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LOAN COMMITTEE 1971

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Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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LM/M/71-32

July 21, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to consider "Iraq - Telecommunications Project" held at 4:45 p.m. on Thursday, July 15, 1971 in Conference Room B.

J. Chaffey
Acting Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

Copies for Information:

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

LM/M/71-32

July 21, 1971

Minutes of Special Loan Meeting to consider "Iraq - Telecommunications Project" held at 4:45 p.m. on Thursday, July 15, 1971, in Conference Room B.

1. Present: Messrs. Knapp (Chairman), Cope, Aldewereld, Broches, Baum, Armstrong, Hartwich, Davar, El Fishawy, Vasudevan, Davies (Secretary).

2. Issue: The meeting considered Mr. Hartwich's memorandum to Mr. Knapp dated July 15, 1971 entitled "Iraq - Telecommunications Project", to which were attached drafts of the loan agreement, supplemental letters, and drafts of a Section 3.07 and a "minutes of discussions", both relating to the rate of return covenant. Two issues arose: (a) the rate of return covenant; and (b) the addition of \$3.5 million to the proposed \$24 million loan to finance a satellite ground station.

3. Rate of Return: The meeting noted that:

(a) The Iraqi negotiators, headed by the Minister of Planning, were unwilling to accept a rate of return covenant stipulating a specific rate of return (the staff had proposed 10%), even in the "taking one year with another" form, on "infringement of national sovereignty" grounds.

(b) Nevertheless, the Minister, adducing that:

(i) Iraqi law required the national telecommunications system to be run on commercial lines.

(ii) An important objective of the Government was that projects included in the national development plan should generate reasonable surpluses to be placed in a central pool from which further public investment was financed.

(iii) The Government had already initiated a study to determine what tariff changes would be necessary when the current expansion of telecommunications had been completed

took the view that the Government's telecommunications investments could thus be expected to generate a reasonable surplus after meeting operating expenses, including maintenance and depreciation, and debt service, so that there was little difference between his position and that of the Bank.

(c) The Area Department felt that the Minister, in taking this position, and agreeing to accept a covenant in qualitative terms, had come a considerable way towards the Bank's point of view, and suggested that the Bank might be satisfied with Section 3.07 of the draft loan agreement, which required, inter alia, "a reasonable surplus to finance future investments". They also proposed a draft "Minutes of Discussions" of a meeting with the Iraqi team in which the Minister would essentially state the Iraqi position on the rate of return issue and the Bank would state its position as well as its proposal on how to define the rate base and other elements for the purposes of the calculation of the return on telecommunications investments in Iraq.

(d) This suggested approach would have two further unusual features:

(i) Any surplus from such investments would be paid into the general pool to be used for public investments, and would not be earmarked for investment in telecommunications.

(ii) The rate covenant would not come into effect until the project had been completed in 1977, since the Iraqis felt that they could not raise the rates charged on the present unsatisfactory facilities.

4. <u>Decision</u>: It was agreed that the approach suggested by the Area Department should be followed, on the understanding that it was intended to meet the special circumstances of the Iraqi case, and not to set a precedent.

5. <u>Satellite Ground Station</u>: The Committee noted that:

(a) Hitherto the Bank had only financed one satellite ground station - in Yugoslavia.

(b) Comsat had appraised the proposed ground station favorably. The total cost of the sub-project was estimated at $4.0 million equivalent, of which $0.5 million equivalent was local expenditure, and $3.5 million foreign exchange expenditure.

(c) Equipment supply had recently become highly competitive; what was now expected to cost about \$3.5 million would have cost \$5 million a year earlier.

6. Decision: It was agreed to include the ground station in the project.

J. Chaffey
Acting Secretary

Cleared by: Messrs. Cope
Hartwich/Davar

cc: Loan Committee
Participants

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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LM/M/71-31

July 9, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to consider "Yugoslavia - Railway Projects (Loans 395 and 531)" held at 4:30 p.m. on Tuesday, June 29, 1971 in Conference Room B.

J. Chaffey
Acting Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

LM/M/71-31

July 9, 1971

Minutes of Special Loan Meeting to consider "Yugoslavia - Railway Projects (Loans 395 and 531)" held at 4:30 p.m. on Tuesday, June 29, 1971 in Conference Room B.

1. Present: Messrs. Knapp (Chairman), J. H. Williams, Baum, Knox, Hartwich, Scott, Horsley, Jaycox, Gregory, Mactaggart, McCunniff, Walser and Pearce (Secretary).

2. Issue: The meeting had been called to consider memoranda from Messrs. Geolot and Hartwich dated May 17 and June 28, 1971 respectively. The issue for discussion was the Bank's position on railway financing in Yugoslavia in the light of continued problems with Loan 395-YU for the modernization of the Yugoslav railway system and, to a lesser extent, with Loan 531-YU for the construction of the Belgrade-Bar railway line. The Bank had loaned $70 million for the first in 1964 and $50 million for the second in 1968 (cf. also LM/M/71-21 dated April 23, 1971).

3. Discussion: The meeting noted that:

(a) The difficulties experienced with the railway modernization program were both political and financial. The decentralization reforms, which in some areas remained unclear and controversial, had not yet stabilized and there were still no indications that the Republics, on whom the responsibility for meeting past railway deficits and supporting the program now fell, were prepared to accept this responsibility. Certainly the letter dated April 8, 1971 from the Federal Secretary of Finance revealed a disturbing gap in the financing plan. The latest cost estimates were 30 percent higher than those of 1968.

(b) Because of the very serious financial problems facing the railways, the Bank had to decide whether a 'hard' or 'soft' approach would be most effective.

(c) The best alternative, in the Transportation Projects Department's view, supported by the Europe, Middle East and North Africa Department, was to review carefully the entire investment program and financial prospects of the railways and in the light of this to consider whether a further loan would be needed to enable satisfactory completion of necessary investments. It had to be recognized that there would be many difficulties with such a loan since it would almost certainly have to finance local costs and contracts already let. If the Committee agreed, it was proposed to retain comsultants to begin a comprehensive review, hopefully in August or September. This would be followed by a Bank transport sector mission. Any new loan would, of course, require realistic undertakings from the appropriate political entities. Moreover, an eventual new loan would have to be conditional upon evidence of improved project performance.

4. Decision: The Chairman approved the Department's recommendations for a thorough review by consultants. For the moment the Bank should keep an open mind on the possibility of a new loan. He said that he would convey this view by letter to the Yugoslav authorities before the consultants began work.

J. Chaffey
Acting Secretary

Cleared by: Messrs. Knapp
Knox
Hartwich

cc: Loan Committee
Participants

LOAN COMMITTEE

LC/M/71-9

July 2, 1971

Minutes of Loan Committee Meeting held on Thursday, June 24, 1971 at 11:00 a.m. in the Board Room.

A. Present:

J. Burke Knapp (Chairman)
J.H. Williams
G. Alter
W.C. Baum
B. Chadenet
R. Chaufournier
R.J. Goodman
E. Gutierrez
D. Hartwich
J.P. Hayes
M. Hoffman
A.D. Knox
M.L. Lejeune
L. Nurick
A. Stevenson
G.B. Votaw
D. Pearce (Secretary)

In Attendance:

P.O. Cheryan
A. Douglas
M. Ebstein
S.L. Feldman
P. Geli
V.W. Hogg
G.S. Kaji
P.M. Mathew
P.M. Meo
C. Olivos
A. Ray
J. Richter
E.P. Wright

B. Panama - Airport and Fisheries Projects

1. The Committee considered a memorandum dated June 21, 1971 from the Central America and Caribbean Department entitled "Panama - Tocumen International Airport Project, Fisheries Project" (LC/O/71-86) and the accompanying appraisal reports, which recommended two loans: $19.7 million to the Dirreccion de Aeronautica Civil (DAC), an autonomous government

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Committee:

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Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
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Vice President (IFC)

agency to help finance the construction of a new runway and passenger terminal at Tocumen International Airport, and $3.4 million to the government to help finance the modernization of Panama's fishing fleet and to prepare studies for a fishing port.

2. The Committee's discussion focussed upon the two issues raised in paragraphs 4-11 and 13-15 of the Central America and Caribbean Department's memorandum: (a) Panama's economic situation, in particular its increasing external debt and (b) the economic analysis of the airport project, in particular the problem of quantifying its expected benefits to Panama's economy.

3. The Committee noted that, although government revenues had increased by about 20% during 1970, mainly due to increased taxation, current expenditures, particularly in education and administration, had increased much faster. Since the contribution of public savings to public investment was insignificant, short- and medium-term borrowing from commercial banks had resulted in a rapid increase in external public debt. The Government, which recognized the need for remedial fiscal action, planned to introduce an austerity program, including a new $15 million (1.5 per cent of GNP) tax package by the end of 1971, external borrowings only within the agreed limits and terms of the IMF standby, and strict budget controls limiting growth in current expenditures to 3 per cent in 1971. A new gasoline tax, currently under consideration, would account for a substantial proportion of the $15 million package. While public savings as a proportion of gross public investment (including amortization) had dropped to 7-8% in 1970, these measures would increase the ratio to about one-third within two years. Since prospects for continued rapid economic growth were good and the Government had recently acted to improve its fiscal performance, Panama could be considered creditworthy for the proposed loan.

4. Turning to the airport project, the Chairman, noting that the appraisal report emphasized the time saved by airport users, mostly foreigners, rather than the improved airport's benefits to the Panamanian economy, commented that one of its most important features would be the encouragement of business and tourism in Panama. In addition, the report did not mention the probable impact of the airport's improvement on freight traffic.

5. The Committee, agreeing that the project's basic justification for Panama was improved communications, tourism and business with the outside world, noted that these effects were difficult to quantify. The Transportation Projects Department said that the economic analysis and justification of airport projects was conceptually the same as that of ports and some highways since they all resulted in time savings, the cost and benefits of which were quantifiable. However, the Bank did not attempt to trace the ultimate benefits to the economy of such projects and, although these might be described in general terms, they could not provide a basis for reaching conclusions on the timing and review of airport or other projects. The Department

nevertheless agreed that the economic justification section of the appraisal report could be expanded to include reference to these ultimate benefits.

6. Replying to other comments, the Transportation Projects Department also agreed that the appraisal report's review (Annex 3) of the incidence of benefits should be included in the main text. In this connection, the terms of reference of consultants engaged to review the structure of airport charges would include criteria for designing procedures, consistent with maintaining the airport's competitiveness, to enable Panama to recapture at least part of the benefits accruing to (foreign) airport users.

7. The Chairman, replying to another question, said that the Bank's approach to airport financing should be selective.

8. In conclusion, the Committee noted that one condition of effectiveness of the proposed loan would be the conclusion of arrangements, satisfactory to the Bank, for the provision and financing of an aircraft refuelling system. The Chairman said that, if the airlines and oil companies concerned were unwilling to handle this part of the project, which amounted to about $1.2 million, including $1 million in foreign exchange, the Bank could consider its inclusion in the loan, but that such an offer should only be made after other possibilities had been exhausted.

9. The Committee approved the Central America and Caribbean Department's recommendation that negotiators be invited for the proposed loan.

C. Adjournment:

10. The meeting adjourned at 12:00 noon.

Secretary's Department
July 2, 1971

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/71-30

June 30, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to consider "Iraq - Telecommunications Project" held at 4:00 p.m. on Wednesday, May 26, 1971 in Conference Room B.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

LM/M/71-30

June 30, 1971

Minutes of Special Loan Meeting to consider "Iraq - Telecommunications Project" held at 4:00 p.m. on Wednesday, May 26, 1971 in Conference Room B.

1. Present: Messrs. Knapp (Chairman), Cope, Broches, Baum, Benjenk, Weiner, Hartwich, Davar, El Fishawy, Vasudevan and Pearce (Secretary).

2. Issue: The meeting had been called to consider Mr. Benjenk's memorandum of May 21, 1971 to the Chairman, and accompanying memoranda from Messrs. Hartwich, Davar and El Fishawy, which recommended that negotiators be invited for a proposed $24 million loan for a telecommunications project on the basis of revised terms and conditions discussed with the Iraqis by a pre-negotiation mission in April (cf. also LC/O/71-37 dated March 17, 1971). The main issue for discussion was the proposed rate covenant.

3. Discussion: The meeting noted that:

(a) Although, under existing legislation, the Iraqi Post, Telegraph and Telephones Administration (PT & T) was autonomous in several areas, it was in fact a government department and, as such, was not required to generate internal resources specifically to finance its own expansion, including the proposed telecommunications project. After building up statutory reserves, PT & T was required to transfer eventual operating surpluses to a centralized pool of Government funds, for allocation by Iraq's Planning Board to any project included in Iraq's development plan.

(b) Taking into account this and other special Iraqi circumstances, the pre-negotiation mission had recommended that the Government should have telecommunications tariffs studied by March 31, 1974 and, from FY 1976 onwards, after project completion, should ensure that telecommunications revenues were sufficient to cover operating expenses, including maintenance and depreciation, and to produce a reasonable return of about 8-9 per cent on the realistic value of PT & T's net fixed telecommunications assets.

(c) In this connection, a critical question for purposes of determining an appropriate rate of return from FY 1976 onwards was whether the telephone excise tax constituted a general (e.g. sales) tax imposed uniformly on services and commodities or a specific user charge for a specific service such as a tax on power. If, as seemed likely, it was the latter, then the receipts therefrom could be included for purposes of calculating the 8-9 per cent rate of return for the project; if, on the other hand, it was a general tax, it should be excluded. It was noted that with the inclusion of the charge, the rate of return without tariff adjustments would be about 8 per cent between FY 1973 and FY 1975 and over 9 per cent thereafter. It was also pointed out that in view of the circumstances described in paragraph 3(a) above, the Iraqis would probably oppose a rate of return covenant calculated on either basis, on the grounds that it constituted an interference in Iraq's internal affairs.

4. The Chairman said that, if the excise tax was indeed a specific user charge, the pre-negotiation mission's recommendation (para. 3(b) above) would be acceptable to the Bank which might then require only a protective covenant against reductions in tariffs through FY 1976. However, the Chairman added that, during negotiations, the Bank should try first to secure agreement on annual rate of return standards through FY 1976; if this failed, it could later accept a covenant against tariff reductions during this period. In view of probably difficult negotiations, the question of which terms and conditions could be covered in a side letter rather than specific covenants in the loan agreement, could be considered later.

5. The Chairman approved the Europe, Middle East and North Africa Department's recommendation that negotiators be invited for the proposed loan on the basis noted in para. 4 above and Mr. Benjenk's memorandum.

David Pearce
Secretary

Cleared by: Messrs. Knapp
Hartwich/Davar
Weiner/Vasudevan
El Fishawy

cc: Loan Committee
Participants

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LOAN COMMITTEE

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June 22, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Ecuador - Third Power Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated June 22, 1971 from the South America Department, entitled "Ecuador - Proposed IDA Credit to the Republic of Ecuador for a third Power Project (Nayon) (LC/O/71-88).

2. Comments, if any, should be sent to reach Mr. Balcazar (ext. 4774) by 1:00 p.m. on Friday, June 25.

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

David Pearce
Secretary
Loan Committee

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Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
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Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/0/71-88

June 22, 1971

LOAN COMMITTEE

Memorandum from the South America Department

ECUADOR: Proposed IDA Credit to the Republic of Ecuador for a Third Power Project (Nayon)

1. Attached is the draft Appraisal Report No. PU-73, recommending an IDA credit of US$6.0 million to the Republic of Ecuador to be relent to Empresa Electrica "Quito" S.A. (EEQ). Two earlier Bank loans (137-EC and 177-EC) had assisted EEQ in financing its expansion programs in the late 1950's.

The Lending Program

2. The proposed credit would be the only Bank/IDA operation for Ecuador in FY 1972 (see attached Five-Year Lending Program). The next operation included in the program is a proposed loan of $5.0 million for Agricultural Credit, which is expected to be ready for consideration by the Loan Committee in September 1972.

The Economy

3. A report on the "Current Economic Position and Prospects of Ecuador" (No. WH-201a) was distributed on August 21, 1970. A subsequent economic mission visited Ecuador in February/March this year, and is presently finalizing its report. A short economic memorandum on Ecuador's current economic situation and prospects will be presented to the Executive Directors in connection with the proposed loan.

4. Ecuador experienced exceptional growth during 1970 as GDP rose by 8.8 percent in real terms, compared with an annual average of 6 percent for 1965-69. The recovery of agricultural production after two successive years of drought was a major factor of growth in 1970. Exports reached record levels, rising 20 percent from 1969. Banana sales, which accounted for 55 percent of total exports, were exceptional due to favorable conditions in the Japanese market and wind damage to Central American plantations. Coffee exports also reached record levels largely as a result of high world prices. Most important from a longer run point of view, Ecuador's potential as a petroleum producer moved closer to reality as the construction of a pipeline from the eastern oilfield across the Andes to the Pacific proceeded ahead of schedule. Highly successful exploration and drilling results have attracted additional oil companies into the country and exploration activities have been accelerated.

5. In recent years Ecuador has suffered from fiscal problems. Successive substantial Central Government deficits, resulting from rapid expansion of current expenditures, were financed largely by borrowing from the Central Bank. The culmination of this process came in mid-1970 when, after a governmental change, a comprehensive monetary and fiscal program, including devaluation of the sucre and supported by an IMF stand-by agreement, was adopted. The program was generally successful: the Central Government deficit was reduced, its borrowing from the Central Bank limited while private sector credit was permitted to expand, and international reserves by year-end ($56.1 million) were double the mid-year level. However, there is evidence that fiscal performance deteriorated somewhat during early 1971. The Government borrowing from the Central Bank for the first quarter is in excess of the ceiling laid down by IMF; and the fiscal deficit for 1971 is currently projected to be of the same order of magnitude as that of 1970. While the Government's plans for financing the deficit are not yet certain, it is likely to obtain advance payment from the oil companies to cover a major portion of the deficit. The fiscal situation should improve considerably in 1972 when oil exports begin. Insofar as the present project is concerned, it is not heavily dependent upon the budget, and the major part of necessary allocations have already been made.

6. The country can look forward to substantial and increasing foreign exchange earnings during 1971-76 as a result of both oil exports and developmental expenditures of oil companies. Net foreign exchange earnings from developmental expenditures in 1971 are projected to be $43 million; such earnings from oil exports will reach $100/150 million by 1976 (40 percent of the current export level). The inflow of resources from petroleum offers an opportunity for the country to break out of the trap of chronically low saving and investment which has inhibited growth in the past. The attainment of a high rate of growth is dependent on an improvement in the domestic saving performance, restraint of current expenditures, and the implementation of a public investment program which supports and complements private investment. Assuming a well-formulated program, public investment over the period 1971-76 could expand at about 15 percent annually, at the same time allowing the necessary expansion of credit to the private sector consistent with 8 percent growth of non-oil GDP and a modest increase in exchange reserves. Despite the inflow of petroleum resources, achievement of public investment targets will require substantial official capital inflows, averaging $70 million per year gross and $43 million per year net over 1971-76. Because of the rapid rise in exports, the debt service ratio, 12.7 percent in 1970, is, however, not expected to change significantly over the period.

7. The petroleum sector is at a very early stage of development; exploratory efforts are far from complete and the magnitude of reserves is still unknown. It is, therefore, impossible at this point in time to predict Ecuador's long-run potential as a petroleum producer. While it is clear that this development will allow a substantial acceleration of growth over the period 1971-76, high growth rates can probably be sustained thereafter only as long as petroleum sector continues to expand. The fundamental weaknesses of the Ecuadorian economy, the modest levels of private saving that can be expected at the country's stage of development, the relatively low income elasticity of public sector revenues and the poor growth

prospects for traditional exports will again limit growth once petroleum exports stabilize. In order to maintain acceptable rates of growth under these circumstances, increased capital flows would be required which, coupled with slower growth of exports, would lead to rapidly increasing debt service pressure after 1976, probably exceeding 20 percent of exports in the 1980's. At the same time, even with very high rates of growth in 1971-76, Ecuador's per capita income ($210 in 1969) in 1976 would still be below the IDA cutoff level.

8. In view of Ecuador's poverty, the anticipated increase in debt service obligations and the uncertain extent to which petroleum development will offset stagnation or sluggishness of its traditional exports, a case can be made that Ecuador should continue to be considered eligible for IDA assistance in addition to Bank lending. So far as the present operation is concerned, we also have an understanding with the Ecuadorians that this would be an IDA credit. I would therefore propose that we go forward with Board presentation on the same assumption, and that this be considered as one of the first IDA credits to be signed following upon availability of resources. Should you find this approach unacceptable, then we would offer the Borrower a choice between two alternatives: a Bank loan with Board presentation scheduled for August 10; or an IDA credit to be presented some time later, after IDA resources become available.

Background

9. The proposed credit would be the third Bank/IDA operation in Ecuador's power sector. In the late 1950's two Bank loans (137-EC and 177-EC) totalling $10 million had assisted EEQ in financing the first stage of the Cumbaya project, including some diesel plant and distribution facilities. The second stage of the Cumbaya plant was financed in the mid-1960's using mainly EEQ's own resources. When in 1967 the company approached the Association for assistance in financing further development, the mission which first appraised the Nayon project in early 1969 considered the company's financial situation unsatisfactory and recommended a tariff increase. However, EEQ was not prepared to increase its tariffs and IDA was therefore unable to consider financing the project at that time. EEQ's new management, appointed in August 1970, approached the Association again at the end of 1970. Realizing the need to improve EEQ's financial situation, the new management agreed to push for an average 35 percent tariff increase, which was allowed by the Government effective May 1, 1971. This increase should permit EEQ to earn a minimum of 8 percent on its net fixed assets in operation, which is satisfactory to the Association.

The Project

10. The proposed credit would assist in financing part of the foreign exchange requirements associated with an expansion of electricity generation and distribution facilities for the capital city of Quito and its environs. The credit would be made to the Government and the Beneficiary

would be EEQ. The government loan to EEQ, which would also finance interest during construction, would be at 7-1/4 percent interest for 24 years, with a grace period of four years. No particular prescriptions are proposed with regard to the use by the Government of EEQ repayments net of allocations for servicing the credit. The Government would carry the foreign exchange risk on the proposed credit.

