						40.0			

INDIA - FIVE-YEAR LENDING PROGRAM

(Continued)		1972	1973	Fiscal Year 1974	1975	1976	1977	Total 1964-68	Total 1969-73	Total 1974-77
		($ millions)								
Education - Agric. Universities	IDA		20.0							
Education Unidentified	IDA				20.0					
DFC - ICICI IX	IBRD	60.0								
DFC - ICICI X	IBRD			55.0						
DFC - ICICI XI	IBRD					50.0				
DFC - IDBI	IDA	25.0								
Fertilizer - Cochin	IDA	20.0								
Fertilizer - Nangal	IDA	20.0								
Fertilizer - Gorakhpur	IDA	10.0								
Fertilizer - Trombay	IDA	15.0								
Fertilizer - Tata	IBRD			25.0						
Iron Ore- Marcona	IDA		40.0							
Industrial Imports VII	IDA	75.0								
Industrial Imports VIII	IDA		75.0							
Industrial Imports IX	IDA			75.0						
Industrial Imports X	IDA				100.0					
Industrial Imports XI	IDA					100.0				
Industrial Imports XII	IDA						100.0			
Small Scale Industry	IDA		20.0							
Industry - Unidentified	IDA			20.0						
Industry - Unidentified	IDA				20.0					
Industry - Unidentified	IDA					20.0				
Industry - Unidentified	IDA						20.0			
Family Planning	IDA	12.0								
Power Transmission III	IDA	60.0								
Power - Unidentified	IDA			50.0						
Power - Unidentified	IDA				60.0					
Power - Unidentified	IDA					60.0				
Power - Unidentified	IDA						60.0			

INDIA - FIVE-YEAR LENDING PROGRAM

(Continued)		1972	1973	Fiscal Year 1974	1975	1976	1977	Total 1964-68	Total 1969073	Total 1974-77
						($ millions)				
Water Supply - Bombay	IDA		30.0							
Water Supply - Unidentified	IDA			15.0						
Water Supply - Unidentified	IDA				15.0					
Shipping I	IDA	80.0								
Shipping II	IDA		80.0							
Highways II	IDA		30.0							
Railways XI	IDA	75.0								
Railways XII	IDA			45.0						
Transportation - Unidentified	IDA					55.0				
Tourism - Unidentified	IDA				10.0					
Tourism - Unidentified	IDA					10.0				
Unallocated	IDA				20.0		50.0			
	IBRD	60.0		80.0		50.0		159.0	140.5	125.0
	IDA	562.5	470.0	416.0	555.0	555.0	540.0	591.0	1,727.9	2,025.0
	Total	622.5	470.0	496.0	555.0	605.0	540.0	750.0	1,868.4	2,150.0
	No.	17	14	16	18	17	15			
Note: the IDA lending program is to be adjusted to --		420.0	375.0	375.0	540.0	540.0	540.0		1,373.4	1,995.0

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

January 6, 1972

MEMORANDUM TO THE LOAN COMMITTEE

Rwanda - Mutara Agropastoral Development Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated January 6, 1972 from the Eastern Africa Department, entitled "Rwanda - Mutara Agropastoral Development Project" (LC/O/72-3).

2. Comments, if any, should be sent to reach Mr. Schaefer (ext. 3545) by 3:00 p.m. on Tuesday, January 11.

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

Dag F. Wittusen
Secretary
Loan Committee

DISTRIBUTION

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

Copies for Information:
President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Economic Adviser to the President
Special Adviser to the President
Mr. J.H. Williams
Directors, Other Departments and EDI
Meeting Participants (minutes)
Overseas Offices and Missions
General and Loan Committee Files
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LOAN COMMITTEE LC/0/72-3

MEMORANDUM FROM THE EASTERN AFRICA DEPARTMENT

RWANDA-MUTARA AGROPASTORAL DEVELOPMENT PROJECT January 6, 1972

Introduction

1. The Loan Committee is asked to consider a US$3.0 million IDA credit to the Republic of Rwanda for an agropastoral development project. An appraisal report (No. PA-112) dated November 17, 1971 is attached.

2. The proposed credit would be the second of two Bank Group operations expected in Rwanda in the current fiscal year. A $3.0 million highway maintenance project was submitted to the Loan Committee on December 3, 1971 and is scheduled for negotiations in early January 1972. In June 1970, an IDA credit (196-RW) of $9.3 million was made to finance the construction of a paved road from Kigali to Gatuna on the Uganda border; this was the first Bank Group operation in Rwanda.

3. The proposed Mutara agropastoral development project would be the first in the agricultural sector. Attached is the five-year lending program for the period FY 1972-76. The next projects are scheduled for FY 1974 and would be for education, agriculture and transport.

The Economy

4. An economic mission visited Rwanda in May/June 1971 and its report will be distributed shortly to the Executive Directors. The memorandum to the Loan Committee on the Highway Maintenance Project, dated December 3, 1971 (LC/0/71/132) gave a brief analysis of recent economic developments and a justification for financing externally a high proportion of the cost of projects.

The Project

5. The project was prepared by the Government with the assistance of several missions from the FAO/IBRD Cooperative Program. It was appraised by an IDA mission in June 1971. The project would aim at the agropastoral development of some 48,000 ha of land in Mutara, west of the Kagera National Park in the North of Rwanda, through organized cropping and ranching settlements for about 5,800 families. Present regional land use is characterized by overgrazing, erosion, and encroachment on the National Park lands, due to unorganized settlement by some 3,000 land-hungry farmers and cattlemen. Since Mutara is one of the few relatively unoccupied areas remaining in an otherwise densely populated country, Government has assigned high priority to the project.

6. The project consists essentially of a cropping settlement, about 130 group ranches, and a bull breeding ranch. Cropping settlements for

about 4,300 families would be established on about one fourth of the project area along the lines of successful settlement schemes in Rwanda ("Paysannats"). Settlers would be given 2 to 2.5 ha plots to grow, besides foodcrops, groundnuts and some coffee as cash crops. While land in Rwanda belongs to the state, settlers would have permanent usufruct rights to their plots, contingent upon following specified cropping practices to be supervised by a Project Authority (para. 8). Small group ranches would cover the other three fourths of the project area. A group ranch would consist of a communal grazing area and of a number of cropping plots mainly for subsistence farming to which participants would have permanent usufruct rights. Graziers participating in group ranches would retain ownership of the individual cattle, but all the cattle within a group ranch would be managed as a herd under the supervision, and with the technical assistance, of the Project Authority. The bull breeding ranch would be established in support of the group ranches.

7. The project would provide for: (i) infrastructure, consisting of plot and grazing area layout, road construction, water supply, staff housing, and cattle handling facilities; (ii) technical and marketing services for project participants; (iii) tse-tse fly eradication from the project area; (iv) a study of the feasibility of completely eradicating the tse-tse fly from Rwanda.

