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Loan Committee - 1971 - Volume 8

Loan Committee

LOAN COMMITTEE

1971



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Loan Committee - 1971 - Volume 8

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LOAN COMMITTEE

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April 22, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Israel - Second Highway Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated April 22, 1971 from the Europe, Middle East and North Africa Department, entitled "Israel - Proposed \$30 million loan for a Second Highway Construction Project" (LC/0/71-63).
2. Comments, if any, should be sent to reach Mr. McCall (ext. 4806) by 4:00 p.m. on Monday, April 26.
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)

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LC/0/71-63

April 22, 1971

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa Department

Israel - Proposed \$30 million Loan for a second
Highway Construction Project

1. Attached for consideration by the Loan Committee is the Appraisal Report (PTR-74) dated March 11, 1971, on the second highway construction project.
2. The Bank to date has made seven loans to Israel totalling \$154.5 million. The last loan, approved in October, 1970 provided \$20 million in support of an agricultural credit program designed to increase the production and export of high value crops. No loans are planned for FY 1972. The attached lending program provides for five loans over the period 1971-1975, totalling \$135 million.
3. The last Economic Report (EMA-7b) was distributed on July 22, 1969, and an up-dating memorandum (EMA-28a) was distributed on September 15, 1970. While the memorandum affirms Israel's continuing credit-worthiness, it does stress the close correlation between Israel's current and projected high rate of growth of GNP and high levels of imports, swelled even further by imports of defense equipment and supplies. These high imports exert continuing pressure toward a deficit on current account; as counters to this pressure, programs to expand exports are therefore particularly important.
4. Effective transportation services, particularly roads for getting export products to the air and sea ports are essential to export growth. Additional highway capacity is required, especially in the area around Tel Aviv, to handle growing transport demands. As the economy moves, as is planned, into producing more perishable agricultural and higher value industrial goods for export, delays will become increasingly costly and untenable. As one example, roses are picked, packed, and shipped four times a day to the markets in Europe where they are sold the following morning. Similar situations exist for other perishable products. To serve this kind of market requires an absolutely reliable transportation system. The proposed project will contribute to expediting transport in the major trans-shipment

and transport area that includes the Tel Aviv Airport and the ports of Haifa and Ashod. The Bank loans made to the Industrial Development Bank of Israel and for agricultural credit are assisting Israel in expanding production for export. By improving internal transportation, the proposed loan provides an important complement to these earlier loans. In addition, the number of vehicles on the road has roughly doubled over the last six years, creating heavier travel and consequent demand for improved highways.

5. The proposed loan is the second for highways in Israel. The first, (\$22 million in 1962) for construction of main and district roads and a transport survey, was satisfactorily completed in 1966. This second project will provide for construction of the first phase of the Ayalon Expressway in Tel Aviv, and other expressways, roads and interchanges included in the Government's 1971-1975 highway program.

Project Issues

Relation to occupied territories and military operations.

6. As the Appraisal report notes, none of the roads in the project is located in the occupied territories. Military traffic constitutes a small fraction of total traffic on the project roads and the feasibility of the project would not be significantly affected by its presence or absence. Thus the justification of the highway construction planned under this project rests on sound economic grounds.

Bidding Procedures

7. At the time of the Bank's first highway loan to Israel in 1962, no foreign contractors tendered, and local contracting firms were insufficiently developed to undertake large highway construction contracts. Consequently no satisfactory bids were received, and the Bank agreed to force account work with sub-contracting to local contractors. For the proposed loan, international competitive bidding will be followed. The Government has already, with Bank agreement, invited proposals from interested contractors to prequalify for the construction of the proposed project. Six foreign firms and eight local firms were subsequently qualified, indicating a satisfactory interest by contractors who are ready to participate in the civil works under the project.

Amount of Loan

8. The proposed loan of \$30 million would cover the foreign exchange cost of consulting services, c.i.f. cost of testing and laboratory equipment for the project, and about 75 percent of the estimated foreign exchange component of construction work.

If construction costs turn out to be less than estimated, the disbursement percentage (presently proposed at 30 percent) should be increased up to a maximum of 42 percent, which is the estimated foreign exchange component of construction under the project. The Appraisal Report proposes a loan term of 25 years including a four year grace period. The Bank has recently reduced loan terms for more developed borrowers, however, and in accordance with this policy I believe the term for this loan should be reduced to 20 years, including a four year grace period.

Issues for the Negotiations

9. During loan negotiations, along with the covenants usual with highway construction projects (see paragraphs 6.01 and 6.02 of the Appraisal Report) assurances should be obtained from the Government that:

- (a) the program of street improvements in Tel Aviv will be carried out in accordance with a timetable agreed upon with the Bank;
- (b) the proposed Regional Transportation Unit for Tel Aviv will not modify the organization and staffing of the Netivey Ayalon Ltd. for coordinating and administering the Ayalon project without prior agreement from the Bank; and
- (c) the weight control regulations will be reviewed and, if necessary, amended in the light of the results of the load limitation study.

We do not anticipate any major disagreements on these assurances with the Government, which has already been apprised that they will be sought by the Bank.

Recommendation

10. I recommend that the Bank ask the Government of Israel to send representatives to negotiate a loan of \$30 million for a second highway project on the lines indicated in Section VI of the Appraisal Report, but with a term of 20 rather than 25 years.

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

Attachment.

