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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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LC/M/70-8

September 30, 1970

Minutes of Loan Committee Meeting held at 3:30 p.m. on Monday, September 14, 1970 in the Board Room.

A. Present:

Mr. J. Burke Knapp, Chairman	Mr. G. Votaw
Mr. S.R. Cope	Mr. J.H. Williams
Mr. A. Broches	Mr. K.G. Gabriel
Mr. G. Alter	Mr. M.L. Hoffman
Mr. W.C. Baum	Mr. A. Stevenson
Mr. M.P. Benjenk	Mr. W. Wapenhans
Mr. B. Cheek	Mr. D. Pearce (Secretary)

In Attendance:

Mrs. S. Boskey	Mr. N. Horsley
Mr. J. Edwards	Mr. S.N. McIvor
Mr. D. Gustafson	Mr. V.J. Riley
Mr. D. Hartwich	Mr. D. Stoops

B. Spain - Agricultural Research and Extension Project

1. The Committee considered a memorandum dated September 10, 1970 from the Europe, Middle East and North Africa Department entitled "Spain - Agricultural Research and Extension Project" (LC/O/70-100) and the accompanying pre-appraisal report dated August 24, 1970 which recommended appraisal of a project designed to improve the efficiency of agricultural research and extension. The project had originated from recommendations of a joint Bank/FAO agricultural survey mission in 1965 and, following considerable revision in the interim, envisaged the establishment of five specialist research centers, each dealing with priority research objectives

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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
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)

relating to Spain's agricultural development program. Total project cost was tentatively estimated at about $21 million, of which about half - including $5 million for building and equipment, $2.5 million for international research specialists and $1 million for overseas training of Spanish researchers - would be in foreign exchange.

2. In reviewing the proposal, the Committee noted that:

(a) Consideration would be given to the feasibility of securing UNDP financing for the project's technical assistance component, although the amounts involved were probably more than UNDP, which had just approved two other projects, wished to allocate to Spain. Moreover, UNDP was expected to reduce its activities in Spain, which was now only marginally eligible for UNDP technical assistance.

(b) While FAO, which had been closely concerned with the original project's initial development, had not yet been formally consulted about the revised project, largely for reasons of time, staff consultations indicated that it did not object to the revised proposal.

(c) The amortization terms of an eventual Bank loan, which in the Chairman's view should not exceed the project's estimated foreign exchange cost, would be relatively short, i.e. 12-15 years.

(d) The relatively large amount of the loan tentatively allocated for expatriate research specialists and overseas training of Spanish researchers was justified by the comparatively backward state of existing agricultural research in Spain and the project's institution-building objectives. The Spaniards apparently welcomed this particular feature of the project.

(e) The conditions which the Bank proposed to attach to the project were necessary to ensure its successful implementation and continuation by the Spaniards in future. In this respect, they were analogous to the conditions required of borrowers for conventional education projects.

3. The Committee approved the Europe, Middle East and North Africa Department's recommendation that, subject to confirmation of the Spanish Government's acceptance of the Bank's proposals, project appraisal be undertaken in November.

C. Adjournment

4. The meeting adjourned at 4:10 p.m.

Secretary's Department
September 30, 1970

FORM No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

September 30, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Iran - Telecommunications Project

1. The Committee is requested to consider, without meeting, the attached memorandum of September 30, 1970 from the South Asia Department, entitled "Iran - Proposed Telecommunications Project" (LC/O/70-106).

2. Comments, if any, should be sent to reach Mr. Aiyer (ext. 2778) by 5:00 p.m. on Friday, October 2.

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

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, 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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Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL
LC/O/70-106
September 30, 1970

LOAN COMMITTEE

Memorandum from the South Asia Department

IRAN - Proposed Telecommunications Project

1. Attached for the consideration of the Loan Committee is the appraisal report (PU-53) dated September 9, 1970 on the Telecommunications Project in Iran, recommending a Bank loan of $36 million. If approved, this would be the first Bank loan for public telecommunications development in Iran.

Background

2. The Bank has made sixteen loans, amounting to $497.2 million, net of cancellations, for projects in Iran, of which some $287.5 million was disbursed as of July 31, 1970. The first loan was made in 1957 for general development ($75 million). Five loans have been made for road construction, amounting to $167.2 million, four for agriculture amounting to $100.5 million, and six for industrial development amounting to $154.5 million. Also, two technical assistance grants were made, one for the power sector and one for a ports study. The lending program as set out in the country program paper, and summarized and updated in the attached Annex I, calls for loans totaling more than $600 million during the next five years. While planned for FY 70 the sixth IMDBI loan ($50 million) was approved after July 1 and now falls into FY 71. In addition negotiations are substantially completed for an education project and a power distribution project (LC/O/70-81 and LC/O/70-95). Together, these four projects would bring the total lending for the current fiscal year to $160 million. We understand that the Agricultural Development Fund of Iran (ADFI) may require additional funds before the end of this fiscal year, in which case a second loan may be proposed ($10 million). This is subject to confirmation by a supervision mission scheduled for late September, but it also depends on finding a place in the heavily booked appraisal schedule of Agriculture Projects Department.

3. The Iranian economy continues to grow rapidly. The real rate of annual growth of GNP has been above 8 percent for nine years with population growing at about 3 percent per annum. The rate of domestic savings is 14 percent per annum, but it has not kept up with the increase in the rate of investment, which is nearly 20 percent per annum. Moreover, the decision of the Government to strengthen Iran's defense capabilities is accentuating the problems of the savings gap.

4. The Government has been highly successful in negotiating larger than expected increases in oil revenues and has also relied heavily on foreign borrowing, much on relatively short term; success in both has obscured the rising resource shortages. However, the Government is aware of a need to improve the management of the economy, and efforts are under way to increase non-oil revenues, to increase private sector savings, to improve the terms of foreign borrowing and to improve further the quality of the investment program. No significant deterioration in overall performance is likely in the next year or two but there are signs of strain. The most recent Economic Report (SA-8a of December 31, 1969) drew attention to the existing difficulties, but concluded that Iran is creditworthy for further Bank lending of the order envisaged in the country program paper. I believe this conclusion still holds. As suggested in the country program paper, we keep the situation under close review, and the next economic mission to Iran is scheduled for October this year.

5. Local telephone services in the country are operated by the Telephone Company of Iran (TCI), a wholly Government-owned joint stock company. Other telephone, telex and telegraph services, as well as the postal services, are operated by a department of the Ministry of Posts, Telegraph and Telephones (PTT), which is also responsible for telecommunications regulatory and licensing functions. TCI is organized along commercial lines, employs competent staff and has an accounting system which meets commercial standards. But PTT does not have an adequate accounting system, is overstaffed, and operates inefficiently. Some telecommunications equipment is manufactured in Iran by the Iran Telephone Manufacturing Company (ITMC), which was established in 1968 with the help of a loan from IMDBI.

6. The present division of responsibilities between PTT and TCI creates organizational problems, and results in additional investment, inefficient use of staff, and customer service problems including dual accounts. The Government is aware of these problems and has made the establishment of a single commercial entity, the Iran Telecommunications Company (ITC) an objective of the Fourth Plan.

7. Telecommunications infrastructure has not kept pace with progress in other sectors in Iran. In the capital city of Tehran where the growth in trade, commerce and other activities has been especially rapid, the telephone system is quite inadequate. The waiting list for telephones includes over 50,000 applicants in Tehran and a further 30,000 in other centers. This number is likely to be understated as applications must be accompanied by deposits of Rls.12,000 ($160) and average delays in providing service exceed two years. On the long distance network, calls between major cities often cannot be completed on the same day. Another evidence of inadequacy is the number of telephones per 100 population which is 0.92 in Iran, compared to 2.05 in th Republic of China ($250 per capita), 1.80 in Malaysia ($290 per capita), 1.70 in Syria ($180 per capita) and 1.60 in Korea ($160 per capita). The social costs resulting from the lack of service are very great and activities in Government, trade and commerce are severely handicapped.

The Project

8. The proposed Bank project is aimed at mitigating the problems mentioned above and is part of the larger five year programs in which both TCI and PTT are involved in order to provide satisfactory service. TCI's program, estimated to cost Rls. 13.4 billion ($178.1 million) reflects feasible achievement levels. PTT's program covers the provision of a nationwide high capacity microwave network for telephone, telegraph and television, automatic trunk switching exchanges permitting nationwide subscriber trunk dialing (STD), and expansion of Telex-Gentex services. This program is expected to cost Rls. 23 billion (about $300 million). The major PTT program items, excepting Telex-Gentex exchanges, are being supplied under "turnkey" contracts and are expected to be completed more or less on schedule.

9. The project for Bank financing consists mainly of TCI's ongoing program for growth of local telephone services during the period March 1970 - March 1974, together with two small items from the PTT program and will provide:

(a) Telephone exchange equipment and auxiliary facilities for about 300,000 additional subscriber lines;

(b) Cables linking local networks with the new trunk dialing (STD) exchanges;

(c) Telex-Gentex switching equipment in Tehran and ten provincial centers to allow for the connection of about 2,000 Telex subscribers, 290 Gentex services; and

(d) Management consultants and engineering services.

All items to be financed from the loan will be procured through international competitive bidding. The loan would be made to Plan Organization through which all of Iran's public sector foreign borrowings are channelled and would be relent to the operating company on the same terms as the Bank loan. The project provides for a growth to 550,000 lines connected by March 1974 which would still be 15,000 lines below the minimum forecast demand. The telephone density will have increased from 0.92 to 1.85 per hundred of population, a level more in line with Iran's needs. The telex development will greatly benefit Iran's business sector. The project is of great importance to the country and the organizational improvements and tariff increases proposed by the Government, and the services of the consultants to be financed under the loan, will help resolve the major problems now facing the sector.

10. Specifications for cables and Telex equipment worth about $12 million have already been prepared and TCI may be ready to place orders in November. To ensure that facilities now available or under construction are brought into service as soon as possible to meet the large waiting demand, the report recommends in paragraph 3.11 that the Bank agree with this and

also to the early appointment of consultants for the establishment of ITC. Timely action on these points is highly desirable.

11. We agree with the appraisal report regarding the importance of the merger of TCI and part of PTT operations into a new telecommunications company, that the proposed tariff increases are necessary to ensure its financial viability, and that good management is essential to the new company. However, subsequent to the preparation of the appraisal report, we have agreed with the Projects Department on modifications to the sequence of events which need to be completed if we are to be assured that the objectives set out in the appraisal report are achieved.

12. In view of the Government's own initiative in pursuing legislation on the formation of the new company, its acceptance of the Bank's comments, the Cabinet's complete agreement on the bill and the intention of the Prime Minister to present it to Parliament when it reconvenes in October, it is agreed that it is unnecessary to make the actual passing of the legislation a condition of presenting the loan to the Executive Directors. However, it is proposed now that this requirement be made a condition of effectiveness of the loan.

13. The Government similarly proposes to initiate legislative action regarding the tariff increases and passage of this bill is considered certain, following presentation to Parliament in October. In view of this situation it is also agreed that passage of this bill is not necessary as a condition for presenting the loan to the Executive Directors. However, it is recommended that during negotiations assurances be obtained that the legal opinions necessary for effectiveness will not be sent to the Bank until the tariff increases have been approved for implementation at a date satisfactory to the Bank.

14. We understand that the present Managing Director of TCI is to be appointed to the position of Managing Director of the new company. He is considered eminently suitable by both ourselves and the Projects Department. This appointment will be confirmed during negotiations and recorded in the grey cover President's Report to the Executive Directors. It is agreed that a specific condition of effectiveness will not be necessary. The position regarding subsequent appointments to this post is under discussion between the Departments concerned.

15. All the issues to be raised during negotiations are listed in paragraphs 6.01 and 6.02 of the appraisal report.

Recommendation

16. Subject to the above comments, I concur with the recommendation in paragraph 6.04 of the appraisal report that the Bank make a loan for telecommunications in Iran, and propose that representatives of the Government be invited to Washington for negotiations which I hope can begin about October 5. On the basis of the installation period and economic life of equipment, a term of 20 years, including a five year grace period, would be appropriate.

Gregory B. Votaw
Deputy Director

Attachments

Annex I: Iran - Five Year Lending Program

ANNEX I

Population: 26.3 m
GNP Per Cap.: $280

IVa. IRAN - 5 YEAR LENDING PROGRAM

($ millions)

		Fiscal Year 1970	1971	1972	1973	1974	1975	Total 1964-68	Total 1969-73
Fisheries	IBRD				30.0				
Agric. Development Fund	IBRD	6.5							
Agric. Development Fund II	IBRD		10.0						
Agric. Development Fund III	IBRD				20.0				
Irrigation	IBRD			40.0					
Agriculture Unidentified IV	IBRD					30.0			
Agriculture Unidentified V	IBRD						30.0		
Telecommunications	IBRD		35.0						
Telecommunications II	IBRD				25.0				
DFC - IMDBI VI	IBRD		50.0						
DFC - IMDBI VII	IBRD			50.0					
DFC - IMDBI VIII	IBRD					50.0			
Education I	IBRD		15.0						
Education II - Arya-Mehr Univ.	IBRD				20.0				
Education III	IBRD					20.0			
Education IV	IBRD						20.0		
Power Transmission	IBRD		60.0						
Power II	IBRD			30.0					
Power III	IBRD				45.0				
Power IV	IBRD						50.0		
Airport	IBRD				20.0				
Highways IV	IBRD	42.0							
Highways V	IBRD				30.0				
Port Equipment	IBRD			8.0					
Pipeline	IBRD			10.0					
Railways	IBRD			10.0					
Transp. Unidentified III	IBRD						30.0		
	IBRD	48.5	170.0	148.0	190.0	100.0	130.0	141.0	626.5
	No.	2	5	6	7	3	4	7	22

P & B 7/23/70

FORM No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

September 25, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Guyana - Livestock Project

1. The Committee is requested to consider, without meeting, the attached memorandum of September 25, 1970 from the Central America and Caribbean Department, entitled "Guyana - Proposed IDA Credit for Livestock Project" (LC/O/70-105).

2. Comments, if any, should be sent to reach Mr. Davar (ext. 4843) by 5:00 p.m. on Tuesday, September 29.

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
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Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/O/70-105

September 25, 1970

LOAN COMMITTEE

Memorandum from the Central America and Caribbean Department

GUYANA - Proposed IDA Credit for Livestock Project

Introduction

1. Attached for consideration by the Loan Committee is Appraisal Report No. PA-61, entitled "Beef Cattle Project, Guyana", which recommends an IDA credit of US$2.2 million to the Government of Guyana to help finance a livestock project.

2. Since Guyana became independent in 1966, Bank loans and IDA credits have aggregated $7.9 million and $2.9 million respectively. There have been two operations: a $5.0 million loan for sea defenses (1968) and $5.8 million, half as a loan and half as a credit, for education (1969). A $1.25 million loan for agricultural credit to British Guiana in 1961 has been repaid in full. The two on-going projects are progressing satisfactorily.

3. There was no Bank Group operation in FY 1970. The proposed credit is the first lending operation in FY 1971. The lending program for this year also contains a power loan presently estimated at $5.0 million. The lending program for FY 1971-1976, which was recently approved by the President, is attached.

Economic Situation

4. An economic mission visited Guyana early this year, and its draft report was discussed with the Government in July. The report is scheduled for circulation to the Board in late September. Its principal conclusions are that Guyana has had a satisfactory pace of economic growth and that, with continued high levels of external assistance, growth prospects are reasonably good. However, the country has a limited capacity to service external debt, and it is important that most of the aid should continue to be extended on concessional terms.

5. Guyana's dependence on foreign-owned and operated bauxite and sugar production has increased further in recent years. At the same time infrastructure has been strengthened. But limitations in administrative capacities have hindered a broader effort in public investments and, as a result, Guyana has not been able to make full use of the available external financing. Nevertheless, with reasonably good financial policies, growth

has been achieved against a background of rising public savings and a strengthened balance of payments.

6. There are some grounds for optimism regarding future economic development. As a result of various tax measures introduced in 1970 and the termination of tax holidays on important bauxite mining investments, government revenues are expected to increase sharply in 1971. At the same time, a newly-created social security system is expected to generate substantial savings available for public sector investments. With the Government's intention to keep non-development expenditures in check - which should be relatively easier to do now that understandings have been reached with Venezuela and Surinam on border disputes - the prospects are for substantially increased public sector savings. These favorable fiscal prospects over the next few years should permit a substantial increase in public investment without detriment to the external balance of payments. A new development plan is currently under preparation. It is likely to propose, as did the recent Bank economic mission, a significantly higher public investment effort than in the past. While administrative constraints will probably set a ceiling on the Government's development expenditures, a gradual improvement in the planning and executing capacity of the relevant ministries can be anticipated.

7. There are also elements of uncertainty clouding future prospects. First of all, the Government has announced a new policy of a majority participation in private ventures involved in natural resource exploitation. Negotiations to this effect are planned with bauxite mining companies and later with sugar companies. Meanwhile, the change in policy makes it less likely that major new investments will be undertaken by foreign companies (Litton Industries are considering the establishment of a pulp and paper mill, for which they have been interested in obtaining some World Bank financing). Moreover, the Government has stated its intention to participate in other ventures without making it clear what this means. Second, the Government wants to rely more on cooperatives than on individual or company efforts in economic life. Here again, the effect of the new policy has not been spelled out in full. So far, however, the Government has taken a rather pragmatic approach to cooperatives versus other forms of organizations. Third, in preparing its own development program, the Government has indicated a shift in strategy from a more intensive exploitation of the soil-rich coastal lands to the opening up of substantial areas for settlement in the interior where resources are not yet proven. Although hinterland development still is largely a vision, financial and administrative resources are being shifted away from "normal" activities. If this shift should continue at recent rates over an extended period, it could affect economic growth prospects as well as financial stability.

The Project

8. The project would be the Bank Group's first effort to develop a

modern livestock industry in Guyana. The country has considerable land resources suitable for the development of a beef cattle industry. The most promising areas are located immediately south of the sugar/rice belt on the coast and in the Rupununi savannas in the south of the country where there are a few extensive cattle ranches. The project is limited to these areas. What has been lacking so far for developing the country's livestock potential is not only experience in modern ranching techniques but, equally important, an institutional framework to channel financial resources into the sector.

9. The project includes the establishment of about 25 group (cooperative), company or private ranches as well as two large ranches of a new livestock development company in which the Government would have a majority holding. Although the project is relatively small by Bank standards, it would cover about 60,000 animals, which is a little over 25 percent of the total cattle population in the country. The primary aim would be to substitute domestic production for imports and to raise local consumption, but some beef might also be produced for export in the longer run. Financing would be provided for pasture establishment/improvement, fencing, water facilities, buildings, livestock and agricultural machinery and equipment. The investment period for an individual cattle ranch would be about 3 years. In addition to long-term credits to ranches, some equipment would be financed for chain clearing of land for pasture establishment on some project ranches. An important technical assistance element would be built into the credit in the form of a Livestock Projects Division, with an experienced project director. The credit would also finance certain developmental studies (on pasture improvement and management and on marketing), which should help in determining the future direction of livestock development in the country (including new areas which might be suitable for ranching) and in preparing proposals for future Bank Group lending or bilateral assistance in this sector.

10. The project is estimated to cost \$4.4 million (including working capital requirements). The proposed credit of \$2.2 million would finance 50 percent of this cost and would cover the full foreign exchange component estimated at \$1.8 million and local expenditure of about \$400,000. I consider this modest local currency financing justified in view of the broad project and sector objectives which the proposed credit is intended to achieve and of the substantial local contribution that would also be made towards on-ranch investments. IDA would finance 60 percent of the on-ranch investment, on the pattern of many Bank/IDA livestock projects, while the participating ranchers and commercial banks would each contribute 20 percent. All six of the existing commercial banks (five branches of foreign banks and the new National Cooperative Bank) are expected to participate in the project. Apart from providing long-term capital, the commercial banks would also provide the short-term financing for the working capital of the ranches, including financing for the herd build-up in the early stage of ranch development. The Government's contribution would

consist of financing the local costs of the Livestock Projects Division, the development studies and part of the assets of the new livestock development company. In all, the Government would be covering 14 percent of the total cost of the project, the commercial banks 18 percent and private investors 18 percent. Of the proposed IDA credit, 82 percent would be used for financing on-ranch investments and land clearing, 13 percent would be for the foreign exchange costs of the project unit and 5 percent for the studies.

11. The Bank of Guyana (the country's central bank) would act as the Trustee of the Government for channelling the IDA funds, through participating banks, to the ranches and in formulating and supervising the implementation of the ranch development plans. Towards these objectives, Government would establish a Livestock Development Fund to be administered by, and a Livestock Projects Division to be located in, the Bank of Guyana. The Livestock Development Fund would be used to rediscount up to 75 percent of the participating banks' loans to project ranches. The loans to ranches would be repaid in 12 years, including 4 years' grace, and carry a 9-1/2 percent rate of interest (loans for land clearance would be for 5 years at 9 percent interest). These terms are acceptable given the generally stable price developments and prevailing interest rates in Guyana. Out of the 9-1/2 percent, one-half percent would contribute to the cost of the Livestock Projects Division and 3 percent would remain with the participating banks, who would carry the full credit risks on the loans. The banks would rediscount their loans with the Livestock Development Fund at 6 percent. However, for the Amerindian ranches in the Rupununi, where the participating banks would make a loan with Government guarantee, the rediscounting rate would be 8 percent. Government would bear the foreign exchange risk. Repayments of IDA funds to the Government would be based on repayments by the ranches to the participating banks. Government would have unrestricted use of these funds and of surpluses available after servicing and repaying the IDA credit, for any public investment purpose, including future livestock development.

12. One of the principal contributions of the proposed credit would be the setting up of an institutional framework which would allow the chanelling of finance and infusion of modern techniques into the livestock industry in Guyana. The institutional changes proposed include the following:

(a) At ranch level: Many of the farmers and ranchers, who are presently obtaining unsatisfactory results from grazing animals on poor land without use of modern ranching techniques, are to be brought together for the first time into efficient and commercially viable ranching units through the formation of the group (cooperative) ranches. These are being set up under new rules (within the existing cooperative legislation), under which such ranches will have professional help, viz., ranch managers with necessary authority to run the ranches on technically sound lines.

(b) At the level of the livestock company ranches: Two existing government ranches are to be brought into the framework of the livestock development company, jointly owned by the Government and the private sector; these will also be run by a manager satisfactory to IDA.