Organization and Management

8. The project would be executed by a new autonomous agency - Office du Développement Agropastoral du Mutara (ODAM) - responsible to a Board of Directors composed of the Ministers of Finance, Agriculture, and Planning, the Governor of the Banque Nationale du Rwanda and the Project Director. ODAM would be responsible for the construction and maintenance of the infrastructure, the provision of technical and marketing services, and the supervision of contracts with project participants, including the collection of settlement and grazing fees. ODAM's management would comprise a Project Director, a Ranching Manager, a Marketing Officer, a Chief Development Officer, a Chief Accountant, a Chief Mechanic and a Paysannat Manager. Due to the acute shortage of qualified and experienced Rwandese, all managerial posts except the Paysannat Manager would be filled during a period of three to five years by expatriate personnel whose tasks would include training local counterparts. ODAM's technical staff would mainly comprise veterinary technicians and agronomists who would be seconded by the Government to ODAM. A condition of effectiveness of the Credit would be the enactment of legislation, acceptable to IDA, creating ODAM.

Production and Markets

9. All cash crops and cattle produced under the project would be marketed by ODAM, as agent for the participants. ODAM would collect fees from the sales proceeds for services and facilities provided. Groundnut production would be bought principally by local oil mills. Incremental production of edible oil is estimated at 600 metric tons a year at full

development, which would substitute for about one fifth of present oil imports. The coffee produced under the project, about 175 tons in 1979, would represent only about one percent of Rwanda's present production and is expected to be sold without difficulty. The incremental cattle production would be 750 tons carcass weight a year at full development. A small part would be sold on the domestic market, but the bulk would be exported to the Kivu province of neighboring Zaire, a traditional and growing market for Rwandese cattle. No export difficulties are expected, as the products of the Kivu herd cover only a small part of the local demand and are unlikely to increase substantially. Other markets, Bujumbura (Burundi) and Kinshasa (Zaire) may become accessible after slaughterhouse and cold storage facilities planned for Kigali will have been established.

Proposed financing

10. The total cost of the project net of import duties and taxes is estimated at $3.4 million. The appraisal report is written on the basis that this cost would be covered by an IDA credit of $2.6 million, a contribution of $200,000 by participating graziers, and a Government contribution of $600,000. However, in view of Rwanda's limited public savings potential, the proposed Government contribution would constitute a heavy burden. Such an amount would represent 40% of the Government's total investment budget for 1972. I recommend, therefore, that we provide an IDA credit of $3.0 million and reduce the Government's contribution to $200,000. This would mean that IDA would cover 88% of the total cost of the project excluding duties and taxes. This is appropriate for a country which has to rely on outside financial assistance to ensure most of its basic administrative services. A revised financing scheme is attached as Annex A.

11. The $3.0 million IDA credit would finance the foreign exchange component of $1.7 million (50% of total project cost) and $1.3 million of local currency expenditures. Specifically, it would cover the cost of infrastructure and equipment, project headquartersfacilities, foreign staff cost, and 90% of local staff cost and of ODAM's operating expenses over a five-year period with the exception of veterinary supplies, estimated at $200,000, which would be financed by fees levied on participating graziers. The Government contribution of $200,000 would cover 10% of local staff cost and of ODAM's operating expenses over a five-year period, and 100% of ODAM's working capital requirements. The Government has stated that it would be willing to exempt from import duties and taxes the goods and services imported for the project.

12. The Government would also have the obligation of providing the project area with schools and medical facilities in line with national standards, of making up losses incurred by ODAM as a result of possible defaults in fee payments by participants, and, after the development phase, of seconding to ODAM local staff as part of the Government extension service.

13. The IDA credit would be made to Rwanda. The Government (i) would on-lend the equivalent of $2.2 million to ODAM for 50 years, including a five-year grace period, without interest but with a service charge of 1 3/4% per annum, and (ii) would second to ODAM at no cost to it, during the development phase, foreign experts and local staff costing respectively the equivalent of about $700,000 and $300,000.

14. The Government would repay the IDA credit in part from ODAM's debt service of the proposed subsidiary loan and in part from tax resources. If the full amount of the IDA credit were on-lent to ODAM, and ODAM were required to repay it, the latter would have to raise the level of its fees beyond the maximum that can be expected from project participants in view of their low income even after project implementation ($50 a year) and the fact that for all practical purposes, similar schemes in Rwanda charge no such fees. If the fees were higher, there would be the serious risk that project participants would avoid selling their products through ODAM and that ODAM, in turn, would be unable to collect fees from sales proceeds. However, the project is expected to increase the Government's annual tax revenues by the equivalent of $75,000 per annum. The additional annual tax revenue would more than adequately cover the annual amount required to repay the portion of the IDA credit not recovered from ODAM.

Procurement

15. Goods would be procured as follows: (i) contracts of less than $2,000 equivalent would be placed on the authorization of the Project Director in accordance with normal Government procedures; (ii) contracts between $2,000 and $20,000 equivalent would be awarded after local competitive bidding; and (iii) contracts of more than $20,000 equivalent through international competitive bidding. Project infrastructure development would be carried out by ODAM employing to the extent possible participants in the project. Expatriate staff would be supplied under a contract between the Government and an international management firm.

Benefits

16. The economic rate of return is estimated at 14%. Principal benefits would accrue to project participants, whose cash incomes would be raised four to nine times. Increased beef and groundnut output is also expected to raise significantly the tax revenue collected in the project area. Finally, the country would derive important unquantifiable returns, including the conservation of land and tourist resources, the development of local managerial skills, and the implementation of the principle of fee collection in return for the provision of infrastructure and services.

Recommendation

17. I recommend that the Association invite the Government of Rwanda to negotiate a credit for the Mutara Agropastoral Development Project on the terms and conditions set forth in paragraph 6.01 and 6.02 of the Appraisal Report, in an amount of $3.0 million as recommended in paragraph 10 of this memorandum.

Michael L. Lejeune
Director

Attachments

POPULATION: 3.4M

GNP PER CAP: $ 70

IVA RWANDA - 5 YEAR OPERATIONS AND LENDING PROGRAMS
(BY FISCAL YEAR - AMOUNTS IN $ MILLIONS)

OPERATIONS PROGRAM

			1972	1973	1974	1975	1976
B-RWA-AD-01	INTEGRATED AGRIC.DEVT	IDA			3.0		
B-RWA-AI-02	MARSHLAND RECLAMATION II	IDA				4.0	
B-RWA-AL-01	MUTARA LIVESTOCK	IDA	2.5				
B-RWA-EX-01	EDUCATION UNIDENT. I	IDA			3.0		
B-RWA-EX-02	EDUCATION UNIDENT.II	IDA					4.0
B-RWA-QX-01	TOURISM UNIDENT.	IDA				2.5	
B-RWA-TH-02	ROAD REHAB.GISENGI	IDA			3.0		
B-RWA-TH-03	ROAD MAINTENANCE	IDA	4.0				
B-RWA-XX-01	UNALLOCATED	IDA					6.0

1977

	1964-68	1969-73	1972-76		1972	1973	1974	1975	1976
IBRD				IBRD					
IDA		15.8	32.0	IDA	6.5		9.0	6.5	10.0
TOTAL		15.8	32.0	TOTAL	6.5		9.0	6.5	10.0
NO		3	9	NO	2		3	2	2

LENDING PROGRAM (12/23/70)

	1964-68	1969-73	1972-76		1972	1973	1974	1975	1976
IBRD				IBRD					
IDA		22.8	30.0	IDA	4.0	9.5	3.0	6.5	7.0
TOTAL		22.8	30.0	TOTAL	4.0	9.5	3.0	6.5	7.0
NO		5	9	NO	1	3	1	2	2

RWANDA - MUTARA AGROPASTORAL DEVELOPMENT PROJECT

Proposed Financing

	IDA	Government	Graziers	Total
		(US $ 000)		
Headquarters facilities	280	--	--	280
Staff:				
- Local	270	30	--	300
- Foreign	700	--	--	700
Initial Operating Expenses	450	50	--	500
Working Capital	--	100	--	100
Veterinary Supplies	--	--	200	200
Infrastructure and Equipment	1,240	--	--	1,240
Tse-Tse eradication studies	60	20	--	80
	3,000	200	200	3,400

Form No. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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WBG ARCHIVES

LC/A/72-1

January 6, 1972

NOTICE OF MEETING

A meeting of the Loan Committee will be held on Monday, January 10, 1972 at 3:00 p.m. in the Board Room.