11. EEQ is responsible for the generation and distribution of electricity in Quito and its surroundings. The company's shareholders are the Municipality of Quito and the Ecuadorian Institute of Social Security which, at the end of 1970, respectively held 44 percent and 56 percent of the subscribed capital of 221 million sucres. EEQ has 53.4 MW in hydroelectric capacity and 9.7 MW in diesel capacity to serve the area. In 1970 maximum demand (about 58 MW) almost reached the installed system capacity (63.1 MW). EEQ has estimated that in that year about 4 GWh could not be supplied to industry, which had to curtail production by an estimated 7 percent. As a result of the expected acceleration of growth of Ecuador's economy in the coming years on account of petroleum development, maximum demand for electric power is forecast to increase at a rate of 11.2 percent annually during the years 1971-75, compared with the average annual increase in sales of about 9.3 percent experienced during the period 1947-70. Thus, maximum demand in 1975 should reach about 98 MW as against 58 MW in 1970.

12. EEQ's managerial and administrative capacity has been weak in the past. Its financial planning has been particularly deficient; for some years the company has had no Financial Director. Over the years distortions have also been introduced into EEQ's tariff structure. The company's present Board and General Manager appreciate these shortcomings, and will therefore engage the services of management consultants to review and improve EEQ's organization and methods, and for a study of its tariffs. The proposed credit would finance the foreign currency costs of these services. During negotiations of the credit we would seek assurances that the post of Financial Director would be filled within six months from credit signing, and that this appointment as well as future appointments to the posts of General Manager and Technical Director would be made only after consultation with IDA.

13. EEQ's 1971-75 expansion program should provide adequate generation capacity until 1975, when Instituto Nacional Ecuatoriano de Electrificacion (INECEL), the national electricity company, hopes to complete the first stage Pucara Plant of its Pisayambo hydro development. The Inter-American Development Bank is presently considering financing this project.

14. The major item in EEQ's expansion program is the 30 MW Nayon hydro plant. Comparison of the Nayon plant (in 1967, 1969 and in the attached appraisal report) with either a steam-electric or diesel-electric alternative shows it to be the least cost alternative. The main civil works contract for Nayon was awarded at the end of 1970 after international competitive bidding. Part of the proceeds of the proposed credit would be

applied to the foreign currency component of this civil workd contract; the electrical and mechanical equipment and some supplies will be financed with suppliers' credits. The 1971-75 program also includes 22 MW of diesel plant of which 4 MW were purchased with suppliers' credits. The proposed IDA credit would finance the foreign exchange component of equipment for the remaining 18 MW. Finally, the program includes a significant amount of transmission and distribution facilities, as well as equipment to improve Quito's street lighting. The proposed IDA credit would finance some distribution equipment as well as equipment for the street lighting program; suppliers' credits will finance most of the remaining facilities.

15. The total cost of the project is estimated to be $17.5 million ($8.3 million for Nayon plant; $3.0 million for the diesel plant; $1.8 million for transmission facilities; $3.8 million for distribution equipment; and $0.6 million for consultant services and tariff studies). The foreign exchange component would be approximately $12.7 million, or about 72 percent of total project cost. The appraisal report recommends that IDA provide $6.0 million (34 percent of total project cost) toward the foreign exchange component of the project. Suppliers' credits would be used to finance $6.2 million. A local loan of up to $2.6 million equivalent (S/ 65 million) is being sought from Comision de Valores/Corporacion Financiera Nacional (CFN), and the remaining about $2.8 million equivalent will be financed from internally generated cash. As pointed out in the appraisal report, the signing of the loan agreement with CFN would be a condition of effectiveness of the proposed credit. In addition, there is still some uncertainty in respect of one of the suppliers' credits which we would expect to be clarified before or during credit negotiations: should these uncertainties persist, I propose, with the concurrence of the Projects Department, that signing of the suppliers' credit agreements be made a condition of Board presentation; otherwise, together with the appointment of management consultants, the signing of such agreements would be a condition of effectiveness. All contracts for the works to be financed from the proposed credit (except consultant services) have been or will be awarded on the basis of international competitive bidding.

Points for Consideration

16. As mentioned in my memorandum of November 18, 1970, and stated in the attached appraisal report, the urgency to proceed with the expansion program and the need to meet interim demand compelled EEQ, in the second half of 1970, to request bids for the main Nayon civil works and for 9 MW of diesel units required for 1971. These items have been already awarded to Mitsui of Japan and General Motors of the U.S., respectively, on the basis of international competitive bidding, and with IDA approval. Retroactive financing to cover the foreign exchange component of the diesel units ($1.2 million) and some civil works ($0.2 million) is therefore proposed. The amount originally recommended in my aforementioned memorandum was $0.7 million. At that time two partial shipments of the diesel units were planned, one occurring before and one after the then scheduled date (June 1971) for presentation of the proposed credit to the Executive

Directors. It was subsequently decided to ship diesel generating plant in one lot in May/June 1970; the original figure has, therefore, been increased to $1.4 million. I believe this level of retroactive financing is justified for the reasons given.

17. Another issue which I would like to bring to the attention of the Committee concerns EEQ's application for a S/ 65 million loan from Corporacion Financiera Nacional (CFN) to meet part of the local financing needs of the 1971-75 expansion program. CFN has expressed its readiness to participate in the financing, but has not reached a decision on the amount of the loan; its preliminary appraisal has apparently found that the full amount of S/ 65 million may not be required. Since EEQ is keen that action on the IDA credit, which it needs urgently, should not be further delayed pending a decision on the loan amount by CFN, I propose to proceed with credit negotiations on the basis of CFN's already expressed intention to participate in the financing plan. During negotiations we would reach firm agreement on the loan amount; we would also require that CFN should have approved such a loan, in an amount and on terms acceptable to IDA, prior to presentation of the proposed credit to the Executive Directors.

18. The appraisal report forecast of EEQ's income accounts is based on the approved 35 percent tariff increase, and on the expectation that the Municipality of Quito will keep its accounts current with EEQ. The Municipality has undertaken to make adequate provisions in its future budgets to pay promptly its accounts, other than street lighting charges. In the case of street lighting charges, the Municipality has proposed to EEQ that these charges be directly collected by the latter through a small surcharge to be included in EEQ's bills to its customers starting July 1, 1971. EEQ has agreed to the arrangement, and is obtaining authority for the incluaion of this surcharge through a Municipal Ordinance. However, should Government's approval to the surcharge be still required, as we are inclined to believe it will, firm arrangements for the recovery of street lighting charges by EEQ would be made a condition for Board presentation.

19. As of December 31, 1970, S/ 44 million is included in EEQ's current liabilities as unpaid dividends. EEQ does not intend to pay these in cash but, instead, will issue stock to cover this amount. The agreement of EEQ's stockholders to this arrangement will be a condition of Board presentation.

20. On May 28, 1971, EEQ sent to the Association a request for an additional $0.27 million over the originally proposed amount of the credit. The major portion ($0.2 million) of this additional amount would assist in the financing of two new distribution substations (Cumbaya and Epiclachiana) and some subtransmission equipment; their need has become more pressing than previously anticipated on account of fast growing housing and industrial developments in these areas. The remaining amount would serve to obtain technical assistance to increase operating efficiency of the generating facilities, taking into consideration the existing plants, the new Nayon

plant and future interconnections. Only foreign currency costs of the additional items would be financed. Local currency costs, not yet made available to the Association, are foreseen to be small and would be met from EEQ's own resources. The Projects Department is satisfied with the justification for this additional work. Therefore, subject to EEQ submitting detailed cost estimates, I believe the Association should be ready, at the time of negotiations, to agree to the inclusion of this additional financing in the proposed credit which would thus be increased to $6.3 million.

Recommendations

21. I recommend that the Government and EEQ be invited to negotiate a credit of US$6.0 million for the Third Power Project on the terms and conditions set forth in the appraisal report. I also recommend that the Association be prepared, during negotiations, to agree to an additional financing of $0.3 million. The credit would not be presented to the Executive Directors until EEQ should have (i) submitted to IDA a draft loan agreement between the Government and EEQ covering the relending of the proposed credit; (ii) reached formal agreement with its stockholders that unpaid dividends, as of December 31, 1970, will not be paid in cash; (iii) obtained a firm commitment from CFN for a loan of about S/ 65 million; and (iv) made firm arrangements for the recovery of street lighting charges. The proposed credit would be made effective only after the Government's subsidiary loan agreement with EEQ, the suppliers' credits agreements (except as indicated in paragraph 15 above) and the agreement for local financing shall have been signed, and consultants appointed for management services and for a study of EEQ's tariff structure, on terms and conditions acceptable to IDA. The Appraisal Report will be suitably modified to reflect the changes indicated above.

Gerald Alter
Director

Attachments

Attachment

ECUADOR: Bank/IDA Lending Program, FY 1967-1975

(US$ Millions)

		1967	1968	1969	1970	Total FY 1954 through FY 1970	1971	1972	1973	1974	1975	Total FY 1971 to 1975
AGRICULTURE		1/4.0		1/5.3	1/1.5	3/10.8						8/50.0
Agricultural Credit I	IBRD								5.0			
Irrigation I	IBRD									2.0		
Irrigation II	IBRD										5.0	
Livestock III	IDA						10.0					
Livestock IV	IDA									10.0		
Fisheries II	IBRD									8.0		
Forestry Industry	IBRD								5.0			
Forestry	IDA										5.0	
EDUCATION			1/5.1			1/5.1						1/5.0
Education II	IBRD									5.0		
POWER						2/10.0						1/6.0
Power III (Nayon)	IDA							6.0				
Power IV	IBRD											
TRANSPORTATION						4/50.0						3/20.0
Airport	IBRD								5.0			
	IDA								5.0			
Highways III	IBRD									5.0		
Ports II	IDA									5.0		
DEVELOPMENT FINANCE COMPANIES												3/31.0
DFC I	IBRD						8.0					
DFC II	IBRD								1.0			
	IDA								10.0			
DFC III	IBRD										12.0	
TOTAL		4.0	5.1	5.3	1.5	10/75.9	18.0	6.0	31.0	35.0	22.0	16/112.0
(Of which IDA)			5.1		1.5	14.6	10.0	6.0	15.0	15.0	5.0	51.0

South America Department

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

D/107

June 22, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Tunisia - Fisheries Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated June 22, 1971 from the Europe, Middle East and North Africa Department, entitled "Tunisia - Proposed Credit for a Fisheries Project" (LC/O/71-87).

2. Comments, if any, should be sent to reach Mr. Julin (ext. 4708) by 1:00 p.m. on Friday, June 25.

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

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

Copies for Information:

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

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LC/O/71-87

June 22, 1971

LOAN COMMITTEE

Memorandum from the Europe, Middle East and North Africa Department

TUNISIA - Proposed Credit for a Fisheries Project

1. Attached for consideration by the Loan Committee is an Appraisal Report entitled "Tunisia - Fisheries Project" (No. PA-91) dated May 10, 1971. It recommends an IDA Credit of $2 million to finance the foreign exchange component of a credit operation for financing the replacement of about 335 obsolete motorized coastal fishing boats and supporting services. Total cost of the project would be about $3 million.

2. This would be the eighth IDA Credit to Tunisia, bringing total IDA lending to $49.8 million, in addition to twelve Bank loans totalling $106.3 million. The current five-year operations program for Tunisia is attached.

3. The proposed project would be the third lending operation for Tunisia's agricultural sector. In 1967, the Bank and IDA financed the Cooperative Farm Project (Loan/Credit No. 484/99 totalling $18 million) which, after changes in Tunisia's agricultural policies affecting the character of the project, had to be revised and was re-negotiated in September, 1970. A loan of $5 million and a credit of $3 million for an Agricultural Credit project was negotiated last March and will be presented in July to the Executive Directors. The time of the signing of the Loan and Credit Agreements will depend on the availability of IDA funds. The main purpose of that project is to support a three-year lending program for grain farm mechanization and dairy farm and date-palm development.

Project Issues

4. The main issues of negotiation for the fisheries project are likely to be procurement of marine diesel engines and the financial terms of the credit operation. These matters are discussed below and take into account informal talks recently held with Government officials in Tunis. It should be noted, however, that the Government's viewpoints set forth in this memorandum are of a tentative character and do not necessarily reflect the position that will be adopted by the Government at the time of negotiations.

5. Procurement: Procurement of motorized boats would be through international competitive bidding (cf. para. 3.15 of the Appraisal Report). Since the competitive position of Tunisian boat builders is favorable, it is envisaged that the boats would be built locally from imported materials and equipped with imported diesel engines. Domestic lumber is not suitable for boat construction (para. 3.03). A Tunisian public enterprise is assembling diesel engines for stationary agricultural purposes under a licence with foreign manufacturers, and the Government may request that this enterprise be considered qualified to participate in bidding for the diesel engines. Although some in-shore boats are equipped with these locally assembled engines, they are not considered suitable for fisheries purposes (para. 2.19). It would therefore be a condition of the proposed credit that only imported marine diesel engines be used.

6. Present Financing Arrangements: Concessionary credit to fisheries has been made available since 1968 through a special government fund (Fonds d'Encouragement à la Pêche - FOSEP; para. 2.25-2.28). At present, the Government provides to fishermen 10 percent of investment costs of motorized in-shore vessels as a grant. The minimum down-payment by fishermen is 20 percent and loans cover up to 70 percent of investment costs at 3 percent annual interest over eight years without period of grace. The Government funds are administered by the National Bank of Tunisia (BNT, the major agricultural bank), which would also be the lending channel for the proposed project and the above-mentioned Agricultural Credit project. BNT does not participate in the default risk on FOSEP funds, but may reject loan applications on grounds of creditworthiness. Final approval or rejection of loan applications is given by the Ministry of Agriculture.

7. Contrary to the information received by the appraisal mission, it now appears that the Government has recently made an additional contribution of D 100,000 to FOSEP and intends to continue FOSEP operations. It is therefore recommended as an additional condition for the IDA Credit that FOSEP lending terms and procedures be brought into line with those that would be eventually agreed upon for the proposed project.

8. Sub-lending interest rate: On the basis of the relatively high risks and financial returns (26 to 30 percent) involved, the Appraisal Report recommends (para. 4.07) that the rate to be charged by BNT to individual fishermen be set at 9 percent. At the time of the visit of the appraisal mission the Government indicated that it would be willing to consider an interest rate of this magnitude. However, during more recent discussions with the Tunisian authorities it became clear that after further consideration, an increase from 3 to 9 percent is now deemed inappropriate. It was argued that the rationale for such a drastic rise would be impossible to explain to the fishermen and the resulting adverse psychological effect would probably deter them from availing themselves of the new credit facilities. The Government further pointed out that a rate of 9 percent would be out of proportion to the prevailing average lending rate in the agricultural sector of about 4 percent.

9. The Government does however realize that, to make the fisheries development credit a viable operation, a rate increase is called for. It has informally given us to understand that it would be prepared to increase the sub-lending interest rate to 6 percent.

10. During the recently concluded negotiations of the Agricultural Credit project it was agreed that, as an important step in re-aligning agricultural interest rates, an effective rate of about 6 percent be used as an interim measure pending, inter alia, a review of the agricultural subsidy system. I propose that such a rate also be accepted for the Fisheries project. The Agriculture Projects Department feels that a higher interest rate would be preferable, but would agree to a rate of 6 percent as a first important step towards a more market-oriented interest rate policy also in the fisheries sector.

11. In the Agricultural Credit project the 6 percent effective rate raised cash-flow problems for the BNT, since the average cost of capital to BNT under that project was about 4.7 percent and it was felt that a margin of at least 3 percent would be necessary to adequately cover administrative costs and risks, and to give an acceptable return on capital. This question was resolved by allowing BNT to charge 8 percent to farmers, with the Government paying subsidies directly to farmers to reduce this rate to an effective 6 percent. In the Fisheries project, however, almost all of BNT's financial needs will come from the proposed IDA Credit, which could be on-lent to BNT at 3 percent, thus allowing BNT to on-lend to fishermen at a nominal (as well as effective) interest rate of 6 percent. The resulting margin to BNT of 3 percent, which is somewhat lower than in the case of the Agricultural Credit project, is considered sufficient. Although the risks in lending to the fisheries sector are greater, the technical aspects of the lending operation are being handled directly by the Government in the Fisheries project, at no cost to BNT, and BNT is being asked to take 50 percent only of the default risk (see also paragraph 15 below).

12. <u>Financing Plan</u>: The Appraisal Report recommends (para. 4.07) that the financing plan for investments in boats and gear being applied under the FOSEP scheme be maintained for the project: 20 percent in the form of a down-payment from the loan applicant, 10 percent in the form of a government grant and 70 percent in the form of a loan over 8 years without period of grace.

13. It has recently become apparent, however, that considerable difficulties are being faced by fishermen to finance the 20 percent down-payment (which under the proposed project would amount to almost $1,400 per boat). By January 31, 1971, a total of 120 approved FOSEP loans were blocked either because the loan applicant had not fulfilled certain procedural requirements or because he had not made the down-payment. The latter obstacle accounted for 68 of the 120 cases. In these circumstances, it is possible that the proposed self-financing requirements could present a serious obstacle to an effective implementation of the project. The

Government is seriously concerned about this matter, and has informally suggested that it would be willing to modify the financing plan to the effect that the self-financing requirements for fishermen be lowered to 10 percent of investment cost and the government grant increased to 20 percent.

14. The problem posed by the current down-payment requirements should not be underestimated. To obviate potential obstacles to an effective project implementation, I recommend that we accept the proposed reduction in down-payment. We would, however, prefer the share of the BNT loans to be raised to 80 percent, leaving the government grant at 10 percent. I recommend, and the Agricultural Projects Department concurs, that this be proposed to the Government during negotiations, should they raise the question of reducing the fishermen's down-payments. This proposal would make necessary a supplementary Government loan to BNT to cover the additional 10 percent investment costs.

15. Default Risk: Currently the Government assumes all the default risk involved in BNT lending to the fisheries sector. In order to ensure a commercial element in the credit operations under the Fisheries project, the Appraisal Report recommends that BNT be required to take 50 percent of the default risk (para. 4.07). The Government has informally proposed that BNT should take 30 percent only of that default risk, but we do not consider this to be sufficient and propose to negotiate on the basis of the appraisal report formula of 50-50 sharing of the default risk by the Government and BNT.

16. Securing of mortgages: The possibilities provided by Tunisian law of securing an adequate mortgage on fishing boats, enforceable vis-à-vis third parties, is presently being further explored in more detail. Should a satisfactory security system not exist and if no other legal alternative is available, an additional condition for the effectiveness of the credit would be the modification of current legislation to ensure the existence of proper mortgage facilities.

Recommendation

17. I recommend that the Bank invite the Government of Tunisia and Banque Nationale de Tunisie to negotiate a $2 million IDA credit for a Fisheries project on the terms and conditions proposed in Chapter VII of the Appraisal Report and in this memorandum. Signing of the credit would be contingent on the availability of IDA funds.

Dieter Hartwich
Deputy Director

Attachments

Population: 4.7 m
GNP Per Cap: $220

IVa. TUNISIA - 5 YEAR OPERATIONS PROGRAM
(By Fiscal Year - Amounts in $ millions)

			1971	1972	1973	1974	1975	1976
4-TUN-AC-01	Agricultural Credit I	IBRD	5.0					
	" "	IDA	3.0					
4-TUN-AC-02	Agricultural Credit II	IBRD				15.0		
4-TUN-AI-01	Irrigation	IDA			9.0			
4-TUN-AF-01	Fisheries	IBRD		2.0				
4-TUN-DD-04	DFC - SNI IV	IBRD		10.0				
4-TUN-DD-05	DFC - SNI V	IBRD				10.0		
4-TUN-DD-06	DFC - SNI VI	IBRD						10.0
4-TUN-EE-03	Education III	IBRD			9.0			
4-TUN-EE-04	Education IV	IDA					10.0	
4-TUN-IM-01	Phosphate Mining	IBRD			5.0			
	" "	IDA			5.0			
4-TUN-NN-01	Population	IDA	4.8					
4-TUN-PP-01	Power	IBRD		10.0				
4-TUN-QQ-01	Tourism Infrastructure I & Sewerage	IDA		7.0				
4-TUN-QQ-02	Tourism Infrastructure II & Sewerage	IBRD				10.0		
4-TUN-TH-02	Road Construction I	IBRD	24.0					
4-TUN-TH-03	Road Construction II	IDA						15.0
4-TUN-TL-01	Pipeline	IBRD	7.5					
4-TUN-TR-02	Railroads II	IBRD			10.0			
4-TUN-WW-03	Water Supply I	IBRD			4.0			
	" "	IDA			4.0			
4-TUN-WE-01	Sewerage I	IBRD					5.0	
	"	IDA					5.0	
		IBRD	36.5	20.0	28.0	35.0	5.0	10.0
		IDA	7.8	9.0	18.0		15.0	15.0
		Total	44.3	29.0	46.0	35.0	20.0	25.0
		No.	4	4	5	3	2	2

	Total 1964-68	1969-73	1972-76
IBRD	34.0	127.3	98.0
IDA	19.0	53.8	57.0
Total	53.0	181.1	155.0
No.	5	19	16

P & B 5/20/71

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

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LOAN COMMITTEE

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LC/A/71-9

June 21, 1971

NOTICE OF MEETING

A meeting of the Loan Committee will be held on Thursday, June 24, 1971 at 11:00 a.m. in the Board Room.

AGENDA

Panama - Tocumen International Airport Project, Fisheries Project.

The Committee will consider the attached memorandum dated June 21, 1971 from the Central America and Caribbean Department, entitled "Panama - Proposed Loan for Tocumen International Airport Project, Proposed Loan for a Fisheries Project" (LC/O/71-86). Discussion will be confined to the Airport Project.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

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

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LC/O/71-86

June 21, 1971

LOAN COMMITTEE

Memorandum from the Central America and Caribbean Department

PANAMA - Proposed Loan for Tocumen International Airport Project
- Proposed Loan for a Fisheries Project

Introduction

1. Attached for consideration by the Loan Committee are appraisal reports for two projects. Appraisal Report No. PTR-90, entitled "Tocumen International Airport Project," recommends a loan of \$19.7 million to the Direccion de Aeronautica Civil, an autonomous agency of the Government of Panama, for the construction of a new runway and a new passenger terminal at Tocumen International Airport, located close to Panama City. Appraisal Report No. PA-94, entitled "Panama Fisheries Project," recommends a loan of \$3.4 million to the Government of Panama to help finance the modernization of the country's fishing fleet, and to prepare studies for a fishing port.