Population: 2.7 m
 GNP Per Cap: \$1200

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

OPERATIONS PROGRAM

			<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
4-ISR-AC-01	Agricultural Credit	IBRD	20.0					
4-ISR-AC-02	Agricultural Credit II	IBRD				25.0		
4-ISR-DD-04	DFC - IDBI IV	IBRD			30.0			
4-ISR-DD-05	DFC - IDBI V	IBRD					30.0	
4-ISR-TH-02	Roads II	IBRD	30.0					

	<u>Total</u>		
	<u>1964-68</u>	<u>1969-73</u>	<u>1972-76</u>
IBRD	<u>35.0</u>	<u>105.0</u>	<u>85.0</u>
No.	<u>2</u>	<u>4</u>	<u>3</u>

IBRD	<u>50.0</u>	<u>30.0</u>	<u>25.0</u>	<u>30.0</u>
No.	<u>2</u>	<u>1</u>	<u>1</u>	<u>1</u>

LENDING PROGRAM (11/23/70)

IBRD	<u>35.0</u>	<u>105.0</u>	<u>85.0</u>
No.	<u>2</u>	<u>4</u>	<u>3</u>

LOAN COMMITTEE

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April 22, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Malaysia - Second Telecommunications Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated April 22, 1971 from the East Asia and Pacific Department, entitled "Malaysia - Second Telecommunications Project" (LC/0/71-64).
2. Comments, if any, should be sent to reach Mr. Amin-Arsala (ext. 3576) by 4:00 p.m. on Monday, April 26.
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
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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)

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DECLASSIFIED LC/0/71-64

SEP 05 2014 April 22, 1971

WBG ARCHIVES

LOAN COMMITTEE

Memorandum from East Asia and Pacific Department

MALAYSIA: Second Telecommunications Project

1. There is attached for the consideration of the Loan Committee a yellow cover appraisal report "Malaysia - Appraisal of the Second Telecommunications Project of the Telecommunications Department of Malaysia," dated April 1971. The appraisal report is circulated to the Loan Committee in yellow cover to permit negotiations to start during the first week of May when most of the staff concerned, due for home leave and missions, are still in Washington. The report has been cleared by the Director, Projects Department and recommends a Bank loan of US\$18.7 million equivalent to the Government of Malaysia to cover part of the foreign exchange cost of a project consisting of part of the telecommunications expansion program under the Second Malaysia Plan (1971-75). The Telecommunications Department (TDM) of the Ministry of Works, Posts and Telecommunications, which is responsible for all public telecommunications services in Malaysia, would carry out the project.

Background

2. The proposed loan would be the Bank's fifteenth to Malaysia and the second for telecommunications. After initial delays in preparing equipment specifications, execution of the first project has been satisfactory but disbursements of the Bank loan have been slow. Of a total loan amount of US\$4.4 million, US\$4.06 million was undisbursed and about US\$1.8 million was still uncommitted as of March 31. However, disbursements are now expected to accelerate, and proposals for the application of uncommitted funds will be presented by TDM during negotiations of the proposed loan.

3. Other loans have been made for projects in agriculture, forestry, industrial finance, power, water supply and education. The execution of these projects has been satisfactory, and disbursements have proceeded as expected except for Loan 434-MA (Muda Irrigation). This loan may require a postponement of the closing date by about 18 months to June 30, 1973. Although 95 percent of the project is completed some works such as slope stabilization, pumping installation, widening of some roads and bridges, and local drain improvements still have to be carried out.

4. As of March 31, 1971, the amount of loans held by the Bank net of cancellations, sales and repayments was US\$237.1 million. Since then, on April 5, 1971, the Bank agreed to cancel US\$2 million from Loan 579-MA made to the National Electricity Board. In addition, the Bank has made a loan (405-MA) to Singapore, guaranteed by Malaysia, to finance the Johore River water project.

The Economy

5. The current course of the Malaysian economy is, paradoxically, one of satisfactory economic growth and financial stability in spite of lagging private and public investment and gradually rising unemployment, both of which are a cause for concern in assessing the long-term growth prospects of the economy. Despite sluggish investment, the economy is buoyed by rising output from heavy investments in the early 1960's, especially in the planting and replanting of rubber and oil palm, which have long gestation periods, and in the development of timber resources. Continuing the trend of the early 1960's, real GNP increased at about 6 percent per year between 1965 and 1970.

6. A major economic policy objective for the future is thus to raise substantially the level of investment, not only in order to maintain the growth of income and employment in the immediate future, but, more importantly, to lay the basis for rapid economic expansion in the long run. The achievement of this objective calls for the strengthening of agricultural and industrial policies so as to induce larger private investment, as well as for a larger public investment program than in the recent past. It will not be easy to develop and execute such policies and programs since the planning and implementation capacity of the government is already being strained by the shortage of technical and other special skilled personnel which is aggravated by the Government's policy of replacing expatriate staff.

7. Resource availability does not seem to be the primary obstacle to investment stimulation. However, if Malaysia were successful in raising the level of investment, resulting in more rapid expansion of the economy and hence import demand, she would need a public capital inflow of about US\$85 million a year (net, including grants) for the coming five years in order to avoid an excessive drawdown of her external reserves. The debt service ratio is low at 3 percent, and is expected to remain below 5 percent for the rest of the 1970's. Malaysia is thus creditworthy for substantial external borrowings on conventional terms.

The Operations Program

8. The Country Program Paper was approved on March 30, 1971. The Bank's revised operations program for FY 1972-76 is attached as Annex I. During the remaining part of FY 1971 one more project, Sabah Ports, remains for presentation to the Executive Directors.

The Project

9. The Second Malaysia Plan (1971-75) includes an extensive program to improve and enlarge telecommunications facilities. Malaysia has asked the Bank to assist in its financing. The total cost of the program, including ongoing work brought forward from the First Malaysia Plan (1966-70) will be equivalent to US\$115.9 million. The estimated cost of the new program, the proposed project, is equivalent to US\$94 million. The foreign exchange component of the project is estimated at US\$47.3 million equivalent. The amount

of the proposed Bank loan is US\$18.7 million equivalent. Malaysia also expects to utilize existing bilateral financing offers or obtain supplier's credits on reasonable terms in an amount of US\$8.5 million equivalent to finance the cost of microwave equipment which will be procured through international competitive bidding. The remaining foreign exchange requirements, mainly for switching equipment to be supplied by a local assembly plant, equipment for external services and teleprinters, as well as local costs will be financed from TDM's own funds.