AGENDA

Bolivia - Mining and Metallurgical Sector Report

The Committee will consider the attached memorandum dated January 6, 1972 from the South America Department, entitled "Bolivia - Mining and Metallurgical Sector Report" (LC/O/72-4) and the accompanying sector report (PI-14).

Dag F. Wittusen
Secretary
Loan Committee

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LC/0/72-4

January 6, 1972

LOAN COMMITTEE

Memorandum from South America Department

BOLIVIA - MINING AND METALLURGICAL SECTOR REPORT

Introduction

1. For some years, the Bolivian Government has been seeking Bank Group assistance in the development of the important mining and metallurgical sector. Although this sector contributes only 8-10 percent of Bolivia's GNP, it provides over 80 percent of Bolivia's export earnings. A Bank mission visited Bolivia in February/March 1971 and prepared a sector report (P114) consisting of four volumes. The first volume, which contains the summary of the mission's findings, is attached.

2. The Report identifies the role which the Bank Group could play in the development of Bolivia's mining and metallurgical sector. That role would consist of assisting the Bolivian Government in solving critical sector issues, particularly in the fields of institution building and the design of policies, including the attraction of foreign capital; the Bank Group would also provide financial assistance to the sector for which there is scope and need.

3. The Report is based on discussions with the Bolivian Government which was deposed in August 1971. The new Government, headed by President Banzer, is in the process of designing a new set of policies for the mining and metallurgical sector and has indicated interest in discussions with the Bank Group on the basis of the mission's report.

Main Problems of the Mining and Metallurgical Sector

4. The Report identifies the following major problem areas and defects in the policies and practices in the mining and metallurgical sectors:

(1) lack of a proper balance between the private and public sectors; under the Ovando and Torres (1969-1971) regimes the Government adopted a militantly public sector orientation and resorted to the expropriation of foreign firms. This led to a cessation of foreign investment and sharply reduced domestic private investment. The weak state of Bolivia's public finances, and the dearth of public sector entrepreneurial talent did not, however, allow the public sector to successfully exploit and develop Bolivia's mineral resources;

(2) inadequate appraisal of projects in the public sector; this has led to the preparation and implementation of projects of questionable economic and financial justification such as the Vinto tin smelter and the proposed antimony and zinc smelters. It has failed to foster the identification and development of potentially more beneficial projects such as the recovery of tin tailings and exploiting the iron ore deposits at Mutun;

(3) deteriorating performance of COMIBOL, a government-owned enterprise accounting for about 50 percent of Bolivia's total mineral output. Increasing Government and labor union interference have left COMIBOL's management with little autonomy and flexibility in adopting efficient commercial, financial and technical practices. As a result, financial performance has deteriorated recently, leaving little in the way of profits for exploration and development;

(4) lack of investment in geological mapping, exploration and mineral reserve evaluation; this has resulted in:
(a) the depletion of known reserves to a critically low level; and
(b) the continued working of uneconomic mines.
The lack of this investment has been occasioned by the weakness of COMIBOL's finances, the deterioration in the private investment climate and by the lack of adequate credit facilities;

(5) insufficient availability of credit for both the working and development needs of the medium and small mines, in part the result of an inadequate credit structure;

(6) inadequate functioning of Government institutions, in part due to inter-agency overlapping and rivalry; and

(7) inadequate availability of technical staff and assistance. This reflects, in part, the lack of proper development of training and research institutions in Bolivia and, in part, the antagonism to foreign participation that has prevailed in the recent past.

Remedial Action Required

5. The Report states that the following action is called for in order to improve the aforementioned deficiencies:

(1) clarification of mining legislation, specifying the role to be played by Bolivia's public sector, and by the private sector, both domestic and foreign. This would entail revision of the Mining Code;

(2) institutionalization of pre-investment activities and feasibility studies so that potential projects are carefully scrutinized before investment decisions are taken;

(3) improvement in COMIBOL operations by allowing its management more autonomy, restructuring of COMIBOL by decentralizing operations, and improving its financial performance; this could be accomplished by a negotiated modus vivendi with the mining union which would permit a return to rational management practices, a freeze on the size of the labor force and agreement to limit wage increases to increases in productivity;

(4) reform of the country's credit institutions and initiation of an adequate credit program with support from abroad. This is likely to entail a reorganization of the financial institutions presently operating in the mining sector;

(5) initiation of vigorous and concerted efforts to offset the adverse effects of past neglect of investment in geological mapping, exploration and mineral reserve evaluation, principally through the creation of an Exploration Fund. The Exploration Fund, along with the proposed national survey of small mines, would provide finance on a project by project basis to induce and support much-needed exploration activity;

(6) improving the management of key public agencies and augmenting their technical staff; and

(7) securing technical expertise from abroad, and developing the country's training and research institutions to cater for future needs.

Possible Investment Program

6. In the expectation that the above-mentioned improvements will be commenced at an early stage, the mission recommends that the following projects merit additional study which may lead to consideration by external lenders in the coming five years (1972-1976)

		Total Estimated Cost (US$ million)
Identified Potential Projects		52
Tin Tailings Recovery	10	
Mutun Iron Ore	34	
Regional Facilities	2	
Tungsten Processing	6	
Credit for development of medium and small mines		20
Exploration Fund (including National Survey of small mines)		14
	Total	86

In addition, the Report proposes institutional reorganization and preinvestment studies involving an expenditure of about US$300,000. The mission expects that these pre-investment studies, in combination with projects likely to materialize from the proposed exploration program, would result in further projects warranting additional investments of anywhere between $35-80 million.

Proposal for hydrocarbon exploration

7. In November 1971 the Minister of Hydrocarbons and Electric Energy wrote to the Bank requesting assistance in securing the risk capital and expertise required for oil and gas exploration. The Minister envisages a Government-supported fund, with Bank Group participation, on the lines of the fund for mineral exploration proposed in para.5 above. We feel the proposal deserves further study and consideration. The Industrial Projects Department has, however, reservations about the utility of pursuing this proposal.

8. The Industrial Projects Department feels that Bank Group support of hydrocarbon exploration is not justified because:

(1) oil and gas exploration is financed by the major oil companies in all parts of the world and should readily be available in Bolivia given suitable arrangements between the Bolivian Government and oil companies;

(2) funds needed for hydrocarbon exploration are many times larger than those needed for mineral exploration and the small amount of funds that the Bank Group would put up would not provide real impetus to hydrocarbon exploration;

(3) mineral exploration and hydrocarbon exploration are technically diverse fields and should be separated both administratively and technically;

(4) promoting hydrocarbon exploration in conjunction with mineral exploration would detract from the administrative and other reforms needed in the mineral sector;

(5) no facts have been produced to show that oil and gas exploration in Bolivia should be treated differently or deserve special consideration from the Bank Group as opposed to other member countries.