2. To date, Bank loans to Panama total \$60.6 million. \$42.0 million of this amount is accounted for by the Second Power (Bayano) loan made in March 1970 to the Instituto de Recursos Hidraulicos y Electrificacion (IRHE). Implementation of this project is delayed by almost a year, resulting from a change in engineering consultants and delays in the supply of the last two units at Las Minas by the Italian manufacturer. IRHE's performance has been satisfactory and arrangements have been made (with Eximbank financing) for the provision of diesel units to meet the 1971/72 peak demand. No loans were made to Panama between 1962 and 1970. All of the loans prior to the Bayano loan, of which there are six, are fully disbursed and three of them are already repaid. The amount outstanding on all loans as of April 30, 1971, was \$48.8 million, of which \$41.7 million was undisbursed.

3. The proposed two loans, aggregating \$23.1 million, would be the only lending operations in FY72. This is a substantial amount for a country of Panama's population (1.4 million). No loans, however, have been made to Panama in FY71. The lending program for FY72-76 is attached.

Economic Situation

4. For more than two years the "Revolutionary Government of October 1968" has provided a frame of domestic tranquillity with a minimum of civil constraints. General Torrijos, head of the National Guard, has exerted strong leadership, but relied on civilians to staff all levels of Government. With the new group of mostly young and able technocrats, traditional corruption in public offices appears to have diminished. However, the number of talented

men available for public services has remained scarce and too many assignments have limited their efficiency. Moreover, some of the best talents in the economic team have been drawn toward the new Canal treaty negotiations which are to be resumed soon.

5. An economic mission which visited Panama early this year has prepared a report that is scheduled for circulation to the Board in late June. The mission's findings confirm that the new Government has adopted an aggressive economic policy in contrast to the low economic profile of past administrations. This marked change was reflected primarily in public investment which in 1970 was two-and-a-half times that in 1967, reaching over 6 percent of GNP. The Government recognized at an early stage - in good part at the Bank's suggestion - that new revenues would be needed to sustain an increased investment effort. In early 1970, just prior to the presentation of the Bayano project to the Bank's Board, a large tax package was enacted. As a result revenues expanded by about one-fifth in 1970, reaching over 16 percent of GNP, which is almost twice as high as that of the rest of Central America. The tax effort in Panama thus ranks well above the average for Latin America.

6. Economic growth has remained high. In 1969 and 1970 GNP growth averaged about 8 percent in real terms, slightly above the 7.5 percent annual rate achieved during 1960 to 1968. The high rate of growth until 1968 was generated by the private sector and was financed mainly by domestic savings, with foreign savings reaching a low of 2 percent of GNP by 1968. Subsequent increases in the rate of investment raised the savings gap to about 5 percent of GNP in 1969 and 8 percent in 1970. The public sector has been responsible for much of the stimulus to demand. The Government has justified this push both on grounds of employment and social reform. Probably more progress has been made during these two years than during the preceding decade toward better income distribution, land reform and improved education and health services in the countryside. The private sector showed renewed vigor in 1970 after an initial sharp drop in investment following the change of Government.

7. Growth in government revenue during 1970 was not accompanied by any growth in government savings because of rapid increases in virtually all categories of current expenditure, particularly education and administration (including justice and police). Public savings have financed only an insignificant share of public investment. The result has been a rapid increase in the external public debt, with much of the new debt being contracted on hard terms from U.S. commercial banks. As a result, external debt service will average about 9 percent of Panama's prospective earnings from the export of goods and services during the next four years. This is a large jump from the 1967/68 level (about 3 percent), but is still manageable. However, until vigorous steps are taken to increase public savings, a substantial deficit will remain to be financed by general purpose borrowing abroad.

8. The Bank has informed Panama of its concern about this situation. As a result of discussions which I had with General Torrijos, President Lakas and the Government's economic team, the President has informed the

Bank that it will introduce immediately tighter controls over public current expenditures, that certain investment outlays included in the 1971 budget will be cut, that current expenditures for 1972 will be kept within levels spelled out at the recent CIAP meeting, and that a new tax package of $16 million ($1\frac{1}{2}$ percent of GNP) will be initiated by the end of 1971. The Government has also reaffirmed that it intends to stay within the limits of external borrowing set under the IMF stand-by which limits borrowing, exclusive of a $16.6 million rollover, to $27.0 million and specifies an original maturity for these loans of not less than seven years, with grace periods of not less than 18 months.

9. The Government has therefore recognized the need for remedial fiscal action, but it remains to be seen how far this will actually be carried out. We could defer negotiation of the proposed loans until new taxes were enacted, but I believe that an attempt to apply leverage in this way might well be counter-productive, given the assurances that we have already received. Moreover, I do not see any immediate threat to Panama's creditworthiness since prospects for continued rapid economic growth are reasonably good, and the longer-term outlook is improved by the fact that Panama and the U.S. are about to resume Canal treaty negotiations which, if successfully concluded, would probably result eventually in a large increase in royalty payments to Panama (a draft treaty initialled in 1967 foresaw an increase of $20 million above the present figure of about $2 million a year). The present Government is the first in Panama to give high priority to economic development, and while not all the increase in public investment to date has been well directed, economic performance as a whole during the past two years must be rated good by any standards.

Tocumen International Airport Project

10. This is the first airport project for which financing by the Bank is proposed. The loan would be made to the Direccion de Aeronautica Civil (DAC), an autonomous agency of the Government of Panama. The loan would be guaranteed by the Government of Panama.

11. The Government approached the Bank for financing of the Tocumen Airport project in 1969, shortly after DAC was established. DAC subsequently retained, at its own cost, the Parsons Corporation, Los Angeles, to execute a feasibility study for an expansion of the Tocumen Airport. We commented on the terms of reference for the study. After review of the draft study, the Bank asked for two addenda to explore technical alternatives more thoroughly and to present a detailed economic justification of the project.

12. The proposed project includes the construction of a new runway, of a new passenger terminal and of related facilities, and consultants' services for design and supervision of construction, for strengthening management and for the preparation of a National Aviation Plan as a guide to the allocation of DAC resources. Total cost of the project is estimated at $34.8 million. About 60 percent of total cost would be for the terminal building and related works, about 30 percent for the runway, and the

remainder for consultants' services. The proposed Bank loan of $19.7 million would cover foreign exchange costs. Financing of local costs would be provided mainly through a government loan to DAC. I agree with Transportation Projects Department that the proposed Bank loan provide for retroactive financing of the foreign exchange cost of engineering services performed by the Parsons Corporation. Assuming the loan would be signed by the end of July, the amount involved would be approximately $750,000.

Issues

13. Particular attention has been given to developing methods for evaluating the economics of this project. The economic analysis has been carried out separately for the two main parts of the project: the terminal building with its related facilities and the runway. On the terminal building, the benefits have been estimated in terms of time savings by passengers and aircraft resulting from the proposed new terminal, as against the continued use of the existing building. Under the assumption that no value should be given to the time of passengers who are not gainfully employed, a rate of return of 13.0 percent would be obtained on the investment in the terminal building. An alternative higher estimate of time values for passengers would bring the rate of return on the terminal to 17 percent. Because of the difficulties in establishing a satisfactory basis of estimation, these calculations do not take into account the costs of congestion arising from continued use of the existing facility eventually becoming unmanageable, with resultant diversion of traffic to airports outside Panama.

14. The present runway, built in stages since the late 1940's has reached the end of its physical life. The alternatives therefore are a major improvement of the present runway or an entirely new runway. The two alternatives are estimated to require the same amount of funds (approximately $11 million), but improvement of the present runway could be phased to limit the initial investment to about $8 million with the rest being required several years later. However, the alignment of the new runway is superior, improving both the safety and economics of operation and will provide Panama with uninterrupted international air services. In addition a new runway will enable the transfer of general aviation services from a built-up area in Panama City (Paitilla) to the existing runway at Tocumen, thus releasing high value land in Paitilla with concomitant environmental benefits. Taking into account the economic resources freed by moving general aviation facilities from Paitilla to Tocumen but without quantifying the first two benefits which are difficult to measure the rate of return on the incremental investment in a new runway, as compared to an improvement of the existing runway, would be about 35 percent. The economic rate of return on the new runway is estimated at 25% on the basis of savings in aircraft operating and runway maintenance cost.

15. Besides the economic justification, the appraisal gives special attention to the financial viability of the proposed project. Panama's Tocumen airport is one of the principal airports in South America. Tocumen has more international flights than for example Rio de Janeiro (though 20 percent fewer passengers). During its full first year of operation (1970),

DAC achieved a rate of return on its largely depreciated assets of 6.0 percent. In January 1971 DAC introduced a passenger departure tax and has, in principle, accepted the need to raise landing fees for international flights from $1.00 to $2.00 per 1,000 kg. maximum permissible take-off weight. These charges are in line with what is being levied at major airports in the area. On the basis of these rates, DAC should be able to earn a financial rate of return of 4 percent by 1975 when the project would be completed and over 10 percent by 1982. The financial position of DAC is projected to remain sound on the assumption of the proposed Bank loan and a long-term government loan of $14 million. The Government intends to make the loan interest-free - this subsidy would roughly offset the losses of DAC on its operation of other airports - and its amortization schedule would be kept flexible to ensure a satisfactory cash position of DAC. Moreover, the Government would be required to meet any overruns on project costs.

16. The third aspect to which careful attention has been given in the preparation of the proposed project, is the institutional set-up. The Borrower of the proposed loan, DAC, has developed into quite an effective airport authority for developing civil aviation throughout Panama in general and for running the Tocumen Airport in particular. DAC's Board of Directors consists of three high-level government representatives. Its powers include the establishment of policies relating to user charges and the setting of rates. The Director General is responsible for executing the operations of DAC within the guidelines laid down by the Board. There is also an advisory board, with no executive power, consisting of DAC's Director General and representatives of the Planning Office, the Tourism Institute, the Public Works Ministry, the airlines and pilots. Despite its good start, DAC still has considerable weaknesses in internal organization, planning and accounting. DAC is conscious of these shortcomings and has agreed to engage management and accounting consultants and to obtain a consulting firm's assistance in the preparation of a master plan for the future expansion of other domestic airports and aviation services.

17. The amortization terms of the proposed loan (twenty-four years including four years of grace) are recommended on the basis of the estimated economic life of the project. In the case of the runway, the economic life is equal to the estimated physical life; the physical life of the terminal building is likely to be considerably longer.

Fisheries Project

18. This project was identified and prepared by an FAO/IBRD Cooperative Program mission in August 1969 which based itself on an investigation of fisheries resources in Central America financed by the UNDP. The proposed project would be the first phase of a program to support Panama's fisheries industry; a second phase would consist of the construction of a fishing port on the Pacific Coast; a third phase would provide improved fishing vessels which could be serviced by the new on-shore facilities.

19. The proposed project includes (a) credit to fishermen to replace 40 old wooden vessels with modern steel shrimp trawlers equipped with up-to-date fishing gear, (b) technical assistance to design and assist in procurement and supervision of construction of the trawlers and to give training in basic navigation and the use of modern fishing gear, and (c) consulting services for the preparation of a feasibility study for a fishing port. The total cost of the project is estimated at $5.2 million. The proposed loan of $3.4 million would finance all the foreign cost of the project. Local cost of $1.8 million would be financed by the sub-borrowers ($865,000) and by the Government-owned Banco National del Panama ($935,000). This partial renewal of Panama's shrimping fleet will reduce production costs and thus improve the country's competitiveness rather than increase the catch of shrimp. The present shrimp catch cannot be increased at this time without the danger of over exploration. New grounds are being investigated by Panama and UNDP/FAO. Both the economic and financial returns on the project are projected at above 20 percent under the most realistic assumption of further price increases for shrimp (at present prices the economic and financial returns would be 14-15 percent). The project would also have a desirable social effect since it would stop a trend of individual vessel owners selling their licenses (there are 238 boats licensed in Panama) to larger owners, in part because no adequate credit facilities have so far been available.

Issues

20. The appraisal report proposes, and I agree, that the Bank loan be made to the Government which would on-lend $3.0 million to BNP and directly use $0.4 million for the port feasibility study. Under normal circumstances we would make the proposed loan directly to BNP with the Government acting as guarantor. BNP is the only suitable lending channel for loans to boat owners since commercial banks have evidenced no interest in lending for fisheries activities (except for export trade operations). However, BNP has shown a mixed and generally poor performance during recent years. Since the Inter-American Development Bank, which has made three loans to BNP mainly for industrial credit purposes, is providing assistance for an improvement in the BNP's organization and for the establishment of a better management information system, (using Peat Marwick and Mitchell as consultants) our role in strengthening BNP through the proposed loan would be limited except for setting up a satisfactory Project Unit in BNP. Moreover, the government auditor is presently making a complete review of BNP's portfolio. There appear to be distinct advantages therefore in making the Government rather than BNP the Bank's borrower, but we shall want to keep BNP's performance under continuous review, and if its weaknesses are corrected, we might lend directly to BNP next time (a second fisheries credit is included in the Lending Program for FY74).

21. The trawlers included in the project would be procured under international competitive bidding. At present Panama has import regulations for trawlers which in effect prohibit any importation of vessels to fish in Panamanian waters. These regulations would be amended so as to permit the importation of new trawlers financed under the proposed project. Local

bidders would be given a preference margin of 10 percent of the c.i.f. bid price. A local shipyard is able to build the type of boats included in the project and is expected to supply all the trawlers financed by the proposed loan.

Recommendation

22. I recommend that the Bank invite

(i) the Direccion de Aeronautica Civil (DAC) and the Panamanian Government to negotiate a loan to DAC of $19.7 million for the proposed Tocumen Airport project, and

(ii) the Government of Panama and the Banco Nacional de Panama to negotiate a loan to Panama of $3.4 million for a proposed Fisheries Credit project,

on the terms and conditions set out in the attached appraisal reports.

Attachments

Annex I

Population: 1.4 million
GNP per Cap: $660

PANAMA - 5-YEAR OPERATIONS AND LENDING PROGRAMS
(By Fiscal Year - Amounts in $ millions)

OPERATIONS PROGRAM		1971	1972	1973	1974	1975	1976
Livestock	IBRD			4.0			
Fisheries I	IBRD		3.4				
Fisheries II	IBRD				5.0		
Power III	IBRD					15.0	
Airport (Tocumen)	IBRD		19.7				
Highways III	IBRD			10.0			
Highways IV	IBRD						10.0
Fishing Port	IBRD			6.0			
Container Port	IBRD				12.0		

	1964-68	Total 1969-73	1972-76		1971	1972	1973	1974	1975	1976
IBRD	-	85.1	85.1	IBRD	-	23.1	20.0	17.0	15.0	10.0
IDA	-	-	-	IDA	-	-	-	-	-	-
Total	-	85.1	85.1	Total	-	23.1	20.0	17.0	15.0	10.0
No.	-	6	9		-	2	3	2	1	1

LENDING PROGRAM

	1969-73	1972-76	1971	1972	1973	1974	1975	1976
IBRD	79.1	67.1	-	23.1	14.0	10.0	10.0	10.0
No.	5	7	-	2	2		3	

Central America and Caribbean Department

June 18, 1971

FORM No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LC/M/71-8

June 15, 1971

Minutes of Loan Committee Meeting held at 11:00 a.m. on Wednesday, May 26, 1971 in the Board Room.

A. Present:

J. Burke Knapp, Chairman	R.J. Goodman
S.R. Cope	L.J.C. Evans
G. Alter	P.D. Henderson
W.C. Baum	M.L. Lejeune
A. Broches	E. Lerdau
B. Chadenet	D. Richardson
R. Chaufournier	G. Votaw
R.H. Demuth	E.P. Wright
K.G. Gabriel	D. Pearce (Secretary)

In Attendance:

H. Adler	M.L. Hoffman
G.B. Baldwin	G. Losson
J. Bevan	F. Lowenstein
F. Chaudhri	S.N. McIvor
B.M. Cheek	B.G. Sandberg
S.M. Denning	N. Sukkar
B.A. de Vries	D. von Busse
J.N. Halverson	R. Wadsworth

B. Liberia - Rubber Rehabilitation Project

1. The Committee considered memoranda to the Chairman dated May 11 and 21, 1971 from Messrs. Chaufournier and Evans respectively and a draft (yellow cover) appraisal report dated January 2, 1971 prepared by the Agriculture Projects Department. The issue for discussion was whether, in view of t

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Committee:

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

appraisal mission's negative findings, IDA should help finance a \$5.8 million rubber rehabilitation project in Liberia. Mr. Evans' memorandum, drawing attention to the project's high risk and low economic rate of return (about 6-7 per cent) concluded that IDA financing for this or any other rubber project in Liberia in the present state of knowledge could not be justified. Mr. Chaufournier's memorandum, on the other hand, while acknowledging the project's risks and marginal economic justification, recommended that, in the absence of alternative agricultural projects in Liberia, IDA should finance a scaled-down pilot project as the best first step towards developing Liberia's non-enclave agriculture.

2. In considering the various issues noted in paragraphs 6-13 of Mr. Chaufournier's memorandum, the Committee noted that:

(a) While the appraisal report's estimate of a 6-7 per cent internal economic rate of return assumed a price for project labor of 70 cents/day, it had subsequently been agreed that 50 cents/day should be used as the opportunity cost of project labor. This estimate, which the Western Africa Department still considered high, combined with a long-term rubber price projection of 16.5 cents/lb c.i.f. New York, resulted in an internal economic return of 9.5 per cent, which might almost satisfy the Bank's conventional criterion for financing projects.

(b) The project's rate of return was depressed by (i) the long gestation period before rubber trees became effective, (ii) modest yields, (iii) declining rubber prices forecast by the Economics Department, and in particular, since extension and credit services were at present inadequate, by (iv) the high overheads (about 40 per cent of total project costs) of the Rubber Development Agency (RDA). The latter largely accounted for the disparity between the appraisal report's estimate of the project's economic return (6-7 per cent) and the financial rate of return (14 per cent) to farmers. While overhead costs had been included in the economic rate of return calculation, the secondary extra-project benefits resulting from RDA's extension services, if any, had not. However, in the Agriculture Projects Department's view, the exclusion of the RDA from the project and its separate financing by, e.g. a grant, would not affect the economic analysis because these costs, however financed, were essential to achieve the estimated benefits of the project.

(c) Another consequence of excluding the RDA component from the project might be too rapid exploitation of rubber trees and little or no replanting. In this event, the risks to Liberia's rubber industry and economy of not proceeding with the project and the RDA component, would, in the Western Africa Department's judgement, be greater than with IDA's participation.

3. The Committee, noting that the assumptions underlying the project's technical aspects and justification were subject to varying interpretations, agreed with the Chairman that the basic issue was one of how much confidence could be placed in the project's successful execution and impact, in the absence of alternatives for lending to Liberia's agricultural sector. The Agriculture Projects Department felt strongly that, quite apart from a marginal economic return, the risks that the project would fail were too high to justify IDA support at this time. The Western Africa Department, on the other hand, felt equally strongly that in the circumstances, IDA should be prepared to accept these risks and help finance a scaled-down pilot rubber project.

4. The Chairman, responding to suggestions that the project be redefined to include substantial technical assistance, eventually to be financed separately, proposed that the Western Africa and Agriculture Projects Departments should discuss recasting the project as appraised into a small experimental pilot project with a heavy element of technical assistance. The amount of IDA financing originally envisaged ($4 million) should be considerably reduced and, in presenting the revised project to the Directors in due course, IDA should disclose fully the experimental nature of the operation and its associated risks.

5. The Chairman approved Mr. Chaufournier's recommendation on the basis noted in paragraph 16 of his memorandum and paragraph 4 above.

C. <u>Adjournment</u>

6. The meeting adjourned at 12:30 p.m.

Secretary's Department
June 15, 1971

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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June 11, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Greece - National Investment Bank for Industrial Development

1. The Committee is requested to consider without meeting, the attached memorandum dated June 11, 1971 from the Europe, Middle East and North Africa Department, entitled "Greece - Proposed Third Loan to National Investment Bank for Industrial Development S.A. (NIBID)" (LC/O/71-85).

2. Comments, if any, should be sent to reach Mr. Siebeck (ext. 4707) by 1:00 p.m. on Wednesday, June 16.

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

David Pearce
Secretary
Loan Committee

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Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
Director of the Economics Department
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Sir Denis Rickett, Vice President
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Vice President (IFC)

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LC/O/71-85

June 11, 1971

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa Department

GREECE - Proposed Third Loan to
National Investment Bank for Industrial Development S.A. (NIBID)

1. Attached for consideration by the Loan Committee is an appraisal report entitled "Greece - National Investment Bank for Industrial Development, S.A." (No. DB-80) dated June 1, 1971. It recommends a third loan of $25 million to National Investment Bank for Industrial Development S.A. (NIBID). Two previous loans were made to NIBID, the first of $12.5 million in March 1968, the second of $20 million in April 1970. In addition to the NIBID loans, a loan of $13.8 million has been made to Greece for education and another for groundwater development ($25 million) has been approved by the Executive Directors on June 10.

2. The economic report on "The Current Economic Position and Prospects of Greece" (No. EMA-36a) was distributed to the Executive Directors on May 28, 1971. It concluded that Greece was creditworthy because of its favorable growth prospects, but that the recent increase in the external debt burden has to be watched.

3. The proposed loan would enable NIBID to continue to step up its lending to private industry in Greece. NIBID's performance under the two previous loans has been satisfactory. The first one has been fully committed, and $10.3 million have been disbursed. Of the second $17.9 million have been committed and $3.6 million disbursed. (All figures as of April 30, 1971).