10. TDM is a well run and efficient organization. Some weaknesses in financial management, however, were recognized during the appraisal of the first telecommunications project and it was agreed that TDM would introduce a commercial accounting system. Legislation making provisions for these improvements has been enacted in February 1971. During negotiations confirmation will be sought to the effect that sufficient qualified staff will be made available to ensure effective operation of the commercial accounting system by December 1972.

11. All items to be financed by the Bank would be procured after international competitive bidding. Since there may be an extension of local manufacture to include larger sized cable and telephone apparatus, planned for Bank financing the Appraisal Report recommends that a margin of preference of 15 percent or the customs duty, whichever is lower, be used in comparing local and foreign bids. This margin would, however, only be applied when the value added in Malaysia is substantial.

12. The proposed loan would be disbursed against the actual foreign exchange costs of the imported items to be financed. However, the Report recommends that the Bank finance only the estimated foreign exchange cost of purchases from local manufacturers. This is an unnecessary restriction in the case of Malaysia and I recommend that the Bank finance instead the ex-factory costs, minus any applicable sales taxes, of such purchases. This could lead to the financing of some local costs; the case for such financing on country grounds has been made and accepted in the past.

Recommendation

13. I agree with the recommendation of the Appraisal Report, with the exception mentioned in paragraph 12 above, and recommend that Malaysia send representatives to Washington to negotiate a Bank loan of US\$18.7 million for the Second Telecommunications Project on terms and conditions set forth in the attached report.

Douglas J. Fontein
Deputy Director
East Asia and Pacific Department

Attachment

Population: 10.8 million
Per Cap Inc: \$366

MALAYSIA - PROPOSED OPERATIONS PROGRAM 1972-76
(\$ millions)

		1972	1973	1974	1975	1976
Agricultural Credit I	IBRD	10.0				
Agricultural Credit II	IBRD				10.0	
Land Settlement - Jengka III	IBRD		15.0			
Land Settlement - Johore	IBRD			20.0		
Land Settlement - Pahang-Tenggara	IBRD				20.0	
Land Settlement - Other	IBRD					20.0
Smallholder Rubber Rehabilitation	IBRD		10.0			
Drainage - West Johore	IBRD		15.0			
Livestock - Sabah	IBRD			4.0		
Forestry II - West Malaysia	IBRD			10.0		
Forestry III - Sarawak	IBRD					15.0
Communications III	IBRD				20.0	
DFC - MIDF II	IBRD		8.0			
DFC - MIDF III	IBRD				10.0	
Education II	IBRD	10.0				
Education III	IBRD			10.0		
Education IV	IBRD					10.0
Population	IBRD		4.0			
Power - NEB VI	IBRD		10.0			
NEB VII						20.0
Malaysia Airports	IBRD		10.0			
Highways I - Federal Highway	IBRD	10.0				
Highways II - Route I	IBRD		18.0			
Highways III - Other	IBRD				18.0	
Sabah Highways	IBRD			7.0		
Railways I	IBRD	12.0				
Railways II	IBRD			10.0		
Water Supply - Kuala Lumpur II	IBRD		8.0			
Sewerage - Kuala Lumpur	IBRD			8.0		
Sewerage - East Malaysia	IBRD				5.0	
Unallocated	IBRD					15.0
Total						
IBRD		1964-68	1969-73	1972-76	IBRD	
No.		165.9	244.2	372.0	No.	
		6	22	31		
		42.0	98.0	69.0		
		4	9	7		
		83.0	80.0			
		6	5			

East Asia and Pacific Department
April 20, 1971

LOAN COMMITTEE

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April 21, 1971

LM/M/71-18

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to consider "Botswana - Shashe Infrastructure Project" held at 9:15 a.m. on Wednesday, March 31, 1971 in Conference Room B.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

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)

April 21, 1971

Minutes of Special Loan Meeting to consider "Botswana - Shashe Infrastructure Project" held at 9:15 a.m. on Wednesday, March 31, 1971 in Conference Room B.

1. Present: Messrs. Cope (Chairman), Broches, Chadenet, Baum, Fuchs, Gabriel, Lejeune, Weiner, H. Scott, J.H. Williams, Dean, Wyatt, Bailey, Glenshaw, Ljungh, Loh, Niehuss, Poncia, Raizen and Pearce (Secretary).
2. Issue: The meeting had been called to review the Eastern Africa Department's memorandum of March 25, 1971 to the Loan Committee entitled "Botswana - Shashe Infrastructure Project" (LC/0/71-43), which recommended that the Botswana Government be invited to negotiate a \$30 million loan to help finance infrastructure required to support a copper/nickel mining development in Selebi/Pikwe, northeast Botswana and that Metallgesellschaft AG (MG), Bamangwato Concessions Limited (BCL) and the guarantor-shareholders be invited to negotiate guarantees for the loan.
3. Discussion: The meeting noted that:
 - (a) The project's justification, in the absence of any industrial activity or infrastructure in the Selebi/Pikwe area, was directly linked to the proposed copper/nickel mining development. The latter, owing to the high cost of mining underground, the relatively low grade of the ore and the distance between the mine and the market for its products (the United States and Germany), was a somewhat marginal commercial operation and, from the Bank's point of view, was justified mainly by its expected contribution to Botswana's economic growth, particularly foreign exchange earnings and direct and indirect employment.
 - (b) While proven ore reserves were adequate, mining rates could vary considerably and might therefore exhaust reserves before the end of the mine's expected 26 year life, upon which the 25 year term of the Bank's loan was based. Since Botswana's ability to repay the Bank's infrastructure loan rested ultimately upon the success of the mine, the Bank might wish to provide that, if necessary, the term of its loan be subject to adjustment, if it was later determined that reserves would be exhausted more quickly than expected.
 - (c) However, Bank insistence on a provision to adjust the term of its loan in these circumstances might imply that it doubted the worth of the guarantors' obligations to cover commercial and financial risks.