9. The South America Department takes the view, which is shared by the Bolivian Government, that the history of the nationalization of Gulf properties in Bolivia, coupled with Bolivia's unparallelled record of frequent changes in government, makes it extremely doubtful whether the major international oil companies would be ready to undertake exploratory activities in Bolivia on their own, even if the Government were to be prepared, as it presently is, to offer generous incentives for doing so. The realities of the situation in Bolivia are now such that public opinion will not tolerate the admission of international companies except in partnership with the Government, even if the Government's financial contribution is only token. Foreign oil companies are, therefore, likely to feel much more at ease if they can come in under some arrangements which in advance reduce the risk of future political attacks. We feel that the proposed Hydrocarbon Exploration Fund operating along the lines indicated in para. 11(4) above would be a suitable vehicle to accomplish such arrangements without placing great burdens on the Government's finances.

External Financial and Technical Assistance for the Mining Sector:

10. Between 1961 and 1970 a massive program of assistance, financed by USAID, IDB, a group of German banks and to a lesser extent Argentina, provided about US$42 million for the development of the public mining sector. USAID also provided about US$6 million credit to the small mining sector between 1964 and 1968 and is presently financing a study of industrial projects which covers feasibility studies of the Mutun iron ore and the tungsten processing projects. The UNDP promoted a pilot mining survey (US$1.4 million) in 1961, assisted in establishing the Instituto de Investigaciones Minero - Metalurgicas in 1965 and is presently engaged in investigations regarding the Mutun iron ore and manganese deposits. The medium mining sector has relied primarily on private financing and suppliers' credits but about US$7 million equivalent were provided by the IDB through the Corporacion Boliviana de Fomento.

Recommended Bank Position

11. We propose that the Bank Group enter the sector with the objective of improving sector performance and providing some of the external financing required. We believe this should be done in a systematic way. As a first step, we would have discussions with the Bolivian Government and, to the extent possible and necessary, with other foreign lenders during which we would indicate the following:

(1) if we can reach agreement on a specific and time-phased program of action, we would begin active preparation and, in due course, appraisal of some of the projects listed in paragraph 6, above. This would be consistent with our current five-year lending program which includes two IDA operations of US$8 million each;

(2) we expect to play an active role in the initiation of adequate credit programs and the development of an investment program for the sector;

(3) prima facie the building up of one institution as the channel for all credit to the mining sector seems desirable. This would best ensure the accumulation of expertise and experience in the appraisal of mining projects. In order to be effective under Bolivian conditions, such institution would probably have to be controlled by the Government but it should also have a substantial participation by the private sector. Setting up such an institution is likely to entail major policy decisions and possibly far-reaching reorganization of the financial institutions presently operating in the mining sector. If the Government

were to agree in principle to entering with the Bank Group into an intensive dialogue on new and mutually acceptable institutional arrangements for the channeling of credit to the mining sector, we would dispatch an additional mission to work out the details; and

(4) as regards the proposed mineral Exploration Fund, given our assessment of Bolivia's fiscal prospects, we do not consider it prudent or possible for the Government to commit itself to substantial budgetary expenditures on exploration in the near future. In these circumstances, we conceive of the Exploration Fund as playing essentially a catalytic role. For the larger and medium enterprises the Fund would perhaps cover only very basic early expenditures in individual exploration schemes and later on make only a relatively small contribution to the further execution of these schemes by private domestic and foreign companies. Even limited participation of the Government-sponsored Exploration Fund would however be significant, being a token of Government support and protection of private exploration activities, and it would also hopefully spark off a flow of funds from abroad for this purpose. Prima facie it appears desirable that the aforementioned new institutional channel for financial credit should also be responsible for the financial management of the Exploration Fund. This would assure an economic use of scarce Bolivian talent and more intensive coordination of exploration and financing activities. If the Government were to establish the Fund within a framework acceptable to the Bank Group we would be prepared to consider lending to the Government to help finance the activities of the Fund. We would also, if the Committee agrees, similarly pursue the possibility of establishing a parallel fund to cover the requirements of the hydrocarbon sector.

12. The prospects for arriving at an understanding with the Government along the above lines appear favorable. The present regime which came into power in August 1971 is about to arrive at a settlement regarding the nationalization of the IMPC tin tailings recovery project. It is also reported to be actively pursuing the settlement of the Mina Matilde expropriation. A new Investment Code providing opportunities and security for domestic and foreign private investment has been promulgated recently. The new Government has also declared that it proposes to amend the Mining Code so as to attract private capital and encourage foreign investment in the sector.

13. In summary, I recommend that the Bank Group:

(1) distribute the Report to the Bolivian authorities and also to other possible financing agencies, especially the IDB, AID and UNDP;

(2) use the Report as a basis for conducting a dialogue with the Bolivian authorities along the above lines; and

(3) aim at agreeing with them on a satisfactory program of policy action as outlines in paragraph 5.

14. If we can secure general acceptance of the recommendations in the Report from the Government and reach agreement on the program of policy action, I recommend that we:

(1) associate ourselves with the preparation of credit and investment programs along the lines indicated in paragraph 9;

(2) initiate discussions on, and subsequently associate ourselves with, the proposed mineral Exploration Fund; and

(3) initiate discussions on, and pursue the feasibility of associating ourselves with the Government proposed Hydrocarbons Exploration Fund.

Gerald Alter
South America Department

Form No. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

January 3, 1972

MEMORANDUM TO THE LOAN COMMITTEE

People's Republic of The Congo - First Railway Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated January 3, 1972 from the Western Africa Department, entitled "People's Republic of The Congo - Proposed Credit for a First Railway Project" (LC/0/72-1).

2. Comments, if any, should be sent to reach Mr. Leduc (ext. 4740) by 10:00 a.m. on Friday, January 7.

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

Dag F. Wittusen
Secretary
Loan Committee

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CONFIDENTIAL

LC/O/72-1

January 3, 1972

LOAN COMMITTEE

Memorandum from the Western Africa Department

PEOPLE'S REPUBLIC OF THE CONGO
Proposed Credit for a First Railway Project

Introduction

1. The Government of the People's Republic of Congo, hereinafter referred to as the Congo, has asked for IDA assistance in financing a railway project for the Congo-Ocean railway (CFCO), a section of the national transport agency, Agence Transcongolaise des Communications (ATC). This project would be the sixth Bank/IDA operation in Congo and the second one proposed for FY 72.

2. Projects already financed are:

(a) in FY 67, a US$30.0 million loan to the Compagnie des Potasses du Congo (CPC) for the opening of a potash mine (480 COB);

(b) in FY 69, a US$630,000 Highway Engineering Credit (S-6 COB);

(c) in FY 70, a US$1.5 million Highway Improvement Credit (189 COB); and

(d) in FY 71, a US$3.5 million Education Credit (237 COB).

A US$4.0 million Highway Maintenance credit, including the refunding of (b) above, was signed on December 22, 1971. The current five-year lending program is attached.