Issues

4. Amount of the Loan - Over the next two years, that is between July 1971 and June 1973, which would be the anticipated commitment period for the proposed loan, NIBID foresees needs for fresh funds amounting to $102 million. About $5 million will come from a proposed increase in share capital by the existing shareholders. Issues of non-voting stock to the public are to bring in about $2 million. Another $10 million is expected to come from domestic bond issues, and $5 million from internal

cash generation. NIBID also hopes to obtain over the next two years $20 million from National Bank of Greece, its largest shareholder, and a like amount from the Bank of Greece (Greece's central bank). These resources would narrow NIBID's resource gap to $40 million, and to cover this NIBID is looking to external sources, among which the Bank figures prominently. NIBID expects to raise $10 to $15 million from European banks, for which discussions are under way, and is therefore seeking $25 million from the Bank. This would amount to about 25 percent of NIBID's requirements over the 2-year period. Past Bank loans represent, to date, about 30 percent of the total resources mobilized by NIBID.

5. The Operations Program for Greece as agreed at the CPP review in March (attached) schedules an amount of $20 million for this operation. I propose increasing the amount to $25 million to help cover NIBID's substantiated needs at an appropriate level, representing a somewhat lower proportion of total requirements than heretofore, over a two year commitment period (the previous loan of $20 million covered an eighteen month commitment period). There is only one other operation in Greece scheduled for FY 1972, a highway loan, which is likely to amount to $4.5 to $6.0 million depending on whether or not UNDP will have funds available to finance highway feasibility studies. This would keep the yearly total well within the limits approved in the CPP.

6. Debt/Equity Ratio - NIBID has been granted a Dr300 million loan by the Bank of Greece which originally was to be subordinated to other loans and to rank pari-passu with share capital in the event of liquidation. Legal problems have arisen, however, in having the loan rank pari-passu with share capital. The resolution of the problem is uncertain and also the subordination is therefore not yet effective. Furthermore, under the Bank's present practice of not including in the borrowing base the maturities of such subordinated loans due prior to the last maturity of the Bank's loans, none of this Dr300 million subordinated loan would be eligible for inclusion in the borrowing base in two years' time. DFC Department consequently recommends that NIBID's debt limitation be expressed in terms of an overall debt equity ratio and that the limit be set at 7:1 (see paras. 6.12 - 6.15 of the appraisal report). Debt would include all of NIBID's borrowings with an original maturity of one year or more. This procedure would avoid a situation where NIBID would be asked to reduce actual leverage when the point is reached where none of the subordinated loan qualifies as equity.

7. Considering NIBID's financial performance and portfolio quality, I agree with this recommendation.

8. Amortization Schedule - The Bank of Greece will continue to cover the exchange risk for NIBID on its indebtedness to the Bank. Both NIBID and the Bank of Greece would, therefore, like to repay the loan according to a fixed schedule. This removes some uncertainty that the Bank of Greece would have on its foreign exchange risk coverage as compared with the

situation existing on schedules normally applied to DFC loans, which are continuously amended to reflect amendments in the underlying sub-project amortization schedules. Given the fairly narrow range of maturities NIBID extends on its loans, a fixed amortization schedule can be forecast that will mirror quite realistically the actual composite repayment of funds by the sub-borrowers involved. I think that in the circumstances the proposal is sound.

9. Currency of repayment - The first loan to NIBID was repayable in US dollars as was standard policy for all DFC loans at that time. During negotiations for the second loan NIBID and the Government representative claimed that the normal Bank policies under which disbursement and repayment would be in multiple currencies would cause considerable difficulty for the Bank of Greece (which carries the foreign exchange risk). It was agreed, that the Bank in this particular case only, while not entering into any legal undertaking, would endeavour to disburse and to ask for repayment in one of six currencies, specified in a side letter, for which NIBID could express a preference.

10. Under the proposed loan we do not intend to extend such special arrangements.

Recommendations

11. I recommend that the Bank invite NIBID and the Government to send representatives to negotiate a loan of $25 million on the lines indicated in Chapter VII of the appraisal report and in this memorandum.

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

Attachments

Population: 8.8 m
GNP Per Cap: $740

GREECE - 5 YEAR OPERATIONS PROGRAM

(By Fiscal Year - Amounts in $ Millions)

OPERATIONS PROGRAM			1971	1972	1973	1974	1975	1976
4-GRE-AI-01	Irrigation I	IBRD	25.0					
4-GRE-AI-02	Irrigation II	IBRD			15.0			
4-GRE-AI-03	Irrigation III	IBRD				10.0		
4-GRE-AL-01	Livestock I	IBRD			10.0			
4-GRE-AX-01	Agriculture Unidentified	IBRD						10.0
4-GRE-DD-03	DFC - NIBID III	IBRD		20.0				
4-GRE-DD-04	DFC - NIBID IV	IBRD				20.0		
4-GRE-DD-05	DFC - NIBID V	IBRD						12.0
4-GRE-DD-06	DFC - HIDB	IBRD					20.0	
4-GRE-EE-01	Education I	IBRD	13.8					
4-GRE-EE-02	Education II	IBRD			18.0			
4-GRE-EE-03	Education III	IBRD					15.0	
4-GRE-TH-01	Roads I	IBRD		4.5				
4-GRE-TH-02	Roads II	IBRD					15.0	
IBRD			38.8	24.5	43.0	30.0	50.0	22.0
No.			2	2	3	2	3	2

	Total 1964-68	1969-73	1972-76
IBRD	12.5	136.3	169.5
No.	1	8	12

May 20, 1971

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

June 10, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Democratic Republic of The Congo - SOCOFIDE

1. The Committee is requested to consider, without meeting, the attached memorandum dated June 10, 1971 from the Eastern Africa Department, entitled "Democratic Republic of The Congo - Proposed Second IDA Credit for the Societe Congolaise de Financement du Developpement (SOCOFIDE)" (LC/0/71-83).

2. Comments, if any, should be sent to reach Mr. Moreau (ext. 3615) by 5:00 p.m. on Monday, June 14.

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

David Pearce
Secretary
Loan Committee

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Committee:

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

CONFIDENTIAL

LC/0/71-83

June 10, 1971

LOAN COMMITTEE

Memorandum from the Eastern Africa Department

DEMOCRATIC REPUBLIC OF THE CONGO

Proposed Second IDA Credit for the

Société Congolaise de Financement du Développement (SOCOFIDE)

1. Attached for consideration of the Loan Committee is the appraisal report (No. DB-79) dated May 28, 1971, on a proposed $10 million second IDA credit to the Government of the Democratic Republic of the Congo for onlending to Société Congolaise de Financement du Développement (SOCOFIDE).

Background

2. The five-year lending program for the Democratic Republic of the Congo is attached. The volume of lending is expected to average about $40-50 million per year over the next few years. A highway project based on preparatory work under the first road credit, as well as a first education project have been appraised and will be submitted to the Loan Committee in the near future. As I mentioned in my memorandum LC/0/71-47 dated March 29, 1971 to the Loan Committee with regard to a river transport project, we are still in the early stages of a lending program for the Congo. The primary emphasis in project preparation has been, and will for some time remain, focussed on the rehabilitation of the transport sector.

3. A Bank economic mission examined in 1968 the need for a development finance institution. It concluded that there was a substantial and unsatisfied demand for medium and long-term finance for new investments, mainly in manufacturing industry, and that the establishment of a development finance company would be justified.

The Bank Group thereafter took an active part in the setting up of such a company and made arrangements for a group of foreign shareholders to participate in the share capital of the new company. Société Congolaise de Financement du Développement (SOCOFIDE) was established in January 1970, and the Bank Group contributed a substantial share of SOCOFIDE's initial capital resources, through an IFC investment of $750,000 and an IDA credit of $5 million, both approved in May 1970.

The project

4. Private investment in the Congo has increased considerably over the past few years. Most of the investments have been carried out by firms already installed in the country, but new foreign investors are also expressing interest, following the Government's efforts to diversify the foreign business community. There were an estimated 170 investment projects under study or under execution at the end of 1970, with a total estimated cost of Zaïres 500 million (US$1 billion).

5. SOCOFIDE's share capital of Zaïres 2 million ($4 million) is fully paid in. 30% is held by private investors in the Congo and 25% by the Government and the National Bank. Foreign investors hold 26.25% of the capital, and IFC 18.75%. The Government granted SOCOFIDE an interest-free advance of Z 1 million which remains at the disposal of SOCOFIDE during its entire life and a long-term and low interest (1% per annum) loan of Z 2 million to be disbursed in two equal installments in June 1971 and June 1972. The proceeds of the IDA credit of $5 million were relent by the Government to SOCOFIDE at the interest rate of 7% per annum.

6. SOCOFIDE has been able to create the base for developing an efficient organization. It has been actively engaged in lending operations; its financial position is sound. As of April 30, 1971, it had approved loans totalling $6.2 million. Its prospects are very good. The company ended its first six months of operations at the end of 1970 with a profit of $40,000, as forecast. Of the $5 million IDA credit, $1.7 million was committed by the end of April 1971; the balance is expected to be committed by July 1, 1971.

7. SOCOFIDE will need about $16 million in new foreign exchange borrowings to cover its commitments from mid-1971 to mid-1973. The lending program for the Congo (attached) shows an amount of $7 million in FY 72 for a second credit to SOCOFIDE, but this was based on what now appears too conservative an estimate of SOCOFIDE's requirements for the next two years. The appraisal report recommends a credit of $10 million, the assumption being that additional needs might well be filled from other sources. SOCOFIDE is actually seeking

loans from such sources as Kreditanstalt für Wiederaufbau, the European Investment Bank and the Caisse Centrale de Coopération Economique. If the results of these efforts are not enough to meet SOCOFIDE's needs for the next two years, we might have to consider further lending in FY 1973 as now scheduled.

8. The proposed IDA credit would follow the general pattern of IDA credits in support of development finance companies. The Government would relend proceeds of the credit to SOCOFIDE at the Bank's interest rate at the time of credit approval. Repayments to the Government by SOCOFIDE would match the repayment schedules of SOCOFIDE's individual sub-loans.

The Economy

9. An Economic Report entitled "The Congo's Economy: Evolution and Prospects" (AE-13a) dated December 8, 1970, was distributed to the Executive Directors on March 29, 1971.

10. The economic revival, which was introduced by the monetary reform of 1967 and reinforced by high copper revenues, has continued without interruption for the last three years, with real GDP growing at a yearly rate exceeding 7 percent. This growth has been reflected in all sectors of the economy, although the rise in agricultural output has been somewhat less than that of other sectors. Copper output rose from 320,000 tons in 1968 to 385,000 tons in 1970. Furthermore, industrial production recovered from the shock of increased foreign competition caused by the liberalization of imports in 1967 and expanded by almost 10 percent in 1970 alone.

11. Although the impact of the recent fall in copper prices began to be felt in the second half of 1970, its full consequences will be felt only this year, when Government receipts are expected to fall by about 13 percent. In an effort to maintain public investment while keeping the overall budgetary deficit as small as possible, the Government has taken various measures to reduce current budget expenditure. Furthermore, it is exploring methods of mobilizing domestic savings, and is firmly determined to continue its policy of encouraging foreign investment.

12. The medium-term prospects for the Congolese economy thus continue to be promising. Any fall in public investment in the next five years will probably be offset by an increased foreign aid. Consequently, it is quite possible that the country will continue to develop at a yearly rate of 6-7 percent.

13. Because the bulk of the Congo's post-independence foreign aid has been given in the form of grants, its present foreign debt is fairly low ($379 million), with debt service representing only 3 percent of exports earnings. However, in view of uncertainties regarding future developments in the country, and in the light of its present poverty (per capita GDP $100), the provision of finance from IDA is appropriate at this time.

Issues

14. SOCOFIDE's good performance, so far, is due largely to the strong leadership of SOCOFIDE's Director-General, Mr. Serge Guetta, a Bank staff member seconded to SOCOFIDE for an initial term of two years. Under his direction, a small staff of thirteen professionals including three UNDP-financed financial analysts has been handling commendably a heavy load of project work. Mr. Guetta's employment contract with SOCOFIDE expires in March 1972, but there are strong indications that he will agree to extend it by another year. The Appraisal Report recommends that if it appears during negotiations that Mr. Guetta will leave SOCOFIDE in March 1972, the proposed IDA credit of $10 million be split into two tranches; the second tranche could be drawn upon only when a new Director General satisfactory to IDA has been appointed. The DFC Department, however, agrees that if during negotiations the Congolese delegation would accept a clause requiring prior consultation with the Association on any proposed appointment of a Director-General, the splitting of the IDA credit would not be necessary. I concur and feel that it would be indeed advisable to have such a consultation clause even in case Mr. Guetta decided to extend his term with SOCOFIDE until March 1973. This would have the advantage of giving the Association an opportunity to comment on the selection of SOCOFIDE's Director General, if for any reason Mr. Guetta were to leave SOCOFIDE before the end of his term.

15. At the senior staff level, at least four expatriate experts, including an engineer, are likely to be required for some years to come. SOCOFIDE's management intends to take the necessary steps to ensure continued employment of qualified staff in senior positions, and assurances on this should be obtained during negotiations.

16. SOCOFIDE's project appraisals have been of reasonably good quality. However, there is much room for improvement with regard to economic evaluation of projects. We intend, during negotiations, to discuss with the Government and SOCOFIDE the importance we attach to SOCOFIDE making an independent economic appraisal of projects it finances and to reach an understanding on this point. The need for SOCOFIDE to make such an appraisal is related closely to the broader issue of Government policy concerning industrial investments. In the past, investment proposals submitted to SOCOFIDE and for which the Government had granted fiscal and other privileges under the Congolese Investment Code, have not always been adequately studied by Government authorities. We therefore intend to explore during negotiations with the Government ways and means by which the Bank Group might assist the Government in this respect.

Recommendation

17. I propose that the Association invite the Congolese Government and SOCOFIDE to negotiate a credit of $10 million, along the recommendations in paragraphs 59-61 of the Appraisal Report as modified by paragraphs 14-16 of this memorandum.

Michael L. Lejeune
Director

Attachments

Population: 16.7 m
GNP Per Cap: $90

IVa. CONGO K - 5 YEAR OPERATIONS AND LENDING PROGRAMS
(By Fiscal Year - Amounts in $ millions)

OPERATIONS PROGRAM

			1971	1972	1973	1974	1975	1976
8-CØK-AF-01	Lake Fishing	IDA			3.0			
8-CØK-AP-01	Rubber Development	IDA		3.7				
8-CØK-AD-02	Cotton Development	IDA			5.0			
8-CØK-AL-01	Livestock	IDA			5.0			
8-CØK-AX-01	Agriculture Unidentified I	IDA				20.0		
8-CØK-AX-02	Agriculture Unidentified II	IDA					10.0	
8-CØK-AX-03	Agriculture Unidentified III	IDA						15.0
8-CØK-CC-01	Communications	IDA				10.0		
8-CØK-DD-02	DFC II	IDA		7.0				
8-CØK-DD-03	DFC III	IDA			20.0			
8-CØK-DD-04	DFC IV	IDA						15.0
8-CØK-EE-01	Education I	IDA		7.0				
8-CØK-EE-02	Education II	IDA					15.0	
8-CØK-QQ-01	Tourism	IDA						15.0
8-CØK-UU-01	Special Project - Urban	IDA					10.0	
8-CØK-TH-03	Highways II	IDA		17.0				
8-CØK-TP-02	River Transport	IDA	7.0					
8-CØK-TH-04	Highways III	IDA			15.0			
8-CØK-TH-05	Highways IV	IDA					35.0	
8-CØK-TX-01	Transportation Unidentified	IDA			25.0			
8-CØK-WW-01	Water Supply	IDA				10.0		
8-CØK-XX-01	Unallocated	IDA						15.0
		IDA	7.0	34.7	73.0	40.0	70.0	60.0
		No.	1	4	6	3	4	4

Total	1964-68	1969-73	1972-76
IDA		125.7	277.7
No.		13	21

LENDING PROGRAM (12/7/70)

	1964-68	1969-73	1972-76		1971	1972	1973	1974	1975	1976
IDA	-	82.0	135.0	IDA	10.0	36.0	25.0	14.0	30.0	30.0
		10	13		1	4	3	2	2	2

P & B 5/20/71

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

June 10, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Somalia - Second Highway Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated June 10, 1971 from the Eastern Africa Department, entitled "Somalia - Second Highway Project" (LC/O/71-84).

2. Comments, if any, should be sent to reach Mr. Roeloffs (ext. 3553) by 5:00 p.m. on Monday, June 14.

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

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

Copies for Information:

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

CONFIDENTIAL

LC/0/71-84

June 10, 1971

LOAN COMMITTEE

Memorandum from the Eastern Africa Department

SOMALIA: Second Highway Project

Introduction

1. Inadequate transport facilities within Somalia are one of the main impediments to economic development. The country has no railways, the air transport system is rudimentary, there are only two deep water ports, and the road network has not more than about 900 km of paved roads, a large part of which are in a poor state of repair.

First Highway Project

2. Our involvement in roads in Somalia goes back to 1965 when the European Development Fund (FED) of the European Economic Community (EEC), the United Nations Special Fund (UNSF) and IDA joined together in an operation to provide about $13.5 million to the Somali Republic for a highway project. This project included the engineering, construction and paving of a 200 km road between Baidoa in the hinterland and Afgoi near the coast, thus providing access from the agricultural areas inland to the port of Mogadiscio. The project also provided for road maintenance installations and equipment, the creation of a maintenance organization, feasibility studies of future roads and an analysis of transport investment needs.

3. Construction of the Afgoi-Baidoa road started only in 1968; the main reasons for the delay being the unforeseen difficulties in FED's approval of the contractual arrangements with the consulting engineers, a realignment of the road, and slow progress by the consultants in design and specifications. Because of this, it was not possible to invite bids for the construction of the road until March 1967. By that time construction costs had increased by $2.8 million, probably due to the Middle East war and the closing of the Suez Canal, and work on the road could not proceed until additional financing had been arranged. To cover part of the additional construction cost of the road, a supplemental IDA credit amounting to $2.3 million was granted in June 1968.

4. Construction of the Afgoi-Baidoa road has just been completed. The current estimate of the remaining costs, excluding unsettled claims by the contractor, is about $100,000 less than the funds still available from IDA and FED. However, the contractor has submitted claims totalling about $2.7 million. A recent supervision mission estimated that eventual settlement of these claims could amount to a minimum of about $900,000 and thus the Government may be called upon to meet a sizeable cost overrun. Because of the time likely to be required to settle these claims, the Closing Date of the Credit, December 31, 1971, may need to be postponed.

The Proposed Project

5. Based on the findings of the transport survey and a feasibility study carried out by consultants financed under the First Highway Project, the Government requested Bank Group assistance in financing a second highway project in an area of high agricultural potential in the northern region of Somalia. The detailed engineering of the road was prepared by consultants with financing provided by UNDP and the African Development Bank (ADB), with the Bank as Executing Agency. An IDA mission appraised the proposed project in December 1970. A representative of the ADB joined the mission and ADB has since agreed in principle to participate with IDA in financing the proposed project under joint financing arrangements.

6. The Appraisal Report entitled "A Second Highway Project in Somalia" (PTR-81 of April 16, 1971) is attached. It recommends that, subject to the conditions set forth in paragraph 6.01 through 6.04, the proposed project is suitable as a basis for an IDA credit of $8.6 million equivalent.

7. The proposed project will facilitate the development of one of Somalia's main agricultural districts. It would consist of:

(a) the construction of a 158 km all-weather surfaced highway from Hargeisa, the largest city of the northern region, to the recently expanded port of Berbera, Somalia's only part for ocean transport on the Gulf of Aden;

(b) assistance of consultants to (i) supervise construction and (ii) undertake a feasibility study of the road between Hargeisa and Borama (140 km) with a spur to Tug Wajale (20 km) on the Ethiopian border and subsequent detailed engineering should the roads prove to be technically feasible and economically justified.

8. Although the Hargeisa-Berbera road is the backbone of transportation of the northern region of Somalia, it is basically a trail which has been improved slowly over the years. The predominant economic activity in the influence area of this road is raising livestock, Somalia's main export. Total animal exports in 1968 were valued at $18 million of which 66%, or about $12 million, was realized from animals transported along the proposed project road and through the port of Berbera. The Hargeisa-Tug Wajale road is a logical extension of the Hargeisa-Berbera road, since it serves the most fertile areas in the northern region and completes the route from the coast to the Ethiopian border. It could become the main import and export route of a 50,000 sq km area in the Ogaden Province in Ethiopia where a number of agricultural and animal raising programs are being planned.

9. The internal economic return of the proposed project is 19% in terms of estimated road user savings and savings resulting from decrease in loss of weight and death of cattle during transport on the project road. The improved highway would also allow the operation of larger trucks more suitable for the transportation of livestock.

10. The Civil Engineering Department (CED) of the Ministry of Public Works would be responsible for the execution of the proposed project. Construction would be by contract awarded after international competitive bidding in accordance with Bank/IDA guidelines.

11. The project is estimated to cost about $9.5 million equivalent. The estimated foreign exchange component is $6.9 million (approximately 73%). It is proposed that 90% of project costs be financed by a $8.6 million IDA credit, considered as covering $6.2 million (90%) of foreign exchange expenditure and $2.4 million (90%) of local expenditures. The remaining project costs would be financed by a $0.9 million loan from ADB, considered as covering $0.7 million (10%) of the foreign exchange expenditures and $0.2 million (10%) of local expenditures. The cost of Russian fuels, which are estimated to cost about $300,000 and which are the only fuels available in Somalia, would be covered by the ADB loan. UNDP has been approached regarding financing of the feasibility and engineering studies; if such financing is obtained, the corresponding allocation ($0.55 million) would be deleted from the IDA credit, but the studies would remain in the project.

12. ADB's participation in this project could only be through a conventional loan carrying about 7% interest. Since Somalia is not in a position to service more than a very limited amount of such finance, it is appropriate to keep ADB's participation small. The justification of IDA's financing 90% of total project cost and 100% project financing from external sources, is discussed in paragraph 18 below.

13. In view of the uncertainties involved in contracting in Somalia, it was decided to obtain actual bid prices for road construction before Board Presentation to confirm the economic feasibility of the project and the adequacy of the financing plan. The Government has prequalified contractors and will shortly call for bids. With the concurrence of the Chairman of the Loan Committee, I informed the Government that, subject to the approval of the Executive Directors, we would be prepared to include in the proposed project, provision for retroactive financing of consultants' services up to about $20,000 to assist Government in the tendering process prior to credit signature.