Moreover, the guarantors might, using the same argument, request an extension of terms if mining rates were slower than expected. Thirdly, an annual certification to check the mining rate against the originally estimated reserves would not provide a meaningful basis for Bank action, if that were necessary.

4. The Chairman said that, if ore reserves were exhausted sooner than expected because of a miscalculation of their extent, the shareholders and Metallgesellschaft, the purchaser of copper and nickel, would assume the mining project's commercial and financial risks and the Bank should rely unreservedly on their guarantees for repayment of its loan. If, on the other hand, the project were successfully completed in less than 25 years, the Bank could reasonably expect to have its loan repaid more quickly. The feasibility of negotiating a provision to cover this latter, admittedly unlikely, event should be considered further.

5. In considering other aspects of the East Africa Department's memorandum, the meeting noted that:

- (a) As presently drafted, the Guarantee Agreement would not relieve the guarantor-shareholders of their obligations if they agreed to a sale to the Government of BCL's assets or their shares in BCL in the face of a threatened expropriation. The guarantor-shareholders had argued that a forced sale was more likely than outright expropriation and, at their request, the Bank proposed to specify precisely in a side letter the circumstances in which it would be willing to release the guarantors from their obligations under the Guarantee Agreement in the event of a forced sale to the Government.
- (b) The concessional terms of American and Canadian financing for water and power more than offset the high cost of procurement in these countries, compared with international competitive bidding. If these costs exceeded the amount of American and Canadian financing already agreed, which would be known when bids were received in June, 1971, CIDA and USAID would be required to assure the Bank, before presentation of the loan to the Directors, that they would provide any necessary additional financing.
- (c) Up to \$0.25 million in respect of infrastructure engineering costs and expenditures on the dam construction contract incurred before signature of the loan would be eligible for reimbursement.

6. The Chairman approved the Eastern Africa Department's memorandum that negotiators be invited for the proposed loan and associated guarantees.

David Pearce
Secretary

Cleared by: Messrs. Cope
Baum
Dean
H. Scott/Loh
Glenshaw

cc: Loan Committee
Participants

LOAN COMMITTEE

DECLASSIFIED

SEP 05 2014

WBG ARCHIVES

LM/M/71-19

April 21, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to consider "Bolivia - Gas Pipeline Loan" held at 9:30 a.m. on Thursday, April 8, 1971 in Conference Room B.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

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)

April 21, 1971

Minutes of Special Loan Meeting to consider "Bolivia - Gas Pipeline Loan" held at 9:30 a.m. on Thursday, April 8, 1971 in Conference Room B.

1. Present : Messrs. Cope (Chairman), Aldewereld, Alter, Chadenet, Gabriel, Knox, Nurick, Scott, Skillings, van der Meer, Fajans, Sassoon, and Pearce (Secretary).

2. Issue: The meeting had been called to consider the South America Department's memorandum of April 6, 1971 to the Loan Committee entitled "Bolivia - Gas Pipeline Loan" (LC/0/71-53), which recommended that the Bank's \$23.25 million loan to Compania Yacibol Bogoc Transportadores (YABOG) (Loan No. 635-BO) for the construction of a gas pipeline from Santa Cruz in Bolivia to Yacuiba on the Bolivian/Argentine border be renegotiated.

3. Discussion: In reviewing the South America Department's memorandum, the meeting noted that:

- (a) Gulf and the Bolivian Government had recently signed an agreement under which Gulf had agreed to accept the decision of Bolivian courts on the Bolivians' unresolved claim of about \$3.5 million in respect of alleged unpaid social security taxes. (cf. para. 6).
- (b) Since the basic project was the same as that approved by the Directors in July, 1969, the interest rate on the renegotiated loan would remain unchanged, i.e. 6.5 per cent. The borrower would therefore pay commitment charges on the loan from September 20, 1969, i.e. 60 days after signature of the original Loan Agreement. (cf. para. 13).
- (c) The Bank would accept Argentina's request that its guarantee of the loan be qualified to include a "force majeure" exception where gas was not delivered as a result of a deliberate action of the Bolivian Government or as a result of insurrection, revolution or war in Bolivia.

4. The meeting considered Mr. Alter's memorandum of April 7, 1971 to Mr. Knapp and noted that, in view of its risk in guaranteeing the Bank and IDB loans, Argentina wished to play an active role in the management of the gas and oil fields formerly owned by Gulf and the source of gas for the pipeline. The Argentines had proposed that the Bank's observer on the three-man management committee should be an Argentine nominee, subject to Bank approval. This proposal was acceptable to the Bank and was expected to be acceptable to the Bolivians.

5. Decision: The Chairman approved the South America Department's recommendation that negotiators be invited to renegotiate the loan.

David Pearce
Secretary

Cleared by: Messrs. Cope
Alter/Skillings
Chadenet
H. Scott

cc: Loan Committee
Participants

LOAN COMMITTEE

DECLASSIFIED

SEP 05 2014

WBG ARCHIVES

LM/M/71-20

April 21, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to consider "Turkey - Power Project" held at 3:00 p.m. on Tuesday, April 13, 1971 in Conference Room B.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

April 21, 1971

Minutes of Special Loan Meeting to consider "Turkey - Power Project" held at 3:00 p.m. on Tuesday, April 13, 1971 in Conference Room B.