(c) At the technical supervision level: A Livestock Projects Division, to be set up in the Bank of Guyana, is to be headed by an internationally recruited project director satisfactory to IDA;

(d) At the commercial bank level: Again for the first time in Guyana, commercial banks are to provide long-term financing directly for the development of ranches, and this has necessitated the establishment of certain legal instruments:

(i) an appropriate chattel mortage legislation,
(ii) the introduction of long-term land leases,
(iii) improvements in land surveying legislation, and
(iv) a government guarantee for loans to Amerindian ranches.

13. The draft legislation necessary under (d) of the foregoing paragraph is basically satisfactory, and the various drafts will be finalized during negotiations. Conditions of effectiveness will include the enactment of these laws and the effective establishment of the livestock company. Since the Government has a clear majority in the legislature, I do not anticipate any problem in this. However, this is going to be an extremely complicated project to set up and administer, and it will require very careful supervision. We should not be surprised if some things go wrong, but I think that the risks are worth taking.

Recommendation

14. I concur with the conclusions of the appraisal report and recommend that the Government of Guyana be invited to negotiate an IDA credit of $2.2 million, on the terms and conditions set forth in the report.

E. Peter Wright
Deputy Director

Attachments

Population: 1970 0.735 million
Per capita income: $275

GUYANA - ACTUAL AND PROPOSED LENDING THROUGH FY 1976

($ million)

		Through 1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	Total 1964-68	Total 1969-73	Total 1972-76
Agricultural Credit	IBRD	1.25																
Sea Defense I	IBRD							5.0										
Sea Defense II	IBRD											5.0						
Livestock I	IDA									2.0								
Livestock II	IDA													5.0				
Fishery Development	IBRD											4.0						
Black Bush/Tapakuma Rehabil.	IDA											4.0						
Agriculture or Forestry (unidentified)	IBRD												5.0					
Education I	IBRD							2.9										
Education I	IDA							2.9										
Industry (Litton Pulp)	IBRD										20.0							
Power I	IBRD									5.0								
Power II	IBRD														6.0			
Highways I	IDA										5.0							
Highways II	IDA												5.0					
Georgetown Protective Works	IBRD										4.0							
	IBRD	1.25	-	-	-	-	-	7.9	-	5.0	24.0	9.0	5.0	-	6.0	-	45.9	44.0
	IDA	-	-	-	-	-	-	2.9	-	2.0	5.0	4.0	5.0	5.0	-	-	13.9	19.0
	Total	1.25	-	-	-	-	-	10.8	-	7.0	29.0	13.0	10.0	5.0	6.0	-	59.8 2/	63.0
	No.	1	-	-	-	-	-	2	-	2	3	3	2	1	1	-	10	10

1/ excluding $20 million enclave loan proposed for FY 1972. Loan disbursements would take about four years.
2/ the corresponding figure for the period 1969-73 in the current Five-Year Lending Program was $65.8 million.

Central America & Caribbean Department

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

September 16, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Dominican Republic - Education Project

1. The Committee is requested to consider, without meeting, the attached memorandum of September 16, 1970 from the Central America and Caribbean Department, entitled "Dominican Republic - Proposed $4 Million Credit for Education Project" (LC/O/70-104).

2. Comments, if any, should be sent to reach Mr. Bochenski (ext. 2631) by 5:00 p.m. on Friday, September 18.

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/0/70-104

September 16, 1970

LOAN COMMITTEE

Memorandum from Central America and Caribbean Department

DOMINICAN REPUBLIC - Proposed $4 Million Credit for Education Project

1. Background: The proposed credit would be the first by IDA to the Dominican Republic and the first lending from the Bank Group to the Government, the only previous Bank financing being to Falconbridge Dominicana, C. por A., the US$25 million equivalent loan of December 10, 1969 (646-DO) for the power component of a ferronickel project. A mission is now in the Dominican Republic appraising a livestock project for which an IDA credit has also been requested.

2. The Economy: A report on the "Current Economic Position and Prospects of the Dominican Republic" (WH-176b) was circulated to the Executive Directors on April 12, 1968. This report concluded that performance of the public sector and external debt management appeared to be generally satisfactory but the balance of payments was precarious and very limited capacity existed to service external debt on conventional terms. After reviewing the report, the Economic Committee on January 17, 1968 concluded that the country qualified for IDA assistance on the grounds of satisfactory economic performance as well as poverty and limited creditworthiness. A mission which visited the country in November/December 1969, although concentrating mainly on the agricultural sector, basically confirmed the above conclusions. A new economic mission is scheduled to go to the Dominican Republic in October 1970.

3. While the Dominican Republic's external debt management has been generally satisfactory, there have been delays with a British debt which arose from various "deals" generated by promoters and suppliers which were subsequently covered by a British export credit guarantee. The debt was recognized by the Government at $3.9 million in February 1965 and installment payments totalling $350,000 were made by successive Administrations, including the present one. No payments were made for about three years and with accumulated interest the debt increased above the amount recognized in 1965. During recent negotiations, the parties have agreed to reduce the total amount to $2.6 million which are to be paid within approximately one year and a half. It is expected that this agreement will be signed and a substantive payment will be made within the next six weeks.

4. The Project: Attached is a report entitled "Appraisal of an Education Project Dominican Republic" (PE 20) which recommends a credit of $4.0 million equivalent to the Government, to cover the estimated foreign exchange cost of the project, the total cost of which is estimated at US$8.1 million equivalent.

5. The project consists of construction and equipment for secondary schools and primary teacher colleges and of the financing of technical assistance for project implementation. It is of an obvious priority in view of the shortcomings in quantity and quality of existing educational facilities and in teacher training. The project also fits well into the secondary education reforms undertaken recently by the Government. These reforms include a switch in secondary education to a new common four-year lower cycle followed by a new two-year diversified course, which will emphasize pre-vocational training in industrial arts, home economics and commerce. The proposed credit will strengthen and accelerate the transition to the reformed system of secondary education. In order to strengthen the Office of the Secretary of Education in general, and in particular to help to overcome its lack of experience in school construction, a special unit should be established within the Office of the Secretary of Education with a director and architect acceptable to the Association. I agree with these and other recommendations as formulated in part V of the Report.

6. Recommendation: I recommend that IDA inform the Government of the Dominican Republic that it will be prepared to begin negotiations during the month of October for a credit of $4.0 million equivalent for an education project on the basis set forth in the appraisal report.

Edgar Gutierrez
Director

Attachment

Population: 3.9 m
GNP Per Cap: $298

DOMINICAN REPUBLIC - 5 YEAR LENDING PROGRAM

		Fiscal Year						Total	Total
		1970	1971	1972	1973	1974	1975	1964-68	1969-73
Irrigation I - Yaque del Norte	IDA			6.0					
Irrigation II - Yaque del Norte	IDA				6.0				
Livestock/Dairy Farming I	IDA		5.0						
Livestock/Dairy Farming II	IDA					5.0			
DFC - FIDE	IDA			5.0					
DFC - FIDE/Financiera Dominicana	IBRD						2.5		
" " " "	IDA						2.5		
Education I	IDA		4.0						
Education II	IDA					5.0			
Industry - Mining	IBRD	25.0							
Tourism	IDA				5.0				
Unallocated	IBRD						3.0		
	IBRD	25.0					5.5		25.0
	IDA		9.0	11.0	11.0	10.0	2.5		31.0
	Total	25.0	9.0	11.0	11.0	10.0	8.0		56.0
	No.	1	2	2	2	2	2		7

CA&C 9/14/70

FORM No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

September 15, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Upper Volta - Cotton Project

1. The Committee is requested to consider, without meeting, the attached memorandum of September 15, 1970 from the Western Africa Department, entitled "Upper Volta - Proposed Credit for a Cotton Project" (LC/O/70-103).

2. Comments, if any, should be sent to reach Mr. Maillard (ext. 4757) by 5:00 p.m. on Thursday, September 17.

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
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Director of the Development Services Department
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Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/0/70-103

September 15, 1970

LOAN COMMITTEE

Memorandum from the Western Africa Department

Upper Volta - Proposed Credit for a Cotton Project

Introduction

1. Attached for the consideration of the Committee is Report No. PA-58 "West Volta Cotton Project -- Upper Volta". It recommends an IDA credit of US$4.5 million. The project was identified in 1968 by PMWA and was prepared by SEDES (Société d'Etudes pour le Développement Economique et Social) with the assistance of CFDT (Compagnie Française pour le Développement des Fibres Textiles) on the basis of terms of reference prepared by PMWA. The project was appraised in February 1970.

2. The proposed credit would be IDA's second operation in Upper Volta. In February 1969, IDA made a credit of US$0.8 million for telecommunications (UV-141). Execution of this project is satisfactory. No other projects are expected to be submitted to the Loan Committee during FY1971. The Five-Year Lending Program is attached.

3. The Committee is invited to pay particular attention to the following aspects of the Project:

a) local currency financing and financing plan (para. 14)
b) arrangements between Government and CFDT (para. 15)
c) advances of the Government to BND (para. 16)
D) procurement (para. 19)

The Economy

4. An economic mission headed by Mr. de Wilde visited Upper Volta in November of last year. Its report will be available shortly. The main conclusions have been set out in the Country Program Paper dated May 13, 1970, and approved by the Chairman of the Economic Committee. They can be summarized as follows:

5. Upper Volta is one of the poorest of our member countries and least endowed in natural resources. The capacity of the economy to generate savings is severely limited but the Government has made a commendable and successful effort to restore

balance in public finance. The general thrust of the Government's development strategy appears to be sound, with the focus on the development of whatever productive capacity the country has in agriculture and livestock. With the coordination and assistance of all sources of external aid, it is expected that its performance will continue to improve and that the pace of economic development in the country will accelerate in the coming years.

6. The terms of external financing will have to take into account the extremely limited capacity of Upper Volta to make contributions from its budget. The Government has been able in the last three years to generate budget savings, but in part at the expense of necessary outlays on current operations. These savings have had to be devoted almost entirely to the portions of road maintenance and construction not financed by foreign aid. Upper Volta's contribution to the financing of development projects will have to be principally in the form of complementary current expenditures. Even on this basis, its contribution can only be modest. Given the large proportion of project costs which will have to be financed by external sources, and the probability that the foreign exchange content of projects will be relatively small, the Bank Group must be prepared to finance a significant part of local costs. Upper Volta will only be eligible for IDA financing.

The Project

7. The project would be a part of the Government's efforts to develop cotton production by extending cotton growing areas and increasing productivity. Under the project, the total cotton area would expand from the present 44,000 ha. to about 76,500 ha. in 1975. Yields would be expected to increase from an estimated 750 kg/ha. in 1970 to about 870 kg/ha. About 46,000 farmers would benefit from the project.

8. Cotton growing was introduced in Upper Volta in 1951 by CFDT. Progress was slow during the initial development period until 1963 when it started accelerating. Total production reached 17,500 tons in 1967/68 and about 36,000 in 1969/70. From the beginning, cotton development has been financed in great part by the French Government.

9. Cotton is now Upper Volta's second export product, after livestock. In 1968, cotton products represented almost 20 per cent of total exports. After livestock, cotton is the only hope for agricultural development in Upper Volta.

10. The project would cover the 1971-75 period. It would consist of the following:

(a) strengthening regional development bodies (ORDs - Offices Régionaux de Développement) which administer extension, credit and marketing in the project area;

(b) establishing a revolving fund to meet the cotton growers' incremental credit requirements for fertilizers, insecticides and agricultural equipment;

(c) providing a laboratory gin to improve research on cotton varieties;

(d) constructing an additional ginnery;

(e) establishing a mechanical road rehabilitation unit to improve about 820 km. of tertiary roads in the project area;

(f) providing funds for:

(i) a feasibility study for a similar cotton project in an area adjacent to the project area;

(ii) detailed engineering for the improvement of two secondary roads in the project area (about 200 km.).

11. Total project cost is estimated at US$9.0 million equivalent, including about US$1.0 million in local taxes, US$1.0 million for tertiary road rehabilitation and US$250,000 for the two studies. The foreign exchange component is estimated at about US$5.1 million or 57 per cent of total project cost. A credit of US$4.5 million, as proposed in the appraisal report, would finance the estimated foreign exchange cost less US$0.6 million to be financed by CCCE (Caisse Centrale pour la Coopération Economique) and represent about 50 per cent of total project cost. FAC and CCCE together would finance 31 per cent, the Government 16 per cent and the participating farmers 3 per cent. The credit would be disbursed against c.i.f. costs of imported materials and equipment, and a percentage of the cost of extension and the entire cost of consultant's services.

12. IDA is proposing that a revolving fund be established within BND (Banque Nationale de Développement) to finance its short and medium term credit operations under the project. As suggested in the appraisal report (para 5.03) IDA's and CCCE's contributions (close to US$1.3 million) to the financing of imported incremental inputs and farm implements would be made available to BND in the form

of equity capital to finance this fund. Since CCCE is not willing to make its contribution ($0.6 million) available in this form (equity) we have proposed that IDA finance the total amount. But CCCE wishes to remain associated with this project and has only agreed to reduce its share from $0.6 to $0.2 million. This means that our share for these categories would increase from about US$0.65 million to about US$1.1 million, and the proposed IDA credit from US$4.5 to about US$4.9 million.

13. During our discussions on the financing plan, FAC explained that since they had spent considerable sums on developing cotton production during the last 10 years, and since they wished to shift their financing to developing other, poorer areas as well as other sectors, they would welcome IDA's willingness to finance a high proportion of project costs, including local currency expenditures. This is also the Upper Volta Government's wish. I think FAC has a valid point. They are indeed financing the greater part of Upper Volta's highway maintenance needs, which explains why we have had no maintenance operation there, as in most neighboring countries. They will finance cotton development in the Tougan area, which we have rejected because cotton growing there is still in an early state of development and natural conditions are less favorable than in the project area; for some time to come returns will therefore be much lower. FAC is also financing the creation of several new ORDs in the poorest parts of the country.

14. In the light of the economic considerations outlined in paras. 5 and 6 above, I propose an increase of about US$1.3 million which would bring IDA's contribution from US$4.9 to about US$6.2 million or about 69 per cent of total project cost. The proposed increase would cover the local cost of expatriate personnel and the cost of additional local personnel, two essential parts of the project. This proposal would result in a decrease in FAC-CCCE's contribution from about 31 per cent to about 20 per cent and of the Government's contribution from about 16 per cent to about 8 per cent; the farmers' contribution would be unchanged at about 3 per cent. I consider this new financing plan to be reasonable.

15. The project (including the road rehabilitation program) would be managed by CFDT in the ORD framework, under the responsibility of the Ministry of Agriculture. CFDT is a French public company established in 1949 to develop the production and marketing of textile fibers. French public institutions and a few cotton traders and users are represented on its board. CFDT is well managed and its achievements in developing cotton production in African countries are remarkable. CFDT would provide the project manager and a financial controller and all staff required for ORD positions which cannot be filled by local staff. The contract between the

Government and CFDT would provide for training of local personnel and every year the Government and IDA would review the personnel situation in order to try and accelerate the africanization of ORD personnel. CFDT has entered into a participation agreement with the Government (Association en Participation) under which CFDT assets (ginneries) and government assets (new ginnery to be financed by IDA under the project) will be managed by CFDT. CFDT will be paid under a schedule of fees outlined in Article 14 of Annex 16. The fees are considered reasonable.

16. BND would administer project funds. BND staff is well qualified and receives technical assistance support from CCCE. For the purposes of this project, BND staff would be reinforced by a credit inspector who may be provided by CCCE. ORDs would continue to administer short term credits for inputs, and under the project administration of medium term credits would also be transferred from BND to ORDs. These credit operations would be financed by the proposed revolving fund. Farmers would receive short term credit at about 8 per cent for fertilizer and insecticide loans and medium term credit at about 7.5 per cent for the purchase of farm implements. The appraisal report (para. 6.05) recommends that the Government advance to BND the equivalent of one year's estimated expenditures for ORD operations amounting to about US$1.1 million. I think that this is not justified and would put an unnecessary burden on Upper Volta's tight budget. An advance allocation of three months should be sufficient.

17. Other institutions involved in the project would be IRCT (Institut de Recherches du Coton et de Textiles Exotiques) which would continue to be in charge of research; IRHO (Institut de Recherches pour les Huiles et Oléagineux) and CIDR (Compagnie Internationale de Développement Rural) which might provide limited services under sub-contracts with CFDT; CSPP (Caisse de Stabilisation des Prix des Produits), an agency set up to protect farmers from seasonal price fluctuations, and which is therefore administering cotton price supports, would also be the trustee of the new government-owned ginnery financed by IDA.

18. To ensure coordination between the agencies and Ministries involved, a coordinating committee would be set up. The Government has agreed in principle to set up this committee under the chairmanship of the Minister of Agriculture, or his designate. Senior officials would represent the Ministries of Planning, Industry and Public Works, Finance and Commerce and BND. The project manager would be the Committee's secretary.

19. Procurement of farm inputs and road equipment would be made on the basis of international competitive bidding. As

explained in the appraisal report (para 5.05), the new ginnery would also be subject to international bidding but a preference would be granted to the US firm Lumnus. Tenders for office furniture and equipment, vehicles and construction of houses, stores and offices amounting in total to about US$0.8 million, are too small to be of interest to foreign bidders and would be let locally. Local tendering procedures are satisfactory. The selection of consultants for the two studies would be made according to standard Bank procecures.

20. The Project's primary benefit would be the increased production of cotton resulting in substantial foreign exchange earnings for the Government and higher income for participating farmers. Increases in farmers' incomes will depend on the producer price of cotton, which would be adjusted in accordance with export prices. The forecast producer price reductions are not expected to be large enough to constitute a disincentive to farmers. Based on the Bank's estimate of the world market price of cotton of 22.5¢ per lb. in 1975, the economic rate of return of this project is estimated at about 31 per cent. Net foreign exchange earnings from the project would amount to about US$4.4 million annually from 1975 on. The high rate of return for this project is a result of cumulative past development efforts which were not capitalized in the cost imputable to the project.

Recommendation

21. I recommend that representatives of the Republic of Upper Volta be invited to negotiate a credit of US$6.2 million equivalent to assist in the financing of this cotton project, otherwise substantially in accordance with the terms and conditions set forth in para. 9.01 (except for (j) where advances from the Government should be reduced from one year to three months; and (m) which should mean that the qualifications and experience of ORD Directors, Deputy Directors and Accountants should be acceptable to IDA) and 9.02 of the Appraisal Report.

Roger Chaufournier
Director

Western Africa Department

Attachment
L.P.

Population: 5.1m
Per Cap. Inc: $50

Attachment I

UPPER VOLTA: ACTUAL AND PROPOSED LENDING THROUGH FY1976
($ millions)

		Fiscal Years (through) 1969	1970	1971	1972	1973	1974	1975	1976	Total 1964-68	Total 1969-73	Total 1972-76
Black Volta Cotton	IDA			6.3								
Cotton II	IDA						3.0					
Rural Development I	IDA				0.5							
Rural Development II	IDA						1.5					
Regional Development I	IDA								5.0			
Livestock	IDA					2.5						
Unidentified	IDA							4.0				
Rural Education	IDA					4.0						
Education II	IDA								4.0			
Telecommunications I	IDA	0.8										
Telecommunications II	IDA					2.0						
Telecommunications III	IDA								3.0			
Road Construction	IDA				1.5							
Road Maintenance	IDA						3.0					
Tambao Railway	IBRD							10.0				
	IBRD	-	-	-	-	-	-	10.0	-	-	-	10.0
	IDA	0.8	-	6.3	2.0	8.5	7.5	4.0	12.0	-	17.6	34.0
	Total	0.8	-	6.3	2.0	8.5	7.5	14.0	12.0	-	17.6	44.0
	No.	1	-	1	2	3	3	2	3	-	7	13
IBRD Loans Outstanding												
Including Undisbursed								10.0	10.0			
Excluding Undisbursed									3.4			
IDA Credits Outstanding												
Including Undisbursed		0.8	0.8	7.1	9.1	17.6	25.1	29.1	41.1			
Excluding Undisbursed		-	0.3	0.6	2.9	5.7	11.4	17.3	23.9			

August 10, 1970

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

September 14, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Kenya - Highway Maintenance

1. The Committee is requested to consider, without meeting, the attached memorandum of September 14, 1970 from the Eastern Africa Department, entitled "Kenya - Highway Maintenance Project" (LC/O/70-102).

2. Comments, if any, should be sent to reach Mr. Roeloffs (ext. 4918) by 5:00 p.m. on Wednesday, September 16.

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
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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/70-102

September 14, 1970

LOAN COMMITTEE

Memorandum from the Eastern Africa Department

KENYA - Highway Maintenance Project

I. INTRODUCTION

1. The Bank Group has made six loans and credits for highways and agricultural roads during the past decade totalling \$49.5 million. The appraisal of the Third Highway Project (Loan No. 639 KE) revealed that road maintenance was inadequate and that the condition of the road network was deteriorating rapidly. The inadequacies of the organization for road maintenance were compounded by the lack of adequate staff and equipment. Funds were therefore provided under Loan No. 639 KE to finance a study by consultants of a comprehensive program to improve road maintenance.

2. The study concluded that the responsibility for the maintenance of the entire road network of about 25,000 miles, which had been shared by the Ministry of Works (MOW) and local authorities, should be consolidated and entrusted to the MOW. To enable the MOW to discharge enlarged responsibilities, the consultants recommended an extensive reorganization and worked out a comprehensive maintenance program. The Government of Kenya accepted the consultants' recommendations and in January 1970 requested that the Bank Group assist in financing the maintenance program. An IDA mission appraised the proposed project in March 1970.

3. There have been four Bank loans to Kenya totalling \$40.1 million and ten IDA credits totalling \$48.7 million. A proposed Bank loan of \$8.3 million for the Nairobi Water Supply Project is expected to be considered by the Executive Directors in October and a loan of about \$20 million for a hydroelectric project is also expected to be concluded in FY 1971. The 1971-75 Five-Year Lending Program for Kenya is attached.

II. THE PROJECT

4. Attached is a report entitled "Appraisal of Highway Maintenance Project"(No. PTR 61). The proposed project is designed to give the MOW the capacity to assure adequate maintenance of the road network and to eliminate the backlog of maintenance on about 12,000 miles of the most economically important roads. The project consists of:

(a) provision of experts to fill key positions in the Roads Branch and to train Kenyan counterparts;

(b) construction, equipment and staffing of the training center;

(c) purchase of road maintenance and workshop equipment;

(d) improvement of regional workshops, offices and road camps; and

(e) necessary consulting services.