3. Bank support for improved transport services in the Congo will continue to be the cornerstone of our lending and is essential to future agricultural and forestry development. It is also important for external lending to help directly in the development of agriculture. Project identification and preparation is under way and we hope to appraise a livestock project early in 1972.

The Economy

4. An economic report entitled "The Economy of the People's Republic of Congo - Recent Evolution and Prospects" (AW-26a, dated November 18, 1971), based on the June 1970 mission and subsequent discussions, was circulated to the Executive Directors on December 3, 1971.

5. The report concludes that the dominant feature of the Congolese economy is its position as a regional transport center. The bulk of the Transequatorial Route, a road-river-rail network from Chad through Central African Republic (CAR) to the sea port of Pointe Noire, is located in Congo. Transit is about 80 per cent of traffic at the river port of Brazzaville and about 64 per cent at the port of Pointe Noire, Congo's only sea port. Some 60 per cent of rail traffic is also transit. There is no economically justified alternative route for traffic from the CAR, Southeastern Cameroon, Southern Chad, and Southern Gabon in the medium term. Increasing the capacity of the Transequatorial Route is basic to the strengthening of this transit role, the increase of national and regional timber exports, and the success of further possible investments in livestock, agro-industries, and mining.

6. In 1969 the Government withdrew from the convention establishing the Agence Transéquatoriale des Communications (ATEC), a multi-national transport agency jointly established with the CAR, Chad, and Gabon to operate and maintain the facilities of the Transequatorial Route. The Government took over ATEC's facilities located on its territory and set up ATC with financial autonomy and guided by commercial principles to run them. ATC is organized in three self-contained operating sections: the port of Pointe Noire; the railway from Pointe Noire to Brazzaville (CFCO); and river transport on the Congo and Oubangui rivers. It is continuing transport services to the former ATEC partners under a series of bilateral agreements which have led to satisfactory cooperation.

7. As stated in the economic report, growth prospects in the Congo depend mainly on:

(a) Congo's ability to generate again significant public savings;
(b) reorganization and reduction of losses of state enterprises;
(c) continued ability of ATC to provide reliable and efficient service for the country and its neighbors;
(d) improvement of the process of planning and allocating resources in relation to a rational set of priorities in the productive sectors;
(e) adaptation of education to the manpower needs of the economy; and
(f) continued attraction of foreign private investment within the framework of a mixed economy.

8. Budgetary performance deteriorated considerably in 1970 and 1971. The actual deficit in 1970 amounted to CFAF2.1 billion on current account, or 14.5 per cent of total revenue, and CFAF3.6 billion overall, or 25 per cent of total revenue. Increasing recurrent expenditures for large public investments, the inherited problem of an inflated bureaucracy, and large capital expenditures on state enterprises were the major reasons for the budgetary deficit. Serious financing problems necessitated the use of all available treasury resources, including maximum drawings on the Central Bank. Declining imports of capital goods and import-substitution resulting from the Government's industrial investment effort have also had a considerable effect on import tax receipts, one of the Government's most important sources of revenue. The Government is aware that further increases in expenditures for personnel will have to be limited and additional measures to increase public revenues are being taken.

9. Congo's development prospects are better than those of many African countries, because of its endowment with natural and trained human resources. In view of favorable petroleum and timber export prospects, and assuming an inflow of public external capital at current levels, the balance of payments in the near future will be manageable if the level of imports is kept under control. However, even with a sustained effort to generate public savings, the Congo will have to rely heavily on external assistance to sustain an adequate rate of growth. Total public savings for the five-year period 1971-1975 are estimated at CFAF16 billion, or 22 percent of the investments which our mission thinks could be implemented during the same period.

10. Congo's creditworthiness is presently constrained by the high debt burden which accounts for 22 per cent of merchandise exports and net service receipts and almost 20 per cent of government revenues, if government guarantees are considered as debts, and 12 per cent of the former and almost 10 per cent of the latter, if such guarantees are excluded. External assistance should therefore be on concessionary terms and include a high percentage of project cost.

The Project

11. The attached report "Appraisal of a First Railway Project - Congo (Brazzaville)" (PTR-98), dated November 9, 1971, appraises a project to help CFCO satisfy the long-term requirements of increased traffic created by the development of timber, mineral, and other resources in a large area of Equatorial Africa. The issues for the Committee's attention are summarized in para. 26 below.

12. The project comprises the 1972/73 portion of CFCO's 1971-1975 Investment Plan, and is essentially an interim operation designed to prepare the ground for a larger project, the realignment of the mountainous Holle-Dolisie section (110 km), which is the major bottleneck of the railway.

13. The project cost is US$23.8 million, with a foreign exchange component of US$17.6 million, of which US$5.6 million would be financed by the proposed credit and the balance of US$12.0 million by other sources (para. 19). Local costs of US$6.2 million equivalent would be completely met from CFCO's own resources. The proposed credit would finance almost 25 per cent of the project, namely:

(a) the acquisition of freight cars (US$4.04 million);
(b) the foreign exchange cost of the final engineering of the Holle-Dolisie realignment (US$1.33 million); and
(c) a traffic costing study (US$0.23 million).

The proposed credit is 89 per cent of the total cost of these three items (but only 9 per cent of the total cost of CFCO's 5-year plan). During negotiations, we will adjust the cost estimates, which are based on pre-August 15, 1971 exchange rates, and review accordingly the amount of the credit.

14. The Congolese Government would relend the proposed credit to ATC for a term of 25 years, including a 4-year grace period and a 7-1/4 per cent interest rate. ATC is a well-managed institution reinforced by French technical assistance. Its three operating sections (see para. 6) are autonomous in their operations and self-contained in their finances but are linked by ATC's policy of internal financial solidarity, whereby the surplus of one section may be used to meet the deficits of others.

15. ATC's balance sheet for 1970, the first year of its operation, shows a satisfactory position, with a liquidity ratio of 1.4, a current ratio of 2.4, and a debt/equity ratio of 13/87. There is no reason to believe that ATC will have any financial difficulties in the future. However, we are not in a position to make the detailed forecasts of ATC's finances that are needed to document our judgment that this entity is creditworthy for the level of borrowing envisaged in its 1971-1975 investment plan. The necessary information has been requested and will be provided by ATC during negotiations. The grey cover report will contain a fuller coverage of this aspect of the appraisal. Assurances will be sought from ATC at the time of negotiations that the 5-year plans for each of the sections, including CFCO, are capable of being financed by the external loans arranged or in prospect and by the net cash flow expected from operations. I would envisage that such assurances would be incorporated in a separate letter of understanding, and not in the credit agreement itself. Agreement will be sought that no change in ATC's 1971-1975 Investment Plan involving the equivalent of US$0.5 million or more on any item will be made without prior consultation with the Association.

16. The appraisal report concentrates on an evaluation of the CFCO, which is the largest of ATC's sections, with assets amounting to 2/3 of the total, and net contributions to total profit in the same proportion or higher. Freight traffic on the CFCO, including transit traffic from the COMILOG manganese mine located in Gabon, more than doubled in 1960-1970. In 1970 traffic amounted to 3.1 million tons and is estimated at

5.3 million tons in 1975, and 6.3 million tons by 1985. The ongoing and proposed expansion for the 1972/73 period will bring the railway capacity in the critical export direction up to about 4 million net tons per annum for a short period, just about sufficient to meet forecast export traffic for 1975.