1. Present: Messrs. Cope (Chairman), Baum, Benjenk, Chadenet, Gabriel, Nurick, Weiner, Hartwich, Howell, Bart, Wyatt, Nijhof, Southall and Pearce (Secretary).
2. Issue: The meeting had been called to consider the Europe, Middle East and North Africa Department's memorandum of April 12, 1971 to the Loan Committee entitled "Turkey - Proposed \$24 million loan to Turkiye Elektrik Kurumu (TEK)" (LC/0/71-56). There were two issues for discussion: procurement and power rates.
3. Discussion: Regarding procurement, the meeting noted that:
 - (a) Local manufacturers would participate in international competitive bidding for materials and equipment to be financed from the proposed loan and both TEK and the Government had requested preference for these local manufacturers.
 - (b) However, since the local value added, principally to conductors and transformers, would be small (about 25-35 per cent) and duties on imported components and materials were high (about 65 per cent), the Bank's "conventional" addition of 15 per cent to the c.i.f. price of foreign bids would result in effective protection of 50 per cent or more, if duties were waived, or negative protection if they were not.
 - (c) In practice, the Turks were expected to waive duties on imported materials and components but to retain the duty on assembled/finished goods to stimulate local industry.
 - (d) In the circumstances, the simplest administrative solution would be to apply the Bank's normal procedure of adding 15 per cent (or the prevailing duty, whichever was lower) to the c.i.f. price of foreign bids, leaving it to the Government to decide whether or not to waive duties on imported components incorporated in local bids.
4. The meeting also agreed that, to avoid discrimination against local manufacturers and uncertainty about the amount of the loan and the borrower's financing plan, loan disbursements in respect of contracts won by local manufacturers should finance the full cost of such contracts,

not just the foreign exchange component. The small amount of local expenditure financing eventually involved, i.e. up to about \$1.5 million, would be justified in Turkey.

5. Regarding power rates, the meeting noted that:

- (a) While the Turks were concerned about the possible inflationary impact of the proposed 48 per cent increase in TEK's tariffs effective April 1, 1971, the increase would be necessary to enable TEK to comply with the 8 per cent rate of return provision of its law of incorporation (1312). Moreover, alternative means of financing TEK's investment plan might be equally or more inflationary.
- (b) Although the Government had reportedly agreed in principle to a tariff increase, an invitation to negotiate the proposed loan would not be issued until formal notification had been received, expected within a few days.

6. Decision: The Chairman approved the Europe, Middle East and North Africa Department's recommendation that, upon receipt of notification of the tariff increase, negotiators be invited for the proposed loan.

David Pearce
Secretary

Cleared by: Messrs. Cope
Baum
Benjenk/Hartwich/Nijhof
Weiner/Wyatt
Southall

cc: Loan Committee
Participants

LOAN COMMITTEE

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SEP 05 2014

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April 21, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Morocco - Second Education Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated April 21, 1971 from the Europe, Middle East and North Africa Department, entitled "Morocco - Proposed IDA Credit of \$7.3 million for a Second Education Project" (LC/0/71-62).
2. Comments, if any, should be sent to reach Mr. McCall (ext. 4806) by 4:00 p.m. on Friday, April 23.
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)

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LC/O/71-62

April 21, 1971

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa Department

Morocco - Proposed IDA Credit of \$7.3 million for
a Second Education Project

1. Attached for consideration by the Loan Committee is the Appraisal Report (PE-29) dated April 6, 1971, on a Second Education Project in Morocco. The first, an IDA Credit of \$11 million, was signed in 1965. Total Bank loans to Morocco amount so far to \$153 million (of which \$15.3 million have been repaid), and IDA credits total \$18.3 million. The proposed IDA Credit would be the third of the four operations planned for Morocco in this fiscal year. The fourth loan, an agricultural credit project, is under preparation and would bring the total lending for Fiscal Year 1971 to \$78 million. The Five-Year lending program for FY 1972-1976 is attached.

2. The proposed project is smaller than what the Government had originally requested. A number of project items in the request had to be dropped because they were insufficiently prepared. These items could be included in a future education project. The project now proposed supports the continuing effort to improve Morocco's secondary education system. This effort started with the construction of 18 secondary schools under our first credit, and it will now be followed by support for educational research, an expansion of secondary teacher training, strengthening of science teaching, expansion of middle level agricultural education, and a reform of the technically oriented secondary schools. In addition, the proposed project would assist in establishing training of veterinarians and in expanding vocational training. To ensure continuity, a future education project might take up where the present proposal leaves off: assisting higher education on the one hand, and improvements in primary education on the other. To make sure that future lending is adequately prepared, the proposed credit provides for technical assistance for a pre-investment study of higher education.

Issues Relating to the First Education Project

3. Implementation of the project continues to suffer from inadequate management, poor coordination among government units concerned, and inefficient contracting procedures. As a result, progress in school construction and equipment procurement has been slow, and only 40 percent of the Credit has been disbursed since 1965 (closing date: June 30, 1971). In a letter dated August 28, 1970 I pointed out to the Moroccan Government the measures needed to improve the implementation of the project. Last March, after noting that progress was still very slow, the Bank indicated that the extension of the closing date of the first credit and negotiation of the second credit depended on satisfactory measures to improve the first project, i.e.:

- (a) strengthen the project unit by appointing full time staff;
- (b) improve the supervision of construction work by inspections and visits;
- (c) accelerate equipment contract awards;
- (d) resume regular quarterly reports on project progress;
- (e) improve administrative procedures to accelerate the submission of withdrawal requests to IDA.

A preliminary reaction indicating some remedial measures, has just been received, and a supervision mission has been sent to review the actual progress made.

Issues Relating to the Second Education Project

4. Education Cost and Expenditure: Both capital and recurrent expenditures in education have been rising rapidly in the past and are expected to continue to increase in the immediate future; there is a lack of cost-consciousness and a strong need for cost control (see paras. 3.02-3.07 of the appraisal report). The project should contribute substantially to the reduction of personnel cost of secondary education by helping the expansion of the training of Moroccan teachers to replace expatriates. However, stricter control of other current expenditures would also be needed. During negotiations, we shall underline IDA's serious concern with the spiraling costs in education and emphasize the need for stricter cost control.

5. Education Development Plans and Programs: The efforts of the Government to correct major deficiencies in the needs of education and training continue to be hampered by the absence of a coherent overall development plan for the sector. The Government will be informed during negotiations that IDA attaches great importance to

such a plan which should improve and coordinate the design and planning of programs in all subsectors, and form a basis for major policy decisions (see para. 4.19) including the higher education items which were dropped from the proposed project.