14. Before Board Presentation, we also need to receive the following essential information:

(a) Government approval of the reorganization of CED, as recommended by the consultant financed by UNDP under the First Highway Project; and

(b) enactment of legislation on vehicle weights and dimensions, as required under the First Highway Project.

15. We are concerned that the amounts allocated in the Government's budget for road maintenance have been substantially less during the last six years than has been necessary for proper maintenance. Although earmarking has not been practised in Somalia, we would reach agreement with the Government during negotiations on earmarking specific Government revenues, or other appropriate steps, to obtain adequate allocations for highway maintenance. Such arrangements would be a condition of effectiveness.

16. We propose to reach an agreement with ADB during negotiations on the financial arrangements, as well as the arrangements for project supervision and for procurement and disbursement, for which functions the Association should have prime responsibility. A condition of credit effectiveness would be the conclusion of a loan agreement between ADB and the Government and an administrative agreement among ADB, the Association and the Government.

Past and Future Lending Operations

17. Past IDA operations in Somalia have included two credits totalling $8.5 million for the First Highway Project and a credit of $550,000 for engineering and accounting assistance for the port of Mogadiscio. In addition, an IDA credit of $3.3 million for an education project was signed on June 3, 1971. Two lending proposals for Somalia are presently under consideration; namely, a credit of approximately $7.5 million for the construction of a new port at Mogadiscio which, it is hoped, would be a joint financing operation

with FED, and a credit of an amount still to be determined for a livestock project which the Bank's Permanent Mission in Eastern Africa is helping to prepare. The 1972-1976 Lending Program for Somalia is attached.

Economic Situation

18. An Economic Report on Somalia (AE-10) was distributed to the Executive Directors on January 15, 1971, and summarized in my memorandum to the Loan Committee entitled "Somalia - Education Project", dated January 18, 1971. The report concluded that Somalia, since independence, has been faced with a severe financial constraint and has had to rely on external sources not only for the whole of its development budget but also to finance a large part of its recurrent budget. It is to Somalia's credit that much progress has been made towards reducing budgetary deficits, and it now looks possible that the Government will soon be able to eliminate its recurrent budget deficit, provided the present tough and pragmatic policies are continued. With a careful husbanding of its resources the Government should be able to cover the increase in its recurrent expenditure arising from the development program over the period 1971-1975. However, Somalia will still have to rely on external sources of capital to finance virtually the whole of the capital costs, foreign and domestic, of its development. In these circumstances, the financing of 90% of project cost including financing of $2.4 million of local expenditure, is considered justified.

Recommendation

19. I recommend that the Bank invite the Government to send representatives to negotiate a proposed credit of about $8.6 million equivalent for the Second Highway Project, substantially on the terms and conditions set forth in paragraphs 6.01 through 6.04 of the Appraisal Report.

Michael L. Lejeune
Director

Attachments

Population: 2.8 million
Per Capita Income: \$50 - \$60

Attachment

SOMALIA - ACTUAL AND PROPOSED LENDING THROUGH FY 1976

($ millions)

		Through 1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	Total 1964-68	Total 1969-73	Total 1972-76
Livestock I	IDA									3.0						
General Agriculture	IDA									2.0						
Livestock II	IDA										3.0					
Irrigation	IDA										5.0					
Agriculture - Unidentified	IDA												6.0			
Road Project I	IDA		6.2													
Road Project Supplementary	IDA				2.3											
Road Project II	IDA								8.6							
Port of Mogadiscio I	IDA					0.6										
Port of Mogadiscio II	IDA								7.5 1/							
DFC	IDA											1.0				
Education I	IDA							3.3								
Education II	IDA											3.0				
IDA Total		Nil	6.2	-	2.3	0.6	-	3.3	16.1	5.0	8.0	4.0	6.0	8.5	25.0	39.1
No.			1		1	1		1	2	2	2	2	1	2	6	9
IDA Credits Outstanding																
- including undisbursed		Nil	6.2	6.2	8.5	9.1	9.1	12.4	28.5	33.5	41.5	45.5	51.5			
- excluding undisbursed		Nil	Nil	Nil	Nil	2.3	5.5	9.1	10.5	16.7	24.3	34.3	36.3			

1/ assuming 7.5 from FED

Eastern Africa Department
June 8, 1971

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LC/A/71-8

June 3, 1971

NOTICE OF MEETING

A meeting of the Loan Committee will be held on Wednesday, June 9, 1971 at 2:30 p.m. in the Board Room.

AGENDA

Bidding Procedures for Indian Civil Works

The Committee will consider the attached memorandum of May 27, 1971 from Messrs. Chadenet and Baum to the Chairman on this subject. Mr. Kirmani's memorandum of May 24, 1971 to Mr. Baum, also attached, examines some major issues in the Bank's procedures for international competitive bidding.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

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

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

OFFICE MEMORANDUM

TO: Mr. J. Burke Knapp

DATE: May 27, 1971

FROM: B. Chadenet and Warren C. Baum

SUBJECT: Bidding Procedures for Indian Civil Works

1. An issue has arisen between the Government of India and the Bank on the application of the Bank's procedures for international competitive bidding to civil works to be financed under forthcoming irrigation and highway projects. This issue is considered in this paper under three headings:

a) What is the present capability of Indian civil works contractors to execute road and irrigation projects and how can it be improved?

b) What is the correct technology for executing civil works in India, taking account of the relative scarcity of capital and abundance of labor? and

c) In the light of (a) and (b) and of the Bank's general policies, what bidding procedure should the Bank require for the irrigation and highway projects?

2. The issue could potentially affect irrigation projects costing \$475 million, for which IDA credits of about \$250 million are scheduled in the five-year lending program. Major works suitable for international tendering under these projects are estimated to amount to \$150 million. In addition, one highway project for which an IDA credit of \$30 million is proposed is scheduled for FY 1972, and another highway credit (presently unidentified) could conceivably be made later in the five-year program.

I. CAPABILITY OF THE INDIAN CONTRACTING INDUSTRY

3. In general, highway and irrigation construction works are executed under the direct control and supervision of the State Departments of Public Works, normally with separate departments for highways and irrigation. Each department customarily divides its projects into very small units for different types of work (e.g. earth moving, canal lining, road paving) which are contracted to small local firms. Basically these firms undertake to supply labor, and sometimes materials, which are incorporated into the works under the direction of departmental engineers; this is essentially a modified form of force account execution.

4. This traditional system of project execution has carried over from the period when engineering technology and skills were in short supply or available only in government departments. The execution of civil works under direct departmental control involves public works engineers not only in the planning, design, programming, and supervision of works, but also in the overall management of the construction project. This, together with the division of the works into small sections which are allocated to numerous "contractors", who are little more than suppliers of labor, has seriously retarded the development of local contracting firms. Most developing countries have abandoned the execution of civil works by departmental forces, and have instead encouraged the development of a local contracting industry.

5. The system of departmental project execution of civil works has made it possible to spread limited financial resources over many -- perhaps too many -- starts since no extended commitments to contractors covering multi-year contracts need be made. The financing plans of public sector projects have tended to be rigidly molded by state and national plans and by the fiscal arrangements through which the Government of India supports State Government's annual development budgets. The system has provided incentives to under-estimate costs to ensure inclusion of projects in plans. Consequences of under-estimates are less obvious since no contractor claims need to be faced and since the contracts cover only the day-to-day costs of labor; therefore cost overruns show up most directly as a loss of time. One of the most serious consequences has undoubtedly been the excessive period of time required to complete irrigation works in India. The Kadana irrigation project, for example, was started in 1954 and Tawa irrigation in 1956; both will take 20 years to completion. Capital resources have thus been tied up unproductively over long periods of time, at a heavy cost to the economy.

6. The traditional attitudes towards the execution of civil works are reflected in the standard form of contract. Public Works Department engineers not only negotiate contracts and impose modifications thereto, they also unilaterally arbitrate and settle claims to which they themselves are a party. Contract sizes, and especially construction periods, often reflect the uncertainty of future levels of funding rather than the needs of efficient project execution. A first priority should be to develop and adopt provisions with respect to size, length and comprehensiveness of contracts which ensure better project execution,and to recognize the legitimate interest of contractors by means of a neutral source of arbitration. Local contractors have also had difficulty in gaining access to credit facilities and in acquiring locally-made or imported equipment, and have not been accorded the tax status of a "priority" industry.

7. There are a small number of Indian contractors with competent engineering and management staffs and sufficient resources to execute projects throughout India. They have undertaken major works at home (e.g. bridge building) which by their nature have not been amenable to force-account procedures, and abroad (e.g. transmission lines), but have not made much impact on irrigation or highway projects; firstly, because lacking allocations of Indian-made equipment or of foreign exchange for imports, they are under-equipped; secondly, because their main potential asset -- management ability -- directly threatens traditional powers of entrenched civil servants; and thirdly, because pressure to relate their bids to the published PWD estimates has narrowed their profit margins. The PWD estimates rely on unit rates which are unrealistic, being based on past experience of direct expenditures without regard for the "hidden" cost of supervision and management, and even of machinery overheads, inherent in the force account system.

8. In recent years Bank staff have interviewed representatives of contracting firms in India, both large and small, all of whom expressed an interest in forthcoming Bank-financed projects. Contractors wish to increase their capacity to execute large irrigation and highway works, but are reluctant to do so until such time as the Government has committed itself to putting to contract a continuing and increasing amount of development works. Furthermore some contractors have expressed interest in associating themselves, on a limited basis, with foreign firms to the extent that this would be necessary to cover skills which they felt they did not possess at the moment.

9. There is evidence that the Government has become increasingly aware of the shortcomings of its present contracting procedures. It has undoubtedly been influenced by the findings of the Indian team of (government) highway engineers and contractors which visited Thailand, Kenya and Mexico at the Bank's invitation. The time is therefore ripe for the Bank to assist India in the transition to modern methods of contracting and executing civil works, the long-term benefits from which would extend far beyond the particular projects which would be financed. The principal elements of the necessary reforms are:

(i) concentrating financial and technical resources on priority projects so as to make possible commitments extending beyond annual budget periods;

(ii) a public statement of Government intent to develop the local contracting industry by putting entire works to tender on contracts of substantial size and for a duration of years;

(iii) improvement in the tax status of the contracting industry and in its access to public credit facilities;

and (iv) improvements in contract provisions to include, inter alia,

a) a neutral source of arbitration;

b) strict delineation of Public Works Department engineers' responsibilities, which should be limited to those of planning, design, and general control rather than project management;

c) access of contractors to the equipment of their choice, either local or foreign;

d) provision of reasonable advances for purchase of equipment and other mobilization costs.

10. With these improvements it should be possible for India to develop an efficient contracting industry capable of carrying out large civil works contracts both at home and abroad.

11. Since the Public Works Departments have had little experience in supervising construction of large works of the type envisaged for currently proposed Bank projects, consultants may have to be employed in some cases to supervise these works. As there are few Indian consulting firms experienced in this type of work, foreign consultants will have to be used as well. The Bank should encourage foreign consulting firms to associate themselves with Indian firms, in order to form the nucleus for an Indian consulting industry specialized in modern construction techniques.

II. CHOICE OF TECHNOLOGY AND SHADOW PRICING

12. In India, as in most other developing countries, there is a shortage of capital and, at least in some regions, a surplus of unskilled labor. It is therefore important that the design and execution of projects take account of this resource situation. When, as is also often the case, market prices for capital and labor do not reflect their true economic costs, a further issue arises whether "shadow" pricing of factor inputs should not be used in the design and execution of civil works. Shadow pricing of foreign exchange, capital and labor is now being done by Bank

staff as a matter of routine in the economic evaluation of all projects to which it is relevant, and to the extent that project selection is thereby influenced or determined an important objective is already being accomplished. The question is whether such shadow pricing could practically be extended to the design and execution of the projects.

13. The optimum choice of technology, as between the use of capital and labor, is a complex subject about which much more needs to be known. At the risk of great oversimplification, civil works can be divided into three categories, described below in descending order of technology:

(a) Skill-intensive works involve not only highly mechanized types of operations but the use of special skills as well. Such works are now emerging as an important factor in agricultural projects because of the requirements of more sensitive crop varieties, improved cultivation and irrigation practices, and attendant distribution problems. Land leveling to small tolerances and silo construction are typical examples which have already been encountered during appraisals; others will undoubtedly arise. In land leveling, special skills are needed at every stage: planning, survey and layouts, and operation of specialized machinery. For silo construction, the most economical construction technique -- slip forming -- requires special skills and experience. If specialized skills were diffused too widely, e.g. by expecting every State Public Works Department to acquire them and to procure specialized equipment, under-utilization of capacity could easily result. Given an effective demand for services, contractors could quickly develop such skill-intensive capabilities, ensuring that the available talent and equipment are mobile and not restricted to one State.

(b) Machine-intensive works include a number of key operations which cannot be properly done by labor, e.g. compaction of highway pavement and of earthen dam embankments and canal banks. More generally, this category includes a range of operations where labor or machines can be used, but where (i) the financial advantage (at current prices) lies heavily with machines, or (ii) the much faster rate of machine work produces tangible economic benefits. When earth has to be moved over fairly long distances, or raised vertically over certain heights, as may be the case for highway construction in rolling and mountainous terrain, machine-intensive methods may be the only ones possible. Acqueducts, bridges and similar canal and highway structures usually require machine-intensive methods, but ditches, culverts, regulators and turnouts can just as well be built in labor-intensive masonry. The technical selection of machine- or labor-intensive methods for canal linings often depends on local availability of materials (brick-clay versus concrete aggregates).

Traditionally, fairly large contracts have been awarded for dams in India, but sometimes only for one year's work at a time. Only small contracts have been awarded for excavation and other earthworks. In situations where the Government agreed that machine-intensive methods had a clear advantage, the equipment was purchased (as in all IDA credits to date) by Government and used departmentally or rented to contractors. However, Indian contractors have the "know-how" to operate earthmoving equipment and, given access to equipment and to technical advice when needed, they should be able to bid for major civil contracts involving machine-intensive works.

(c) Labor-intensive works include earthworks (clearing, leveling, excavating) of small size or with short hauls and any type of work where individual jobs are small and the sites so scattered that it is uneconomic to deploy machinery and to provide skilled management. Typical examples are field drains and distributory canals with their structures, feeder or secondary roads, and small storage buildings and markets. Vast labor forces have been assembled on some irrigation projects (e.g. Nagajunasagar in Andhra Pradesh where a masonry dam 409 ft high was built in about 15 years by the ultimate in labor-intensive methods). However, there are areas where severe local shortages occur; the Madhya Pradesh Government estimates that 85% of all labor (and more than 90% of skilled workers) for the Tawa project will have to be imported over considerable distances from other States. Rajasthan,Orissa, Andhra Pradesh, Kerala, and Tamil Nadu are the main reservoirs of workers willing and able to undertake the arduous labor of dam construction and canal excavation, involving headloads of up to 70 lb of rock or soil. Present methods of mobilizing this labor are inefficient and costly. The Tawa appraisal mission found that, even for contractors (who are more efficient in this respect than PWD), the total cost of unskilled labor is about Rs 7.50 per day or more than twice the daily cash wage which averages Rs 3.50 for piecework. A careful analysis must be made in each case to ascertain that labor will in fact be available in the numbers and skills desired and at the right time of the year.

Substitution between Levels of Technology

14. Labor-intensive methods can rarely substitute for skill-intensive technology without serious loss of benefits. For example, experience shows that land can be leveled by hand, but that the process is too slow in the context of a modern irrigation scheme with heavy investments in the dam and canals. For some machine-intensive works such as compacting or hauling earth over certain distances, the technical superiority of equipment is such that labor is unlikely to prove a substitute over any realistic range of prices. On the other hand, for a considerable range of operations there is the possibility of technical substitution between labor and machines, or between machines of different types, with their associated labor requirements. Excavation of minor canals and drains and some other types of earthworks are cases in point. In these operations, the technological choice is likely to turn on relative prices, and the issue of shadow-pricing (discussed below) becomes relevant.

15. More needs to be known about the substitutability of factor inputs. For this reason, two major studies are underway jointly in the Transportation Projects Department and Economics Department concerned with: a) the optimum design of highways; and b) the substitutability of labor for capital in highway construction. 1/ Less comprehensive studies of farm mechanization have been or are being undertaken in the Agriculture Projects Department. The Economics Departments have also undertaken some studies of the economic aspects of shadow pricing in agriculture, and others are underway.

16. The above-mentioned studies should shed some light on the possible role of shadow pricing. However, since the Indian procurement issue is a pressing one, some tentative observations are ventured below.

Use of Shadow Pricing in Design and Execution

17. It is possible to distinguish between shadow pricing in project design and in tendering for project execution, although the two are in some respects interrelated.

1/ A staff paper done in 1965 on the "Substitution of Labor for Equipment in Road Construction" (SecM 65-118) concluded that the range of possible substitution of labor for equipment averages about 15% of the total costs of road construction. The study now underway would examine this question in a much more comprehensive fashion, including extensive field investigations. The range of substitution is likely to be considerably greater in the case of irrigation projects in view of differences in terrain.

18. Given a situation in which market prices do not reflect real costs, shadow pricing could potentially be a significant aid to choosing the most appropriate project design. The shadow prices to be considered at the design stage are those for foreign exchange, domestic capital, and labor. The foreign exchange rate is relevant for the imported equipment and materials used in construction. Selection of an appropriate shadow rate for foreign exchange is difficult, but Bank staff have had some experience in this matter. It would be more difficult to make the necessary adjustments in import duties, taxes and similar items to modify the prices of foreign and domestic equipment to reflect economic costs. Even more formidable is the task of determining the shadow price of domestic labor, i.e. its opportunity cost in alternative employment activities. This would have to be differentiated according to the skills and types of labor and season of the year, and be done for the region or regions from which labor would be recruited for the project. Cultural attitudes which affect the labor for certain kinds of activities would also have to be considered.

19. Once the appropriate design for the project has been established, it is a separate question whether shadow pricing should also be followed at the tendering and construction stage. If market prices are used, the project may still be executed according to the appropriate design, but the financial costs may be larger than they would otherwise have been. This in turn may result in the diversion of funds from other investments; since these investments presumably will not have been based on shadow pricing it is not evident that the diversion will necessarily improve the allocation of resources within India.

20. Furthermore, the technological options are never fully foreclosed at the design stage, and for any given design there may be a range of possible construction techniques using different combinations of labor and equipment which may be sensitive to their relative prices. If shadow pricing is to be used to influence the choice of construction methods, it would therefore be desirable that it apply at the tendering stage as well. However, this would introduce additional complications. The tender documents would have to specify the shadow rates to be used by bidders. Presumably there would be strong objections to having the bid evaluations based on a published foreign exchange rate different from the official one, and we would need to explore whether ways could be found to circumvent this obstacle. What could be done about domestic equipment would depend on the solution, if any, found for the foreign exchange rate. The shadow labor rates would be those used in the design analysis. Bank staff have, of course, already been estimating shadow prices for the economic evaluation of projects in many cases. However, this has been done to test the sensitivity of the economic return to alternative assumptions with respect to the key variables; to the extent that detailed and complex decisions on the use of resources, and on the nationality of firms which may win the bids, are involved, a higher degree of precision should be required. Moreover, it would be necessary to reach agreement with the Government on the shadow rates to be used, which is not the case for a project's economic evaluation.

21. With bidders tendering on the basis of shadow prices, there would be two alternatives with respect to project execution: a) the successful bidder would be paid on the basis of market prices for labor, etc., but would be required to carry out the works in accordance with a detailed schedule of equipment and labor as specified in his bid proposal. (This would be necessary to ensure that the "economic" proportions of capital and labor on which his bid was based are in fact used, even though different proportions would be more advantageous to him on the basis of market prices); or b) the successful bidder would pay his labor on the basis of the shadow wage rates, with supplementary payments to reach money wage levels provided directly by some level of government. The first alternative, while perhaps involving fewer administrative complications, has the disadvantage of freezing the decision of the contractor; it would deny him the necessary flexibility to change his proportions of equipment and labor as the work progresses and as relative prices (including "real" ones) change. This lack of flexibility could in the end result in higher project costs. The second alternative could involve substantial additional payments outside the contract, which could introduce administrative problems concerning the respective responsibilities of the state and central government. Whichever method is used, the project will cost more in financial terms; given the chronic budgetary difficulties of India in the field of project finance, the importance of the added financial transfers which arise from shadow pricing should not be minimized.

22. As the foregoing illustrates, our thinking on this subject is still at a preliminary stage. The principal questions which have arisen concern the difficulties of estimating shadow prices and making other adjustments to market prices with the degree of accuracy required for project design, tendering and execution; of raising the additional funds which result from the fact that resources must ultimately be paid in market prices; and of ensuring that the correct resource allocation decisions are in fact reached in a situation where shadow prices are used for Bank-financed projects but not for other investments in the country.

23. In conclusion, it is important to ensure that the design and execution of projects in India, and elsewhere, are not linked to capital-intensive techniques if these are not appropriate to the resource needs of the country. We shall continue to pursue actively the question of shadow pricing. Discussions are now being held with several large contracting and consulting firms to ascertain their reactions to the possible use of shadow prices for project execution. As soon as our understanding is more advanced, and some results are obtained from the studies underway, we should try a controlled experiment with shadow pricing on a limited scale, beginning at the feasibility stage where the design options of the project are still open. At present, however, we are not in a position to recommend the use of shadow pricing, for design and procurement purposes, for the Indian irrigation or highway projects now under consideration.

24. It should be noted that while shadow pricing, to the extent that it encourages labor-intensive techniques, would tend to favor local over foreign firms, this <u>per se</u> is not an argument against international competitive bidding. Firms of all nationalities could be given equal opportunity to bid on the basis of whatever prices are specified in the contract documents.

III. INTERNATIONAL COMPETITIVE BIDDING FOR INDIAN CIVIL WORKS

25. It has been the general policy of the Bank to require international competitive bidding for civil works; the exceptions, which have been few, have been related to works which, by their special nature, were unsuitable for foreign contractors. 1/ The Indian Government is reported to be opposed in principle to the application of international competitive bidding to civil works. Inability to reach agreement on this issue has postponed a prospective highway project for several years. Exceptions have been made in irrigation projects because the Bank was financing on-going projects for which the large contracts (e.g. for the dam and main canals) that would be suitable for international competition had already been placed. However, in the irrigation projects now under consideration there are large civil works remaining to be carried out for which an exception to international tendering on technical grounds cannot be made.