17. The feasibility of increasing CFCO's capacity, especially on the critical Holle-Dolisie section, has been investigated by Tecsult International (Canada), in association with Canadian National Railways. These services are financed by the United Nations Development Program (UNDP) with the Bank as executing agency. The consultants have completed their field work and the draft final report is due in February 1972. Three alternative solutions have emerged from this study:

(a) realign the Holle-Fourastié section, and build a new southern route from Fourastié to Moukondo near Dolisie;

(b) improve track and communications on the existing line between Holle and Dolisie; and

(c) partially improve the existing line between Holle and Dolisie and build the new southern route when capacity is reached, around 1983.

A Bank review of the consultants' interim report, as stated in the appraisal report, concludes that the alternative (a) above is the best technical and economic solution and that the final engineering for this alternative should be carried out as soon as possible. This would provide an early solution of CFCO's capacity problems and the retention of the same consultants to proceed with the final engineering immediately upon completion of the feasibility study.

18. The interim project is economically justified and well devised for the integrated economic development of the Congo and neighboring countries. The rate of return on acquisition and replacement of rolling stock is about 18 per cent. The economic benefits of the ultimate realignment project are calculated to yield an internal rate of return of about 40 per cent and therefore justify undertaking the final engineering. Alternative regional routes can be foreseen as possibilities in the long term only; should the COMILOG traffic be directed to another route by 1980, the project would still yield an 18 per cent rate of return. During negotiations, we will ensure that the Government does not construct any major road between Pointe Noire and Brazzaville, which would duplicate ATC's facilities, without a feasibility study and the Association's comments on this study.

19. ATC is presently negotiating the financing of the remainder of the project with other donors, comprising the French Caisse Centrale de Coopération Economique (CCCE) and Fonds d'Aide et de Coopération (FAC) for a total of US$9.8 million, and the People's Republic of China for the balance of US$2.2 million. During negotiations, assurances on the availability of these funds will be sought and we would also ensure that

the Government and ATC will make funds available as may be necessary to complete the CFCO project, including coverage of any possible cost overrun.

20. The appraisal report recommends that the signing of the loan agreements with FAC/CCCE be a condition of effectiveness of the proposed credit (Appraisal Report, para. 6.09). To do so, would delay the beginning of final engineering and the costing study. Both should start in early 1972 and are unrelated to the equipment which the CCCE loans would provide in conjunction with IDA-financed equipment. I therefore propose - and Transportation Projects Department agrees - that signing of CCCE loan agreements be only a condition of withdrawal of the funds allocated to the purchase of freight cars (item (a) of para 13 above).

21. As mentioned, the project is part of CFCO's 1971-1975 Investment Plan amounting to almost US$80.0 million. The plan will be reviewed and agreed on during negotiations, subject to a final decision on the realignment after completion of the final engineering. When discussing the financing of the plan during negotiations, we will again ask the Government and ATC about the possibilities of obtaining capital contributions and/or a guarantee of minimum traffic from COMILOG and adjoining countries.

22. Since our lending program is already substantial in absolute and per capita IDA terms, we are declining the Government's request to finance a river transport program for 1972-1975 amounting to about US$9 million. We recognize, however, that river navigation investments are essential and should be met as needs arise. Indeed, the present project requires some expansion of river facilities. The Government has also approached the African Development Bank for its 1972/73 program and PMWA might help work out a comprehensive river transport program for the period after 1975 when the realignment of the railroad will hopefully be completed. We will review these questions with the Government and ATC during negotiations to insure that river transport capacity keeps step with that of CFCO.

23. During negotiations, we will also obtain assurances that ATC will improve its accounting techniques, that auditors satisfactory to the Association will carry out the annual audit, that the Government will reduce its debt to CFCO, that CFCO will reach a 6 per cent financial rate of return on average net fixed assets in use in the period 1972-1975, and that satisfactory programs for training professional staff and improving workshop facilities will be carried out.

24. We have told the Government that including the final engineering of the Holle-Dolisie section in the proposed credit would not commit the Bank to participate in the ultimate implementation of the US$40.0 million project. However, our lending program does include a US$5.0 million contribution in FY 74 for this realignment. A final decision on the realignment cannot be made before the technical details and cost estimates are

specified in the proposed final engineering. This decision also depends on the annual growth rate of timber traffic, at present estimated at 19 per cent for 1970-1975, and 17 per cent for 1975-1980, which we could better assess in two or three years, when the proposed project is completed. By that time, we should also have a clearer idea of the amount of public revenues created by off-shore petroleum production, and therefore of the Government's possible contribution to financing the realignment.

Investment Disputes

25. Apart from the establishment of ATC, the Government has undertaken a number of nationalizations. The status of settlement efforts is as follows:

(a) Société Equatoriale d'Energie Electrique (SEEE) -- Agreement has been reached:

(b) Union Electrique d'Outre-Mer (UNELCO) - The Government has recognized the principle of compensation, but agreement has yet to be reached on the valuation of assets;

(c) Compagnie Africaine des Services Publics (CASP) - The Government has similarly recognized the principle of compensation, but agreement has not yet been reached on the valuation of assets;

(d) Compagnie Générale de Transports en Afrique Equatoriale (CGTAE) -- The Governments of the Congo and CAR, who both nationalized CGTAE, have reached a common position. The outstanding issues concerned the valuation of the assets of the Company, benefits for Headquarters' staff, and the terms of payment of compensation. Discussions between the Congo, CAR, and the Company were resumed in February 1971, and another meeting was planned for November 1971. We understand agreement has now been reached; and

(e) Société Industrielle et Agricole du Niari - Société Sucrière du Niari (SIAN-SOSUNIARI). The Government has endorsed the outstanding debts. Agreement has been reached with CCCE on the payment of all obligations and with Compagnie Française d'Assurance pour le Commerce Extérieur on short-term debts. The Government has recognized the shareholders' right to compensation. Before negotiations between the two parties can begin, the Company has to submit financial data and balance sheets up to September 25, 1970, the date of nationalization.

The Bank will continue to follow closely the progress made in the settlement of these investment disputes.

Issues

26. The Committee's attention is called to the proposed position on the following:

(a) Assurances about the financing of ATC's Investment Plan for 1971-1975 (paras. 15, 19, and 21);

(b) The proposed limit to ATC's changing its Investment Plan without consulting with the Association (para.15);

(c) Assurances on the Government's not duplicating ATC's new investments with paralell road facilities (para.18); and

(d) The goal of a 6 per cent financial rate of return for CFCO (para. 23).

Recommendation

27. I recommend that the Government of the People's Republic of the Congo be invited to send representatives to Washington to negotiate a credit of US$5.6 million on the terms and conditions summarized in paragraphs 7.01 to 7.03 of the Appraisal Report, with the qualification of paragraph 13 above regarding project cost and the change suggested in paragraph 20.