6. Primary Teacher Training: Although the stagnation of primary education is a critical problem, one item relating to this sub-sector -- primary teacher training colleges -- had to be dropped from the present project because the lack of a consistent policy in this field prevented the preparation of a sound proposal. It would be desirable to include this item in the next education project. Sound preparation, however, will be possible only if the Government ends the present indecision and develops a primary education policy. The Government should decide what form of elementary education would be most suitable for the children in rural areas whose future will most likely lie in the rural sector of the economy, and at what pace primary enrollment should develop. In the same context, our discussion with the Government about training for rural development will be resumed. The Government's decision on this point will determine the need for various types of primary school teachers. In addition, primary teacher training should be reorganized and a number of small schools should be consolidated into larger, more economical units. Once the Government has taken satisfactory decisions on these politically sensitive issues, a suitable project could be prepared. We will therefore urge the Moroccan Government during negotiations not to postpone the decisions any longer, but the chances of early action are remote.

7. Higher Education Study: We have proposed to the Moroccans to undertake a pre-investment study of higher education to define and prepare for a future project the items which had to be dropped from the present project, in particular medical, engineering, and technical higher education and training of agricultural and technical teachers. We are awaiting the result of discussions between the Government and UNDP concerning the financing of this pre-investment study. If the study cannot be incorporated into UNDP's program, it could be included in the present project. We will urge a decision before negotiations.

8. Appointment of Staff for Implementation of Project: The Appraisal Report recommends that IDA's approval be required for appointments to several positions to be created under the project. I feel that such approval should be required only where IDA finances the post, as in the case of some staff in the project unit and in the maintenance unit (para. 5.27). Where the appointee will be on the government payroll, as in the case of the Deputy Director of the project unit (para. 5.35), we should not require the right to approve the appointment; we should require that, in accordance with the provisions to be inserted in the credit documents, an experienced and qualified candidate be chosen and point out to the Government that IDA would expect it to provide all relevant information on the candidate sufficiently in advance to enable IDA to convey its views so that the Government could take them into account before finally deciding on the appointment. This would be similar to the solution adopted in 1969 for the Moroccan Sebou project.

9. Technical Assistance: The Appraisal Report points to teacher shortages in the short-run in various areas of education that will be served by the project (paras. 5.08, 5.12, 5.15, 5.24) and indicates that French assistance is expected. In direct contacts with the French authorities, we will ensure before negotiations whether French assistance will be available, and in what form.

General Issues

10. Cooperation with UNESCO: During project preparation, members of a UNESCO mission had at the Government's insistence, to include a number of ill-conceived and poorly prepared items into the government request, thus acting against their own better judgement. Our appraisal mission was confronted with an incoherent, weak project, and they had to spend considerable time on eliminating the undesirable items. This raises general questions as to the effectiveness of the present division of labor between the Bank and cooperating UN agencies. These questions ought to be reviewed within the Bank with a view to strengthen the cooperative program.

11. Expatriate Teaching Staff: Expatriate teachers are an important element in the operation of the Moroccan education system. However, the present standard of low workloads of French secondary school teachers and inadequate qualifications of a large percentage of expatriate teachers at the lower secondary school level contribute greatly to high costs and low efficiency in Moroccan education (see paras. 3.04 and 4.03). Moreover, the low workloads of the expatriates set an example for their Moroccan colleagues, thus spreading the high costs throughout the education system. Since these conditions seem to exist also in other new French speaking nations, it might be useful, after careful preparation by the staff, to review this problem at management level, with a view to discuss with the French authorities this very delicate situation.

Recommendation

12. I propose that, subject to being satisfied on the progress of the first education project (para. 3 of this memorandum), IDA invite the Moroccan Government to send representatives to negotiate a credit of \$7.3 million along the recommendations set forth in Chapter VI of the Appraisal Report, except for the modification proposed in para. 8 of this memorandum.

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

Attachment

Population: 14.1 m
GNP Per Cap.: \$190

ATTACHMENT

MOROCCO - 5 YEAR OPERATIONS PROGRAM
(By Fiscal Year - Amounts in \$ millions)

			<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
4-MYC-AC-02	Agricultural Credit II	IBRD	26.0					
4-MYC-AC-03	Agricultural Credit III	IBRD			10.0			
4-MYC-AC-04	Agricultural Credit IV	IBRD					15.0	
4-MYC-AX-01	Agriculture Unidentified I	IDA			15.0			
4-MYC-AX-02	Agriculture Unidentified II	IDA				20.0		
4-MYC-AX-03	Agriculture Unidentified III	IDA					20.0	
4-MYC-DD-05	DFC - BNDE V	IBRD	35.0					
4-MYC-DD-06	DFC - BNDE VI	IBRD			20.0			
4-MYC-DD-07	DFC - BNDE VII	IBRD					25.0	
4-MYC-DD-08	DFC - CIH Hotel Financing I	IBRD	10.0					
4-MYC-DD-09	DFC - CIH Hotel Financing II	IBRD		15.0				
4-MYC-DD-10	DFC - CIH Hotel Financing III	IBRD				20.0		
4-MYC-DD-11	DFC - CIH Hotel Financing IV	IBRD						20.0
4-MYC-EE-02	Education II	IDA	7.3					
4-MYC-EE-03	Education III	IBRD				10.0		
4-MYC-PH-01	Power I - Sidi-Cheho Hydro	IBRD		15.0				
4-MYC-PH-02	Power II - Roches Noires	IBRD				15.0		
4-MYC-PH-03	Power III	IBRD						15.0
4-MYC-TH-02	Roads II	IBRD			10.0			
4-MYC-TH-03	Roads III	IDA						15.0
4-MYC-WW-01	Casablanca Water Supply	IBRD		10.0				
	" " "	IDA		10.0				
4-MYC-WW-02	Water Supply II	IBRD			10.0			
4-MYC-WW-03	Water Supply III	IBRD						10.0