26. We can see no basis for exempting India from the Bank's requirements for international competitive bidding. The principal advantages of this bidding are familiar and will only be mentioned here. They are: a) providing all the member countries of the Bank an opportunity to participate in the supply of goods and services under its projects; and b) helping to ensure that projects are carried out economically and efficiently, to the benefit of the economy of the country in which the project is undertaken.

27. For international competitive bidding to be effective in India, a number of changes in the present maze of regulations, restrictions and cumbersome procedures would have to be implemented, such as those surrounding the granting of import licenses. Even so, foreign firms would be at a natural disadvantage, and it is very likely that most, if not all, of the contracts would be won by Indian firms. This would particularly be so if the reforms in Indian contracting procedures referred to in Section I, which would strengthen the position of the Indian contracting industry, are carried out and if, as indicated in Section II, the design of civil works projects gives due attention to the Indian resource situation in the choice of technology.

28. It cannot be said, however, that no foreign firm would be interested in participating in Bank projects in India. Joint ventures of local and foreign firms have won other large civil works contracts in the past, although their experience with the Indian authorities during project execution has been less than satisfactory. Provided

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1/ A recent restatement of Bank policy on this subject can be found in SecM 71-111 of March 1, 1971.

that contracts are of sufficient size and that the Government's intention to follow international competitive bidding is made clear, there is no reason to believe that international firms would not be interested in the future. Moreover, foreign firms should be given the opportunity to decide for themselves whether or not they wish to participate, rather than being excluded in advance on the basis of a staff judgment as to the extent of their interest. International competitive bidding has been the rule in countries with more advanced contracting industries than that of India (e.g. Argentina, Brazil, Colombia, Iran, Mexico, Yugoslavia) and where virtually all of the awards have gone to local firms, occasionally in joint venture with foreign firms.

29. It is understood that some Indian authorities have expressed concern that, if the present force account procedures are abandoned in favor of competitive tendering, the few large Indian contracting firms would get together to fix higher prices. This is one of the ways in which international competitive bidding, with the potential threat of foreign entry if local prices are too high, will help to ensure that the projects are executed at minimum cost.

30. In interviews with Bank staff, a number of Indian contractors have expressed interest in being associated with foreign firms in joint ventures, to take advantage of the technical skills of such firms. Joint ventures should be encouraged in the bidding documents (but not made compulsory), and most firms interested in bidding would undoubtedly seek Indian partners. Even in the unlikely event that a purely foreign firm were to win an award, exposure of Indian contractors to modern technology and management practices, together with the stimulus of outside competition, could be expected to have a salutary effect on the local industry.

IV. SUMMARY

31. A major objective of Bank Group lending for irrigation and highways in India should be to help develop a modern local contracting industry capable of carrying out civil works projects in an economical and efficient manner. The Bank Group should support recent Government initiatives to this end, and should ensure that the civil works contracting procedures are consistent with this objective by shifting from force account to public tendering for contracts of adequate size and duration and making other changes in contracting procedures and in Government policies towards the contracting industry. Financing should be included in Bank projects for the procurement of construction machinery and equipment by local contracting firms and for technical assistance to these firms.

32. Care should be taken in the preparation and appraisal of civil works projects to ensure that the choice of technology in design and execution takes proper account of the scarcity of capital and surplus of labor. The possibility of using shadow prices in the design and execution phases should continue to be explored, but shadow prices should not be introduced into Indian projects for this purpose until the consequences of doing so are better understood.

33. The Indian Government should be informed that future Bank Group lending for civil works projects will be based on international competitive bidding, except in cases where it is technically unsuitable, in order to ensure both that projects are executed economically and that there is continued international support for Bank Group lending to India.

WCBaum:rma

cc: Messrs. Aldewereld, Shoaib, Cope, Christoffersen, Cargill, Votaw, Kirk, Evans, Wapenhans, Haynes, Knox, Hardy, Weiner, Kirmani, Lithgow, Baldwin, Henderson, Reutlinger

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

OFFICE MEMORANDUM

DRAFT

TO: Mr. W.C. Baum

DATE: May 24, 1971

FROM: S.S. Kirmani

SUBJECT: Bidding Procedures for Indian Civil Works

1. Of all the problems in the Bank's lending operations, the one relating to procurement of goods and services is perhaps the most difficult. It has caused more arguments and misunderstandings, more protracted negotiations and more delays in the commencement of works than any other aspect of Bank policies. What is there in the Bank's procurement procedures which is so objectionable to the developing countries? The Draft Memorandum of May 19, 1971 discusses several aspects of this problem with reference to bidding procedures for Indian civil works. It would be useful, however, to examine some major issues in the bidding procedures which are creating difficulties in Bank's operations.

2. Developing countries want to get from a Bank-financed project, not only the project infrastructure but also the experience and the know-how on all aspects of the project implementation. They want to use the opportunities provided by the project to develop local talent and competence of both public and private institutions to handle similar jobs in the future without external assistance. They would like to engage national consulting firms and construction contractors, use locally produced goods and employ local staff and labor for the execution of the project. In brief, they would like to utilize the proceeds of the Bank/IDA loans to the maximum extent within the country. There is no doubt that they could achieve the above objectives more effectively and more speedily if they have the opportunity to do the jobs themselves provided, of course, that it is feasible to do so in practice without adversely

affecting the other requirements of the project.

3. In the above situation, the reluctance of the Government of India to accept the normal Bank procedures for procurement of goods and services is not surprising. The initial reactions of Pakistan to Bank procedures on the Indus Basin Project were similar. My experience on projects financed by IDA in Ceylon and Indonesia also shows that these countries had similar reservations on Bank procedures for international competitive bidding.

4. The main objectives of the Bank in requiring international competitive bidding are: (a) to ensure that the projects are carried out economically and efficiently according to sound, technical, financial and management practices; and (b) to provide the member countries of the Bank an opportunity to participate in the supply of goods and services under its projects. It is also clear that an international institution like the Bank has to follow uniform procedures for procurement of goods and services in all its member countries and cannot apply different procurement procedures in different countries to suit the wishes of individual member countries.

5. The question to be answered is: Is there a real conflict between the objectives of the developing countries and the policies of the Bank? Stated somewhat differently - can the developing countries achieve their objectives in practice without violating the policies of the Bank on procurement of goods and services? And, can the Bank's policies promote and make possible for the developing countries to achieve their objectives without compromising the principles of procurement?

6. I do not believe that there is any real conflict between the policies of the Bank and the aspirations of the developing countries. The Bank's main objective is economic development which includes development of institutions, methods and practices to optimize economic growth as much as the building of the economic infrastructure. The answers to the above questions, however, would depend upon how the procurement procedures are understood and interpreted; how they are applied by the Bank in practice, and how the developing countries use them to achieve their goals.

7. The first major objective of the procurement procedures is to ensure that the projects are carried out economically and efficiently according to sound, technical, financial and management practices. No developing country could reasonably object to the above principles although the concepts of what are sound, efficient and economical practices may differ widely. This is an area where the Bank should mount a major effort to develop an understanding of its policies in the developing countries. Since there are no basic differences on principles, it should not be too difficult to agree on details. The second objective of the procurement procedures is to provide the member countries of the Bank, including the borrower, an opportunity to participate in the supply of goods and services under its projects. This is an area where suspicion often governs the thinking and attitudes of the borrowers rather than the merit and fairness of competitive bidding. The Bank's procedures are widely misunderstood and misinterpreted by borrowers as a deliberate mechanism to promote the business of the developed countries. They are regarded as a /constraint to

achieving their aspirations to develop local talent, local competence and local construction industry. As a consequence, most developing countries do not like the procedures and some tend to take the extreme position that competitive bidding should be limited to local contractors or that the works be split up into such bits and pieces as to virtually exclude the possibility of foreign consultants and contractors. This approach leads to other controversies on the concepts of sound, efficient and economical practices and on bidding procedures, forms of contract, design and construction methods.

8. The Bank is sympathetic to the aspirations of the developing countries. As an international institution, however, it can neither agree to restrict competitive bidding to local contractors in a developing country nor serve as an instrument for promoting the business of developed countries. It is an institution for economic development and, therefore, it is as much concerned with the building of economic infrastructure as in the development of efficient institutions, sound procedures and effective practices for efficient planning, construction and management of the infrastructure. The difficulties in introducing institutional reforms are often political, mostly due to inter-departmental bickerings and jealousies. Their success depends on how effectively the developing countries were able to resolve their own internal conflicts. But the Bank's efforts have been always appreciated and there was seldom any misunderstanding about its objectives.

9. The problems of introducing sound procedures and practices for efficient planning and implementation of projects have often proved more difficult because they involved sudden and drastic changes in the existing procedures and practices. The proposed new changes, which are based on demonstrated success of practices in developed countries often cause strong reactions, particularly in those countries which feel proud, with some justification, of their past achievements and which do not consider themselves as "backward" as the advocates of the new practices seem to believe. The main reasons for such reactions are:

(a) The proposed changes in effect discredit the existing practices of the developing countries as outdated and inefficient; hurt their pride, create a feeling of inferiority; and lower the esteem of their technical staff in the eyes of the higher government echelons;

(b) Because they do not have the experience of the new practices, they are afraid and loathe to lose their authority as decision-makers, designers and builders and the pride and satisfaction it provides; and

(c) They feel jealous of the high remuneration of the foreign consultants'and contractors' staff and deeply resent the unfair treatment to their own staff both in terms of salaries and amenities.

10. The above reactions are mostly psychological but they are important because they influence the attitudes of the borrower to Bank's efforts for development. The success of the Bank's efforts depend not merely on the merits of the new procedures and methods but also on how the borrowers are introduced to the new practices; how they are allowed to participate and adopt them; and how they are made to own and feel proud of them. Unless the Bank focuses on these questions, the arguments on procurement procedures would continue to affect the development in the borrowing countries as well as the success of the Bank's operations. The Bank often uses its lending program as a leverage to introduce the new practices. The leverage is effective and the Bank has been quite successful in using it to ensure implementation of the projects according to sound, efficient and economic criteria. But as long as the borrowers feel that they are forced to accept the Bank's procedures, the success is temporary and the Bank does not achieve its main objective which is to introduce the improved practices in the countries as a standard to be followed for all development projects and not merely for the projects financed by the Bank. There is the need to explore other possible alternatives for achieving Bank's objectives. The main issues are: (a) form and system of contracts; (b) choice of designs and construction technology; (c) bidding practices and (d) promotion of local construction industry.

Form and System of Contracts

11. There are several forms of contracts - if "contract" is the right word for some of them - followed in the Indo-Pakistan Sub-continent and in most of the former British colonies. They are "Muster Roll","Work orders based on approved schedule of rates," "Work orders based on competitive bidding" and "Unit Price Contracts." Except the Muster Roll works in which the department hires labor directly, all the other types of contracts are based on some kind of competitive bidding. The Muster Roll work is now rarely used except for petty repairs requiring very few laborers for a few

days or in emergencies such as canal breaches when immediate action is necessary. Most small works are carried out on the Work Order system and the contractor has no choice but to accept the printed schedule of rates which are generally way below the market prices. For medium size works, contractors are invited to bid unit prices in the form of percentage premium[1/] over the existing schedule of rates. Although the PWD codes require that the Work Order system should not be applied to works exceeding certain specified sums, which are usually small, the departments often split the works to avoid violation of the rules. For larger works, bids are invited on the basis of unit prices.

12. There are serious weaknesses in the above forms and system of contracting, but the most damaging features of the above contracts which frustrate the development of local construction industry are:

(a) The contractors' responsibilities are limited only to supplying the labor;

(b) The department assumes all the four functions of the "Employer," the "Engineer," and the "Arbitrator" as well as of the "Contractor" in as much as it does everything except recruitment, payment and management of the labor. The word contract as normally used in the developed countries is, therefore, not really applicable to the above "contracts."

1/ For example, if the existing schedule of rate for earth excavation is Rs 0.50 per cubic yard, the contractors bid the percentage increase over this rate at which they are willing to do the job.

12. A major reform is thus required in the form and system of contracts irrespective of whether they relate to Bank-financed projects or to projects financed with local resources. The contractor should have full responsibility for the labor, materials, workmanship, programming, management and all logistics of the construction operations. He should be paid on work done and measured according to specifications and terms of contract and should have the right to seek arbitration on any disputes through some neutral body which is not connected directly with the project. The Engineers' responsibility should be limited to design, supervision of works and contract administration. If it is necessary for the Employer to supply specific materials or equipment which cannot be easily procured by the contractors, the terms of such supply should be specified in the contracts, and the contractors should be responsible, subject to the Employer meeting his obligations, for the works. The main purpose of the above changes in existing contracting practices is to elevate the status of the contractors to the position of a partner in the contract for the project with clearly defined obligations, responsibilities and rights, as offered and accepted under the contract. Unless this is done, all efforts to build up the local construction industry would not produce the desired results. These changes, together with such incentives as improvements in the tax status, reasonable advances for mobilization and purchase of equipment, bonus and penalty provisions, interest on delayed payments, etc., would accelerate the development of the construction industry. The introduction of a form of contract similar to FIDIC or other standard forms followed in developed countries with modifications to suit the local conditions in the developing countries is the key to the solution of most problems encountered in Bank's operations.

13. The above form and system of contract is not new to developing countries. In Pakistan, for instance, all private industries and semi-autonomous organizations like WAPDA, PIDC, ADC are now using this system, not only for Bank-financed projects but also for locally financed projects. Once an organization adapts this system, its merits are appreciated and the weaknesses of the old systems become more obvious. It is not easy, of course, to introduce this system in established Government Departments, like the Irrigation and other PWD departments whose activities largely concern maintenance and operation. But when such departments undertake large new construction works, special arrangements could be made to create a "project cell" under a Project Director to operate on the contract system. This is consistent with the provisions of the PWD codes in India and Pakistan.

14. The Bank can help to introduce the contract system in the developing countries in the following ways:

(a) Adopting the contract system on projects financed by the Bank Group;

(b) Encouraging the governments to establish new institutions having primary responsibility for construction of development programs, quite separate from the normal departments for maintenance and operation. (For example, WAPDA, PIDC and ADC in West Pakistan.)

When the scope of the program is not large enough to justify establishment of a new institution and if it more convenient to implement it through the existing departments, a separate project cell can be created to operate the contract system; and

(c) Providing technical assistance to governments to establish commissions or use private institutions like the Institution of Engineers, Association of Contractors, etc. to review the existing contracting practices and develop the form and conditions of contract to be followed as a Standard Form of contract for all projects. The development of form and conditions of contract in other countries has been largely done through the efforts of such private institutions. (For example, by the Institution of Civil Engineers, London; FIDIC in Europe; American Association of Contractors; American Society of Civil Engineers, etc.)

15. The Bank is already following (a) and (b) above for Bank-financed projects, but its efforts are being regarded as an imposition from outside. The merit of (c) above is that it will be a national effort and when approved by the government, the system will have the legal force of a "Code of Practice."

Design and Construction Technology

16. The design of the works, the methods used for construction and the economics of the alternatives are interrelated. As the designs are completed before the project is contracted, the designers' experience and judgment of the construction methods best suited for the job have a strong influence on the type of design selected and the choice of materials. For example,

foreign consultants usually select designs which are conducive to use of equipment with minimum input of labor. In doing so, they are reflecting their own experience on similar jobs in the developed countries. Engineers in the developing countries tend to select the designs which permit employment of a large labor force with minimum use of equipment, more often because of their own past experience on such works rather than the consideration of the economics of employing labor. There are many variations in practice between the above extreme choices of construction methods depending on the nature and size of the jobs.

17. When works are contracted on the basis of competitive bidding, it is important that the contractors are given the freedom to choose their own tools and construction methods because what we are contracting for is the completion of the works according to a given specification, at an agreed cost and within a specified time and not the construction tools and methods. Contractors have their own preferences for tools and construction methods which vary from one contractor to another, sometimes very considerably, for the same design and specifications. For example, of the 8 new link canal contracts under the Indus Basin Project contracted on the basis of international competitive bidding, 3 contracts were won by Pakistani, 2 by US, 2 by Italian and one by French contractors. Although the design and specifications were identical, the construction methods differed considerably. The Pakistani contractors used manual and donkey labor extensively with limited mechanical equipment; one US contractor used mostly scrapers with complementary equipment; another US contractor used 25 c.y. heavy draglines with complementary equipment; the Italians used a combination of

draglines and scrapers but employed a much larger labor force (including donkey labor) compared to other foreign contractors; and the French used the novel Buck-Wheel Excavator with limited complementary earth-moving equipment. Another interesting example is of a French contractor for the Sidhnai Barrage who constructed a 11 mile long 500 cusecs capacity canal by constructing a wide embankment and then excavating the canal prism from the top. This method may appear very costly, but with the idle equipment he had at that time he evaluated it as the most economical way of doing the job.

18. The economics of construction technology, therefore, depends on the experience of the contractor, his familiarity with the type of equipment, his dealings with the equipment manufactures, and his ingenuity in using a combination of methods to reduce his costs and overheads taking into account all aspects of the job. Contractors are extremely cost conscious;the Engineer's designs and his judgement of construction technology suitable for the works sometimes has no bearing on what is best from the point of view of the contractors. Two examples will illustrate this point. WAPDA and its consultants thought that the Qadirabad Bulloki Link Canal (a 90 million c.y. job with most of the excavation under high groundwater table) could be constructed most economically by dredgers. An expert on dredging was specially engaged for a period of 6 months to prepare the design and specifications. But Morrison-Knudson who won the contract used heavy draglines instead. In the Mangla Dam contract, the tunnels were designed on the assumption that they would be excavated according to conventional benching method and adequate provision was made for "overbreak."

Guy F. Atkinson, who won the contract used the "Mole" instead, avoided "overbreak" and claimed the excavation up to the "pay line" including overbreak on the ground that the savings should accrue to him because the Employer would have paid the cost had he followed the Engineer's method.

19. It seems unwise to classify the jobs as machine-or-labor intensive or to specify the methods of construction. Use of "shadow" pricing of factor inputs in the design and execution of works could also lead to erroneous conclusions. Specification of "shadow-rates" in the tender documents and inviting bids on this basis may not only complicate contract administration and payments but could lead to numerous claims and litigations. The conditions of contract should be simple and clear. Sometimes we create more problems by writing too much and specifying alternatives than we think we could solve.

Bidding Procedures

20. Competitive bidding is a requirement under the law in the Indo-Pakistan continent and I believe it is the same in all countries although detailed procedures vary and exceptions are sometimes made for good or bad reasons. I do not share the concern of the Indian authorities (as mentioned in para 28 of the Draft Memo) that, if the present force account procedures are abandoned in favor of competitive bidding, the few large Indian contracting firms would get together to fix higher prices. The Indus experience has shown that projects can be executed at minimum cost only through competitive bidding. Contracting firms live on competition. They have strong self-interest. They form joint ventures only if the size of the job is beyond their capacity or to supplement their financial

resources to meet the investment costs, to share the risks, to make up for their lack of experience on new types of works, or to get prequalified if it is not possible to do so on their own.

21. International competitive bidding, aside from the fact that the Bank as an international organization has to follow it, is in the best interest of the developing countries because of the following reasons:

(a) It is the quickest way to introduce improved technology, methods and practices in design, construction and management of development projects in the country;

(b) It provides better opportunities to build local construction industry compared to other alternatives of developing it by excluding foreign contractors because; first, competition, and the urge to do what others can do and excel them, is a strong motivating force; second, it provides the opportunities to learn how experienced foreign contractors plan their construction operations, manage their staff,labor and machines and attend to even minute details which are often ignored as of minor importance; thirdly, foreign contractors leave behind trained local staff and skills[1/] (as in the case of Indus Basin Contracts) and also some used equipment which are a great asset to the local construction industry.

1/ There is a great difference between the training of staff under the contractors and the consultants. Contractors get their money's worth out of every penny spent on their staff and this they can do only by making them efficient. Consultants do not have the same motivation. On the contrary, from a purely commercial point of view, it suits them better to do most of the work through their own staff or at their home office.

22. The developing countries must weigh the temporary advantage of what appears to be a loss of business to foreign firms against the more lasting benefits of building up the local industry to capture the business. The local contractors have some natural advantages over the foreign firms. Their mobilization cost and time is shorter; their overheads are small and can be spread over other contracts in the country; they can handle the local labor more effectively [1/]; and the labor is willing to work for them at lower wages because of the prospects of continuity on other jobs. Experience on the Indus Project has shown that the common belief, or perhaps the fear, that international bidding would frustrate the development of local construction industry is more imaginary than real.

Factors Affecting the Growth of Local Construction Industry

23. The factors which really hurt and retard the local construction industry are the form of contract, the delays in payments, the shabby way in which they are treated by the authorities compared to the consideration given to foreign contractors; the lack of equal privileges and opportunities provided to them in competing with the foreign contractors; and more importantly the lack of faith in their competence on the part of the country as well as the Bank which often leads to their disqualification. The first three problems are within the control of the governments and they are themselves to blame for the frustration caused to local contractors. The introduction of international form of contract (see paras 12, 13), however, would largely eliminate these problems. The fourth and fifth problems are discussed in the following paragraphs.

1/ There were virtually no labor strikes on jobs won by Pakistani Contractors on the Indus Project.

24. Local contractors are not often provided the same privileges and opportunities as the foreign contractors. The Indus Basin Contracts were an exception where the conditions of contract were the same to both local and foreign contractors participating in international bidding although local contractors were discriminated by the government in some matters such as foreign exchange controls, issue of import permits and providing facilities for insurance and performance bonds, which severely hampered the contractors' operations. In most cases, they could not get their equipment until almost half the job was done in spite of the intervention by WAPDA and the Bank. Nevertheless, the conditions of contract of the Indus Basin Contracts provided them better opportunities than any system on which they had worked before. A major incentive for both local and foreign contractors on the Indus Contracts was the reimbursement of Customs Duties, Excise Duties and Sales on goods imported for or in connection with the works. Aside from the price advantage to the contractor, which was important, the chief merit of this provision was the flexibility it provided to the contractors in construction planning and in choice of tools and methods which have a very significant effect on the cost of his operations and on his ability to conform to the schedules and earn bonuses. This facility is not always extended to local contractors on other Bank projects. The instructions in the Guidelines for Procurement provide for "Preference for Domestic Manufacturers" and do not apply to civil works contractors. The issue is not of giving a price preference to the local civil works contractors but of providing them the same facilities and privileges as applicable to foreign contractors.