5. The project is estimated to cost about $18.7 million equivalent. The estimated foreign exchange component is $13 million (approximately 70 percent), towards which the U.K. will provide a grant of $0.4 million equivalent for training equipment and a contribution to certain salaries. The balance of the foreign exchange costs would be covered by the proposed IDA credit of $12.6 million. The decision to finance this project entirely by IDA followed the preparation of the attached appraisal report, which reflects an earlier proposal for an IDA credit of $8 million supplemented by a Bank loan of $4.6 million.

6. As in the case of previous Bank Group financed highway projects, the Ministry of Works will be responsible for executing the project. Consultants will assist in project implementation.

7. The project is designed to preserve the substantial investments already made in the highway sector and to ensure that economic development is not hindered by the deterioration of the road network and consequent rise in transport costs. The economic rate of return is about 33 percent, in terms of estimated savings in vehicle operating costs.

III. HIGHLIGHTS AND MAIN ISSUES

8. About 92 percent of the proposed credit would go to finance physical plant and equipment, together with usual consulting services. Critical to the success of the project, however, is the proposed provision of expatriate staff within the Roads Branch of the MOW, towards which the balance of IDA financing would be applied. Effective roads administration in Kenya has been and continues to be hampered by lack of technical and executive staff, both at headquarters and in field offices. As in the case of other sectors, adequately qualified and experienced Kenyans are simply not available in anything approaching the numbers required at the present time; only about 18 percent of the professional positions in the Roads Branch are filled by Kenyans.

9. The appraisal report concludes that the success of the project requires the employment of 27 expatriates in the reorganized Roads Branch of the MOW, 12 at headquarters and 15 at field offices. Two arrangements have been worked out which, between them, should ensure that the necessary expatriates are available. The U.K. Ministry of Overseas Development (ODM) has agreed to help the Kenya Government recruit staff required for the 12 positions at the Roads Branch headquarters, and will make a contribution towards their salaries. The remaining 15 expatriates required for the senior positions at field offices will be provided under contract by the Crown Agents for Overseas Governments and Administrations (U.K.) against payment of a comprehensive fixed fee, which will also cover the cost of assistance in the evaluation of bids.

10. The proposed credit would finance the foreign exchange cost of the services of the Crown Agents and the foreign exchange cost of the expatriates to be recruited with the assistance of the U.K. Government, net of the U.K. salary contribution.

11. Although the need for expatriates on so large a scale has been accepted by the Kenya Government, which has already worked out the arrangements described above, I should note that the past experience with other Bank Group projects in Kenya has shown that even when the Government, as in this case, has accepted the need for expatriates, they have been most reluctant to utilize proceeds of loans and credits to finance that part of their cost which is in excess of local salary scales. The desire to exhaust all possibilities of bilateral grant assistance, rather than use loan/credit funds already available, has resulted in inordinate delays in obtaining key staff with serious consequences for project implementation. For the present project the Kenya Government approached various bilateral sources, including Canada, Denmark, Norway and the United Kingdom, to obtain grants towards the salaries of the 27 expatriates required and assistance in recruiting them. Mr. Knapp will discuss the general issue of adequate project staffing with the Minister of Finance of Kenya in Copenhagen. However, during the course of the negotiations for the proposed credit, if authorized by the Loan Committee, we should reach a very explicit understanding that the arrangements that have been made for recruiting and financing expatriates in this case will not be frustrated by subsequent attempts to find alternatives.

12. The employment of expatriates would resolve the immediate problem of ensuring an effective roads administration, but is only an expedient, and moreover a costly expedient, justified by the need to protect a very large investment. Looking ahead, it is essential to make sure that qualified Kenyans will be ready to take over when the expatriates leave. In the course of negotiations it is therefore proposed to focus hard on the need to attract, train and perhaps above all, retain suitably qualified Kenyans to replace expatriates in the Roads Branch. The Government will be required to prepare, within six months of credit signature, a program, to be agreed with the Bank, for the appointment of Kenyans as

counterparts. We would also discuss and agree on the minimum qualifications and experience required. Paragraph 6.02 of the Appraisal Report recommends that the Government should agree that it will provide counterparts within two years of credit signature. We have to recognize, however, that it may well not be feasible to secure suitable counterparts for all the expatriate positions within that time. We therefore plan to discuss and agree on a number that can realistically be provided within two years of signature, with the intention of holding the Government to an obligation within its reach.

13. Procurement of all equipment and spare parts for the project, except for the training center equipment to the value of $0.3 million to be financed out of the U.K. grant, will be on the basis of our normal international bidding procedures. The training center equipment will be procured on the basis of competitive bidding within the U.K. Improvement and construction work will be carried out by Government forces or by local contractors selected on the basis of competitive bidding in Kenya. This is considered acceptable as the buildings are mostly of low standard construction, scattered all over the country, and would not attract international bidders.

14. Disbursements would be against the actual foreign exchange cost of goods and services and the foreign exchange cost component of locally awarded construction contracts, estimated at 5%.

15. The Government has requested that the Association agree to reimburse the foreign exchange cost of consulting services incurred since January 1, 1970 for preliminary work on contract documents for equipment purchases, curriculum planning and project implementation. The consultants retained are acceptable and I recommend that we agree to the request, which will involve retroactive financing of about $150,000.

IV. THE ECONOMY

16. An economic report entitled "Economic Development Prospects in Kenya" (Report No. AE-6a, in two parts) was distributed on October 31, 1969. Since then, the Kenya Government has published its 1970-74 Development Plan, which is essentially the same as the draft plan examined by the economic mission that visited Kenya in April/May 1969. The mission found the Plan to be realistic and concluded that Kenya would continue to warrant substantial external assistance. Although Kenya could handle rather more aid on conventional terms than in the past, there is a continuing requirement for a large proportion of assistance on concessionary terms if future debt servicing difficulties are to be minimized.

V. RECOMMENDATION

17. I recommend that the Association invite representatives of the Republic of Kenya to negotiate a Development Credit of $12.6 million equivalent substantially on the terms and conditions set forth in paragraphs 6.01 to 6.03 of the Appraisal Report, with the qualification in paragraph 12 of this memorandum.

J. H. Williams
Deputy Director

Attachment

Population (1969): 10.48 million
GNP per head (1968): $117

Attachment 1

KENYA - PAST AND PROPOSED LENDING PROGRAM THROUGH 1975*
Fiscal Year - $ Million

		Thru' 1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	Total 1964-68	Total 1969-73	Total 1971-75
Land Settlement	IBRD	8.4															
Agriculture and Roads	IBRD	5.6															
Agricultural Roads	IDA					5.3											
Tea Development I	IDA			2.8													
Tea Development II	IDA						2.1										
Tea Development III	IDA										3.0						
Tea Roads	IDA			3.0													
Agricultural Credit I	IDA					3.6											
Agricultural Credit II	IDA											6.0					
Livestock I	IDA							3.6									
Livestock II	IDA											8.0					
Crop Development I	IDA											3.0					
Crop Development II	IDA												3.0				
Irrigation	IDA													5.0			
Agriculture Unidentified	IDA													6.0			
Rural Development	IDA												4.0				
Forest Plantation	IBRD								2.6								
Education I	IDA					7.0											
Education II	IDA								5.9								
Education III	IDA										7.0						
Education IV	IDA												10.0				
Kamburu Electric Power	IBRD									20.0							
Highways I	IDA			4.5													
Highways II	IDA						10.7										
Highways III	IBRD								23.5								
Highways IV)	IBRD										(10.0						
Highways IV)	IDA										(10.0						
Highways V)	IBRD													(10.0			
Highways V)	IDA													(10.0			
Road Maintenance Equipment	IDA									8.0							
Airport Development	IBRD									8.0							
Nairobi Water Supply	IBRD									8.5							
Tourism	IBRD											4.0					
	IBRD	14.0	--	--	--	--	--	--	26.1	36.5	10.0	4.0	--	10.0	--	76.6	60.5
	IDA	--	--	10.3	--	15.9	12.8	3.6	5.9	8.0	20.0	17.0	17.0	21.0	39.0	54.5	83.0
	TOTAL	14.0	--	10.3	--	15.9	12.8	3.6	32.0	44.5	30.0	21.0	17.0	31.0	39.0	131.1	143.5
	NO.	2	--	3	--	3	2	1	3	4	3	4	3	3	8	15	17
IBRD Loan Outstanding:																	
Including Undisbursed		10.8	10.8	9.7	9.7	5.9	5.8	4.8	28.9	65.0	74.8	78.5	78.2	87.9			
Excluding Undisbursed		1.6	2.4	2.0	2.4	3.4	3.6	3.9	4.8	13.9	33.2	57.9	67.6	72.8			
IDA Credits Outstanding:																	
Including Undisbursed		--	--	10.3	10.3	26.2	39.0	42.6	48.5	56.5	76.5	93.5	110.5	131.4			
Excluding Undisbursed		--	--	0.1	1.5	5.5	9.6	20.7	27.0	37.5	49.5	62.0	78.0	91.0			

* This program does not include past or proposed loans made to the East African Community, although Kenya benefits directly from the loans made to the Community for the expansion of common services. The proposed Community lending program also provides for loans to financial intermediaries some of which might be national development agencies such as the Industrial and Commercial Development Corporation of Kenya. Legally, however, all three member states of the Community are jointly and severally responsible for all three member states of the Community are jointly and severally responsible for all loans made to the Community (See attachment 3).

December 10, 1969

5 - YEAR ECONOMIC DEVELOPMENT PROGRAM

Kenya

			Actual Data						Projected Data						Period Growth Rates	
			1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1964-68	1971-75
Population - growth rate	%	1													2.9	3.0
birth rate	per 1000	2														
Price Change - c.o.l. index	%	3	2.2	4.3	2.1	2.9	2.0								2.7	
exchange rate (Kenya Shillings)	per US$	4	7.14	7.14	7.14	7.14	7.14									
Means of Payment - change	%	5	2.1	3.6	19.9	10.8	7.6								8.6	
GNP at factor cost; 1964 prices - Total /a	$ mil.	6	928	933	1,068	1,109	1,182						1,715	1,806		
per capita /a	$	7	102	100	111	111	116						141	144	3.3/b	
GNP at constant market prices /a - real growth rate	%	8		0.5	14.5	3.9	6.6							5.3	6.2	
GDP at current market prices - Total	$ mil.	9	997	1,000	1,162	1,231	1,299									
Production Growth (real) - agriculture	%	10		-9.6	22.9	1.8	5.4								4.5/b	
food per capita	%	11														
manufacturing	%	12	14.8	5.4	6.2	3.8	7.4								7.5	
GDP by Branch - agriculture	%	13	39.3	34.9	37.5	36.0	34.8						29.4	28.6		
mining	%	14	0.5	0.4	0.4	0.5	0.5						0.5	0.5		
manufacturing	%	15	10.2	11.3	10.9	11.1	11.4						13.8	13.9		
construction	%	16	3.8	4.1	4.3	5.0	5.1						5.9	6.0		
transport & communication	%	17	7.6	8.4	8.3	8.2	8.3						8.8	9.0		
public admin. & defense	%	18	13.0	13.3	12.6	13.1	13.3									
other branches	%	19	25.6	27.6	26.0	26.1	26.6						41.6	42.0		
Resource Gap	% of GDP	20	-4.1	-1.0	0.1	2.2	3.2						2.6	2.6		
Net Factor Payments	% of GDP	21	2.0	1.8	1.5	2.0	0.9									
National Saving - private	% of GDP	22	16.3	14.6	17.3	18.1	17.6									
public	% of GDP	23	-0.8	-0.8	-0.3	0.9	1.5									
Total	% of GDP	24	15.5	13.8	17.0	17.2	16.1						18.5/c	18.7/c		
Marginal Saving Rate		25														
Consumption - private	% of GDP	26	68.5	69.6	67.6	66.2	68.3						67.1	66.9		
public/d	% of GDP	27	14.0	14.8	13.9	14.6	14.7						14.4	14.4		
Total	% of GDP	28	82.5	84.4	81.5	80.8	83.0						81.5	81.3		
Exports of Goods and Services	$ mil.	29	335.2	331.8	379.4	363.7	377.4		423.6	452.8	483.8	517.7	554.4	582.4	3.0/b	6.6
Imports of Goods and Services	$ mil.	30	294.0	322.3	380.8	391.2	418.6		455.3	488.3	526.7	562.2	604.8	635.6	9.2/b	6.9
Net Goods and Services	$ mil.	31	41.2	9.5	-1.4	-27.5	-41.2		-31.7	-35.5	-42.9	-44.5	-50.4	-53.2		
Interest on Public Debt, Gross: Outflow (-)	$ mil.	32	-7.6	-6.7	-8.4	-8.1	-8.4									
Other Investment Income, Net: Outflow (-)/e	$ mil.	33	15.1	-2.0	-9.2	-21.0	12.4									
Net Investment Income: Outflow (-)/e	$ mil.	34	7.5	-8.7	-17.6	-29.1	4.0									
CURRENT SURPLUS(+) DEFICIT(-)	$ mil.	35	48.7	0.8	-19.0	-56.6	-37.2									
Long Term Private Capital, Net inflow	$ mil.	36	-42.0	4.2	2.8	22.1	29.4									
Long Term Public Capital, Gross inflow	$ mil.	37														
less: amortization	$ mil.	38														
Net long term pub. cap. inflow	$ mil.	39	-2.8	18.5	38.1	23.5	18.8									
Short Term Capital, Net inflow	$ mil.	40	0.3	-1.7	-35.0	1.7	-25.8									
Other Capital, Net Inflow (incl. errors & om.)	$ mil.	41	-13.7	-16.8	45.9	-7.0	46.5									
NET BALANCE	$ mil.	42	-9.5	5.0	32.8	-16.3	31.7									
IMF Drawings(+) Repayments(-)	$ mil.	43														
Foreign Exchange Reserves, Inc.(+) Dec.(-)	$ mil.	44	-9.5	5.0	32.8	-16.3	31.7									
Foreign Exchange Reserves, Net - Total	$ mil.	45	70.5	75.5	104.2	88.2										
Foreign Exch. Reserves, Gross - govt. entities	$ mil.	46	64.1	66.5	76.8	87.4										
comm. banks	$ mil.	47	52.6	12.9	33.6	14.0										
Total	$ mil.	48	116.7	79.4	110.4	101.4										
External Debt	$ mil.	49	311.0	353.7	386.4	384.2	408.0									
Debt Service Ratio/f	%	50	10.7	5.8	6.0	7.3	7.6									
Export Price Index	%	51		0.0	1.0	-2.0	1.0									
Central Government - Current revenue	% of GDP	52	13.4	14.2	13.4	14.8	15.9									
Current expenditure	% of GDP	53	14.2	14.9	13.7	13.9	14.4									
Saving	% of GDP	54	-0.8	-0.8	-0.3	0.9	1.5									
Capital revenue	% of GDP	55	2.8	2.9	1.4	1.0	1.2									
Capital expenditure	% of GDP	56	5.0	4.8	5.0	5.3	5.9									
Surplus(+) Deficit(-)	% of GDP	57	-3.0	-2.6	-3.9	-3.4	-3.2									
Military expenditure/g	% of GDP	58	0.3	0.8	1.0	1.2	1.3									
Education - expenditure (general government)/g	% of GDP	59	2.1	1.9	1.7	1.8	2.1									
school enrol., primary & second.	%	60					65/h							75/h		
literacy rate, adult	%	61					30									
Tax Revenue (general government)/g	% of GDP	62	10.3	11.1	10.7	12.1	12.8									
Public Saving (% of public fixed investment)	%	63	-25.2	-22.7	-5.7	13.3	20.8									
Gross Investment - private fixed	% of GDP	64	9.6	9.7	10.0	13.4	12.3						19.5/m	19.5/m		
public fixed	% of GDP	65	3.1	3.3	4.7	6.5	7.3									
increase in stocks	% of GDP	66	0.7	1.6	3.9	1.5	0.6						1.6	1.8		
Total	% of GDP	67	13.4	14.6	18.6	21.4	20.2						21.1	21.3		
Finance of Investment - National saving	%	68	116.0	94.0	91.1	80.5	79.6						87.9/c	88.3/c		
Foreign capital	%	69														
private	%	70	-11.0	9.4	1.4	6.4	17.4						16.8			
public	%	71	-2.1	12.7	17.6	8.9	7.2						20.2			
Total	%	72	-13.1	22.1	19.0	15.3	24.6						37.0	11.7/i		
Residual /j	%	73	-2.9	-16.1	-10.1	3.2	-4.2						-24.9			
Public Investment by Sector - agriculture	%	74	11.7	11.8	7.7	7.3										
industry	%	75	0.9	5.0	9.3	9.7										
power	%	76	3.9	1.7	1.5	4.2										
housing	%	77	6.3	7.6	5.7	7.3										
transportation/k	%	78	42.3	18.5	32.5	27.0										
telecommun.	%	79														
education	%	80	5.4	5.0	4.6	4.6										
health	%	81	4.5	10.9	4.6	3.9										
other	%	82	25.0	39.5	34.1	36.0										

/a GDP at 1964 factor cost. /b 1965-68. /c Gross Domestic Saving. /d Central Government. /e Includes transfers. /f Includes 1/3 of East African Community Debt. /g Central Government. /h Primary. /i Includes residual. /j Includes changes in reserves, short term capital and net errors and omissions. For 1974 includes net factor payments to abroad. /k Includes storage and telecommunications. /m Total fixed investment.

December 1, 1969

Attachment 3

EAST AFRICAN COMMUNITY

A. Past Lending Operations

		($ millions) Through 1963	1964	1965	1966	1967	1968	1969
Railroads I	IBRD	24.0						
Railroads II	IBRD				38.0			
Post and Telecoms.	IBRD					13.0		
		24.0			38.0	13.0		
		1			1	1		
IBRD Loans Outstanding								
- including undisbursed		0.1	0.1	0.1	38.1	51.1	51.1	51.1
- excluding undisbursed		0.1	0.1	0.1	4.4	14.8	30.1	38.4

B. 5 Year Lending Program

		($ millions) 1970	1971	1972	1973	1974	1975	Total 1964-68	Total 1969-73	Total 1971-75
Posts and Telecoms. II	IBRD	15.6								
Posts and Telecoms. III	IBRD					25.0				
DFC I	IBRD			3.0						
DFC II	IBRD				4.0					
DFC III	IBRD					5.0				
Railways Corp. I	IBRD	42.4								
Railways Corp. II	IBRD					45.0				
Harbors Corp. I	IBRD	35.0								
Harbors Corp. II	IBRD				10.0					
		93.0	-	3.0	14.0	75.0		51.0	110.0	92.0
		3		1	2	3		2	6	6

FORM No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

September 14, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Argentina - Railways

1. The Committee is requested to consider, without meeting, the attached memorandum of September 14, 1970 from the South America Department, entitled "Argentina - Proposed Loan for Railways" (LC/O/70-101).

2. Comments, if any, should be sent to reach Mr. Skillings (ext. 2483) by 5:00 p.m. on Wednesday, September 16.

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

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, 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
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Vice President (IFC)

CONFIDENTIAL

LC/0/70-101

September 14, 1970

LOAN COMMITTEE

Memorandum from South America Department

ARGENTINA - Proposed Loan for Railways

1. Attached is a report appraising a railway project in Argentina (No. PTR-62).

Economic Performance and Prospects

2. The latest economic report on Argentina (WH-191a) was dated May 23, 1969. The report of the most recent economic mission to Argentina (May/June 1970) is now in preparation, and will be available to the Executive Directors before the presentation to them of the proposed railway loan. The mission's back-to-office report dated August 4 has been distributed. Its conclusions are outlined below.

3. The Argentine economy has enjoyed substantial growth in recent years: GDP grew by 4.5 percent in 1968, 6.9 percent in 1969, and is projected to increase by around 5.5 percent in 1970; this compares with an annual average growth of only 2.7 percent in 1960-67. This growth is primarily attributable to the sound economic policies which have aimed at a realistic exchange rate, monetary stability and accelerated public investment. Very good harvests in 1969 and 1970 and an aggressive meat export policy have made possible high levels of export receipts, contributing to the growth in output. The robust and positive response of the private sector during this period was evident in increased private investment and the increase in exports. Improved expectations and enhanced confidence were also reflected in the rise in private savings and the increased holding of savings in monetary form.

4. Given her relatively high savings and investment levels, resource endowment and export potential, Argentina should be capable of a growth rate of some 5.5 percent a year. Since the rate of population growth is comparatively low (around 1.6 percent annually) this would make possible a significant rise in per capita income. Such a sustained increase in output would require the effective implementation of a number of policies, including (i) an active incomes policy and a substantial improvement in public finances, thereby contributing to an economic environment favorable to investment; (ii) policies aimed at achieving a substantial, sustained increase in exports, while progressively reducing tariff protection so as to lower industrial products' prices; such

policies should accelerate the integration of Argentina into the international economy. Measures already taken by the new team that assumed key positions on the economic side in mid-June suggest that such policies will be pursued.

5. The achievement of the 5.5 percent growth target may require much greater capital inflows than we had previously estimated. This may justify a somewhat larger Bank lending program, which is presently projected at US$100 million per annum. External capital requirements continue to be in excess of the foreign exchange component of investment projects for which it is practical to arrange foreign financing, justifying some financing of local currency expenditures. Argentina continues to be creditworthy for substantial foreign borrowings.

Bank's Lending and Size of Proposed Loan

6. In FY 1970 Bank lending of $60 million fell short of the lending target due to delays in project preparation. At the beginning of this year, we expected the following lending operations in FY 1971:

	Million US$
Railways	60
Highways III	35
Meat Packing	20
	115

The meat packing project is not likely to materialize before FY 1972. The third highway project is expected to be in the range of US$30 million to US$45 million (or more if we agree to finance more than the estimated 30 percent foreign exchange cost). If we now increase the $60 million tentatively earmarked for the railways to the $84 million recommended in the appraisal report and if the highway project turns out also to justify a large loan, we might be lending as much as $140 million for FY 1971, compared to our target of $100 million a year. This increased lending should be considered in the context of our lending only $60 million last year. Moreover, there may well be a case for increasing this target. In these circumstances, a railway loan of $84 million would appear to be consistent with our lending program.