Bruce M. Cheek
Deputy Director

Attachments: Appraisal Report
Lending Program

December 30, 1971

POPULATION: .9M

GNP PER CAP: $ 230

IVA CONGO B - 5 YEAR OPERATIONS AND LENDING PROGRAMS
(BY FISCAL YEAR - AMOUNTS IN $ MILLIONS)

OPERATIONS PROGRAM			1972	1973	1974	1975	1976
7-COB-AL-01	LIVESTOCK	IDA		2.0			
7-COB-TH-03	ROAD MAINTENANCE	IDA	3.4				
7-COB-TH-04	ROADS II	IDA				4.0	
7-COB-TR-01	RAILROAD ENGINEERING	IDA	5.6				
7-COB-TR-02	RAILROAD CONSTRUCTION	IDA			5.0		

	1964-68	1969-73	1972-76
IBRD	30.0		
IDA		16.6	20.0
TOTAL	30.0	16.6	20.0
NO	1	6	5

	1972	1973	1974	1975	1976
IBRD					
IDA	9.0	2.0	5.0	4.0	
TOTAL	9.0	2.0	5.0	4.0	
NO	2	1	1	1	

LENDING PROGRAM (3/ 9/71)

	1964-68	1969-73	1972-76
IBRD	30.0		
IDA		14.6	18.0
TOTAL	30.0	14.6	18.0
NO	1	6	5

	1972	1973	1974	1975	1976
IBRD					
IDA	7.0	2.0	5.0	4.0	
TOTAL	7.0	2.0	5.0	4.0	
NO	2	1	1	1	

Form No. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

January 3, 1972

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MEMORANDUM TO THE LOAN COMMITTEE

Nicaragua - Water Supply Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated January 3, 1972 from the Central America and Caribbean Department, entitled "Nicaragua - Proposed Loan for Water Supply" (LC/O/72-2).

2. Comments, if any, should be sent to reach Mr. Gonella (ext. 4641) by 12:00 noon on Friday, January 7.

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

Dag F. Wittusen
Secretary
Loan Committee

DISTRIBUTION

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Mr. J.H. Williams
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General and Loan Committee Files
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CONFIDENTIAL

LC/O/72-2

January 3, 1972

LOAN COMMITTEE

Memorandum from Central America and Caribbean Department

NICARAGUA - Proposed Loan for Water Supply

1. Attached is a report entitled "Appraisal of the Second Managua Water Supply Project - Nicaragua", dated December 15, 1971 (No. PU-82), recommending a Bank loan of \$6.9 million to Empresa Aguadora de Managua. The five-year lending program, reviewed by Mr. Knapp in November 1971, is also attached.

Background

2. The World Bank Group has made fifteen loans to Nicaragua totalling \$59.9 million and a credit of \$3 million (net of cancellations). The last operation, a \$15.3 million loan for power, was concluded in June 1968. There were no new loans in 1969-70 because of Nicaragua's unsatisfactory economic policies. After the Government took corrective fiscal and monetary measures in May 1970 (see paragraph 8), it was decided, at the CPP review in February 1971, that "in view of the 1970 improvement, we should slowly resume our lending." For FY1972 the lending program includes also a loan of a tentative amount of \$18 million for an eighth power project, appraisal of which is being completed.

3. As of November 30, 1971, a total of \$6.8 million remained to be disbursed on two loans, one for education and one for power. Execution of the education project has been delayed by initial financing and management problems, which seem now to be solved. Although we expect disbursements to pick up over the next few months, the closing date of June 30, 1973, will have to be extended. The power project is expected to be completed on time, although some delays resulted from unsatisfactory performance of a foreign contractor.

4. The proposed project would be the second one for water supply in Nicaragua. In 1962 a \$3 million IDA credit financed a first water supply project, which was completed satisfactorily by Empresa Aguadora de Managua in 1966.

5. Institutional changes are now underway in Nicaragua. Congress was dissolved in August 1971, and some legislative powers were granted to the President. In February 1972 a Constituent Assembly will be elected to prepare a new constitution by early 1974. The Constituent Assembly is

expected to nominate a three-man Junta (including a member of the opposition) which would exercise executive power as of May 1, 1972. Presidential elections are expected to be held in mid-1974. During negotiations we intend to review the constitutional implications of these changes, and explore in detail the Government's authority to guarantee the loan under the current institutional conditions and what additional action, if any, is needed for this purpose. No major variations in economic policy are expected to arise from these institutional changes. President Somoza is expected to remain the chief policy-maker after the end of his term in April 1972, and to be a candidate for President in 1974.

The Economy

6. A report entitled "Current Economic Position and Prospects of Nicaragua" was distributed to the Executive Directors on April 27, 1971. It noted that during most of the sixties Nicaragua's economy expanded rapidly (about 10 percent annually), with per capita income growing twice as faster as the rate of population growth. Between 1967 and 1970, however, cotton production fell sharply, after extension into marginal lands had created unmanageable pest control problems. The cotton decline was to some extent offset by rapid growth of new exports, particularly meat to the United States and manufactures to the Central American Common Market, but per capita income stagnated. The growth of GDP recovered in 1970, mainly because of increased coffee prices and stepped up sales of manufactures to Honduras and Costa Rica. In 1971 the expansion of the economy was modest, in spite of a marked recovery of cotton exports, as coffee prices and regional exports declined. Over the next few years the real growth of GDP is unlikely to exceed 5 percent annually because of limited export prospects for cotton, coffee, beef and manufactures, but, if a longer view is taken, Nicaragua's ample unexploited resources offer the possibility of sustaining a considerably faster growth rate.

7. The Government is increasingly aware of the need to diversify and strengthen the economy and, perhaps more than other Central American Governments, is striving to create a suitable administrative framework. A new Planning Office, established in April 1971 and enjoying substantial political support, is working on a five-year development plan for 1972-1976. An efficient project preparation unit is being developed within the Central Bank with assistance from consultants. This unit is concentrating its efforts on projects in agriculture and industry, in agreement with the Government's policy of placing increasing emphasis on the development of directly productive sectors. The Government also intends to maintain a sizeable investment level in social infrastructure, especially in education and water supply, two sectors which the Bank plans to support with financing.

8. During the last two years the Government adopted fiscal and monetary policies aimed at arresting a sharp fiscal and balance of payments deterioration which the cotton crisis and inadequate policies had brought about in 1966-68. In 1970 the Washington-based agencies, led by the IBRD

and CIAP, impressed upon the Government the need to adopt more realistic monetary policies, and to mobilize additional public savings. In May of that year the Government introduced a 5 percent general sales tax and raised interest rates to levels more in line with those of the world money markets. As a result, government current revenues increased sharply in 1970 (17 percent) and continued to grow substantially in 1971 (10 percent), while the growth of current expenditures was contained at about 6 percent in each year. Central government savings increased from $5.4 million equivalent in 1969 to $12.7 million in 1970 and are expected to grow by about one-third in 1971. Total public sector savings recovered from roughly 2 percent of GDP in 1969 to 3 percent in 1970, public investment rose from about 4 percent of GDP in 1969 to 5 percent in 1970, and the gap was financed from official external loans. The Government plans to introduce in 1972-73 new tax measures designed with assistance from the IMF.

9. Nicaragua's balance of payments also improved. Net international reserves - negative in 1969 - increased by $14 million in 1970, thanks to increased foreign exchange earnings from coffee and manufactures, the slower growth of imports and a stepped up inflow of foreign capital to the public sector. Net reserves are expected to increase further by $10 million in 1971 to $22 million at the end of the year. This level, equivalent to about 4 weeks current payments, is still low in view of the cyclical instability of Nicaragua's exports.