25. The question of prequalification is crucial to the growth of the local construction industry. Because the local contractors do not have the experience of jobs of a given size, they do not satisfy the standards set for prequalification. On the other hand, unless they are provided the opportunity to do such jobs, they cannot have the experience required for prequalification. The Guidelines state that:

> "In order to foster widespread competition individual contracts, whenever feasible, should be of a size large enough to attract bidders. On the other hand, if the project can easily be divided into contracts of a specialized character,1/ it should be so divided."

The above clause is now being considered for revision as follows:

> "The size of contracts will vary in accordance with the type and size of projects. While international competition is desired whenever feasible, it may not be advisable for small labor intensive civil works or for relatively small amounts of equipment or small numbers of equipment items. However, whenever practicable small civil works contracts should be grouped into packages of sufficient size to interest foreign firms and both foreign and local bidders should be given the option of bidding for individual contracts or for the package as a whole."

26. The original provision almost prohibits splitting up of the civil works contracts. The proposed revision refers to "small labor intensive civil works" for which international bidding may not be advisable with the qualification that whenever practicable small civil works contracts should be grouped into packages of sufficient size to interest foreign firms and that both foreign and local contractors should be given the option of bidding for individual contracts or packages as a whole.

1/ Such as power, water supply or large industrial projects where it is feasible to invite bids separately for civil works and equipment.

27. The focus of these provisions appears to be more on local versus foreign contractors and labor versus machine-intensive types of jobs rather than on considerations for achieving the common objectives of the Bank and its borrowers. There should be no compromise on international competitive bidding and on the form and conditions of contractor which should apply equally to local and foreign contractors. Subject to this provision, the works should be of a size which:

(a) will attract both foreign and local contractors;

(b) can be accomplished at a competitive and economical price irrespective of whatever tools or methods the contractor may choose;

(c) when completed, will form a complete and integral unit which can be used and independently operated to provide the benefits to the borrower.

28. The above principles will not permit, for example, the splitting of a single canal into different sections because, unless the whole canal is completed, it cannot be used and operated. On the other hand, branch canals and distribution systems could, in some cases, be separately contracted. Similarly, a long road connecting different towns can be split up into separate sections between towns provided the distance between the towns is long enough to yield an economic price for each section. As long as the separate but independent parts of the works are contracted at reasonable time intervals to give opportunities to the winner, as well as the losers of the first part to compete for the other parts, the bigger contractors would be attracted even if the first part itself may not be large enough to attract their interest. A contractor who wins the first part has usually the advantage and also a

a better chance of winning the other parts because he could afford to spread his mobilization costs and overheads on the other parts and offer a better price. The experience on link canals and barrages of the Indus Project has clearly demonstrated the above hypothesis although the experience on dams was surprisingly different. Dams are usually large works which cannot be easily split up to conform to the principles stated above. There are hardly any local contractors in the developing countries who can or expect to be prequalified for such large works.

29. The package concept proposed in the revised Guidelines for Procurement has not proved successful for civil works contracts in the Pakistan experience. It creates difficulties in the evaluation of bids and in the award of contracts. It also seems to be a little unfair to the contractors, especially the one who bids for the whole package and normally spreads his mobilization and overhead costs over the whole package in the hope that he would win the complete package. But if one contractor bids a lower price for one part and gets the award, the price structure of the package becomes imbalanced often to the detriment of the contractor who opted for the whole package. This problem is not so acute in supply contracts.

30. The above principles were followed in the Indus Basin Project with considerable success. Housing, access roads and other preliminary works were separately contracted, but they were all based on international competitive bidding and on the same form of contract. All these works were won by Pakistani contractors. Three of the eight link canals, which were relatively smaller in size ($6 to 15 million) and the only major works for which Pakistani contractors could be prequalified under the agreed principles, were won by Pakistani contractors in international competition. The share of Pakistani contractors in the Indus Basin contracts,

excluding the Mangla and Tarbela Dams, was only next to the Italians in terms of the total price of contracts. The effect on the growth of local construction industry was remarkable and this was achieved without violating the principles of the Bank's procedures. The form of contract and the provision of equal opportunities and facilities to local contractors were the main factors which helped the growth of local construction industry. The models followed by India on Bhakra and Beas Dams and on the Rajasthan Canal were different. I had the opportunity to visit these works in 1968 to study their system. Considering all aspects of the two systems - their advantages, disadvantages and their accomplishments in respect of costs, benefits, progress of works, promotion of local construction industry and their potentialities for future developments - I was convinced that the contracting system followed on the Indus Project is in the best interest of the developing countries.

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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June 1, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Zambia - Hydroelectric Power Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated June 1, 1971 from the Eastern Africa Department, entitled "Zambia - Hydroelectric Project Proposed Supplementary Loan" (LC/O/71-82).

2. Comments, if any, should be sent to reach Mr. Myhrer (ext. 2579) by 5:00 p.m. on Wednesday, June 2.

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

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

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

CONFIDENTIAL

LC/O/71-82

June 1, 1971

LOAN COMMITTEE

Memorandum from the Eastern Africa Department

ZAMBIA: Hydroelectric Power Project
Proposed Supplementary Loan

1. The President's memorandum to the Executive Directors, "Zambia-Hydroelectric Power Project" dated January 11, 1971 (R71-5), copy attached, gave notice to the Executive Directors that the President intended to submit to them in due course "appropriate proposals to lend an additional amount of some $11 million for the Kariba North project in order to finance the full foreign exchange requirements".

2. The need for additional financing arises from the large increase in estimated costs resulting from the bids received after the signature of Loan 701-ZA to the Kariba North Bank Company (KNBC). Since memorandum R71-5 was prepared, the consultants to the Borrower have further refined the cost estimates. The revised estimates, in which the Public Utilities Projects Department concurs, are summarized below, together with the financing available and the additional financing required:

Kariba North Project
Estimated Costs and Financing

(US $ million)

	Local	Foreign	Total
Civil works	19.99	20.56	40.55
Plant and equipment	2.65	23.09	25.74
Total construction costs	22.64	43.65	66.29
Interest during construction	3.96	6.85	10.81
Total financing required	26.60	50.50	77.10
Financing available	17.05	40.00	57.05
Supplementary financing required	9.55	10.50	20.05

3. The memorandum R71-5 set out the history of the arrangements required in connection with Loan 701-ZA for the North Bank project to deal with problems created by Southern Rhodesia's Unilateral Declaration of Independence (UDI) in November 1965 and the particular importance of the Bank's association with the project. In brief, UDI made it impossible to follow the basic pattern of the two previous Kariba loans under which

the Kariba North station would have been owned by a joint Zambian-Southern Rhodesian entity (now the Central African Power Corporation (CAPC)) to which the Bank would have lent directly with Zambia and Southern Rhodesia each guaranteeing half of the loan. It was in fact necessary to establish KNBC, a wholly Zambian company, as the Borrower and for Zambia to guarantee 100 percent of the loan. 1/ In order to compensate Zambia for having to guarantee the whole of Loan 701-ZA (and thereby incur a greater liability with respect to the three Bank loans for the Kariba scheme taken together than she would have incurred in the absence of UDI), the Bank agreed, with the concurrence of the United Kingdom and a large participant, to release Zambia from liabilities as guarantor of the two earlier loans, Nos. 145-RN and 392-RNS, in an amount comparable to half the liability to be assumed by Zambia in connection with Loan 701-ZA. To continue to preserve the equitable distribution of guarantee liabilities with respect to Zambia, a further release would thus be required in connection with the proposed additional Bank lending. By "appropriate proposals" the President had in mind, therefore, that arrangements for this further release should, if possible, go hand in hand with arrangements for supplementary Bank financing.

4. The Bank has made representations to the United Kingdom, stressing the importance in the Bank's eyes of a further release. The United Kingdom, however, takes the formal position that its obligation to assist Zambia in carrying out the Kariba North project under the arrangements agreed with the Zambian Government and the Bank was fully discharged by the release agreement signed in connection with Loan 701-ZA. Any further release would consequently involve a new decision by the Cabinet and Parliamentary approval of an increase in the United Kingdom's contingent liability in respect of Loans 145-RN and 392-RNS arising from payments that might have to be made by the United Kingdom on behalf of Southern Rhodesia. The current state of relations between Zambia and the United Kingdom is not favorable to sympathetic consideration by the United Kingdom of a further release, and we have concluded that it would not be helpful to press the matter at this time. The Zambian Government appears to have come to the same conclusion. Even if the United Kingdom were agreeable to a further release, it cannot be taken for granted that the various participants who hold the outstanding maturities of the old loans to which a further release would have to apply would consent to it. Their attitude is not known since, in the absence of any present indication of willingness on the United Kingdom's part, it has been pointless to approach them.

5. Agreement on a further release, while highly desirable from the Bank's point of view, is not essential. It is in any case not essential that details be worked out at the same time as the proposed supplementary loan, since there is no formal connection between the loan and guarantee

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1/ CAPC, under Agency and Lease Agreements with KNBC, will supervise construction, lease and operate the station as part of its system; it will also lend to KNBC the local currency required for the construction. The rental under the Lease Agreement will be sufficient to cover all KNBC's debt service payments.

undertakings under Loan 701-ZA and any supplement to it and undertakings concerning obligations under the two earlier loans. In the circumstances Zambia has requested that we proceed without further delay to work out the arrangements for the proposed supplementary loan, and I recommend that we do so, leaving open the decision on when to present it to the Executive Directors after further discussion with Zambia and consultation with the Chairman of the Loan Committee. This memorandum is therefore confined to the question of supplementary lending.

6. I recommend that we make the new loan at the Bank's current interest rate under arrangements that would assimilate the supplementary lending to the original loan as closely as possible. The Controllers, Legal, Public Utilities Projects and Eastern Africa Departments agree that we should set up the Kariba North financing in effect in two tranches, the first being the original loan at 7 percent, the second being a new loan of $10.5 million at 7-1/4 percent, both tranches to be repaid on the same amortization schedule. KNBC would draw down the whole of the original loan before drawing on the proposed new loan, which would cushion somewhat the impact of the higher interest rate on the new loan. The Allocation of Proceeds of the original loan would be amended to provide that the commitment charge of the new loan, which would in this case run from 60 days after its signature, would be paid from the original loan. The capitalization of interest charges on the original loan would continue to be made from the new loan after the original loan had been fully drawn down. All the covenants of the original loan would be repeated in the new Loan and Guarantee Agreements.

7. The Board of the CAPC has already approved in principle the additional loan in Kwacha required to cover the increase in estimated local costs. A condition of effectiveness of the proposed new Bank lending would be the effectiveness of the additional lending by CAPC.

Recommendation

8. I recommend that the Committee authorize negotiations with KNBC as Borrower and the Government of Zambia as Guarantor for a supplementary loan of $10.5 million, substantially along the lines set out in paragraph 6 above.

Michael L. Lejeune
Director

Attachment

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/71-29

May 28, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to consider "Morocco - Second Education Project" held at 3:00 p.m. on Monday, May 24, 1971 in Conference Room B.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

LM/M/71-29

May 28, 1971

Minutes of Special Loan Meeting to consider "Morocco - Second Education Project" held at 3:00 p.m. on Monday, May 24, 1971 in Conference Room B.

1. Present: Messrs. Knapp (Chairman), Broches, Chadenet, Benjenk, Calika, Hartwich, Springuel, van Dijk, T.M. Jones and Pearce (Secretary).

2. Issue: The meeting had been called to consider Mr. Benjenk's memorandum of May 21, 1971 to the Chairman, which recommended that, in view of the Moroccans' improved performance under the first education project (Credit No. 71-MOR), negotiators be invited for a $7.3 million credit for a second education project (cf. LC/O/71-62 dated April 21, 1971). The only issue for discussion was whether the improved performance cited in Mr. Benjenk's memorandum was sufficient to justify inviting negotiators forthwith.

3. Discussion: The meeting noted that:

(a) The issue was tactical: whether further delay in inviting negotiators for the second education project was more or less likely to promote continued improved performance and quicker disbursement under the first $11 million education credit (No. 79-MOR). The Europe, Middle East and North Africa Department preferred inviting negotiators immediately on country relations grounds.

(b) The Education Projects Department, on the other hand, preferred postponing an invitation to negotiate until at least the promised withdrawal applications and new disbursement schedule for the first credit had been received and evaluated. In this connection, at least 60 per cent disbursement by June 30, 1971, 80 per cent by December 31, 1971 and 100 per cent by June 30, 1972 - a schedule that would require a 12 month extension of the original closing date - was a reasonable IDA requirement.

4. The Chairman suggested that the Moroccans should be invited to Washington to discuss an extension of the closing date of the first credit on the basis of the targets noted in para. 3(b) above. In line with the request made in the Prime Minister's letter of April 24, the closing date should in the first instance be extended only to December 31, 1971.

Assuming that IDA was satisfied with the outcome of these discussions, negotiations for the proposed second education credit could begin immediately thereafter. The Chairman noted that the timing of the presentation of the credit to the Directors for approval would depend upon the availability of IDA resources.

5. The Chairman approved the Europe, Middle East and North Africa Department's recommendation that a contingent invitation for negotiations on the proposed second education project be issued on the basis outlined in para. 4 above.

David Pearce
Secretary

Cleared by: Messrs. Knapp
Calika
Hartwich

cc: Loan Committee
Participants

FORM No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

May 27, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Ireland - Education Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated May 27, 1971 from the Europe, Middle East and North Africa Department, entitled "Ireland - Education Project" (LC/0/71-81).

2. Comments, if any, should be sent to reach Mr. Riedl (ext. 4725) by 1:00 p.m. on Tuesday, June 1.

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

David Pearce
Secretary
Loan Committee

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Committee:

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

CONFIDENTIAL

LC/0/71-81

May 27, 1971

LOAN COMMITTEE

Memorandum from the Europe, Middle East and North Africa Department

IRELAND - Education Project

1. This memorandum recommends a Bank loan of US $13 million for a term of 20 years, including five years grace, to Ireland to finance school construction, furniture and equipment and related technical assistance. A report entitled "Appraisal of an Education Project in Ireland" (PE-31), dated April 29, 1971, is attached in support of the recommendation.

Background

2. The Bank has made three loans to Ireland since 1969 totalling $44.5 million. Two loans were made to the Electricity Supply Board (ESB) for power projects, the first one in FY 1969 amounted to $14.5 million, of which $8.4 million was undisbursed on April 30, 1971. Performance under this loan has been satisfactory and there are no outstanding problems. The second power loan of $20 million became effective on April 28, 1971. The most recent loan of $10 million to The Industrial Credit Company, Limited (ICC) was approved by the Executive Directors on May 4, 1971. Bank lending to Ireland in FY 1972 envisages two operations: the proposed education loan and a third power loan. The Five-Year Lending Program for FY 1972-1976 is attached. An updating memorandum on the economic situation of Ireland (EMA-23a), dated July 27, 1970, and Part V of the recent President's Report on the loan to ICC (P-911), dated April 19, 1971, discussed Ireland's recent economic performance and future prospects and concluded that the country is creditworthy for additional Bank lending.

3. Bank operations in Ireland aim to support the country's development effort to overcome critical constraints to expansion. The program is oriented towards industry as the most significant growth sector and focuses on credit, power supply and skilled manpower. In Agriculture the program is intended to induce more economically oriented policies to develop a beef cattle industry and to upgrade the level of farmers' education to increase productivity and to keep rural migration under control. The prevailing education system of the country also impedes economic development. In recognition of this, the Irish authorities have been undertaking an overall educational reform to achieve greater efficiency and productivity of the system and a better distribution of educational opportunities. It is in this context that an education project has been incorporated in the Bank's lending program.

The Project

4. The proposed project would be the first Bank operation in the education sector in Ireland and would have the dual objectives of supporting the reform of general secondary education and the expansion of agricultural as well as secondary and higher level technical education. No unusual project issues are involved; however, one special feature is discussed in paragraph 8.

5. The present secondary level education is ill suited to the development needs of the country. It is now changing from a system of small, academically-oriented private boys' and girls' schools generally owned and operated by religious orders to a system of comprehensive, coeducational schools. The new comprehensive schools are fully financed by the Government and are managed by boards consisting of representatives of the religious orders, and local and state authorities. The major objective of this reform is to make students more adaptable to subsequent studies and to further training and employment needs. The old curriculum which was traditional in orientation would be replaced by a broad diversified curriculum, including academic and practical subjects, and offering counseling and guidance services. Four pilot comprehensive schools have already been in existence since 1966 and the proposed project would add 24 more, replacing 46 inadequate private schools. The Bank's assistance would facilitate and accelerate these reform endeavors.

6. In an effort to upgrade the level of farmers' training, a prerequisite to increasing farming efficiency and keeping rural migration in line with overall employment objectives, agricultural extension centers have been developed on a county basis. These centers would offer farm management courses for practicing farmers and introductory courses to school leavers. The programs of the centers are geared to local agricultural needs and interests. In addition to the existing network of 20 agricultural education centers, the project would provide 30 more.

7. The manpower requirements projected for 1980 show a widening gap of skilled workers, technicians and business graduates beyond that which exists at present. This would put Ireland in an even more unfavorable position vis-a-vis the more developed countries in Western Europe. The three technical institutions (Regional Technical College, Cork; Senior Secondary Technical School, Limerick; College of Commerce, Ballymun, Dublin) included in the proposed Bank project would supply about half of the estimated deficiency of skilled workers and middle level technicians by 1980 and cover about 15 percent of the shortage of higher technicians and business graduates.

8. The implementation of the proposed project would incorporate an important general feature for educational construction in Ireland, i.e. the introduction of more efficient school sizes and construction methods and the use of design suitable for modern teaching methods and teacher time-saving equipment. The construction of 24 comprehensive schools would permit standardized schedules of accommodation. Technical assistance would be provided to assist in the development of a system approach to design and building, and to introduce the use of industrialized building components.

9. The total cost of the project (including contingencies) is estimated at $33 million, of which $13 million in foreign exchange. The proposed loan would cover the total foreign exchange component and would be equivalent to about 40 percent of the estimated project cost. Ireland should be able to meet the annual recurrent costs of the project institutions estimated at about $10.8 million and its share of the capital costs without compromising other high priority educational or other government expenditure.

10. Contracts for civil works and procurement of equipment and furniture will be awarded on the basis of international competition with packages of a sufficient size to encourage foreign contractors and equipment producers to participate in the bidding.

11. The Irish Government has already been informed about the remaining actions which have to be taken before Board presentation and no major difficulties are foreseen during negotiations.

Recommendation

12. I propose that the Bank invite the Irish Government to negotiate a $13 million loan along the lines of the recommendations in Chapter V of the attached appraisal report.

M. P. Benjenk
Director

Attachments

Population: 2.9 m.
GNP Per Cap: $980

IRELAND - ACTUAL AND PROPOSED LENDING PROGRAM THROUGH FY 1976

($ millions)

Attachment 1

		Through 1968	1969	1970	Fiscal Years 1971	1972	1973	1974	1975	1976	Total 1964-68	Total 1969-73	Total 1972-76
Livestock I	IBRD						10.0						
Livestock II	IBRD								10.0				
DFC - ICC I	IBRD				10.0								
DFC - ICC II	IBRD						15.0						
DFC ICC III	IBRD								15.0				
Education I	IBRD					13.0							
Education II	IBRD							10.0					
Education III	IBRD									10.0			
Power - Turlough Hill	IBRD		14.5										
Power - Tarbert 3	IBRD				20.0								
Power - Pigeon House B	IBRD					15.0							
Unidentified	IBRD							17.0					
	IBRD	-	14.5	-	30.0	28.0	25.0	27.0	25.0	10.0	-	97.5	115
	No.		1		2	2	2	2	2	1		7	9
IBRD Loans Outstanding													
- including undisbursed		-	13.6	13.6	43.6	71.6	96.6	123.2	147.3	155.6			
- excluding undisbursed		-	-	2.1	6.5	19.1	36.7	59.8	82.6	112.2			
IBRD Gross disbursement				2.1	4.4	12.6	17.6	23.3	23.7	31.3			
Net disbursement				2.1	4.4	12.6	17.6	22.9	22.8	29.6			
Net transfers				1.9	3.7	17.8	20.2	19.9	8.2	2.3			

Europe, Middle East and North Africa Department
(May 25, 1971) revised

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LC/M/71-7

May 27, 1971

Minutes of Loan Committee Meeting held at 4:00 p.m. on Friday, May 7, 1971 in Room C1006

A. Present:

J. Burke Knapp (Chairman)
S.R. Cope
M. Shoaib
G. Alter
W.C. Baum
V.C. Chang
B.M. Cheek
J.H. Collier
R.J. Goodman
D. Hartwich
J.P. Hayes
C.G. Melmoth
P. Sella
A. Stevenson
E.P. Wright
D. Pearce (Secretary

In Attendance:

D.S. Ballantine
O.H. Calika
W. Diamond
S.S. El Fishawy
D.J. Fontein
N.A. Gibbs
K.S. Krishnaswamy
A. Maillard
G.M. Street

B. Thailand - Kasetsart University

1. The Committee considered a memorandum dated May 5, 1971 from the East Asia and Pacific Department entitled "Thailand - Kasetsart University Project" (LC/0/71-76) and a memorandum dated May 5 from Mr. Ballantine to the Chairman regarding a proposed $13.5 million loan to finance the estimated foreign exchange cost of a $27 million project for the expansion and improvement of the Kasetsart (Agricultural) University.