Background of the Project

7. The Bank became associated with the Argentine transport sector in 1961 when it lent $48.5 million for highways and, as Executing Agency for the UN Special Fund, organized a comprehensive study of the country's transport system. The study (the 1962 Larkin Report) concluded that far reaching reforms were needed, but implementation of these reforms proved to be difficult. After the

Ongania Government took office in 1966, the Bank and the Government agreed in 1968 on the need to establish a system for highway planning and development and to rehabilitate and improve the railways. It was also agreed that in the next few years the Bank would relate a substantial part of its lending to the progress of reforms in the transport sector. The Bank sent a sector review mission to Argentina in September 1968, and in June 1969 made a second highway loan of US$25 million with special provision for reinforcing highway planning procedures.

8. The Argentine railways came into being piecemeal, serving various areas and clienteles. In 1946 the Government purchased the privately-owned systems and consolidated the entire network into the Ferrocarriles Argentinos (FA). Nevertheless, the creation of a fully unified organization and the adjustment to the changed demographic pattern, the new distribution of economic activity and the development of other transport modes was not undertaken at that time. As a result of increasing competition from roads, political interference, inadequate management and lack of investment, traffic and revenues declined, staff morale became low, the equipment deteriorated and general inefficiency prevailed. The enterprise ran increasingly large deficits, culminating in the maximum of US$158 million equivalent in 1965. These deficits were a drain on the national budget and contributed greatly to the nation's fiscal problems and inflation.

9. The management of FA was in July 1967 entrusted to an energetic group of army officers committed to the rehabilitation of the system. Since then several Bank missions have assisted FA in identifying the necessary reforms and in formulating a satisfactory comprehensive program for rehabilitating the railways. The new management has already made considerable organizational changes and secured the adoption of a new enterprise law which assures FA's autonomy. It has also performed creditably in achieving an improvement in staff discipline, as is evident in the punctuality of trains and the better maintenance of equipment. Partly in consequence, traffic has increased and the operating loss has been reduced by almost two-thirds (in real terms).

The Project

10. The Government and FA have asked the Bank for assistance in financing FA's five year (1971-75) investment plan of US$649 million. The major items are track renewals and improvements (32 percent), freight cars (19 percent), locomotives (13 percent), locomotive and car maintenance (10 percent), passenger cars (8 percent). We have suggested that for the present only the first two years of this plan period be considered, and the appraisal report treats the investment of US$289 million equivalent proposed for 1971-72 as the project. Of this, the foreign exchange cost (if all freight cars were procured abroad) would be US$176.3 million.

11. While satisfied with the achievements of FA so far, the appraisal mission felt that the rehabilitation program would have a better chance of success if FA adopted detailed targets and time schedules for certain important aspects of the task. Therefore, programs for action on reducing staff, rationalizing services and closing lines, rehabilitating diesel locomotives, reorganizing workshops and adopting a dynamic commercial approach, consistent with the efficiency and financial goals of the recovery program were worked out in draft by FA during the appraisal mission's visit and FA has agreed to submit to the Bank for review prior to loan negotiation, its final plans with respect to these programs.

12. The improvement of lines in the Buenos Aires suburbs, especially the project for electrifying the Roca suburban system, which was prompted by Japanese suppliers' offers of finance, has great political appeal in Argentina. We have recommended to the Government and FA that these and other investments proposed be subjected to thorough study, and be undertaken only if they appear economically justified. We intend to seek a commitment during loan negotiations that any major addition to (or deletion from) the railway program be subject to Bank agreement, so that the recovery program as a whole is not defeated or distorted. We have suggested terms of reference for an economic study of the Roca project, and indicated that should the results show it to be economically feasible we may be able to recommend Bank financial assistance for the project.

13. FA's program of rehabilitation calls for revenues to cover all operating expenses (including adequate depreciation) by 1977. A large investment program for an enterprise which is at present far from financially viable is justified by:

(a) the progressive improvement expected in FA's financial position, with resulting salutary effect on national finances;

(b) the important role foreseen for the railways in long haul freight carriage and suburban passenger travel, and

(c) the attractive economic return (at least 17 percent) expected on the proposed investment.

14. The appraisal report assumes the following financing for the project:

	million US$
Argentine Government	126
Local financial institutions	20
Supplier credits	59
IBRD	84
	289

Any financial requirements not provided by the Bank, by supplier credits or by local financial institutions will be met by the Government. The items proposed to be financed by the Bank loan are:

	million US$
Track relaying and renewal items	18
Signalling and telecommunications	4
Locomotive and car rehabilitation	
(a) components	11
(b) improvement of workshops and rolling stock	9
Freight cars	42
	84

15. As noted in the appraisal report (Paragraph 4.10), we have recommended to FA that certain goods not being financed under the loan should be obtained after bidding among suppliers from countries that are willing to offer favorable credit terms. This was the procedure contemplated for the procurement of locomotives (both main line and shunting) and electric rail cars. Since the appraisal report was completed, we have learned that in fact FA is negotiating with selected suppliers in United States and Europe for locomotives, and for the related credits. If locomotives turn out in fact to be procured on a negotiated basis, we shall satisfy ourselves that prices and credit terms are reasonable.

Issues

16. We have carefully considered whether a loan in the order of \$84 million is appropriate, taking into account sector and project considerations and the nature of the items to be financed, as well as the macroeconomic considerations previously discussed. Lending US\$84 million, the Bank would finance only 29 percent of the total cost of the project, and total foreign financing would be equivalent to no more than fifty percent. Taking into account the important institutional reforms associated with our financing a Bank loan of this amount would appear to be the minimum required.

17. Moreover, a loan of this size will allow us to provide \$42 million for freight cars (excluding bogies already ordered). There is a possibility that Argentine suppliers may win a substantial part of these contracts in international competition with a 15 percent preference margin and this is desirable, from an industrial development point of view, as these suppliers would be exposed to the discipline of international competition. Inclusion of freight cars on the scale proposed could, however, involve financing local expenditures to the extent of \$17.6 million; this is considered justified in Argentine economic circumstances. If foreign suppliers win freight car orders they would assemble locally so that only 90 percent of the delivered price would represent

foreign exchange expenditure: it is proposed that the loan finance 90 percent of the cost of freight cars whether they are procured in Argentina or abroad. (see Appraisal Report paragraph 4.13).

18. Also proposed to be financed under the Bank loan is $11 million of components and new parts for the rehabilitation of locomotives and cars, which necessarily must be procured on a negotiated basis from the nine original suppliers in six countries (paragraph 4.05). Bank financing of these components, even though they will be procured on a negotiated basis, is justified because long-term finance from other sources is not available for these goods and because it may facilitate somewhat closer supervision by the Bank of a vital aspect of the rehabilitation effort. For these reasons, we recommend that procurement of components and new parts be financed under the Bank loan even though, as an alternative, we might consider financing the $11 million of interest on the Bank loan during the construction period.

Recommendation

19. I recommend that the Bank invite the Government and FA to send representatives to negotiate a loan of $84 million for the railways, including the features discussed in Paragraphs 17 and 18 above. The invitation will only be issued after the Transportation Projects and South America Departments are satisfied that FA has adopted sound detailed targets for the matters referred to in paragraph 11 above.

Gerald Alter
Director

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LC/A/70-9

September 10, 1970

NOTICE OF MEETING

A Meeting of the Loan Committee will be held on Monday, September 14, 1970 at 3:30 p.m. in the Board Room.

AGENDA

Spain

The Committee will consider the attached memorandum of September 10, 1970 from the Europe, Middle East and North Africa Department entitled "Spain - Agricultural Research and Extension Project" (LC/0/70-100).

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
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LC/O/70-100

September 10, 1970

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa Department

SPAIN - Agricultural Research and Extension Project

1. The Government of Spain has requested a Bank loan to help finance an agricultural research and extension project. The project is an unusual one, of a kind that the Bank has not previously financed. In its present form it raises certain questions that should be decided before appraisal.

Background

2. The project stems from recommendations of a joint Bank/FAO agricultural survey mission in 1965 that gave high priority to the improvement of agricultural research, extension and education. In response to a request from Spain in August 1967, the FAO and IBRD, working within the Cooperative Program, assisted the Spanish authorities to prepare a project to implement these recommendations. The project so prepared was formally submitted to Mr. McNamara by the Minister of Finance in October 1969. The agricultural education elements in the project were eliminated subsequently on the advice of Bank/UNESCO/FAO missions. A revised project, designed to remedy certain organizational weakness that had been pointed out by the Bank, was submitted in May 1970.

3. A Bank mission reviewed the status and nature of the project in June. It found that although a Bank/FAO Cooperative Program team had been working on the project for about two years, they had not produced a satisfactory result. The FAO proposals concentrated on recommendations for structural changes in the research services, but did not come out with any clearly defined research objectives related to the needs of Spanish agriculture. Furthermore, the Bank mission found that the project, as devised by FAO, did not express the wishes or intentions of the Spanish Government. However, the mission succeeded in formulating the outlines of a project which was relevant to Spanish needs and capacity, and further work was done on this reformulated project by the Spanish authorities.

4. At the invitation of the Government, a second Bank mission visited Spain in July and succeeded in going some way towards an appraisal. The mission's report is attached. 1/

1/ Spain - Agricultural Research and Extension Project: Agriculture Projects Department, August 24, 1970.

The Project

5. The objectives and scope of the original project are outlined in Annex 1 of the attached report. Under the present proposals of the Bank mission, the project is considerably changed, especially in a reduction in the number of research centers and the abandonment of a "polyvalent" regional approach in favor of a "specialist institute" approach to research. The mission proposes that five specialist research centers would be supported, each dealing with a high priority research objective. It is believed that FAO is in agreement with the principles of the revised project. Details of the proposed project are set forth in Chapter III of the report.

6. Only rough estimates of project costs can be made at present, but total project costs would be about US $21 million equivalent, of which about half would be foreign exchange cost. Of the US $10 million foreign exchange cost, about US $5 million would be for building and equipment, US $2.5 million would be for international research specialists and US $1 million would be for overseas training of Spanish research men. Thus, an unusual feature of the project (but a feature that is likely to be characteristic of all research projects) is the high foreign cost of employing foreign staff and training local research workers.

Matters for Consideration

7. While in Spain, the Bank mission obtained the verbal agreement of the Spanish authorities to the mission's conclusions. Mr. Evans recommends, and I agree, that we send a mission to complete the appraisal in November. Before making arrangements for another mission, however, we would like to have:

(i) agreement within the Bank that a project on these lines would be acceptable. This is not the kind of international research project which we have been considering in relation to the setting up of a consultative group; it does seem to be, however, a high priority national research program which the Bank might support; and

(ii) confirmation from the Spanish Government that they accept the Bank mission's proposals as the project for which they want to borrow; and specifically that they accept, in principle, the important conditions for the project, including commitments to provide continuing financial support (both during and after the Bank's loan has been disbursed) for the recurrent cost of research, to employ 20-30 internationally recruited research specialists (including technical directors or co-directors at each national center), to provide overseas training for at least 100 young scientists outside Spain for a 4-5 year period, and to raise professional salaries to levels permitting full-time dedication of personnel to research.

The reasons for the requirements in (ii) above are discussed in the report, and further requirements are summarized in Chapter V.

8. Consideration should also be given to the feasibility of obtaining financing from the United Nations Development Programme for the technical assistance component of the project, although the amounts involved may be more than UNDP may wish to allocate to Spain. Moreover, even if the Bank were the Executing Agency, the exclusion from the financing of this key element would take away from the unity of direction necessary in such a complex undertaking.

9. In accepting the submission of the project by the Minister of Finance in October 1969, Mr. McNamara expressed the Bank's interest, provided that the research had practical application. He later confirmed this interest in a formal reply to the Minister. In a memorandum dated October 9, 1969, Mr. Lejeune invited Mr. Knapp's reaction to what was then an "Agricultural Education and Research Project." Mr. Knapp replied in a memorandum dated October 13, as follows:

> "Regarding your memorandum to me dated October 9 on the above subject (returned herewith), I have discussed the matter once more with Mr. McNamara, and you may be assured that we have no objection in principle to an operation along the lines described in your paper. I should add, however, that Mr. McNamara is particularly anxious that when the research aspects of this proposed project are appraised, we obtain for this purpose the best available talent in order to clearly establish that the proposed research facilities are satisfactorily geared to the needs of Spanish agriculture."

Mr. Evans and I believe that it would be consistent with Mr. Knapp's memorandum to proceed with appraisal of the project in November.

10. The appraisal mission would be led by Mr. McMeekan, who has led the recent Bank missions to review the project, and mas made seven visits to Spain on our behalf during the past two and a half years. We believe that we have now a clear concept of the needs as a result of the FAO/IBRD review of Spanish agriculture made in 1965 and of our experience since then with the Spanish Livestock Loan. Provided we have confirmation of the Spanish Government soon, Mr. Evans could arrange to have Mr. McMeekan and the experts who accompanied him on the latest mission available to complete the appraisal in November.

11. I recommend that we proceed along the lines set out above.

M. P. Benjenk
Director

Attachment

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

September 9, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Venezuela - Second Telecommunications Project

1. The Committee is requested to consider, without meeting, the attached memorandum of September 9, 1970 from the Central America and Caribbean Department, entitled "Venezuela - Proposed Bank Loan to C.A. Nacional Telefonos de Venezuela for a Second Telecommunications Project" (LC/0/70-98)

2. Comments, if any, should be sent to reach Mr. Schloss (ext. 4763) by 4:00 p.m. on Friday, September 11.

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

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, 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/0/70-98
September 9, 1970

LOAN COMMITTEE

Memorandum from the Central America and Caribbean Department

VENEZUELA: Proposed Bank Loan to C.A. Nacional Telefonos de Venezuela for a Second Telecommunications Project

Introduction

1. Attached for consideration by the Loan Committee is Report No. PU-50, "Appraisal of the 1970-1974 Telecommunications Program, Venezuela", recommending a Bank loan of $35 million to Compania Anonima Nacional Telefonos de Venezuela (CANTV), a government-owned corporation, to finance part of the foreign exchange costs of the Company's five-year expansion program.

2. To date, the Bank has made nine loans in Venezuela totalling $298.3 million, about half of which has been for electric power and the rest for roads, telecommunications and water supply. The last two loans were made in June 1969: $20 million for an expressway in Caracas and $31 million for the expansion of the powerhouse of the Guri hydroelectric project. IFC has committed $25 million to Venezuela since 1960, covering investments in five enterprises. The most recent operation was in June 1970, when IFC extended a two-tranched loan of $10 million to C.A. Venezolana de Desarrollo (CAVENDES), a private development finance company.

3. Execution of Bank-financed projects in Venezuela has on the whole been satisfactory except for a water supply project in Caracas (444 VE) where, because of non-compliance with tariff covenants, disbursements have been suspended for almost two years. The loan was closed at the end of August when the remaining balance of $4.2 million was cancelled.

4. Apart from the proposed loan for the second telecommunications project, two other lending operations are planned for FY 1971: a loan of $10 million for a livestock credit project and a loan of $30 million for a new international airport near Caracas. The Five-Year Lending Program (FY 1970-75) is attached. A revised program for FY 1972 and subsequent years is under preparation and will be discussed with the President in October.

Economic Situation

5. A memorandum updating information on economic developments in Venezuela was circulated to the Board in May 1969, prior to the presentation of the loan for the Guri project. An economic mission, which visited the country in the spring of 1970, has prepared a draft report which has just been reviewed with the Government and is now being revised for distribution to the Economic Committee and subsequently to Executive Directors.

6. Petroleum continues to dominate the economic prospects of Venezuela, accounting for over 90 percent of merchandise exports and for two-thirds of the revenues of the Central Government. Crude oil production has expanded at diminishing rates in recent years, and there was a slight absolute decline last year. The main reasons for the trend include a policy decision by the Venezuelans ten years ago not to grant further concessions and increased competition in world markets from new lower-cost producers elsewhere. The Government hopes to keep petroleum exports expanding at the rate of about 2-1/2 percent annually by reactivating exploration under service contract arrangements between the State petroleum enterprise and private concerns and by obtaining quota preferences in the U.S. market. Production and exports in 1970 are benefitting from the closing of the Syrian pipeline and restrictions on output imposed by the Libyan Government, and exports will probably be about 3 percent up on last year. The Venezuelan Congress has now finally approved the terms of the service contracts, and bids for five blocks south of Lake Maracaibo are expected shortly. It will be three or four years at least before production begins to flow under these new arrangements, but if one looks to the next five to ten years, a 2-1/2 percent annual growth rate appears to be a reasonable forecast. The best possibilities of developing new exports during this period lie in petrochemicals, iron and steel and the sale of liquified gas to the United States. Specific projects in various states of advancement exist in each of these fields. The economic report also stresses the need for a general reorientation of industrial policies away from import-saving in the direction of export promotion, and if this is done, there could be a significant increase in other manufactured exports.

7. The present state of the economy is healthy, and there is no serious immediate threat to the internal and external financial stability which has characterized Venezuela's development during most of the past decade. Official foreign exchange reserves stand around $1 billion, which is an all-time high. A gap has nevertheless begun to open in the balance of payments on current account, reflecting in part the lag in public savings associated with the slower rate of increase in revenues from petroleum and a growing demand for public services. During the past eighteen months the Government has turned to medium-term borrowing from banks abroad to help cover a widening fiscal deficit, and it is evident that substantial additional tax revenues will be needed in the coming years to maintain an adequate level of public investment without excessive recourse to external borrowing. At the

beginning of October, when the budget for 1971 is due to be presented to Congress, the Government will be proposing a package of new tax measures designed to yield additional annual revenues equivalent to 1-1/2 to 2 percent of GDP. However, they will not be able to carry this tax program through without the support of the principal opposition party, and this may not be forthcoming. Venezuela has traditionally adopted a conservative approach to external borrowing, and if additional taxes are not approved by the end of this year, the probable consequence in the short run will be a slow-down in development expenditures. It is unlikely that any of the three projects being considered for Bank financing in FY 1971 would be affected, but there would be delays in proceeding with other parts of the public investment program which the Bank mission has endorsed as being important for the long-term growth of the economy.

8. The telecommunications program does not require any direct budgetary contribution, and it is not intended that additional fiscal action should be made a condition of the proposed loan. The present public external debt of Venezuela is still very low, and the service of this debt absorbs less than 3 percent of the country's current account receipts net of investment income payments. This situation makes Venezuela creditworthy for substantial amounts of external borrowing for high priority projects. However, the debt service burden would increase sharply over the next few years if the Government were to attempt to carry through the presently proposed investment program without mobilizing additional public savings, and the overall level of Bank lending in future years must depend to an important extent on the steps which Venezuela takes to deal with its fiscal problem.

The Project

9. The Bank made a first loan of $37 million to CANTV in December 1965. The loan was to finance part of the foreign exchange cost of the 1965-1968 program designed to expand and improve the national and international telephone and telex services of Venezuela. Because of delays caused by some late equipment deliveries and by the redesign of buildings following the 1968 earthquake, the loan, which had an original closing date of March 31, 1969, is expected to be used by the present closing date, October 31, 1970 (the undisbursed balance on July 31, 1970, was $1.4 million).

10. The 1970-74 program appraised in the attached report is a continuation of the earlier project and provides for the further expansion of the telephone system which would meet about 65 percent of the presently estimated demand for new subscriber connections, while catching up with the demand for long-distance and international services and accommodating the 15 percent annual growth foreseen in this traffic over the next few years. The number of direct exchange lines is to be increased by about 269,000, new

microwave and VHF links will be provided for long-distance services, a satellite ground terminal station will be established, and telex services will be expanded through the installation of 1,300 sets. The total cost of the program is estimated at around $300 million, of which $133 million would be in foreign exchange. The proposed loan of $35 million, which would be guaranteed by the Republic of Venezuela, would finance 26 percent of the foreign exchange costs and would cover the items listed in paragraph 4.08 of the appraisal report. The other probable sources of financing are indicated in paragraph 6.01 of the report, and the financing plan would be firmed up during negotiations. One-third of the total funds required would be generated within the enterprise; close to another third would be obtained through suppliers' credits and long-term loans from U.S. banks, one-fifth would come from domestic bond issues and just over one-tenth from the proposed Bank loan.

11. CANTV still has to obtain the authority of Congress to borrow from the Bank, but no difficulty is foreseen in obtaining such authorization, and congressional action is expected in time for the loan to be presented to the Board in November. The other conditions for Board presentation are in process of being met. The Government has agreed to the arrangements proposed for the procurement of cables, including the issue of the necessary import licences (see paragraph 12 below); the U.S. bank loans have already been arranged; and CANTV is presently finalizing arrangements for collecting debts due from government entities.

12. A primary objective of Bank involvement in this project was to widen the scope for international competitive bidding and reduce the overall cost of the program, and I agree with the Public Utilities Projects Department that reasonable progress has been achieved in this direction. More than 60 percent of the equipment and cables required for the program, including all the items to be financed by the Bank, would be procured through full international competitive bidding. For another 15 percent, international bidding would be limited to the suppliers of the two types of modern switching equipment now installed or on order, while 11 percent would be bought under negotiated contracts for reasons of standardization (mainly to complete existing installations to their planned capacity). Finally, one-third of the cable (13 percent of total procurement) would be reserved for domestic manufacturers in view of the spare capacity available in the industry. The industry was pressing for a larger share, but the Government has agreed to limit reserved procurement to this amount on the understanding that the rest will be put out to international competitive bidding, with domestic manufacturers being allowed a margin of preference equal to 15 percent of c.i.f. prices or the actual customs duty, whichever is lower.

13. Part of the equipment for the program has already been ordered, but Bank financing would be limited to orders placed after loan signature (assuming that this takes place before the end of November). The contracts for consultants' services (estimated to cost $600,000) may have to be placed in advance of loan approval, but it is unlikely that there would be any significant amount of retroactive disbursements.

14. A second major objective of the proposed loan would be to continue the process of institutional improvement which was begun during the period of the first Bank loan. In this connection it is proposed to include in the Loan Agreement a special covenant on staffing. CANTV's personnel are among the best paid in the country (average annual emoluments about $5,300 per employee), and under the proposed covenant the enterprise would undertake to improve the utilization of staff from over 18 persons per thousand telephones in service at present to 15 per thousand telephones in 1974.

15. The financial position of CANTV is sound, and as already noted, one-third of the costs of the program would be covered out of internal cash generation net of debt service. However, in addition to the proposed Bank loan, CANTV will have to rely heavily for financing on suppliers' credits and the sale of bonds in the domestic market, and this will mean a substantial increase in debt service. The appraisal report accordingly recommends a lowering of the minimum requirement for the coverage of debt service (by net revenues) to 1.5, as compared with a ratio of 2.0 under the previous loan. The report also recommends that CANTV be required to maintain costs and tariffs at levels that will achieve a rate of return of at least 11 percent on average net plant in service beginning in 1973 (as compared with the 8 percent prescribed under the previous loan). I agree with both these recommendations.