10. Nicaragua's debt service ratio increased from about 4 percent in 1965 to 10 percent in 1970, following a substantial increase in short- and medium-term borrowing from foreign commercial banks in 1967-68. The present debt service level is fairly high. However, the Government intends to lengthen the maturity structure of the debt and, as part of a stand-by arrangement being negotiated with the IMF, has agreed to set a limit to new external borrowing with maturities of less than 12 years. Accordingly, the debt service ratio is expected to decline after outstanding shorter term external liabilities are repaid over the next three years or so.

11. At the end of 1970 IBRD/IDA's share of Nicaragua's debt service payments was about 13 percent, and liabilities to the Bank Group represented only 18 percent of debt repayable in foreign currencies, which totalled $224 million including undisbursed balances. About 62 percent of this debt was owed to international organizations and to USAID at long terms. If the recent fiscal improvement is sustained and the authorities curtail medium- and short-term borrowing, Nicaragua should remain creditworthy for substantial amounts of additional long-term borrowing at conventional terms.

The Project

12. The project is the second stage of a long-term program started in 1963 to expand the water supply system of Managua, the capital of Nicaragua. The project envisages the construction of 7-8 wells to increase water supply from an average of 22 million gallons per day to 33 million; expansion of transmission, distribution, pumping and storage facilities; construction of a new administration building; and consultants' studies for management improvement. The estimate of total cost ($10 million) has been reviewed in light of recent adjustments of exchange rates and market prices, and is considered adequate. The proposed Bank loan of $6.9 million would be for 24 years, including a 3-1/2 year grace period. It would finance the estimated foreign exchange cost of the project, but it would not include interest and other charges during construction. The proposed loan amount includes $200,000 for the administration building, on the assumption that the borrower will be responsive to recommendations we have made to keep the building's specifications and cost within the limits of functional needs. We intend to review this matter during negotiations. If agreement cannot be reached, we would exclude the building from Bank financing.

13. The project is necessary to meet Managua's needs over the next decade. Demand for water in Managua is expected to grow, as in the past, at about 8 percent per year, as a result of population growth in the city (about 6 percent per year), increased share of population served (from 72 percent in 1971 to 81 percent in 1984) and a modest increase of per capita consumption. The latter, at about 70 gallons, is about the same as in other cities in Latin America where the Bank has financed water supply projects.

14. The project's internal financial rate of return is about 11 percent. The economic rate of return is expected to be higher because public health and fire protection benefits are not fully reflected in the prices charged for water.

15. Procurement would follow Bank Group international bidding procedures. The appraisal report proposes that the provisions for international competitive bidding give recognition to existing arrangements in the Central American Common Market by allowing a margin of preference in bid evaluation equal to 50 percent of existing import duties, so long as this does not exceed 15 percent of the CIF price, for bids submitted by suppliers in all Central American countries. Similar provisions were made in previous loans to Costa Rica (631 and 632-CR) and Guatemala (not yet signed) and in the proposed telecommunications loan to El Salvador. Under the proposed arrangement it is expected that all equipment supply contracts ($5.5 million equivalent) would be won by foreign firms, including about $0.5 million by suppliers in other Central American countries. Nicaraguan firms are expected to win only civil works contracts,for about $3.7 million equivalent, with a foreign exchange component estimated at about $0.9 million.

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16. The proposed borrower, Empresa Aguadora de Managua, is a well managed autonomous public enterprise. The Empresa has attained virtually all institutional objectives which IDA sought in 1962, but the Bank could still perform a significant role in strengthening the Empresa's organization. We plan to discuss during negotiations a program of management improvements based upon the recommendations of the Pan-American Health Organization, which the Empresa has engaged as consultants to review its personnel administration, accounting, inventory control, and computer utilization.

17. The Empresa's financial position, which has been improving since completion of the 1962 project, is sound and is expected to remain so. The rate of return on average net fixed assets in operation in 1971-73 is expected to be over 7 percent. During negotiations the Empresa should agree to maintain at least a 7 percent rate of return during the term of the loan except during 1974-77, when a 5 percent minimum appears adequate because of the sharp increase in the book value of net fixed assets due to the commission of the new facilities. An increase of about 10 percent in the average tariff in 1974 is expected to be necessary to comply with this rate of return covenant. According to the Empresa's financing plan for 1972-75, about 41 percent of the funds required by its investment program are expected to be generated from within the Empresa and 59 percent from the proposed Bank loan.

18. I recommend that the proposed loan finance expenditures of up to $0.1 million for final designs and management consulting services that have been incurred after September 1, 1971, as proposed in the appraisal report. The management consultants which the Empresa has engaged are satisfactory to the Bank. The Empresa plans to engage engineering consultants shortly in order to keep the project on schedule.

19. The project would have no adverse effect on the environment. The Departamento Nacional de Acueductos y Alcantarillado, an agency of the Ministry of Health operating sewerage systems in Nicaragua, plans to start in 1972 the expansion of Managua's sewerage system with financial assistance from IDB. This expansion would provide for satisfactory disposal of sewerage, including the additions resulting from the proposed water supply project. However, existing industrial discharges now seeping into the soil and possible infiltration by brackish water, if the water table were excessively lowered by overpumping, could affect the Empresa's water sources. Appropriate preventive action will be discussed during negotiations.

Recommendation

20. I recommend that the Bank proceed to negotiate a loan to Empresa Aguadora de Managua of $6.9 million equivalent with the guarantee of Nicaragua, substantially on the terms and conditions proposed in the appraisal report.

Edgar Gutiérrez
Director

Attachments.

Population: 2.1 m
GNP per cap: $430

NICARAGUA - FIVE YEAR OPERATIONS AND LENDING PROGRAMS
(BY FISCAL YEAR - AMOUNTS IN $ MILLIONS)

OPERATIONS PROGRAM		1972	1973	1974	1975	1976	1977
Fisheries I	IBRD		3.0				
Fisheries II	IBRD						4.0
Irrigation (unidentified)	IBRD				4.0		
Livestock I	IBRD			5.0			
Livestock II	IBRD					5.0	
Agriculture (unidentified)	IBRD			3.0			
Communications	IBRD						10.0
Education II	IBRD			3.0			
Education III	IBRD						3.0
Power VIII	IBRD	18.0					
Power IX	IBRD					5.0	
Highways (unidentified)	IBRD				10.0		
Port II (Corinto)	IBRD		5.0				
Port III (Atlantic)	IBRD				3.0		
Port IV (Corinto)	IBRD					3.0	
Water Supply II	IBRD	6.9					

	1964-68	1969-73	1973-77		1972	1973	1974	1975	1976	1977
IBRD	24.3	32.9	66.0	IBRD	24.9	8.0	11.0	17.0	13.0	17.0
IDA				IDA						
Total	24.3	32.9	66.0	Total	24.9	8.0	11.0	17.0	13.0	17.0
No.	3	4	14	No.	2	2	3	3	3	3

LENDING PROGRAM (11/15/71)

	1964-68	1969-73	1973-77		1972	1973	1974	1975	1976	1977
IBRD	24.3	32.9	53.0	IBRD	24.9	8.0	8.0	13.0	10.0	14.0
IDA				IDA						
Total	24.3	32.9	53.0	Total	24.9	8.0	8.0	13.0	10.0	14.0
No.	3	4	10		2	2	2	2	2	2

Central America & Caribbean Department
December 30, 1971