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Committee:

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Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
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Executive Vice President (IFC)
Vice President (IFC)

2. The two memoranda addressed themselves to the general questions of procedures for the preparation and appraisal of education projects, the timing of education loans and credits and the interval between commitment and disbursement of education loans and credits. The basic issue in this respect was whether a loan or credit should be made (a) after completion of the first stage of project preparation, i.e. determination of the courses and physical facilities required, or (b) after completion of the second stage, i.e. detailed design of buildings and preparation of equipment and furniture lists. The East Asia and Pacific Department, noting that a loan after stage (a) resulted in a substantial interval between commitment and significant disbursement and also in a heavy load of project administration during stage (b) which in other sectors would normally be considered part of project preparation and appraisal, recommended that, if the Thais so requested, the proposed Kasetsart loan be postponed until after completion of stage (b) (expected to be about 15-18 months hence) and that it include up to $500,000 to reimburse the Government for project preparation costs incurred in the interim. The Education Projects Department, on the other hand, objected to postponement on the grounds that the Bank's immediate leverage in confirming the agreement reached on the University's location would be reduced, that some re-appraisal would be necessary 15-18 months hence, and that, if the East Asia and Pacific Department's proposal became standard procedure, Education Projects' ability to meet its commitments to the Bank/IDA lending program would be seriously impaired, at least in the short term. The Education Projects Department also stated that the cost estimates obtained for education projects under existing procedures had proven reasonably accurate compared with the wide variations in costs that sometimes resulted, in the absence of detailed engineering, in other sectors.

3. During the discussion, the Committee noted that:

(a) Although the lag between commitment and significant disbursement of education loans and credits, corresponding to the detailed engineering phase of projects in other sectors, was often as long as 18 months, the main thrust of the Bank/IDA institution-building role took place during this period. Some felt that a signed loan or credit probably enhanced Bank/IDA leverage in this respect.

(b) While there might be scope for reducing this lag, by streamlining supervision procedures, its existence was a function of education projects generally which, unlike most projects in other sectors, often lacked objective technical criteria, and were subject to frequent and often substantial change after approval. In addition, the initial implementation of education projects, e.g. establishment of project unit, selection of consultants and key personnel, was a time-consuming process.

(c) While there were arguments for and against advancing or postponing the timing of education loans and credits within the project preparation cycle, a flexible approach was desirable.

(d) The alternative proposed in para. 11(c) of the East Asia and Pacific Department's memorandum to make a separate project preparation loan would involve two appraisal operations and add substantially to the Education Projects Department workload.

4. The Chairman, winding up the discussion, said that, in his view, the two decisive considerations were: effective leverage and, in this case, the Bank's manpower constraints. He was impressed by the arguments advanced by the Education Projects Department and favored proceeding with the proposed Kasetsart loan as soon as legislation enabling the Government to borrow at the Bank's current lending rate (7-1/4 per cent) had been enacted. In the meantime, the Education Projects Department would continue its studies and experiments with various techniques to shorten the project implementation period.

5. The Chairman approved the East Asia and Pacific Department's recommendation to discuss with the Government the next steps in the processing of the project on the basis of alternative (a) in paragraph 11 of its memorandum. If, in the absence of enabling legislation to borrow at 7-1/4 per cent, loan presentation had to be postponed, retroactive financing of project preparation costs incurred in the meantime could also be considered.

C. Adjournment

6. The meeting adjourned at 4:50 p.m.

Secretary's Department
May 27, 1971

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/71-28

May 26, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to consider "Ivory Coast - Second Oil Palm and Coconut Project" held at 3:00 p.m. on Tuesday, May 4, 1971 in Conference Room B.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

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

LM/M/71-28

May 26, 1971

Minutes of Special Loan Meeting to consider "Ivory Coast - Second Oil Palm and Coconut Project" held at 3:00 p.m. on Tuesday, May 4, 1971 in Conference Room B.

1. Present: Messrs. Cope (Chairman), Chadenet, Cheek, Gabriel, McIvor, Rovani, Gue, Rowe, Huas, Schott, Suratgar and Pearce (Secretary).

2. Issue: The meeting had been called to consider the Western Africa Department's memorandum of April 29, 1971 to the Loan Committee which recommended that negotiators be invited for two loans amounting to $7 million, $5.1 million to SODEPALM for the establishment of new coconut estates, and oil palm and coconut outgrowers' holdings and $1.9 million to PALMINDUSTRIE for the construction of a palm oil mill. The main issue for discussion was the proposed lending terms to coconut outgrowers.

3. Discussion: The meeting noted that:

(a) The financing terms for oil palm outgrowers would be the same as those applied under the first project (Loan No. 613-IVC), namely repayment in 19 years, including a 7 year grace period at 2 per cent interest. An increase in the interest rate would be difficult to implement, because the second project would be part of an on-going development program and many participants in the second project would have palms established under the first; moreover, the low rate of interest was still justified by actual and projected palm oil prices, which ensured a satisfactory return to SODEPALM/Government on their investment in the outgrower program.

(b) However, the large yields expected from new hybrid coconuts to be planted under the second project would require a new coconut outgrowers' agreement and, in order to minimize the difference in the return to outgrowers between hybrid and other coconut plantings and between oil palm and coconut plantings, the Bank would recommend that hybrid coconut outgrowers should repay their loans over 21 years, including a 5 year grace period, at 7.5 per cent interest.

(c) The Government, on the other hand, had already proposed repayment over 24 years at 6 per cent interest, in line with existing agricultural credit arrangements including the first project, and was expected to resist a higher rate during negotiations.

4. The Western Africa and Agriculture Projects Departments agreed that a 7.5 per cent interest rate on hybrid coconut plantings would be justified, particularly in view of the already high returns to coconut outgrowers and the interest rate on the Bank's loan to SODEPALM.

5. Decision: The Chairman approved the Western Africa Department's recommendation that negotiators be invited for the proposed loan.

David Pearce
Secretary

Cleared by: Messrs. Cope
Rowe/Huas
Schott
Suratgar

cc: Loan Committee
Participants

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

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LOAN COMMITTEE

LM/M/71-27

May 26, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to consider "Guinea - Boke Bauxite Extension Project" held at 2:30 p.m. on Friday, April 30, 1971 in Conference Room B.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

LM/M/71-27

May 26, 1971

Minutes of Special Loan Meeting to consider "Guinea - Boke Bauxite Extension Project" held at 2:30 p.m. on Friday, April 30, 1971 in Conference Room B.

1. Present: Messrs. Cope (Chairman), Broches, Chadenet, Fuchs, Gabriel, Knox, Cheek Carmichael, Delaume, Adams, Higginbottom, Rosenblad, Sander and Pearce (Secretary).

2. Issue: The meeting had been called to consider the Western Africa Department's memorandum of April 28, 1971 to the Loan Committee (LC/O/71-70), which recommended that negotiators be invited for a $9 million extension to the Boke infrastructure project financed under Loan No. 557-GUI. There were two main issues for discussion: (a) the revised timing of CBG's shareholders' commitments to take delivery of bauxite and (b) whether CBG should be required, as in the original Loan Agreement, to arrange a standby covering the full financing of the expanded mining project at this stage.

3. Discussion: Regarding issue (a), the meeting noted that:

(a) While existing bauxite contracts obliged the shareholders to take delivery of bauxite 90 days after delivery by the Chairman of the Construction Coordination Committee (CCC) of Completion Certificates, originally expected to be not later than April 1, 1972, delays in executing the original project and the proposed extension meant that the Certificates would not be issued until April, 1973.

(b) However, stockpiling of bauxite for shipment was scheduled to begin in December, 1972 and the question had arisen how the existing arrangements could be modified to commit the shareholders to take delivery at or about that time. The Government was understandably anxious to ensure that the shareholders' obligation to take delivery should begin as soon as possible; the shareholders, on the other hand, were reluctant formally to commit themselves to a delivery date in advance of the extension project's expected completion in April, 1973.

4. The Chairman agreed with the position taken in the Western Africa Department's memorandum that arrangements would have to be made to assure the shipment of bauxite prior to the final completion of the project. A possible solution would be to relate the shipment of bauxite to a date close to the original completion date of the project. This might mean the issuance of two certificates by the Chairman of the CCC.

5. Regarding issue (b), the meeting noted that:

(a) Since the $26 million still required to finance the revised total construction cost of the expanded project would cover expenditures to be incurred only 18 months from now, it would be unreasonable to require CBG to raise these fundsimmediately.

(b) On the other hand, the Bank needed assurances that CBG would indeed provide the necessary funds at the appropriate time and at reasonable rates.

(c) The "8.5 per cent letter," limiting the impact of high interest rates on payments to Guinea, would therefore be extended thus permitting CBG to raise its funds as and when it wished on condition that the average cost of financing for the entire project did not exceed 8.5 per cent.

6. Decision: The Chairman approved the Western Africa Department's recommendation that negotiators be invited for the proposed loan.

David Pearce
Secretary

Cleared by: Messrs. Cope
Cheek
Delaume
El Darwish

cc: Loan Committee
Participants

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/71-26

May 26, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to consider "Iran - Ghazvin Development Project" (Loan No. 517-IRN) held at 11:00 a.m. on Friday, April 30, 1971 in Conference Room B.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

LM/M/71-26

May 26, 1971

Minutes of Special Loan Meeting to consider "Iran - Ghazvin Development Project" (Loan No. 517-IRN) held at 11:00 a.m. on Friday, April 30, 1971 in Conference Room B.

1. Present: Messrs. Knapp (Chairman), Cope, Chadenet, Votaw, Wapenhans, Bartsch, Cancio, Ffrench-Mullen, Loos and Pearce (Secretary).

2. Issue: The meeting had been called to consider Mr. Eschenberg's memorandum of April 8, 1971 to the Chairman which recommended (a) that, since the project was a good one, the Bank should continue financing the remainder of the Stage I work program, (b) that the balance of the $22 million loan not now required for the project (Stage I) should be cancelled, and (c) that, in view of possible continued procurement problems and lack of data about its economic viability, the Bank should not proceed with appraisal and financing of Stage II.

3. Discussion: The meeting noted that:

(a) The Iranians had informed Mr. Eschenberg (then in Tehran) that the Government's request to cancel the unusable balance of the loan could be expected shortly. The slow disbursement of the loan was partly attributable to repeated deviations from Bank procurement procedures in respect of pumps and vehicles.

(b) The issue of a feasibility study for Stage II of the Ghazvin Development was now academic since the Bank no longer planned to finance Stage II.

4. Decision: The Chairman approved the three recommendations contained in Mr. Eschenberg's memorandum (cf. para. 2 above).

David Pearce
Secretary

Cleared by: Messrs. Knapp
Votaw/Loos
Wapenhans
Cancio

cc: Loan Committee
Participants

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/71-25

May 26, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to consider "Brazil MBR Iron Ore and Railway Projects" held at 12 noon on Wednesday, April 28, 1971 in Conference Room B.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
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Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

LM/M/71-25

May 26, 1971

Minutes of Special Loan Meeting to consider "Brazil MBR Iron Ore and Railway Projects" held at 12 noon on Wednesday, April 28, 1971 in Conference Room B.

1. Present: Messrs. Knapp (Chairman), Cope, Alter, Chadenet, Fuchs, Gabriel, Nurick, Wiese, Cancio, Husain, Carnemark, Pigossi, Sassoon, Webb and Pearce (Secretary).

2. Issue: The meeting had been called to consider Mr. Alter's memorandum of April 27, 1971 to the Chairman which reviewed the status of negotiations for loans of $50 million and $46 million for the MBR iron ore and railway projects.

3. Discussion: The meeting noted that:

(a) The Brazilian Government, a principal beneficiary of the project, was creditworthy and could be relied upon to assume the risks of the railway project. In the circumstances, the sponsors would not be required to repay the railway loan if the project were not completed.

(b) The sponsors, however, were unwilling to provide an unlimited completion guarantee and the Bank, on the other hand, had never accepted limited completion guarantees in mining projects. In this case, project costs could, under severe circumstances, exceed estimates including contingencies by about $20 million (although the South America Department's memorandum mentioned a figure of $30 million, later calculations indicated that it would be of the order of $20 million); moreover, although the cost estimates included $3 million contingencies for possible overruns in dredging the channel at Sepetiba Bay, plans for the latter were insufficiently advanced to estimate the maximum possible overrun.

4. The meeting noted that, although the Bank should try to obtain an unlimited completion guarantee by the two main sponsors, it could accept a limited undertaking on all project items except dredging. The Government should be advised that, if the cost estimates of dredging were more precisely defined, the Bank might also accept a limited overrun guarantee in respect of dredging.

5. The meeting noted further that:

(a) The Bank would be prepared to accept a guarantee several in form provided that CAEMI could demonstrate that its net worth was sufficient for this purpose.

(b) On the basis of the project's expected cash generation prospects, a continuing working capital guarantee of $20 million, several in form, would be sufficient to cover MBR's current liabilities.

6. Decision: The Chairman approved the South America Department's recommendations regarding completion and overrun undertakings, working capital, dividend restrictions, equity subscription, and the railway tariff.

David Pearce
Secretary

Cleared by: Messrs. Knapp
Alter/Husain
Cancio
Pigossi

cc: Loan Committee
Participants

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LC/A/71-7/1

May 24, 1971

NOTICE OF MEETING

The meeting of the Loan Committee, originally announced for Monday, May 24, 1971 at 4:00 p.m. in the Board Room, will now be held on Wednesday, May 26, 1971 at 11:00 a.m. in the Board Room.

AGENDA

Liberia - Rubber Project

The Committee will consider the memorandum from Mr. Chaufournier to the Chairman dated May 11, 1971 and the draft appraisal report prepared by the Agriculture Projects Department, entitled "Liberia - Rubber Rehabilitation Project," already circulated on May 18, 1971, and the attached memorandum from Mr. Evans to the Chairman dated May 11, 1971.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

Mr. J. Burke Knapp May 21, 1971

L.J.C. Evans

LIBERIA - Rubber Project

1. Mr. Chaufournier's memorandum of May 11 sets out quite well some of the issues which we have been discussing since the field appraisal of the rubber project in Liberia. Mr. Chaufournier's paper, however, was not discussed with Agriculture Projects Department and I am sorry to say we are unable to agree with his recommendations in para. 15.

2. If we had been asked we would not in fact have cleared circulation of the Yellow Cover Report to the Loan Committee. The report provoked considerable discussion and we would have prepared a revised Green Cover version for the Loan Committee. The way in which the Yellow Cover Report is presented is that when optimistic assumptions are made as to yield and farmer participation and effectiveness of administration the economic rate of return still does not justify support for the project. The Area Department aduces the possibility of a higher rate of return by using more favorable assumptions, which gives a total degree of optimism that is really unrealistic. Perhaps we may be accused with some justification of leaning over backwards to be conservative when we are recommending support for a project with an apparently high rate of return; and by the same token our appraisal mission in this case, concluding that the project should not be supported, comes up with a low rate of return even when using the most optimistic assumptions. In my opinion, and that of my senior colleagues, the rubber yield estimates, degree of farmer participation, planting programs, efficiency of administration, are all too optimistically calculated having regard to the administrative and political environment and past performance in the Liberian agricultural sector.

3. There has been considerable debate about the economic justification of the rubber project, especially in relation to the price of rubber and the cost of labor. There is still a serious difference of opinion as to the economic cost of labor. As to the price of rubber, a price of 16¢ a lb. cif New York was used in the appraisal report; recently, a longer term price projection of 16.5¢ a lb. has been made by the Economics Department. It is, of course, ridiculous to put much reliance on any single figure when the price that we are concerned with is that which will obtain in the period 1980 to 2000.

4. It may be that an undue amount of time has been spent talking about the possible economic justification of the project. There are so many uncertainties about the project that it is very doubtful whether any project that we could devise in the light of our present information would work satisfactorily.

5. The project as appraised not only appeared to have a low economic rate of return but also there are considerable doubts as to whether the farmers would in fact perform in the way projected. The financial incentives for farmers would need to be improved before they would participate. Replanting grants could be made and loans on easy terms might be provided for replanting. This would not be out of line with what has been done in other rubber growing countries. However, the project as appraised would benefit only about 1,000 farmers of whom the appraisal mission estimated half would be absentee proprietors living in Monrovia, many of them government officials. It is hard to make a very convincing case for subsidizing "farmers" of this kind, or to represent this as a model project that would provide a useful pattern for rural development in Liberia.

6. The first reason why Western Africa Department recommends going ahead with this project is that despite its low or marginal economic rate of return and high risk "there are no alternative agriculture projects in Liberia." This, with respect, is a bad rationale for going ahead, since the statement should more correctly read "we do not know at present of any better agriculture projects in Liberia." It is not altogether surprising that we do not. Our experience of Liberia has been very spotty. Occasionally an agricultural economist has been there. There have been a few visits by staff from PMWA. We arranged for a feasibility study of an oil palm project but concluded that the project should not be proceeded with. We also helped in the preparation of this rubber project and unfortunately are now coming to a conclusion similar to that for the oil palm project. A review of the agricultural sector was attempted in October 1970 by two men, from PMWA and FAO, who spent a few weeks in the field. The findings of that mission were sketchy and so inconclusive that the preparation of a report was abandoned. (Instead we have now prepared terms of reference for a more systematic and thorough sector review.)

7. I do not recommend making an IDA credit for the rubber project as appraised nor for any other rubber project that we can devise on the basis of our present knowledge. We believe that making a loan for a rubber project at this juncture would not help Liberia, (nor our relations with Liberia), because the project probably would not be successful. A marginally economic project which is attended by high risk, which would benefit relatively few people and which would have to be carried out within an incompetent public administration is not a good basis for an IDA credit. We see the situation as somewhat analogous to that in Senegal where we had considerable doubts whether we should go ahead with the groundnuts and millet project. In retrospect it might have been better if we had not gone ahead with that project, but had instead concentrated our effort towards finding better projects such as, we think, we have now got in the Terres Neuves and Casamance projects.

8. The deficiencies in public administration were stressed in the Country Program Paper of February 18, 1971 especially in paras. 19-25 (see Annex). In my view, improvements are needed before a loan or credit is made for the agricultural sector.

9. We all recognize that we must continue to find ways to help Liberia's agriculture. We believe that the way to proceed would be to offer to arrange for, and (unless UNDP can take it on) to pay for consultants to work within the Ministry of Agriculture in Liberia for a period of about five years. They would review the agricultural sector,1/ help to develop an agricultural policy and development program, and determine priorities; amongst other things they would review the rubber industry, including government's relationship with the concessionaires, the concessionaires' contribution to the economy and the relationship between the concessionaires and the Liberian farmers; they would review the present agricultural administration, such as it is, determine needs and recommend necessary improvements. It is not certain that consultants would, in fact, be successful. The Harvard Advisory Group spent five years in Liberia to little avail. On the other hand, where consultants have been working for Government over long enough periods, as in the roads, ports and power sectors, we understand that there has been quite good progress.

Annex

Cleared with and cc: Messrs. Chadenet/Baum
Wapenhans
McIvor
H.Adler

cc: Mr. R. Chaufournier

1/ A sector review of the normal kind in which a mission of 6-24 experienced people make an indepth field study of 2-3 months is unlikely to be of much use in Liberia owing to lack of data and counterparts.

LJCEvans:lkt

19. Liberia's incapable civil service needs drastic reform. Skill and competency in the administration is rare. The few able civil servants consistently leave for the private sector, or are engrossed in personal commercial and farming interests. Even if projects are identified and prepared with external assistance, the administrative capacity for their implementation will be lacking. In the past decade, the decision-making processes, budget procedures and expenditure controls have improved. But much more needs to be done. The establishment of a public administration institute for training civil servants at the middle and higher levels, which is being discussed with the U.S., should be given Government priority. Poor administration is also due to the inadequate salaries and the lack of promotion, pension and retirement provisions.

IV. ECONOMIC SECTORS

A. Agriculture

20. Liberian agriculture consists of foreign rubber concessions and a large number of Liberian-owned farms, mostly subsistence farms growing rice and cassava, but also some producing rubber and other cash crops. In 1969, the foreign rubber concessions produced 106 million pounds of rubber worth some $23 million. This constituted 70 percent of Liberia's rubber and provided 10 percent of Liberia's export earnings. The largest - Firestone - is doubling the rate of its replanting to 4,000 acres per annum, though it is not expanding its total acreage. The Liberian-owned sector is stagnant, apart from rubber production which has been growing rapidly since 1950 in spite of declining prices.

21. The crops most suited to Liberia's climate, soils, and terrain are permanent tree crops, such as rubber, oil palm, coconut, coffee, and cocoa. A long gestation period is required for projects involving these crops and the market prospects of rubber, oil palm and coffee are not encouraging. Extension services are lacking. Apart from Firestone's limited efforts in rubber and isolated Government assistance to some large farms and a few pilot projects, Liberian farmers receive virtually no advice or assistance. Credit facilities are limited to the commercial banks and the Liberian Bank for Industrial Development and Investment (LBIDI), which generally require collateral security.

22. Marketing is in urgent need of reform. Foreign concessionaires purchase the entire rubber output at New York-based prices and charge an excessive amount for processing and shipping. The other export crops are bought by Liberia Produce Marketing Corporation (LPMC), which is owned equally by the Government and a foreign company. LPMC's margins are high, resulting in large profits, but it does little to stimulate output. With rice, the traditional farmers are faced with sharp variations in prices, competition from subsidized rice imported by the concessions and unofficial levies imposed by Government officials in the interior.

23. The absence of effective Government planning also impedes the development of the sector. Statistics are either unavailable or unreliable. The Department of Agriculture has not kept proper records of ongoing projects and has not reviewed expenditure against actual or potential benefits. The Government's recent proposal to set up an Economic and Planning Unit within the Department of Agriculture is a step in the right direction and a forthcoming agricultural census should provide some statistics. But the Government will continue to require substantial technical assistance in the preparation of projects since there is little grasp of the rationale for investment, even at the highest administrative levels.

24. The Government has established a number of specific programs, including production schemes for Liberia's self-sufficiency in rice, encouragement of livestock development and support for cooperative organizations. However, despite considerable external assistance, little progress has been made in their implementation. We doubt the viability of some of these programs, particularly the schemes aimed at self-sufficiency in rice, and consider that the Government has not yet come to terms with the major constraints.

25. The difficulties of operating in this field are considerable. Of two agriculture projects appraised by the Bank so far, the first - a palm oil plantation - was rejected for its low internal economic return and the second - a rubber project - is in similar difficulties (see paragraph 48 below). A Bank/FAO agriculture sector survey mission visited Liberia in October 1970: its report, currently being prepared, should serve as a first step towards identifying major obstacles in the development of the agriculture sector and indicating some possibilities for future investment. Nevertheless, our knowledge of the sector remains sketchy and our recommendations are still tentative.