Total								
	<u>1964-68</u>	<u>1969-73</u>	<u>1972-76</u>					
IBRD	45.0	244.3	220.0	IBRD	71.0	40.0	50.0	45.0
IDA	11.0	39.6	80.0	IDA	7.3	10.0	15.0	20.0
Total	<u>56.0</u>	<u>283.9</u>	<u>300.0</u>	Total	<u>78.3</u>	<u>50.0</u>	<u>65.0</u>	<u>65.0</u>
No.	4	16	19		4	3	5	4

LOAN COMMITTEE

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April 19, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Tanzania - Third Highway Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated April 19, 1971 from the Eastern Africa Department, entitled "Tanzania - Third Highway Project" (LC/0/71-61).
2. Comments, if any, should be sent to reach Mr. Clements (ext. 4914) by 5:00 p.m. on Wednesday, April 21.
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
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Executive Vice President (IFC)
Vice President (IFC)

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LC/0/71-61

April 19, 1971

LOAN COMMITTEE

Memorandum from the Eastern Africa Department

TANZANIA: Third Highway Project

I. INTRODUCTION

1. The Bank Group's assistance to the highway sector in Tanzania has so far been concentrated upon the development of primary and secondary roads. The First Highway Project, for which \$17.0 million of IDA finance was extended and which was physically completed in 1970, consisted principally of the reconstruction of six sections of main roads in various parts of the country. Under the Second Highway Project, a total of \$22.5 million of Bank/IDA finance is being provided for the reconstruction of a section of the Tan-Zam Highway; work on this project is proceeding satisfactorily.

2. Because of the continued low standard of much of Tanzania's main highway network and the growth of traffic, further improvements to certain major road links are necessary, and this is provided for in the proposed Third Highway Project. At the same time, there is a growing need to improve minor roads serving agricultural districts in order to support the Government's endeavors to promote rural development, on which heavy emphasis is placed in the Second Five-Year Plan (1969-74). The proposed project would assist the Government make a start in establishing an adequate feeder road system by creating permanent betterment/maintenance units in two important agricultural areas. It is envisaged that these units would provide a model for the establishment of similar units in other parts of the country.

II. THE PROJECT

3. The attached appraisal report recommends an IDA Credit of \$5.5 million to help finance a project comprising:

- (a) the paving of a 150 km section of the main Southern Trunk Road between Mtwara and Nanganga, part of which was improved to gravel standards under the First Highway Project but now needs upgrading again;

- (b) betterment of 475 km of feeder roads in the Geita and Mara agricultural districts of Northern Tanzania through the creation of departmental units;
- (c) technical assistance for (i) the supervision of the above works, (ii) training of local staff required for the betterment units to be established under (b), (iii) continuation of the staffing and training program in the Ministry of Communications, Transport and Labour (COMWORKS) initiated under the First Highway Project, and (iv) preinvestment studies of further roads which seem likely candidates for inclusion in future highway projects in Tanzania.

4. The works included in the proposed project, though varying considerably in their character, are all geared to the general objective of stimulating agricultural development. The Mtwara-Nanganga road forms a part of the regional highway linking the port of Mtwara and the entire southern fringe of the country to the Tan-Zam Highway. Most of the present traffic, however, is local and concerned with the movement of the substantial cashew nut crop grown in the area. The feeder roads in the Geita district provide an outlet for the important cotton crop grown in that region, while the Mara district roads are essential to an important milk-producing scheme established recently with Danish financial assistance. The estimated economic rates of return on the major elements of the project range from 16 to 28%.

III. HIGHLIGHTS

Financing Plan

5. The cost of the project is estimated at \$7.9 million, of which the proposed IDA Credit of \$5.5 million would cover the estimated foreign exchange component representing about 70% of the total. The local currency component of \$2.4 million would be financed by the Government. The Association, at the request of the Government, has already agreed to recommend to the Executive Directors that expenditures of up to \$190,000 on preinvestment studies undertaken by consultants in connection with the preparation of the project should be reimbursed retroactively out of the proceeds of the proposed credit.

Cost Estimates

6. The estimate of the cost of upgrading the Mtwara-Nanganga road is based on preliminary estimates by consultants and is therefore subject to adjustment. A final cost estimate is expected to be available in the near future and we would not issue a formal invitation for negotiations until this estimate had been received and reviewed. It is not expected

that the final cost estimate will differ significantly from the preliminary cost estimates, and certainly not by enough to affect the economic justification. However, I would consult with the Chairman of the Loan Committee if it appears necessary to increase the proposed credit.

Feeder Road Program

7. Success of the Government's agricultural development program is dependent on the good condition of feeder roads. In many important agricultural areas throughout the country the condition of feeder roads is inadequate. As a first step to enable the Government to bring these roads to adequate standard and to maintain them properly, the proposed project includes a pilot program for feeder road betterment in the Geita and Mara districts. It is proposed that these works, which are small-scale and scattered and would be of little or no interest to contractors, be carried out by a departmental unit in each district under the supervision of consultants, who would also help train local staff to take over the running of the units. Once the condition of the selected roads had been improved the equipment would be utilized for betterment works elsewhere and general road maintenance.

8. The project would thus enable Tanzania to build up a permanent capacity to plan, execute and maintain rural roads in accordance with the Government's policy of self-reliance. The lessons learnt from these pilot betterment units would assist the Government in setting up a countrywide maintenance/betterment program, which is now under preparation by consultants with financial assistance from USAID.

Preinvestment Studies

9. In order to prepare the next group of roads for consideration for Bank Group financing, consultant services are included in the project for feasibility studies and detailed engineering of about 250 km of roads, which would be selected on the basis of preinvestment studies presently being carried out by the Planning Division of COMWORKS. During negotiations we would review with the Tanzanian delegation the progress made on these studies by the Planning Division. This review may indicate that consultants should be engaged to help with the studies to ensure that they are completed in good time. If so, we would propose that such consultants services should be provided under the Project. The cost involved would be minimal and no adjustment to the size of the credit would be required.