16. The appraisal report recommends that the loan be for a period of 20 years, including 5 years of grace. A similar term was originally proposed for the previous loan in 1965, but this was subsequently reduced on country grounds to 16 years, including 4-1/2 years of grace. While Venezuela is one of the Bank's richest borrowers, it is also facing a difficult period of adjustment as the growth of oil revenues slows down, and I see no justification for any special hardening of the terms of the proposed loan.

Recommendation

17. I recommend that the Bank proceed to negotiate a loan of $35 million to CANTV, with the guarantee of the Venezuelan Government, on the terms and conditions proposed in the appraisal report.

E. Peter Wright
Deputy Director

Attachments

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

September 9, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Indonesia - Third Irrigation Rehabilitation Project

1. The Committee is requested to consider, without meeting, the attached memorandum of September 9, 1970 from the East Asia and Pacific Department, entitled "Indonesia - Third Irrigation Rehabilitation Project" (LC/O/70-99)

2. Comments, if any, should be sent to reach Mr. Kaupisch (ext. 4703) by 4:00 p.m. on Monday, September 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 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
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Deputy Director, Projects
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Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LOAN COMMITTEE

LC/O/70-99
September 9, 1970

Memorandum from the East Asia and Pacific Department

Indonesia - Third Irrigation Rehabilitation Project

1. The Government of Indonesia has asked the Association for a credit of $14.5 million equivalent to help finance a Third Irrigation Rehabilitation Project. Together with a proposed $4 million Second Technical Assistance Credit, scheduled for Board consideration on September 10, and a proposed $4.6 million Education credit, which I hope to present in October, the present proposal would bring the number of credits extended to Indonesia to thirteen, and total commitments to $170.9 million. During FY1971 I expect to submit three other credits to the Committee: a rice seed production and distribution project, a second highways project and a tea estate development project.

2. The project described in the attached Appraisal Report (PA57) comprises the rehabilitation of three irrigation systems in Central Java, West Java, and Sulawesi with a total area of about 200,000 hectares. The project has been prepared by consultants retained under the first Irrigation Rehabilitation Credit (No. 127-IND). It would be carried out by Projek Irigasi IDA (PROSIDA), an executive body created by the Ministry of Public Works and Power under the Directorate General of Public Works to implement irrigation projects financed by IDA.

3. The proposed project would continue the work begun under the first Irrigation Rehabilitation Project of restoring Indonesia's irrigation systems to their full capacity. PROSIDA would have to administer the rehabilitation of 400,000 hectares - about one million acres - or double the area it has been handling under the first project.* The appraisal report therefore proposes a considerable strengthening of management and staff, including expatriate assistance, as a prerequisite for project implementation. The speed with which new personnel can be found, trained and integrated in the existing organization will determine at what time further responsibilities can be assumed by PROSIDA; at present we have a fourth rehabilitation project in our lending program for 1972.

4. Total project cost is put at $28.6 million, not counting the contribution the farmers will be making by completing tertiary irrigation canals on their own land. The foreign exchange cost, in the form of consulting services, management assistance, construction, operating and maintenance equipment and steel and cement for various structures is

* The Second Irrigation Rehabilitation Project for the rehabilitation and completion of the multi-purpose Djatiluhur System is being carried out by an autonomous agency, Perusahaan Umum "Otorita Djatiluhur".

$4.2 million. In view of the severe budgetary constraints under which the Government operates, it is proposed that the Association finance half of the project cost. The rate of return on the project as a whole would be about 25 per cent. With other inputs such as fertilizer, pesticides and extension services, which the Government would undertake to provide, the rate of return would be 37 per cent. The increase in rice production would replace about one third of Indonesia's present rice imports, and annual foreign exchange savings would exceed total project cost once the project is fully developed, as expected, in 1976.

5. The appraisal report, recognizing the importance of an appropriate price relationship between rice and inputs as an incentive for farmers to use these inputs, recommends that the present ratio not be changed without prior consultation with the Association. This issue was extensively discussed with the Government during negotiations for the PUSRI Fertilizer Project. It was found that the price ratio is not the only factor influencing the farmers' decision on what and how much to grow. Among other things the availability and the terms of credit, the convenience of marketing his produce and his acceptance of various inputs also play a role. Moreover, neither we nor the Government are sure whether the presently established ratios are the right ones, or apply to all of the many markets in Indonesia, or will still be applicable when the project has been developed. This thought is also reflected in a recent letter from Mr. McNamara to President Soeharto on the subject of rice price policy, which suggests that the initial level of support prices would have to be reviewed to determine whether they do in fact provide adequate incentives to farmers, and points to the need to adjust the level of these support prices from time to time. In the PUSRI Fertilizer Credit Agreement, the Government undertakes to consult with us on policies concerning the supply, marketing and consumption of fertilizer (Section 4.05 (b)) and to take measures, including a rice price support program or other programs, which will encourage farmers to make optimum use of fertilizer (Section 4.11 (a)). The basis for consultation related to these covenants which mutatis mutandis should be repeated in the proposed Agreement, is provided in a statement by the Government of its agricultural policies contained in a Supplementary Letter (see attached). This letter could also serve as a reference point for consultation under the proposed Agreement. The Agriculture Projects Department agrees.

6. The appraisal report sets forth in Paragraph 4.06 what water rates would have to be charged for each of the areas covered by the project to pay for the cost of operation and maintenance. In each area there would be a uniform rate per hectare regardless of the size of the holding. Since small farms, of a size of about half a hectare, would have only a marginal surplus over and above family consumption, water rates claim an unduly high share of the surplus if other inputs are not used. I, with the agreement of the Agriculture Projects Department, propose that the assurance sought in paragraph 5.12 of the appraisal report be modified to bring into force water charge regulations satisfactory to the Association which would require a collection of charges from each area at least sufficient to cover its operating and maintenance cost. The level of rates applicable to areas and size of holdings would be specified by the Government in such regulations.

7. The list of imported equipment includes $264,000 of trucks and pickups for which assembly facilities exist in Indonesia and the Government is expected to ask, similar to the Highway project, that local assemblers be permitted to participate in international competitive bidding. I agree with the position taken in the appraisal report that no domestic preference be granted to local assemblers, but I recommend that we reimburse 100 per cent of ex-factory cost, exclusive of taxes and duties, for contracts won by local assemblers under international competitive bidding. As in the Highways Credit, duty on vehicles imported fully built up (100%) and duty on vehicles CKD (60%) would be excluded for purposes of bid comparison.

8. I concur in the conclusion and recommendations of the appraisal report that the project would form a suitable basis for an IDA credit of $14.5 million and recommend that the Government of Indonesia be invited to negotiate a credit.

Raymond J. Goodman
Director
East Asia and Pacific Department

Attachment

Indonesia · Credit 193 IND

CABLE ADDRESS: INDONESIA

KEDUTAAN BESAR INDONESIA

EMBASSY OF INDONESIA

WASHINGTON, D. C.

CHANCERY

2020 MASSACHUSETTS AVENUE, N. W.

TELEPHONE 293-1745

June 15, 1970

International Development Association
1818 H Street, N.W.
Washington, D.C. 20433

Re: Credit No. 193 IND (PUSRI Fertilizer Project)
Agricultural Policies

Dear Sirs:

With reference to Sections 4.05(b) and 4.11(a) of the Development Credit Agreement between us of even date relating to the PUSRI Fertilizer Project, we are pleased to furnish to you the following information about the Government's policies in certain agriculturally-related areas relevant to the Project, and the measures which it is at present adopting or proposes to adopt to implement these policies:

1. As emphasized in the current Five-Year Development Plan, the Government's objective is to attain self-sufficiency in rice and other staple foods, as well as to increase agricultural production for export, by stimulating more extensive production. In the latter area, heavy emphasis is being given to intensification of rice production, since it is expected that known technology and increased use of fertilizers will permit high benefit-cost ratios and yield results within a short period of time.

2. Rice Price Support Program: Prior to 1969, excessive fluctuations occurred in the price paid to farmers for their rice. In that year, however, a policy was adopted of stabilizing the rice price within limits which would be low enough to protect the consumer, but at the same time high enough to encourage increased use by farmers of fertilizers and other inputs. This is done by the maintenance of buffer stocks of rice, under the control of BULOG. In outline, the scheme operates as follows:

(a) A minimum price for the sale of their rice is guaranteed to farmers through standing offers by BULOG to purchase such rice at prices which are determined by the Government from time to time as being appropriate. In making such determination, world rice prices are used as a guiding factor, since this permits the Government to dispose of domestic purchases on the world market, and to purchase from abroad for disposal on the domestic market, without significant loss. It will not, however, be the sole determining factor: it may be necessary to allow for limited periods of time some discrepancy between the domestic price and the world price, within the overall framework of the incentive policy which the Government is pursuing. At present price levels, the floor prices offered by BULOG are as follows:

milled rice ex mill	- Rps. 36.00/kg
mill-dry stalk padi at mill	- Rps. 16.00/kg
village-dry stalk padi ex farm	- Rps. 13.20/kg

Every effort is being made to ensure the effectiveness of this scheme. Thus, letters of credit have been opened with domestic banks to ensure prompt payment to the farmers and other sellers, arrangements have been made with international surveyors to survey purchases and thereby to prevent malpractice and discrimination against the farmers, and quality specifications have been set to correspond better with qualities normally being marketed.

(b) At the same time, it is the Government's policy to ensure that the free market price of medium qualities of rice commonly used in each area will not exceed a ceiling which, at present price levels, is fixed at Rps. 50.00/kg. This has been achieved during the present pre-harvest season by sales of BULOG's buffer stocks, in sufficient quantities, at prices slightly below this market ceiling. At present, part of BULOG's stocks are being distributed to supply rice requirements of military personnel as well as of central and regional Government employees. To the extent that requirements of rice for salary payments in kind, market releases to maintain the ceiling price to the consumer, and maintenance of adequate buffer stocks should exceed in any year the domestic availability of rice, recourse will be had to imports of rice, preferably aid financed but also commercially procured if necessary. It is the Government's policy to gradually reduce these salary payments in kind, and increase money wages to compensate, as soon as price stability has been maintained for a sufficiently long time to provide a suitable economic climate for such a change.

3. At the present retail price level for urea and TSP fertilizer it is expected that the rice price support program outlined above will ensure farmers of a margin sufficient to enable them to make use of fertilizer and other inputs, and will provide a strong incentive to increase rice production by greater use of such inputs. This is particularly so in the areas where farmers enjoy relatively reliable irrigation water supply and use new seed varieties which are highly fertilizer-responsive. The program is therefore expected to accelerate the growth of fertilizer consumption and to prevent the fluctuations in such consumption which have occurred in the past years.

4. Every effort has been made to strengthen the administrative ability of BULOG to implement this program. Communication between the head and regional offices has been facilitated by the use of telex, and this, together with frequent reporting of stocks, purchases and distribution, is expected to ensure the degree of control necessary for the success of the program. In addition, detailed procedures for the operation of the buffer stock policy have been formalized in manuals, and seminars have been held to ensure understanding by all concerned. Daily control is maintained on stock positions to provide the flexibility in directing purchases and sales needed to implement price, buffer stock and distribution policies.

At the same time, the Department of Agriculture, beginning in January 1970, is reporting prices received by farmers at the village level. This will supplement the present reporting of prices in major retail markets, and enable rapid adjustment of procurement policies and related activities as necessary. The Government is also aware of shortcomings in the reporting of agricultural production statistics, especially for rice. Consideration is currently being given to improvements of the collection and dissemination of production statistics which in turn will improve program control, although the specific direction for action is still uncertain.

5. Improvements in Irrigation: The Five-Year Development Plan includes extensive rehabilitation of existing irrigation facilities, together with some expansion. Because of higher benefit-cost ratios and quicker returns to such investments, emphasis in the Plan is placed on rehabilitation, and activities in this regard are proceeding rapidly. An IDA loan has already been negotiated with work well under way for the rehabilitation of irrigation serving 180 thousand hectares on Java and for the completion of irrigation facilities serving 25 thousand hectares in Lampung, South Sumatra. Under Japanese aid financing regulation of the Brantas River is proceeding, which should benefit an area of 20 to 30 thousand hectares. An Asian Development Bank loan has been negotiated with work proceeding for the extension of irrigation on the Tadjum project covering approximately 3 thousand hectares. Negotiations have recently been completed for the rehabilitation of irrigation facilities on the Djatiluhur system serving 180 thousand hectares and in Sulawesi serving 20 thousand hectares. Preparation is also being made for the second stage of this same project which is expected to add new irrigation serving an area of between 50 and 60 thousand hectares. Other projects serving smaller areas are either proceeding or under negotiation.

6. Credit Facilities: The rapid expansion of the rice intensification program required to meet the large production increases premised in the Five-Year Development Plan has given rise to problems of effective credit supply and communication of "know-how" in the use of modern techniques

and inputs. An attempt to correct the shortcomings and to improve organization of input distribution resulted in contracts with foreign and domestic private contractors under the program known as Bimas Gotong Rojong. The long-term objective of the Government is to make use of private input distributors as intermediaries to supplement the supply of credit in conjunction with their distribution of inputs to the farmers, and at the same time, hopefully, to supplement agricultural extension activities. In the interim, action is being taken to reduce and eventually to eliminate the Bimas Gotong Rojong program as now practiced, and to substitute improved programs of "National" Bimas. These interim programs will utilize private sector distribution of inputs to the extent feasible in the short-term, and will give major emphasis to improved methods of credit provision, along with improvement of the Government Extension Services. The Government budget has made funds available for the extension of the National Bimas Program to ensure its availability to an increasing number of farmers. Training programs for bank officers who are concerned with extension of credit to farmers have been inaugurated in key parts of the country to facilitate such credit. In areas where such programs already exist, the training programs will be intensified to improve every aspect of the program already described in the statement. A number of other institutional changes and specific methods for improved and increased credit provision are under active discussion and actual trial.

For example almost 30,000 farmers in the Jogjakarta area are now receiving direct individual credit provided by village units of Bank Rakjat Indonesia. Elsewhere mobile credit units have been proven practical and are being expanded to cover farmers in an area of 300,000 hectares on Java. Stress is also being given to expansion of the capacity to provide mobility of extension workers and the upgrading of existing extension service personnel, together with employment of more highly trained personnel.

7. Other Measures: The National Fertilizer Study referred to in the Development Credit Agreement is expected to be completed by about the end of May 1971, and even before that date interim reports will become available which should enable some preliminary implementation work to begin. Other significant activities being undertaken or considered by the Government are summarized below:

(a) Activity is proceeding rapidly aimed at increasing and improving the supply and distribution of certified highly fertilizer responsive seed. A major effort in this regard is expected in the seed production and development project centering in the Sukamandi seed station in West Java. A feasibility study on this project has been made by a team financed by IDA. If the feasibility report is favorable, it is expected that steps can be taken so that this project can start by mid-1970. Activities are simultaneously proceeding on seed research and development, with intensive Government research being supplemented by cooperative research and training arrangements with personnel of the International Rice Research Institute in the Philippines.

(b) A survey on soil fertility is being developed, so that the effect of fertilizer in each district can be clearly observed through intensive fertilizer experiments. It is expected that this will provide the basis for more specific and increasingly productive fertilizer guidelines for all areas of the country.

(c) A survey is underway, in cooperation with the U.S. Agency for International Development, to ascertain the need for rice-processing, storage and marketing, which will be completed in the course of the year. On a pilot-project scale, the Danish Government has provided a number of rice storage and drying facilities, while the United Kingdom is establishing a modern rice mill as a pilot-project complete with its necessary institutional requirement in one of the Bimas areas in West Java.

Japan is supporting the Sukamandi seed station with technical assistance, experts and some equipment, while Germany is working on a pilot project in the West Sumatra and Surakarta areas to develop a modernized Bimas-type scheme, with emphasis on institutional development.

A similar letter referring to the Loan Agreement, will be furnished to the Asian Development Bank.

Very truly yours,

REPUBLIC OF INDONESIA

By ______________________
Authorized Representative

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/70-35

September 4, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to discuss "Botswana Shashe Project" held at 3:00 p.m. on Friday, August 28, 1970 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/70-35

September 4, 1970

Minutes of Special Loan Meeting to discuss "Botswana Shashe Project" held at 3:00 p.m. on Friday, August 28, 1970 in Conference Room B.

1. Present: Messrs. Cope (Chairman), Williams, Sella, El Darwish, Kruithof, Bailey, Dean, Denning and Chaffey (Acting Secretary).

2. Issues: The meeting was called to discuss Mr. Williams' memorandum to the Chairman dated August 27, 1970. The issues were:

(a) whether the mining company (Bamangwato Concessions Limited - BCL) should be permitted to pledge the pipeline of matte and metal to raise short-term finance;

(b) whether the Bank should insist on an amount or cushion to be retained in the general account of the trust;

(c) whether the government tax and royalty accounts should remain in the trust; and

(d) what rate of return on power and water assets should be adopted.

3. Discussion-Issues (a) and (b): The Chairman said that the questions of pipeline finance and the cushion were related. Although the trust might have been conceived as a payment mechanism, the flow of money into the trust and the cushion had security implications, especially in the event of a temporary interruption of the mine's production. These security aspects were to be regarded as in addition to the guarantee and should not be allowed in any way to lessen the importance attached to the obligations of the shareholder guarantors.

4. The more important feature was the flow of sales proceeds of the pipeline into the trust. To the extent that BCL pledged the pipeline, the security of the lenders was diminished. However, there appeared to be no prospect of raising short-term finance on security subordinated to the trust. It was normal mining practice to pledge a pipeline, and in this case the reasons for pledging were more pressing because the pipeline was of unusual length and value. From a security point of view it would be preferable if the project were financed without pledging the pipeline. But if this was not possible, then the lenders would have to consider carefully whether some part of the pipeline could be pledged, say to the extent of one maturity.

5. The Chairman said that the Bank and KfW had a common interest as lenders. As BCL was KfW's debtor, it would be appropriate for KfW to take the lead in the negotiations, with the Bank's support. There were however two qualifications to the Bank's support. First, any answer that might be proposed to the question of pipeline finance would be acceptable only if it enabled the Bank to maintain its position pari passu with KfW. Secondly, although the Bank had an interest as a creditor, it also had an interest, by way of its relationship with the Government, in the profitability of the project. Therefore, the Bank reserved the right to hear the Government's views and to differ with KfW if the profitability was seriously affected by a measure designed to protect the creditors. Subject to these qualifications, the Bank should ascertain KfW's position and, if it was acceptable, agree to present a united front in the negotiations with BCL.

6. A similar approach should be taken on the cushion. As a protection against temporary interruptions in production, the cushion would be comforting. But if the financial position of the company were to be jeopardized by Bank insistence on this safeguard, and if leaving a part of the pipeline unencumbered afforded adequate protection to the Bank, KfW and the Government, then the Bank should be prepared to agree with KfW in giving up the cushion

7. Discussion-Issue (c): The Chairman said that the Bank should support the Government's contention that the tax and royalty accounts should remain in the trust.

8. Discussion-Issue (d): The Chairman agreed that the Bank should press for a 10% rate of return on assets at actual costs. Quite apart from the detailed calculations noted in Mr. Williams' memorandum, the Chairman considered that this figure was more in keeping with current financial conditions than the 8% return which had been used in the feasibility study.

J. Chaffey
Acting Secretary

Cleared by: Messrs. Cope
Williams
Sella
El Darwish

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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LC/A/70-8

August 28, 1970

NOTICE OF MEETING

A meeting of the Loan Committee will be held on Friday, September 4, 1970 at 3 p.m. in the Board Room.

AGENDA

The Committee will consider a general issue affecting the financial relations between Governments and autonomous bodies which has arisen in the context of both the Iran - Tehran Power Distribution and Ghana - Second Power Distribution proposals[1], namely the extent to which the Bank should seek to determine the method adopted by a Government for investing in an autonomous public corporation i.e. whether by way of equity or debt and, similarly, to determine the amount of the dividend declared by such a corporation.

J. Chaffey
Acting Secretary
Loan Committee

1/ Documents already distributed to the Loan Committee:

Iran - Tehran Power Distribution Project (LC/O/70-95, dated August 25, 1970); and

Ghana - Second Power Distribution Project (LC/O/70-97, dated August 28, 1970).

- 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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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)

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

August 28, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Ghana - Proposed Second Power Distribution Project

1. The Committee is requested to consider, without meeting, the attached memorandum of August 28, 1970 from the Western Africa Department, entitled "Ghana - Proposed Second Power Distribution Project" (LC/O/70-97).

2. Comments, if any, should be sent to reach Mr. Ram (ext. 4788) by 12:30 p.m. on Wednesday, September 2, 1970.

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.

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
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Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/O/70 - 97

August 28, 1970

LOAN COMMITTEE

Memorandum from Western Africa Department

GHANA: Proposed Second Power Distribution Project

Introduction

1. Attached is an Appraisal Report (No. PU-52) dated August 24, 1970 recommending a credit of $7.2 million to the Government of Ghana to be relent to the Electricity Corporation of Ghana (ECG) to partly finance the foreign exchange cost of a power distribution expansion project. The project was appraised in May/June 1970.

2. The Five Year Lending Program (1971-75) for Ghana is attached. The proposed credit, which is the only one scheduled for FY 1971, would be the Bank Group's eighth lending operation in Ghana. The earlier commitments consist of two loans amounting to US$53 million to the Volta River Authority for power generation and of five credits totalling US$24.8 million to the Government for power distribution, water supply, highway engineering, fisheries, and cocoa. A highway rehabilitation and maintenance project, originally scheduled for FY 1971, has been deferred to FY 1972 as the necessary feasibility studies have been delayed. In agriculture, certain projects designed to assist diversification of agriculture, such as sugar, cotton and rice, are in various stages of preparation.

The Project

3. The proposed project, for which an earlier credit (118 GH) was provided in June of 1968, would cover ECG's distribution program for the period 1971-73. It would consist of strengthening of the existing facilities, expansion of distribution facilities in existing areas of supply and provision of supplies to some new areas.

4. It is estimated that during the period 1970-82 ECG would require an investment of about US$54 million to expand its facilities to meet forecast power demand. The proposed program for 1971-73 is estimated to cost US$12.7 million, of which US$9 million represent foreign cost and US$3.7 million local cost. ECG would meet the local cost from its own resources. The foreign cost, as proposed by the appraisal report, is to be met from an IDA credit in the amount of US$7.2 million, a loan from the Federal Republic of Germany (Kreditanstalt fur Wiederaufbau (KfW)) of US$0.8 million for tied procurement in Germany

because of the need for matching equipment for part of the Accra system previously financed by German aid, proceeds of a UK loan to the Government of US$0.2 million, and materials already available in Ghana which would account for US$0.8 million.

5. Since the appraisal report was prepared the Government of the Federal Republic of Germany announced the untying of German aid and indicated its interest in joint financing with IDA of ECG's expansion program on this basis. Specifically, the German authorities have proposed to finance the foreign exchange cost of the entire Accra distribution extension amounting to about US$2 million, i.e. US$0.8 million for tied procurement in Germany as indicated in the appraisal report, as well as US$1.2 million on an untied basis. Acceptance of the German proposal was recommended to the Chairman of the Loan Committee who agreed to the proposed arrangements. While a final decision on this matter will not be taken by the German Government before the end of September, there is every indication that the decision will be favorable. As a result the proposed IDA credit OF US$7.2 million would be reduced by US$1.2 million representing the proposed portion of untied aid which Germany would extend. I therefore recommend that we proceed on the assumption that German financing will be forthcoming and that the Ghanaian Government and ECG be invited for negotiations of a US$6 million IDA credit. It should be understood, however, that in case German financing would not materialize, which we will know prior to presentation of the proposed credit to the Executive Directors, the amount of the credit be increased to US$7.2 million as presently proposed by the appraisal report, and that we give assurances to that effect to the Ghanaian representatives during negotiations.

6. The borrower would undertake to ensure that the Association's procurement procedures are followed by the beneficiary. Bids have been received for 80 percent of the equipment proposed for financing, after approval of specifications and tender documents by IDA. Contracts will be awarded only after the Association has approved the proposed credit. Preference for domestic suppliers has been requested by Government, affecting one Ghanaian company manufacturing bare copper and aluminum conductors. The value added through local manufacture in this case averages about 26 percent of the cost price. Although ECG is exempt from import duty, other users of such material are subject to a 50 percent import duty; therefore a 15 percent nominal preference to local manufacturers has been agreed upon by the Association for purposes of bid evaluation. The weighted average rate of return on the project would be 13.2 percent. ECG will execute the project with the assistance of electrical and engineering consultants. The project is expected to be completed by the end of 1973.

7. Two organizations, the Volta River Authority (VRA) and ECG (a public autonomous corporation created in 1967) are charged with responsibility for providing public supplies of power. VRA is responsible for

bulk supplies to Volta aluminum company's smelter at Tema, ECG, the gold and diamond mines in the southern and southwestern part of the country, and Akosombo township. ECG is responsible for the distribution of power throughout Ghana and the generation of public power supply in areas that cannot be economically connected to the VRA transmission system. ECG currently serves four principal cities and 26 smaller centers, of which 16 have locally generated diesel power. Sales by ECG increased at an annual growth rate of 17.9 percent during the last five years and are estimated to increase at an average annual growth rate of 11.5 percent during the next ten years. VRA meets and will continue to meet 97 percent of the power demands of ECG.

8. ECG is in a strong financial position and would be able to meet the cost of the project from its own resources. Only Ghana's very difficult foreign exchange position justifies external assistance to meet the foreign cost component of the project. For this reason it is proposed that the proceeds of the credit be relent to ECG by the Government of Ghana for a relatively short period of 10 years with $3\frac{1}{2}$ years grace period at $7\frac{1}{4}$ percent interest. In view of its strong financial position, ECG also intends to repay the amount owed to the Government under Credit 118 GH by June 30, 1980 instead of December 31, 1988 as scheduled.

9. Although there has been some improvement in ECG's management, especially on the accounting side, there are a number of steps yet to be taken by ECG to strengthen and improve its management. These steps include recruitment of an adequate number of senior staff; retrenchment of redundant staff; inventory control; introduction of procedures for improvement of accounts receivable; and salary revisions. Necessary assurances will be obtained from ECG during negotiations to take adequate action on these matters within an agreed time schedule.

10. It is also proposed to obtain suitable assurances in respect of appointment of Managing Director and certain senior officers, independent audit, rate of return, debt limitation, etc., as provided under the first credit (118 GH).

11. The Committee is invited to pay particular attention to the following:

(a) It is proposed to obtain assurances from the Government to have suitable consultants examine the possibilities of a merger between VRA and ECG and to initiate further steps based on the report of the consultants (see paras. 2.12 and 2.13 of the Appraisal Report).

The creation of VRA as a separate organization in 1961 became necessary because ECG's predecessor, the Electricity Division of the Ministry of Works, was not adequately equipped to undertake the important Volta Project. Established in 1967, ECG, as the successor of the Electricity Division, was faced with important organizational changes which should be completed by 1972, increasing its efficiency. Thus a merger of the two organizations to be responsible for power only should be possible and should result in substantial economies.

(b) It is proposed to obtain assurances from the Government that it will require ECG to undertake rural electrification only if ECG's other operations are not adversely affected and it will relieve ECG of the financial responsibility for establishing and operating such institutions by appointing ECG as its agent and advancing annually the funds needed for their establishment and operation (see para. 2.15 of the Appraisal Report).

This is considered necessary to restrain the Government from embarking upon an ambitious rural electrification program under political pressure, thus jeopardizing ECG's operational efficiency and financial viability.

(c) An amount of N¢3.1 million owed by the Government and certain state corporations be adjusted against the relent amount owed by ECG to Government under Credit 118 GH. A clearing account to be set up for periodically adjusting any amount owed by Government against any amounts owed by ECG on account of debt service, dividends and other payments, if any (see para. 3.18 of the Appraisal Report).

This arrangement is considered necessary to eliminate the accumulated arrears of accounts receivable from the Government and to prevent the build-up of such large arrears in the future.

The Economy

12. A summary of Ghana's economic situation and prospects was included in the Country Program Paper of January 27, 1970. Its assessment of Ghana's creditworthiness indicated that Ghana's debt burden and uncertain export earnings limited the prospects for significant lending on conventional terms. In a review of that CPP on February 9, 1970 it was agreed that Ghana should be treated as an IDA country for the present, barring the achievement of a long-term solution to its debt problem.

13. A Bank Economic Mission which assessed Ghana's economy and development prospects in April 1970 is now finalizing its report. It will be circulated to Executive Directors before the presentation of this credit.

14. The conclusions of the mission underscore the country's difficult economic situation, including its serious unemployment problem and heavy external debt burden. The present Government has exercised caution in its credit and budget management and is continuing the policies of monetary stability of its predecessor.

15. However, the ability of the Government budget to finance substantial increase in development expenditure is basically constrained by four factors: the increase in consumption expenditure and transfers; the continued dependence on revenue from cocoa export duties; the relative decline of non-cocoa sources of revenue and the continued pressure of debt service obligations. The Government is seriously considering to rectify the situation by initiating appropriate measures. Problems of increase and diversification in taxes are being studied by a National Tax Revenue Commission. A one-year Development Plan has been prepared while work on a 3-4 year medium-term plan will start before the end of this year.

16. The immediate outlook for the balance of payments is on the one hand governed by the relatively favorable outlook for cocoa and on the other hand by the need to increase imports somewhat in line with the requirements of the development program. But even with a relatively favorable outlook for cocoa, total export earnings are not expected to show dynamic growth in the medium and longer term. For the decade 1970-80 export growth is not likely to exceed 4 percent per annum. The heavy burden of external debt service, moreover, makes it unlikely that Ghana can achieve significant improvement in the balance of payments situation for some years to come. Appreciating some of these difficulties, Ghana's creditor countries, in a conference held in London in July 1970, agreed to extend relief of 50 percent of the amounts due in 1970-72 in respect of principal and interest on medium-term debt. But even with this relief Ghana will require an increased inflow of external capital mainly on concessionary terms to meet its balance of payments and investment requirements.

Recommendation

17. I concur with the recommendations of the appraisal report except that I recommend that the Government of the Republic of Ghana and the Electricity Corporation of Ghana be invited to negotiate a credit of up to US$6 million for the proposed distribution project of the Electricity Corporation of Ghana on the terms and conditions set forth in paragraphs 7.01 - 7.03, with the understanding that the proposed credit may be increased in accordance with paragraph 5 of this memorandum.

Roger Chaufournier
Director

Attachment : 1 - Ghana - 5 Year Lending Program

Western Africa Department

Attachment 1

Population: 8.1 m
GNP Per Cap: $200

IVa. GHANA - 5 YEAR LENDING PROGRAM

		($ millions) Fiscal Year 1970	1971	1972	1973	1974	1975	Total 1964-68	Total 1969-73
Oil Palm	IDA				2.0				
Cocoa Development	IDA	8.5							
Cocoa II	IDA			8.0					
Cocoa III	IDA						8.0		
Sugar Development	IDA			7.0					
Cotton	IDA				4.0				
Irrigation - Accra Plains	IDA					10.0			
Fisheries I	IDA	1.3							
Fisheries II	IDA				5.0				
DFC - NIB I	IDA			4.0					
DFC - NIB II	IDA				6.0				
DFC - NIB III	IDA						6.0		
Education I	IDA			4.0					
Education II	IDA						4.0		
Power Distribution - ECG II	IDA		8.0						
Power Distribution - ECG III	IBRD				8.0				
Power - Kpong	IBRD				18.0				
Highway Engineering	IDA	1.5							
Highway Maintenance	IDA			12.5					
Roads	IDA					12.5			
Water Supply - Accra-Tema	IDA	3.5							
Water Supply II	IDA				4.0				
	IBRD				26.0				32.0
	IDA	14.8	8.0	35.5	21.0	22.5	18.0	10.0	79.3
	Total	14.8	8.0	35.5	47.0	22.5	18.0	10.0	111.3
	No.	4	1	5	7	2	3	1	18

Western Africa Department

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

August 26, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Indonesia - Education Project

1. The Committee is requested to consider, without meeting, the attached memorandum of August 26, 1970 from the East Asia and Pacific Department, entitled "Indonesia - Education Project" (LC/O/70-96).

2. Comments, if any, should be sent to reach Mr. C.R. de Silva (ext. 4127) by 5:00 p.m. on Monday, August 31.

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.

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
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Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/0/70-96

August 26, 1970

LOAN COMMITTEE

Memorandum from the East Asia and Pacific Department

INDONESIA - Education Project

1. The Government of Indonesia has asked the Association for a credit to finance an education project in Indonesia. The proposed project would consist of the construction and equipping of five technical training centers; the training of teachers to staff those centers; and technical assistance. A copy of the appraisal report entitled "Indonesia: Appraisal of an Education Project" (PE-19) dated August 21, 1970 is attached.

The Lending Program

2. The Association has made ten credits to Indonesia totalling \$147.8 million. A second technical assistance credit and a credit for a third irrigation rehabilitation project will be presented to the Executive Directors shortly; three other credits -- for the production and distribution of rice seeds, the development of tea estates, and the rehabilitation and construction of highways -- are also in the program for Fiscal 1971.

3. If approved, this credit would be the Bank Group's first lending operation for education in Indonesia. Further credits in this sector will be submitted for approval in the future, including an agricultural education project in Fiscal 1972.

The Economy

4. The last full economic report on the position and prospects of Indonesia (EAP-10a) was issued on November 14, 1969, and has since been supplemented by a special report, "Current Investment Activity in Indonesia" (EAP-14a) dated March 27, 1970.

5. Indonesia's recent economic performance has been satisfactory. Inflation has been kept under control and, given the new condition of relative stability, a good start has been made on programs of rehabilitation and development. In April 1970, a basic exchange reform was introduced, including the unification of the exchange rate (except for a special rate for program aid); the foreign exchange markets have since been in balance, and internal price changes have not been significant. Also in April 1970, agreement was reached between Indonesia and the "Paris Club" countries (the Western creditors and Japan) for the re-scheduling of their share of Indonesia's pre-1967 external debt. This settlement accounted for about 36 percent of the country's total outstanding debt of some \$2.1 billion.

6. The 1970/71 development program is larger than last year's, and more of it is being financed from Indonesia's own resources. The effort to expand the hitherto very low levels of public saving and foreign and private domestic investment has been impressive; domestic revenues increased 36 percent in 1969/70, and a similar increase is expected for the current year (1970/71). Commitments of aid for 1970/71 by members of the Inter-Governmental Group for Indonesia have approached the $600 million requested by the Indonesian Government.

7. The immediate development prospects depend largely on the rate at which economic and institutional damage caused by past mismanagement can be repaired. The efforts of the government in this respect are in many ways impressive and, in some ways, already becoming effective. Much remains to be done however if the administrative framework required for the effective implementation of development projects is to be firmly established. If this is done, and if present economic policies continue and the flow of technical and financial aid is maintained, the prospects of at least modest growth appear good.

The Education Sector

8. So far, the emphasis in capital aid has been on agriculture and the country's economic infrastructure. Assistance to education, except for technical assistance, has been minimal. In preparation for fundamental reforms of the educational system, extensive studies are presently under way to assess the system's structure, organization and curricula, and their relevance to the country's manpower requirements. To this end, a manpower survey is being carried out. However, the effective demand for middle level technical manpower is clear, and will increase apace, especially in Indonesia's major cities, as the development process gathers momentum and industrialization proceeds. Increased bilateral and multilateral support in this field will become necessary as the country's manpower requirements are more clearly identified.

9. Responsibility for education in Indonesia is centered essentially within the Ministry of Education. The Ministries of Religion and Agriculture also direct education programs and most of the other Ministries, including the Ministry of Manpower run training programs for the upgrading of specific skills. The Ministry of Education was recently re-organized to clarify responsibilities and improve coordination; and an Office of Educational Planning and Development has been established within the Ministry to improve the basis for planning in the educational sector.

The Project

10. The proposed project would consist of: (a) the construction and equipping of five technical training centers, each located in a major area of industrial employment and serving from two to four senior technical secondary schools, offering them workshops and laboratory facilities;

(b) the training of 330 teachers to staff the centers; and (c) technical assistance in the initial operation of the training centers.

11. The total cost of the project is estimated at $7.71 million, including a foreign exchange component of $4.56 million (approximately 60 percent of the total cost). The proposed credit would cover all the foreign exchange expenditures of the project. If local manufacturers should win contracts for furniture, the credit would also cover the local costs thereof (amounting up to $40,000 equivalent). The Indonesian Government would bear the balance of the local costs of the project. Contracts for civil works, furniture and equipment would be awarded on the basis of international competitive bidding, in accordance with the Association's Guidelines.

12. The project would be administered by a Project Implementation Unit to be established within the Ministry of Education. This Unit would be administered by a Project Director assisted by an architect, a technical educator, a procurement officer, and an accountant, all of whom would be appointed in consultation with the Association.

13. A representative National Advisory Committee would be established to advise the Government on overall policy for the project centers and feeder technical schools. In addition, local Advisory Committees would also be established for each center, to stimulate the employment of graduates and ensure the relevance of revised curricula to the needs of industry.

14. In addition to the staff of the Unit referred to in para. 12 above, a team of five specialists acceptable to the Association would be employed over a period of about four years, to provide about twelve man-years' worth of technical assistance. These specialists, each an expert in a different technical field, would be assigned one to each center; they would, however, also visit the other centers periodically so that all centers would benefit from their specialized knowledge and experience. The specialist residing in Djakarta would serve as the leader of this group, and would also assist the Project Director (para. 12) in the overall programming and supervision of the teacher-training courses.

15. The workshop instructors and laboratory teachers who would staff the five proposed centers would participate in a special one-year training course before assuming their duties at the centers. Assurances would be sought from the Government that such staff would be paid enough to give them an incentive to remain on the job on a full-time basis and devote their entire attention to their duties at the centers.

Recommendation

16. The amount of $4.6 million for the proposed project is included in the Fiscal Year 1971 lending program. I concur in the

findings of the appraisal that the project forms a suitable basis for an IDA credit of $4.6 million equivalent, and recommend that the Government of Indonesia be invited to send representatives to negotiate such a credit.

Raymond J. Goodman
Director
East Asia and Pacific Department

Attachments

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

August 24, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Indonesia - Second Technical Assistance Project

1. The Committee is requested to consider, without meeting, the attached memorandum of August 24, 1970 from the East Asia and Pacific Department, entitled "Indonesia - Second Technical Assistance Project" (LC/O/70-94).

2. Comments, if any, should reach Mr. Kaupisch (ext. 4703) by 5:00 p.m. on Thursday, August 27.

3. It is planned, if the Committee approves, to enter into a new Development Credit Agreement substantially similar to that of December 27, 1968.

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)

CONFIDENTIAL

LC/0/70-94
August 24, 1970

LOAN COMMITTEE

Memorandum from the East Asia and Pacific Department

Indonesia - Second Technical Assistance Project

1. Funds available under the $2 million Technical Assistance Credit (No. 135 IND) are now either committed, or expected to be committed in the near future and the Government of Indonesia has asked the Association for a second credit of $4 million. Headquarters staff has recently discussed this request, and has reviewed the use made of the present credit, with the Government and the Bank's Resident Staff in Djakarta. If approved, the proposed credit would be the eleventh extended by the Association to Indonesia and bring total lending to date to $151.8 million.

2. The following commitments have been made against Credit 135 IND:

	Project	IDA contribution (US$ equivalent)
(i)	Detailed engineering of Djatiluhur Irrigation Project	356,000
(ii)	Feasibility study of two partially established sugar projects	55,000
(iii)	Seeds Industry project preparation	67,000
(iv)	National Fertilizer Study	530,000
(v)	Groundwater project preparation	30,000
		1,038,000

Up to now $420,000 has been disbursed.

3. In addition, the financing of two further projects has been agreed in principle, and commitments are expected to be made soon: an evaluation of the rice intensification program, expected to require approximately $300,000, and an inventory of irrigation facilities, estimated to cost approximately $200,000. Furthermore, there has been for some time agreement in principal that, if UNDP should not agree to finance a planned study of the sugar industry of Indonesia, then Credit 135 would be used for the purpose. The cost of the sugar study is estimated at approximately $500,000. If, as now appears likely, UNDP should finance that study, the balance left in the present Credit would be applied towards subprojects described in paragraph 6 below.

4. The engineering studies for Djatiluhur greatly accelerated the making of the $18.5 million Second Irrigation Rehabilitation Credit (No. 195 IND). The study of two sugar projects has been completed and provides the basis for discussion by the Government and possible lenders with respect to further action on the projects. I expect to propose during the current fiscal year a credit for rice seeds production and distribution based in part on the study financed by Credit 135. The National Fertilizer Study is an essential complement to the Pusri Fertilizer Project (Credit No. 193 IND) and will provide the Government with a basis for further action with respect to fertilizer production, distribution and use. The groundwater project preparation study will provide the basis for judging whether a groundwater development project should be considered for financing in the near future. The other studies presently contemplated are expected either to prepare specific investment projects or to provide the basis for policy and program formulation.

5. For a number of technical assistance projects identified and/or prepared by the Resident Staff, grant financing was obtained or is expected -- from UNDP (for Bali Tourism and Sugar Industries Studies) and from bilateral aid-givers (for studies in the fields of transport, agriculture, industry and power). Efforts will continue to be made in each instance to obtain grant financing but as in the past there will be cases where such alternative financing cannot be arranged at all or on an appropriate basis. Moreover, although considerable technical assistance is available from UNDP and from bilateral aid resources substantial additional technical assistance is required for both planning and execution of programs and projects for which funds would be available once specific action programs and projects have been prepared. The technical assistance available under the proposed credit, because it can be used for a broad spectrum of activities and can be made available quickly and can draw upon expertise available on an international basis, is particularly valuable to Indonesia. Experience has indicated also that bilateral aid-givers are willing to finance projects identified or prepared under Bank or IDA auspices even though they are often reluctant to finance projects developed under other bilateral auspices.

6. We anticipate that the proposed credit would continue to finance, but to a larger extent than hitherto, the final engineering of projects which are specifically intended for Bank/IDA financing where the use of those funds would substantially reduce the leadtime between project identification and appraisal and between approval and disbursement. Specifically, there are two immediate projects which require detailed engineering as a basis for appraisal and where no assistance from sources other than the Association can be obtained. One is a highway project in Sumatra, identified on the basis of a UNDP-financed feasibility study, and scheduled for Board consideration before the end of the fiscal year. Funds for detailed engineering could, of course, be advanced by the Government and management approval was obtained early in July, for retroactive financing of the foreign exchange cost of detailed engineering from the project credit once it was made. However, because of the severe shortage of budgetary funds for development purposes and in keeping with a Cabinet regulation pro-

hibiting such advances to obtain better budget control the Government expresses a strong preference to have the foreign exchange expenditures of detailed engineering financed from the proposed technical assistance credit. The other project is an engineering feasibility study of the addition of thermal power generating capacity in West Java. These two sub-projects alone are likely to absorbe about $3 million. The ultimate project credits would, of course, be smaller to the extent that engineering had already been financed by the Technical Assistance Credit.

7. Other contemplated studies are in agriculture (beef cattle industry in the eastern islands, crop pest situation), in certain areas of transport, and in industry (iron and steel, industrial estates, pulp and paper, timber processing). Some studies planned by the Resident Staff may, as in the past, be financed from other sources; it is therefore not possible to forecast the specific use of the credit funds. But since more than $3 million of the new funds requested can be expected to be promptly committed for engineering as indicated above, a credit of $4 million appears justified. As indicated earlier, $460,000 of the first Technical Assistance Credit remain uncommitted.

8. The arrangements for project implementation, under which authority to act for the Association is delegated to the Director of the Bank's Resident Staff, have worked well and should be continued.

9. Neither the Government nor the Resident Staff, sees any need for a change in the Credit Agreement, and they had therefore proposed, for simplicity's sake, not to negotiate a new Credit Agreement but to amend the present agreement by increasing the amount from $2 million to $6 million and by extending the Closing Date by 23 months to December 31, 1973. However, both the Legal Department and I feel that it would be more appropriate to have a new agreement, which would follow substantially the provision of the earlier agreement.

10. I recommend that the Government be invited to indicate to the Association its readiness to enter into a new Development Credit Agreement, covering a credit of $4 million, substantially similar to the Development Credit Agreement of December 27, 1968.

11. This memorandum has been cleared in substance with the Resident Staff and with the other departments concerned.

Raymond J. Goodman
Director
East Asia and Pacific Department

FORM No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

August 25, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Iran - Tehran Power Distribution Project

1. The Committee is requested to consider, without meeting, the attached memorandum of August 25, 1970 from the South Asia Department, entitled "Iran - Proposed Loan for the Tehran Power Distribution Project" (LC/O/70-95).

2. Comments, if any, should be sent to reach Mr. Loos (ext. ~~3575~~ 2778) by 5:00 p.m. on Friday, August 28.

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.

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
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Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

August 25, 1970

LOAN COMMITTEE

Memorandum from the South Asia Department

IRAN - Proposed Loan for the Tehran Power Distribution Project

1. Attached for the consideration of the Loan Committee is an Appraisal Report (PU-51) dated August 20, 1970 on the Tehran Power Distribution Project, recommending a Bank loan of US$60 million. If approved, this would be the second Bank loan for a power project in Iran; the first loan (247-IRN) having been made in 1960 in an amount of $42 million for the Dez Multi-purpose Project.

Background

2. The Bank has made sixteen loans, amounting to $497.2 million, net of cancellations, for projects in Iran, of which some $287.5 million was disbursed as of July 31, 1970. The first loan for general development ($75 million) was made in 1957; about $70 million has been repaid. Five loans have been made for road construction amounting to $167.2 million, four for agriculture amounting to $100.5 million, and six for industrial development amounting to $154.5 million. Also, two technical assistance grants were made, one for power and one for a ports study. The lending program as set out in the country program paper (CPP) and summarized and brought up to date in the attached Annex I, calls for loans totalling more than $600 million during the next five years. While planned for FY 70, the sixth loan to IMDBI ($50 million) was approved after July 1 and now falls into FY 71. In addition, negotiators have been invited for an education project (LC/O/70-81). The Loan Committee will also receive shortly an appraisal report and recommendations for a telecommunications project ($35 million). This, together with the power loan proposed, would bring the total lending for this fiscal year to $160 million. We understand that the Agricultural Development Fund of Iran (ADFI) may require additional funds before the end of this fiscal year, in which case a second loan to it may be proposed ($10 million). This is subject to confirmation by a supervision mission scheduled for September, but also depends on finding a place in the heavily booked appraisal schedule of Agriculture Projects Department.

3. The Iranian economy continues to grow rapidly. The real rate of annual growth of GNP has been above 8 percent for nine years with population growing at about 3 percent per annum. While a significant deterioration in this performance is unlikely in the next year or two, there are increasing signs of strain. The rate of domestic savings is

14 percent per annum, but it has not kept up with the increase in the rate of investment, which is nearly 20 percent per annum. The decision of the Government to strengthen Iran's defense capabilities is accentuating the problems of the savings gap.

4. The Government has been highly successful in negotiating larger than expected increases in oil revenues and has also relied heavily on foreign borrowing, much on relatively short term; success in both has obscured the rising resource shortages. However, the Government is aware of a need to improve the management of the economy and efforts are under way to increase non-oil revenues, to increase private sector savings, to improve the terms of foreign borrowing and to improve further the quality of the investment program. The most recent Economic Report (SA-8a of December 31, 1969) drew attention to the existing difficulties, but concluded that Iran is creditworthy for further Bank lending of the order envisaged in the CPP. I believe this conclusion still holds. As suggested in the CPP, we keep the situation under close review; the next thorough review of Iran's economy is scheduled for October this year.

5. The development of the electric power potential has been and is of crucial importance to the Government efforts to increase the output of the economy. The rapid expansion of the economy in the sixties coincided with substantial increases in electric power capacity and generation. Prior to the Third Plan period (1963-68) total generating capacity of the country amounted to less than 400 MW, most of which consisted of diesel generating units. The sector itself lacked organization; there were some 30 generating companies in the Tehran area alone. In 1963 the Iranian Electricity Authority was established; a first attempt to facilitate the coordinated development of electric power. The Bank financed study of the power sector in 1963/64 sought to assist the Iranian authorities in formulating a plan for the development of the sector. However, differences of opinion as to the wisest course of action developed, resulting in termination of the study. In the course of the Third Plan period, generating capacity in Iran was increased from 1.9 billion KWh to 4.3 billion KWh annually.

6. A beginning was also made in establishing an inter-connected power system. The rapid expansion of the system presented considerable difficulties of a financial, organizational and technical nature. As the attached appraisal report suggests, considerable credit is due to the Iranian authorities for the initiatives taken which made the large scale expansion of the sector possible. Central authority for the sector was given to the Ministry of Water and Power in 1964. In 1965 legislation was enacted, nationalizing the industry, and by 1967 most of the country's generating capacity was under the jurisdiction of the Ministry. At the present time, the generation and transmission of electric power is the responsibility of one separate company, and distribution the responsibility of eleven regional companies. A very urgent problem of the power sector at the present time is a severe shortage of distribution facilities which is manifested in an over-extended and over-loaded distribution system leading

to inefficiency, frequent breakdowns and unreliability. In turn, this has discouraged industrial users from relying on the national power system, thus extending the need for inefficient self-generation. The need is most acute in the Tehran area, the industrial center of Iran, where demand for electricity is expected to rise 35 percent annually for the next few years.

7. A second problem, of a more general nature, is the organization of the power sector, which is not adequate, particularly given its anticipated size.

The Project

8. The project would assist the Tehran Regional Electric Company (TREC), by far the most important of the regional distribution companies, accounts for more than 50 percent of all power sales, to expand its distribution network sufficiently to enable it to provide satisfactory electric service. It would also include the construction of a 230 kV transmission ring around the city of Tehran. The project would be implemented between 1970 and 1973; its cost is $93 million. The proposed loan of $60 million would cover the bulk (about 86 percent) of the foreign exchange requirements. The loan would be made to the Plan Organization, through which all of Iran's public sector foreign borrowings are channelled. However, the execution of the entire project would be the responsibility of TREC to which the proceeds of the loan would be made available in the form of debt on the same terms as the Bank loan. The project, when completed, would nearly double TREC's distribution facilities. The Public Utilities Projects Department is confident that TREC will be able to operate the system efficiently, but feels that TREC lacks experience to plan and co-ordinate an expansion program as massive as the one proposed. For this reason, the engagement of qualified expatriate consultants who would have overall responsibility for the planning and execution is to be made a condition of effectiveness for the loan. The appraisal report also notes that TREC's accounts were unsatisfactory. However, since a new management was installed less than a year ago, accounting procedures have been improved considerably.

9. As pointed out above, while the present organization of the power sector represents an improvement over conditions that existed some years ago, it is not likely to be adequate given the present and future size of the sector. Problems include: duplication of effort between the Ministry and the operating companies in the planning of new facilities; difficulties of the Ministry to supervise effectively the finances of the companies to set tariffs and to allocate funds provided by the Plan Organization among companies all without the benefit of adequate sector data. In general, the management of the individual companies tend to rely heavily on the Ministry for technical, financial and administrative decisions, responsibilities for which the Ministry is not prepared.

10. While the solution to the organizational problems is not a pre-requisite for the viability of the project, the Bank could be of substantial assistance to the Government in the course of the execution of this project. It is proposed that we seek to reach agreement with the Government that in the course of the next year, the organization of the power sector be discussed with the Bank with the view to formulate a plan for appropriate institutional changes.

Recommendation

11. I concur in the recommendation in the Appraisal Report that the Bank make a loan of $60 million for this project - the period of repayment being 20 years including a grace period of 4 years. This would be subject to acceptance by the Iranian authorities of the recommendations in Chapter VI of the Appraisal Report.

12. However, prior to extending the formal invitation for negotiations, it is proposed that an Area/Project mission should visit Iran to discuss with the Minister of Water and Power, who will not participate in the negotiations in Washington, the details of the proposed project, particularly with a view to reaching agreement that consultants acceptable to the Bank be engaged for the planning and supervision of the project, and that the Government would be prepared in the course of the next year to reconsider the organization of the power sector and to discuss with the Bank possible reforms.

I.P.M. Cargill
Director

Attachment

Annex I "Iran - 5 Year Lending Program"

Population: 26.3 m
GNP Per Cap.: $280

IVa. IRAN - 5 YEAR LENDING PROGRAM

		($ millions)							
		Fiscal Year						Total	Total
		1970	1971	1972	1973	1974	1975	1964-68	1969-73
Fisheries	IBRD				30.0				
Agric. Development Fund	IBRD	6.5							
Agric. Development Fund II	IBRD		10.0						
Agric. Development Fund III	IBRD				20.0				
Irrigation	IBRD			40.0					
Agriculture Unidentified IV	IBRD					30.0			
Agriculture Unidentified V	IBRD						30.0		
Telecommunications	IBRD		35.0						
Telecommunications II	IBRD				25.0				
DFC - IMDBI VI	IBRD		50.0						
DFC - IMDBI VII	IBRD			50.0					
DFC - IMDBI VIII	IBRD					50.0			
Education I	IBRD		15.0						
Education II - Arya-Mehr Univ.	IBRD				20.0				
Education III	IBRD					20.0			
Education IV	IBRD						20.0		
Power Transmission	IBRD		60.0						
Power II	IBRD			30.0					
Power III	IBRD				45.0				
Power IV	IBRD						50.0		
Airport	IBRD				20.0				
Highways IV	IBRD	42.0							
Highways V	IBRD				30.0				
Port Equipment	IBRD			8.0					
Pipeline	IBRD			10.0					
Railways	IBRD			10.0					
Transp. Unidentified III	IBRD						30.0		
	IBRD	48.5	170.0	148.0	190.0	100.0	130.0	141.0	626.5
	No.	2	5	6	7	3	4	7	22

P & B 7/23/70

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

August 20, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Industrial Financing to Central America

The attached memorandum is distributed to the Loan Committee for information at the request of Mr. Edgar Gutierrez, Director of the Central America and Caribbean Department.

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
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President
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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: Messrs. J. Burke Knapp and William S. Gaud DATE: July 22, 1970

FROM: William Diamond

SUBJECT: Industrial Financing in Central America

The Problem

1. In the past several months the Bank Group has received formal and informal requests for assistance in financing (mainly) industry from several institutions in Central America. One request, from the inter-governmental Central American Bank for Economic Integration (CABEI), has been to the Bank itself; it has approached Mr. Gutierrez for technical assistance to strengthen CABEI's industrial financing operations with a view to enabling it to serve as an intermediary for World Bank lending for industry in Central America. Several requests have gone to IFC from private institutions: one already operating regional financial intermediary, which IFC has turned down because its outlook and policies are not, for the time being at least, congenial to IFC;1/ another regional investment bank still on the drawing boards;2/ and various development finance companies working within national boundaries.3/ One other institution has asked for a loan from either the Bank or IFC.4/ (Additional applications may be expected.) These requests are for subscriptions to share capital or for loans or for both, with the emphasis on loans; the amounts involved vary from $500,000 to $5 million.

2. The large number of approaches to IFC results from the fact that private institutions cannot expect to get a government guarantee for a Bank loan; at least some would not want a government guarantee if they could get it. Their desire is generally for loan capital; when they have asked for an IFC subscription to share capital, there is reason to believe the request has been motivated by the belief (based on IFC's previous, known policy) that IFC would not lend to a development finance company in which it did not have a share investment, and even then only in special circumstances.

3. The number, size and nature of financial requests from institutions in Central America suggest that we should work out a clear and consistent approach to development finance companies in Central America. That is, the Bank Group should look at Central America as a whole in considering a

1/ Central American Exchange Bank (CAEB).

2/ Inversiones y Valores, a project of T. Mooney and H. Wilkinson.

3/ COFISA of Costa Rica; CNI of Nicaragua; FICENTRO of Panama; FIASA of Guatemala.

4/ Banco Industrial of Guatemala.

reaction to individual Central American applications, whether national or regional. For financing individual national institutions will have an effect on the demand for finance from regional institutions and vice versa. Moreover, the administrative consequences of going into retail business in Latin America would be onerous, and a regional approach--the choice of an instrument--would greatly relieve the burden.

Some Background

4. The Bank Group once sought to establish a private Central American development finance company. Missions in 1959 and 1960 led to a proposal to the governments; but the proposal collapsed when, with the support of the U.S. Government, the inter-governmental CABEI was established in 1960. Since then, (a) relations with CABEI have been distant, (b) until recently there was reason to question the existence of a significant unrequited demand for finance for industrial investment, and (c) IFC has maintained a continuing interest in industrial and other productive private financing in Central America.

5. CABEI. Relations with CABEI were dominated by the Bank's conviction that CABEI had no reason to exist, by the politicking which reportedly dominated CABEI's deliberations and decision-making, and by the fact that AID and BID (as well as official and private institutions in Europe and Japan) were prepared to fund it. CABEI's requests for technical assistance and loans for infrastructure projects were turned aside by the Bank. The Bank's suggestions for joint financing were distrusted by CABEI apparently because it feared Bank dominance in the infrastructure field, because the Bank charged a higher interest rate, and because CABEI did not necessarily require a contribution from borrowing governments in financing "integration" infrastructure projects. Overhanging the matter was the "legal" question of the guarantee required by the Bank. On the other hand, CABEI has joined IFC in financing three specific projects: Fabritex in Nicaragua, Copino in Honduras, and Holiday Inn in Guatemala. There were also, at one time, discussions with CABEI staff about the possibility of establishing a Central American Investment Bank.

6. Attached are some salient facts about CABEI.

7. Demand for finance for industry. In the mid-60's, the Bank made a general survey of the economic development and prospects of Central America, including a survey of the industrial sector. The report, issued in June 1967, concluded that the demand for investment capital had been small in relation to the growth in output, implied that the flow of private and public capital for industrial expansion was adequate, and suggested that working capital had become a critical shortage. These general conclusions are reflected in the non-activity of the Bank in the industrial sector since 1961. (From 1956 to 1961, the Bank made four loans to the Central Bank of Costa Rica

for relending through the three government-owned commercial banks.) Country programs for Central American countries have contained no proposals for industry (and only slight amounts for tourism), attributing the fact (in general terms) to the small size of the market, low per capita income and its unequal distribution.

8. Development finance companies, and IFC. Despite the creation of CABEI, we continued to explore the prospects for a private regional development finance company. In 1964, 1965, 1969 and 1970, representatives of IFC toured Central America to test the temperature for a private regional institution. Until recently, the reactions were usually negative, for several reasons. Firstly, national feelings were strong, and the preference was for national institutions. U.S. AID provided concessional financing to such national institutions. As a result at least one private financiera (and in some cases more than one) was set up in each Central American country during the years 1963-68. Secondly, the demand for finance for industrial investment in Central America appeared to be limited in relation to the available resources.

9. We maintained a close relationship with the private financieras, played an important advisory role in the establishment of one (Corporacion Nicaraguense de Inversiones--CNI) and have kept up a correspondence with all and have visited them on occasion. In the case of CNI, we were preparing a recommendation to the Board for an investment in share capital (in 1963), when the proposal was dropped. IFC has had one joint venture with CNI, and other joint ventures are under discussion.

Present Situation

10. There is some reason to believe the situation in Central America may be changing, with respect to the demand for long-term capital for industry. One relevant fact is that, one after another, new institutions have appeared in the individual countries and now new regional institutions have begun to appear. Another fact is the recent in-flow of applications to IFC, which cannot be entirely a response to Mr. Arango's swing around Central America in March; to the contrary, he found evidence of increasing demand for untied capital (a significant part of the demand no doubt being for working capital).5/ Moreover, the increasing integration of the Central American market (thanks in part to the Bank's work over the years in financing infrastructure) and the slowdown in AID financing to individual private institutions, may have induced an increased demand for capital. A proposed new $30 million AID loan6/ to CABEI for industry and tourism, may also be evidence of such an increase, although one result of this AID proposal and continued BID and other financing activity may well be to preclude Bank action. And, CABEI

5/ The continued availability of AID funds to some of the companies that have applied suggests either that they have hope of obtaining funds from IFC for working capital or that they are visualizing future shortages.

6/ Arrangements are under discussion for $5 million of the loan to be made available through private finance institutions.

has now asked the Bank for technical assistance, with a view to putting itself in shape for Bank lending. Third, there is an increasing need to promote export-oriented industry, rather than industry which relies on national, and the regional markets.

11. The other side of the coin is that, in the past 18 months, the Central American Common Market has fallen on bad times. Since the "soccer war" of mid-1969, the "market" has broken down and this fact has already affected, and may continue in the short run, to affect industrial investment prospects. As a result, practically all Common Market policies, especially industrial policies and legislation, are being re-examined and are likely to undergo significant changes in order to strengthen the process of integration and to provide a better distribution of the benefits of integration. This is, therefore, an auspicious moment for inquiring into the industrial situation and prospects of Central America.

12. In the circumstances, the Bank Group needs to review its position on industrial financing in Central America, and its priorities. Mr. Gutierrez has proposed that we do so. Such a review would involve:

a. A re-examination of the condition and prospects of industry. The conclusions of the Bank survey of 1966-67 are now probably out of date.

b. A reconsideration of the demand and supply for long-term capital.

c. A review of CABEI's performance, and of that of the individual national companies.

d. A review of the prospects for a regional stock exchange and of other regional mechanisms for mobilizing private savings. (The 1966 Bank mission urged that this line be pursued; various proposals have emerged from the region since then, but with no results; Mr. Arango reports the time is now ripe to explore this subject.)

A Bank mission, with IFC participation, to consider these activities would determine whether there is a basis for Bank finance in the industrial field and, if so, how it should proceed.

<u>A Proposal</u>

13. Although a strategy for industrial financing in Central America should emerge from the foregoing survey, I suggest the following as a working hypothesis:

a. For small and medium enterprises, the Bank Group should work through financial intermediaries rather than directly.

b. Where share capital is requested by private intermediaries, whether national or regional, IFC should provide it on a case-to-case basis.

c. The Bank should provide loan funds, and an effort should be made to provide them through a regional wholesaler. For that role, only two alternatives seem possible: CABEI, or a new regional institution created by the national (private or public, or both) financial intermediaries; but the latter does not seem to be a realistic proposition at this time. Bank funds could be made available to the wholesaler in various ways, such as:

i. A loan, to be relent to industrial enterprises directly or through financial intermediaries or both. While some of the terms appropriate to development finance companies would be applicable, other terms would have to be devised to reflect the inter-governmental character of CABEI, and the fact that it is heavily engaged in financing infrastructure.

ii. A loan to finance industrial loans made by national financial institutions. The loan could be used to finance projects (which meet pre-agreed eligibility tests) presented to it by the national companies (which meet eligibility tests).

Only if such a regional framework were not possible should loan financing of individual national companies be considered. That would probably have to be done by IFC, where private companies are the borrowers.

14. This proposal raises several problems:

a. Each of the methods of wholesaling raises legal questions, but Counsel advises they can be dealt with.

b. It is reported that the private financieras will not wish to borrow from CABEI. If being unable to get government guarantees, that is their only route to loan capital from the Bank Group they may change their minds.

c. A loan through CABEI should not be allowed to arrest the growth of sound national institutions. Hence my preference, in principle, for relending arrangements whereby CABEI will not lend to an industrial enterprise directly unless it exceeds an agreed size and even then always in conjunction with national institutions.

d. The mission recommended above will take time. It should not be allowed to become a general survey, but should focus on the essentials needed to make a quick judgment on the key issues.

e. CABEI may not merit a Bank loan; it almost certainly does not, at this time. Time and effort will likely be needed to put it in shape. If Area is satisfied that the results of the industrial mission are likely to be positive, and that there will be a financial role for the Bank, we should proceed with technical assistance to CABEI as rapidly as it can be mounted.

f. Meanwhile, how should IFC react to the proposals before it? I believe it should (i) invest in share capital of private national finance companies where that is justified and (ii) lend only where a substantial amount is involved (e.g. $5 million to CNI). Meanwhile, it should investigate (in collaboration with the Bank mission proposed above) the proposal for the promotion of a Central American securities market. Indeed the development of such a securities market might in the long run prove more important to Central American industry that direct Bank lending to industry.

g. Panama is not a member of CABEI, and cannot be reached through it. Individual arrangements would be needed there.

cc: Messrs: Paterson
Gutierrez
Fuchs
Cancio
Gulhati
Mirski
Acevedo
Arango

Attachment

WDiamond:jmb

July 20, 1970

CENTRAL AMERICAN BANK FOR ECONOMIC INTEGRATION

Origin

1. CABEI is an autonomous regional public development institution created in December 1960 by the Governments of Guatemala, El Salvador, Honduras and Nicaragua. Subsequently, in July 1962, the government of Costa Rica became a member.

Purpose

2. CABEI was established with the purpose of promoting economic integration among, and balanced economic development of, its member countries. To this end, CABEI undertakes and promotes investment in public infrastructure projects and in private industries that are regional in nature or of interest to the market, and which help to expand the supply of goods available for intra-regional trade, or for trade between Central America and the rest of the world. CABEI's scope of operations has been broadened to include the financing of medium-income housing and, more recently, non-traditional export industries and tourism development.

Organization

3. CABEI is organized as follows:

(a) Board of Governors

The highest authority of CABEI rests with its Board of Governors which consists of two representatives from each of the five member countries - one the Minister of Economic Affairs, and the other the President or Manager of the Central Bank. The Board of Governors ordinarily meets once a year. Since the "soccer war", the Board of Governors has not met in formal sessions. This appears to have been a deliverate move to avoid appointing to the Board of Directors the newly nominated Nicaraguan Director, General Bushting, who was nominated and irregularly appointed to the Board by decree of President Somoza.

(b) Board of Directors

The Board of Directors is the top executive and administrative body of CABEI. It consists of one director from each member country who is elected by the Board of Governors. The Directors are appointed for a term of three years, and may be re-elected for successive terms. The Board's members 1/ work full-time at the Bank's headquarters in Tegucigalpa (Honduras). The Board reviews and approves all loans to be made by CABEI and participates in key management decisions. As a result of the "soccer war", the members of the Board have had difficulties to meet. The Director from El Salvador cannot easily travel to Honduras. The Nicaraguan Director and CABEI's Vice-President of the Board has been appointed president of INFONAC in Nicaragua, a post that, according to the Nicaraguan law, is incompatible with a representation in CABEI's Board of Directors.

1/ Enrique Ortez Colindres (Honduras), Jorge Armijo Mejía (Nicaragua), Jorge Sol Castellanos (El Salvador), Raul Sierra Franco (Guatemala), Carlos Manuel Escalante (Costa Rica).

(c) President

The Board of Governors elects one Director to serve as President. Since May 1968, the President is Dr. Enrique Ortez Colindres (38), a Honduran lawyer who previously served as CABEI's Vice-President and Honduran Director, and Alternate Governor to the World Bank.

(d) Vice-President of the Board

The Vice-President is elected by the Board of Directors, of which he must be a member. He is the President's alternate. This position is held by Dr. Jorge Armijo Mejia (45), Nicaraguan Director. Previously to this appointment he was Nicaraguan Vice-Minister of Economic Integration. He is also President of INFONAC, Nicaragua's public development bank.

(e) Executive Vice-President

The Executive Vice-President, nominated by the President and appointed by the Board of Directors, is Rodolfo Silva Vargas (37), an engineer and formerly head of the Costa Rican Planning Board.

(f) Departments and Offices

CABEI is divided into six departments and five offices as shown below:

Departments:	Offices:
Infrastructure	Treasury
Industrial (incl. tourism)	Accounting
Agricultural	Legal
Operations (loan processing and supervision)	Internal Audit
Economic Research and Development	Secretariat
Housing	

Financial Resources

4. There are three distinct "funds", each with its own balance sheet and profit and loss statement. The total of the three "funds" is, in effect, CABEI's consolidated financial statement as shown in paragraphs 12 and 13.

5. At the end of March 1970, CABEI's authorized capital was US$60 million, of which US$40 million was subscribed. Paid-in capital was US$22.5 million and CABEI had an additional US$10 million in the form of promissory notes from the member countries payable in four equal annual installments of US$0.5 million by each of the member countries on April 9, 1970, 1971, 1972 and 1973. In addition to share capital, CABEI showed reserves and retained earnings totalling US$4.4 million, and grants totalling US$2.2 million, obtained mainly from AID.

6. As of December 31, 1969, CABEI reports total loans of US$214.9 million, on which US$112.5 million had been obtained from AID, US$42.2 million from IDB and US$60.2 million from a number of private commercial banks and public institutions from Europe, Mexico and Japan. On March 31, 1970, only a total

of US$66.4 million was outstanding. The bulk of AID loans (US$85 million) have been allocated to a special fund (CAFEI) for the financing of regional infrastructure at interest rates ranging from 1% to 2.5% and repayment in 40 years, including 10 years of grace. IDB loans to this fund amount to US$15 million with interest rates of 3.25% and repayment in 30 years. Loans for the financing of industrial projects and preinvestment studies were allocated to CABEI's "ordinary fund", with slightly higher interest rates - 4% in the case of IDB loans - and shorter maturity - 20 years. AID has also granted a US$10 million loan for the "Home Loan Fund", to help finance medium-income housing. A breakdown of loans from IDB and AID follows (in US$ million):

	AID	IDB	Total
CAFEI	85.0	15.0	100.0
Ordinary Fund	17.5	27.2	44.7
Home Loan Fund	10.0	-	10.0
Total	112.5	42.2	154.7

At present AID is considering extending an additional US$30 million loan to CABEI for the financing of non-traditional export industries and tourism projects, with an interest rate of 2% during the grace period (10 years) and 3% during the 30-year repayment period. A special feature of the proposed loan is that CABEI can extend sub-loans for a total of US$5 million to financial intermediaries in accordance with policy guidelines established for this purpose by CABEI's Board of Directors. (see Annex I). In these relending operations, CABEI would have a 2% spread.

7. Loans from commercial banks have normally been arranged for financing import requirements of CABEI's projects, and are tied to procurement from the lender country. While maturities normally range between 7 and 10 years, in one case the term of the loan was 18 years. Interest rates have normally been fixed at around 6%. In only two or three cases a provision has been made for floating interest rates. A breakdown of these loans follows (million of US$):

Spain 2/	11.0	Belgium 1/	5.0
France 1/	9.0	Switzerland 1/	4.6
Italy 1/	8.0	Union Bank of Switzerland	1.7
U.K. (Bank of London and South America)	7.2	Netherland Inv. Bank	1.3
Japan (Exim. Bank)	6.4		
Banco de México S.A. 2/	6.0	Total	60.2

Policies and Procedures

8. CABEI has thus far engaged in the financing of projects only through loans. Although its charter does not prohibit CABEI from taking equity participations, we do not know of cases in which this has been done. Projects must enhance regional economic integration of the Common Market and/or the balanced develo ment of the area, as well as being technically and economically sound. The fulfillme of these objectives has been questioned by a special committee created by the

1/ consortium of banks
2/ public institutions

IDB in 1967. Pressures created by intergovernmental politicking appear to have been important in the regional distribution of projects, especially with respect to infrastructure projects. CABEI considers a project as having regional integration characteristics if it has a market in more than two countries of the area, or if its development will benefit more than two countries. The Central American Common Market authority has granted to Honduras a privileged status of preferential treatment. Among other advantages, this ensures Honduras's projects a more readily available financing through CABEI. The Directors, in undertaking to accelerate its investment program, have established basic criteria in several fields (see Annex II).

9. CABEI, as a matter of policy, does not grant loans for less than US$50,000, except to defray the cost of feasibility studies. In its direct industrial lending operations, CABEI finances up to 60% of the total cost of projects in the private sector at the following interest rates and maturities:

	Interest rates		Maturity	
	Industries	Hotels	Industries	Hotels
Feasibility studies	7-8%	7-8%	7 years	3 years
Fixed assets	7-8%	8-9%	10/12 years	7/10 years
Working capital	9%	9%	3 years	3 years

Loans for infrastructure projects and for projects in the public sector in general, often cover the total capital budget of the project, and normally carry an interest rate of 5 1/4% to 6%.

Operations

10. CABEI's lending operations are carried out through the following three funds:

(a) Ordinary Fund. Used mainly for financing of private industrial projects. From inception to December 31, 1969, CABEI had approved 123 loans totalling US$59.6 million and had approved another 18 loans for US$1.2 million for industrial feasibility studies. CABEI has not experienced important delays in disbursing the proceeds of these loans. Disbursements during the same period amounted to US$47.3 million, or about 78% of approvals.

(b) Integration Fund (CAFEI). It was created in April 1965, following a proposal made in 1963 by the late President Kennedy on the occasion of his visit to Central America. CAFEI is administered by CABEI under a trust agreement with the five C.A. governments. The Fund is composed of direct allocations of funds by member governments and of foreign loans (AID and IDB). CAFEI loans can be made only to governments and are primarily for the purpose of financing regional infrastructure projects. Each loan normally provides 100% project financing. During the early years of CAFEI's operations, its use was subject to considerable delays reportedly due to a lack of engineering staff in CABEI and to the lack of familiarity of member governments with contracting procedures asked by AID for the employment of private contractors. The procedure for use of CAFEI is complex. A sub-loan for an infrastructure project is approved by CABEI's Board of Directors in accordance with a Central American infrastructure development program. A loan contract is then negotiated with the recipient C.A. Government. The average length of time from CABEI's approval to initiation of construction is now 18 months. Mainly through CAFEI, but also using the ordinary fund (up to US$23.6 million), CABEI has approved until Dec.

31, 1969, 46 loans totalling US$116.5 million to infrastructure projects, and 25 loans totalling US$6.7 million for feasibility studies. Total disbursements since inception amount to US$27.6 million, or 22% of total approvals net of cancellations.

(c) Home Loan Department. It was created in 1963 when an AID loan for US$10 million was signed with CABEI for the financing of housing schemes. As of Dec. 31, 1969, 93% was disbursed. CABEI is now making use of roll-overs from this loan in secondary housing mortgage financing. On March, 1970, CABEI, AID and the Federal Home Loan Banks executed a contract of guarantee and loan agreements for US$10 million loan under the AID Housing Investment Guarantee Program to enable CABEI to become more active in secondary mortgage lending.

11. A summary of CABEI's lending operations during the last years follows: (million of US$)

	FY ending June 30					
	1961-1966	1967	1968	1969	1970 1/	1961 to Dec.31, 1969
Approvals	78.1	15.1	28.5	36.9	34.7	193.3
Disbursements	22.8	16.7	14.4	21.1	9.2	84.2
Outstanding at the end of period	24.8	39.5	49.9	63.3	69.5	69.5

Honduras has taken the largest share of approvals with 24% and Guatemala the smallest with 17%.

Financial Position and Results

12. The following table summarizes CABEI's consolidated balance sheets from June 30, 1966 to March 31, 1970: (million of US$)

	June 30 1966	June 30 1967	June 30 1968	June 30 1969	March 31 1970
	Amount	Amount	Amount	Amount	Amount
ASSETS					
Cash and Banks	2.7	5.0	3.8	1.1	1.8
Time deposits & temp. investments 2/	11.2	11.0	13.6	18.8	17.5
Loan portfolio 3/	24.8	39.5	49.9	63.3	73.7
Accrued interest & commissions on loans outstanding	0.8	1.4	1.6	1.7	2.3
Other assets	1.4	1.3	1.0	11.7 4/	11.3 5/
Total	40.9	58.2	69.6	96.6	106.6

1/ July 1 - December 31, 1969
2/ Represent time deposits in local currencies made in local public development banks, with local currency contributions of member countries.
3/ Of which an unspecified portion corresponds to working capital financing.
4/ Of which 10.5 subs. capital receivable.
5/ Of which 10.0 subs. capital receivable.

	June 30 1966 Amount	June 30 1967 Amount	June 30 1968 Amount	June 30 1969 Amount	March 31 1970 Amount
LIABILITIES					
Borrowing:					
Short-term	0.4	0.9	0.3	-	-
Long-term	21.0	34.0	45.5	58.5	66.4
Other liabilities	1.9	0.6	0.7	0.7	1.1
Share Capital	17.0	20.0	20.0	32.5	32.5
Grants	0.5	2.2	2.2	2.2	2.2
Surplus	0.1	0.5	1.2	2.7	4.4
Total	40.9	58.2	69.9	96.6	106.6
Total debt/equity	1.3:1	1.6:1	2.0:1	1.6:1	1.7:1

14. CABEI's consolidated profit and loss statements for FY 1966 to FY 1969 are summarized below (million of US$):

	FY 1966	FY 1967	FY 1968	FY 1969
Interest & Commissions from loans	1.4	2.4	3.2	4.0
Other income	0.5	0.6	0.7	1.0
Total income	1.9	3.0	3.9	5.0
Financial cost	0.5	0.9	1.4	1.8
Administrative expenses	1.1	1.5	1.7	1.7
Total expenses	1.6	2.4	3.1	3.5
Operating income (loss)	0.3	0.6	0.8	1.5
Operating income as % of average total assets	0.9	1.2	1.2	1.8
Operating income as % of average net worth	2.0	3.0	3.5	4.9
Operating income as % of year-end share capital	1.8	3.0	4.0	4.6
Financial cost as % of average total borrowing	3.1	3.2	3.5	3.4
Interest & commissions from loans as % of average loan portfolio	7.0	7.5	7.2	7.1
Administrative cost as % of average total assets	3.4	3.0	2.7	2.0

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LC/M/70-7

August 17, 1970

Minutes of Loan Committee Meeting held at 4:00 p.m. on Wednesday, August 5, 1970 in the Board Room.

A. Present:

Mr. J. Burke Knapp, Chairman
Mr. S.R. Cope
Mr. W.C. Baum
Mr. I.P.M. Cargill
Mr. R. Chaufournier
Mr. R.J. Goodman
Mr. E. Gutierrez
Mr. M.L. Lejeune
Mr. C.H. Thompson
Mr. G.K. Wiese
Mr. R.H. Demuth
Mr. A.M. Kamarck
Mr. F.R. Poore
Mr. P. Sella
Mr. D. Pearce, Secretary

In Attendance:

Mr. F. Abbate
Mr. L. Cancio
Mr. W. Diamond
Mr. S.S. Kapur
Mr. W.M. Keltie
Sir Gordon Mackay
Miss A.L. Maher
Mr. P.O. Malone
Mr. A. van Dijck
Mr. H. van Helden
Mr. H.M. Sapir
Mr. C.M. Southall

B. Peru - Proposed Road Reconstruction Loan

1. The Committee considered a memorandum dated August 3, 1970 from the South America Department entitled "Peru - Proposed Road Reconstruction Loan" (LC/O/70-83) and the accompanying Transportation Projects Department report dated July 30, 1970 (PTR-59), which recommended that the Peruvian Government be invited to send representatives to negotiate a $30 million loan to assist in the reconstruction of roads affected by the May 31, 1970 earthquake.

- 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)

2. The Chairman, introducing the discussion, said that, in considering how to respond to Peru's request for a $150 million loan and in view of the extraordinary circumstances, the question of IDA assistance had been reviewed. In this connection, the constraints upon IDA resources through FY 1971 and the fact that Peru was not "IDA-worthy" on income per capita grounds had been relevant, but not decisive considerations. The decision against resorting to IDA in this case had been based finally on the principle that IDA was not a disaster-relief organization and should not be given that image. However, in view of the essentially humanitarian nature of this operation and Peru's limited creditworthiness, at least in the short-term, exceptionally favorable terms were appropriate for the proposed $30 million loan.

3. In response to the Chairman's request for comments and questions, the Committee noted that:

(a) While the absence of progress on the IPC issue was not considered a bar to the proposed Bank loan in these exceptional circumstances, the Bank had not determined its position on this question. Accordingly, no further lending to Peru was contemplated pending a satisfactory Bank finding on the IPC issue.

(b) Creditworthiness was a separate although related problem. Resolution of the IPC issue would not by itself decisively affect foreign investors' attitudes towards Peru, which were based mainly on other factors, primarily the Government's general policy towards foreign investment. Peru's future creditworthiness depended in large measure on the extent to which new mining investments by foreign companies went forward.

(c) In view of Peru's need and the nature of its reconstruction program, which necessitated quick action, the loan was proposed exceptionally as a "line of credit." While this technique would not in fact result in more rapid execution of the project than under the Bank's conventional loan procedures, an early commitment of funds was an appropriate gesture in the circumstances.

4. The Committee approved the South America Department's recommendation that negotiators be invited for the proposed loan.

Secretary's Department
August 17, 1970

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

DECLASSIFIED

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WBG ARCHIVES

August 14, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Israel - Agricultural Credit Project

1. The Committee is requested to consider, without meeting, the attached memorandum of August 14, 1970 from the Europe, Middle East and North Africa Department, entitled "Israel - Proposed First Agricultural Credit Project" (LC/O/70-93).

3. Comments, if any, should be sent to reach Mr. Koelle (ext. 4804) by 1:00 p.m. on Wednesday, August 19.

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

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, 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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Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/O/70-93

August 14, 1970

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa Department

ISRAEL - Proposed First Agricultural Credit Project

1. Attached is the Appraisal Report No. PA-55 dated June 24, 1970. It recommends a loan of $20 million to the Israel Bank of Agriculture (IBA) for an agricultural credit project.

The Bank's Lending Policy towards Israel

2. The Bank has made six loans to Israel totalling $134.5 million. The last three loans were made to the Industrial Development Bank of Israel (IDBI) consisting of $20 million in September 1965, $15 million in September 1967, and $25 million in June 1970. In 1966 the Israeli Government adopted a policy of reduced reliance on foreign capital which led the Bank in 1967 to discontinue lending to Israel. However, deflationary policies conducted in this context resulted in large-scale unemployment, and in mid-1967 the Government reverted to a policy of rapid growth financed heavily from abroad. In 1968 the GNP grew by 14 percent, creating a large import surplus which has since continued.

3. On the basis of the findings of the economic mission which visited the country in 1968, the Economic Committee concluded in March 1969 that the Bank should be prepared to resume lending to Israel but that continuation of Bank lending would depend on the adequacy of the country's economic performance in the areas of:

i) internal financial stability;

ii) improving competitiveness and growth of exports;

iii) pursuing the import liberalization program;

iv) adequacy of the public investment effort.

4. An updating economic memorandum was distributed in March 1970 which concluded that performance on these issues was relatively satisfactory. In June 1970 an economic mission visited Israel and its report is under preparation. The preliminary conclusion of the mission is that the major problems identified by the 1968 mission remain important but that the Government has undertaken a number of measures in recent months to correct

these and that overall performance is satisfactory. Among the measures adopted, a wage-price "package" which was concluded between the Government, the employers and the labor unions and put into effect in May, is designed to restrain the growth of consumption while selective incentives have been provided to stimulate the growth of exports.

5. We are preparing a Second Highway Loan for late FY 1971 or for early FY 1972. For FY 1973 Bank loans for education and tourism projects are scheduled (see attached lending program).

The Project

6. Although the contribution of agriculture to overall production in Israel is relatively small - in 1968 only 7 percent of GNP came from the sector and it employed but 12 percent of the labor force - agriculture's importance for exports is quite large. In 1968, agriculture contributed 17 percent to Israel's commodity exports and 28 percent of the value added of commodity exports. Since 1960, when production caught up with local demand, the strategy within the agricultural sector has been to shift resources into exports. For the last ten years citrus has been the main item but the limited growth potential of this market has encouraged the seeking of other exportable products. The current policy is to select those items with high growth potential in the world markets, which also offer Israel a comparative advantage due to her unique combination of climate and skills in production and marketing. Within the spectrum of possibilities, those commodities with the greatest value added to the economy are selected for promotion. The credit program to which the proposed loan would contribute will be a key element in further pursuing this policy.

7. Three banks are presently engaged in agricultural credit: The Israel Bank of Agriculture Ltd. (IBA) (90 percent Government owned), Yaad Agricultural Development Bank Ltd. (YAAD) (50 percent Government owned), and NIR Ltd. (privately owned). The loan would be channeled through them (cf. paragraphs 12 and 13). All three are well managed and have considerable experience in agricultural credit. The three banks' resources originate from their own funds (share capital, deposits, and issue of debentures) and from interest-bearing deposits provided from the Government Development Budget. The banks provide medium- and long-term loans to agriculture in close cooperation with the Government's development plan. Credit control is very efficient. A borrower - most often a cooperative village but sometimes a private farmer - can do business with only one of the three banks. The marketing organization pays the proceeds of the borrower's crop directly to his bank, which recovers its loan before making payment to the borrower. This tight system of credit control has given an excellent repayment record to the banks. The amount of arrears is less than 0.1 percent of outstanding loans on the average.

8. The project, which would form a part of Israel's Five-Year Development Plan, has three main objectives: (i) export crop development (citrus, off-season flowers and vegetables, avocadoes and mangoes); (ii) increasing the capacity of export handling facilities; and (iii) development of water resources. Physical investment will be in greenhouses, planting material,

packing and handling plants, new or improved on-farm irrigation equipment, and small reservoirs and drainage works. Total estimated cost is equivalent to $49 million. Twenty percent of the cost would be borne by the investing farmer himself. The participating banks and the Government would contribute 20 percent each. The balance (40 percent) is the estimated foreign exchange component and would be covered by the Bank loan of $20 million.

9. At full development, which would be reached in the ninth year, annual export earnings would reach about $17 million, and import substitution would bring one additional million annually. The economic rate of return on the total project investment would be about 18 percent.

10. The appraisal report shows that Israel possesses the necessary organization to produce valuable and highly perishable agricultural goods (flowers, fruits, vegetables) in the off-season and ship them to the competitive markets of Western Europe. The Citrus Marketing Board for oranges, grapefruit, and tangerines, and the Agricultural Export Company (AGREXCO) for other perishable produce are responsible for Israel's marketing effort. They handle the export shipments, exert strict quality control and provide continuous information feedback for the producer from the Western European market. European consumption of off-season flowers, vegetables and fruit has increased rapidly in conjunction with quickly rising incomes. Though further substantial increases in consumption appear likely, the market for these products is highly competitive. However, the existence of an effective and aggressive marketing network as well as the imposition of strict quality controls should give Israel a decided advantage in selling the additional production.

11. International competitive bidding would be practicable only for the export handling facilities to be built by AGREXCO (approximately $2 million) because they are the only larger self-contained schemes. All other items financed under the project comprise a large range of goods and would not be suitable for bulk procurement. The supply of these goods in Israel is adequate, international suppliers are well represented, and prices competitive both for imported and domestic items. As usual in loans of this type, it is proposed to procure the latter items through normal commercial channels for most of the project.

12. In the choice of the borrower three alternatives were discussed and reviewed:

i) to make separate loans to each of the three agricultural banks;

ii) to lend to the Government which would re-lend to the three banks on a first come first served basis;

iii) to make the loan to the biggest of the three banks, IBA, which would administer a Loan Fund under the direction of a Project Coordinating Committee and lend on to the two smaller banks under subsidiary loan agreements.

13. After considering the alternatives, I agree that the proposal in the Appraisal Report to make IBA the borrower is the most expedient one. Separate loans to each of the three agricultural banks, which will be responsible for the project, would require that the amounts to be lent to each bank would have to be fixed at the outset, and it would be impossible to determine in advance the proportion of sub-projects which sub-borrowers would submit to each bank for financing. The second alternative, to lend to the Government, which would re-lend to the three banks, was discarded because it would make our relationship with the entities carrying out the project too indirect. The third alternative has the advantage of establishing a direct contact with the experienced organization which would be the major banking entity in the project. The three banks, as well as the Israeli authorities prefer this latter solution.

14. Since the Appraisal Report was written the Bank raised its lending rate to 7 1/4 percent. The project provided for a spread of two percentage points for the participating banks between our former lending rate of 7 percent and the going rate of 9 percent for long-term agricultural loans in Israel. The higher rate for the Bank loan would either narrow the spread to 1 3/4 percentage points or necessitate a raise of the Israeli rate to 9 1/4 percent. The Israelis are discussing the alternatives at this time. The Ministry for Agriculture believes that the banks could easily absorb the shrinkage of their spread. The Agriculture Projects Department feels that a minimum spread of 2 percent should be retained and the rate to the ultimate borrowers consequently increased. I have an open mind on the subject until I hear the views of the banks concerned during negotiations.

Recommendation

15. The project is financially and economically feasible. The three agricultural banks are capable of handling the loan effectively. The proposed $20 million loan would be made on the terms and conditions applicable to recent Bank loans for agricultural credit projects. I propose that the Bank enter into negotiations along the lines of the recommendations in para. 8.01 of the attached Appraisal Report. If the Committee agrees, I propose to issue an invitation for negotiations as soon as possible.

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

Attachment

Population: 2.7 m.
GNP Per Cap: $1200

ISRAEL - 5 YEAR LENDING PROGRAM

		($ millions)							
		Fiscal Year						Total	Total
		1970	1971	1972	1973	1974	1975	1964-68	1969-73
Agricultural Credit I	IBRD		20.0						
Agricultural Credit II	IBRD						30.0		
DFC - IDBI III	IBRD	25.0							
DFC - IDBI IV	IBRD					30.0			
Education	IBRD				15.0				
Tourism	IBRD				10.0				
Highways II	IBRD		30.0						
IBRD		25.0	50.0	0.0	25.0	30.0	30.0	35.0	100.0
No.		1	2	0	2	1	1	2	5