V. THE ECONOMY

10. An economic and preinvestment studies mission from the Bank visited Tanzania during November/December 1970, and its report is being prepared. Tanzania's Second Five-Year Plan was launched in mid-1969.

The growth of the economy in 1969 was slowed down by adverse weather which affected the output of agriculture, the dominant sector of the economy, and also by a decline in mineral output, mainly diamonds. While no firm figure is yet available, it is believed that the growth of GDP in 1970 was close to the Plan target of 6.5 percent a year.

11. Since the Second Plan was launched there has been a rapid increase in the Central Government's development expenditure, including contributions to the parastatal organizations. While this is in line with the objectives of the Plan, there are already indications that expenditure is pressing against the available resources. During the first year of the Plan, the Government financed a larger than anticipated proportion of its development expenditure from domestic sources, including some short-term borrowing from the Bank of Tanzania. It is clear that the momentum of development can be sustained only if there is a steady increase in foreign capital inflows, since the Government's capacity to implement projects has grown more rapidly than the resources currently available to it. More than 90 percent of Tanzania's overall investment since 1966 has been financed from domestic sources, and it would be unrealistic to expect that the proportion could increase. In view of the country's low per capita income and the market limitations facing its principal exports, it is desirable that the major proportion of external assistance should be on concessional terms.

12. In 1970, Tanzania's foreign exchange resources suffered a substantial decline. This was largely caused by a change in the procedure for financing imports by the State Trading Corporation and also by the substitution by parastatal organizations of cash payments for supplier credits. To a lesser extent, the decline is also attributable to very considerable redemptions of Tanzanian currency in Kenya, which virtually amounts to an illegal capital transfer. The Government has since taken steps to restrict credit and has extended exchange controls to Kenya and Uganda. These measures appear to have arrested the decline in reserves. More recently, Kenya has also extended exchange controls to its EAC Partner States. It is not clear at this time as to how long the exchange control measures are to last. The Tanzania Government has already declared that exchange control is not intended to be restrictive in respect of any legitimate "current account payments" within East Africa as defined by the Treaty for East African Cooperation, and there is no evidence that trade between the Partner States has been disrupted.

VI. RECOMMENDATION

13. I recommend that the Association invite the United Republic of Tanzania to send representatives to Washington to negotiate a development credit of \$5.5 million for the project substantially on the terms set forth in Chapter 6 of the appraisal report.

Michael L. Lejeune
Director

Attachment: Five-Year Lending Program

Population : 12.9
Per Cap Inc: \$95

TANZANIA - 5 YEAR OPERATIONS PROGRAM
(By Fiscal Year - Amounts in \$ millions)

		1971	1972	1973	1974	1975	1976
Rural Development Bank I	IDA		5.0				
Rural Development Bank II	IDA				7.0		
Tobacco I	IDA	9.0					
Tobacco II	IDA					7.0	
Tea I	IDA		12.0				
Tea II	IDA					7.0	
Forestry	IDA				7.0		
Livestock II	IDA			10.0			
Livestock III	IDA						10.0
Agriculture (unidentified)	IDA						5.0
Tanzania Investment Bank I	IBRD			3.0			
Tanzania Investment Bank II	IBRD					5.0	
Education III (Agricultural Ed.)	IDA	3.3					
Education IV	IDA			7.0			
Education V	IDA					10.0	
Power II (Kidatu)	IBRD	30.0					
Power III	IBRD				5.0		
Power IV	IBRD						25.0
Urban Development	IDA						5.0
Highways III	IDA		6.0				
Highways IV (Maintenance)	IDA				10.0		
Highways V	IDA						12.0
Unallocated	IDA					5.0	
Operations Program	IBRD	30.0	-	3.0	5.0	5.0	25.0
	IDA	12.3	23.0	17.0	24.0	29.0	32.0
	Total	<u>42.3</u>	<u>23.0</u>	<u>20.0</u>	<u>29.0</u>	<u>34.0</u>	<u>57.0</u>
No.		3	3	3	4	5	5

LOAN COMMITTEE

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WBG ARCHIVES

April 15, 1971

MEMORANDUM TO THE LOAN COMMITTEE

India - Cochin II Fertilizer Expansion Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated April 15, 1971 from the South Asia Department, entitled "India - Cochin II Fertilizer Expansion Project" (LC/0/71-60).
2. Comments, if any, should be sent to reach Mr. David Dunn (ext. 2293) by 4:00 p.m. on Monday, April 19.
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
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Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

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SEP 05 2014 LC/0/71-60

WBG ARCHIVE April 15, 1971

LOAN COMMITTEE

MEMORANDUM FROM SOUTH ASIA DEPARTMENT

INDIA: COCHIN II FERTILIZER EXPANSION PROJECT

1. I attach a draft appraisal report entitled "India - Appraisal of the Cochin II Fertilizer Expansion Project - The Fertilisers and Chemicals, Travancore, Limited", recommending that the Association make a credit to India of US\$20.0 million equivalent for this project. Mr. Chadenet has agreed that the appraisal report be considered by the Loan Committee in its present (yellow cover) draft. The report will be edited and shortened before presentation to Executive Directors but there will be no substantive changes except those occasioned by negotiations, which we hope to begin next week. The report has been discussed with all concerned departments and there are no differences of opinion. The principal problem to be resolved during negotiations concerns the relending rate (paragraphs 12 and 13 below). Also attached is a copy of the gross operating program in its latest revision, which is designed to provide a net lending program for FY71 and FY72 combined of about US\$600 million.

Background

2. This would be the first Bank loan or IDA credit to the fertilizer manufacturing sector in India, although we have provided through the industrial imports credits large amounts of foreign exchange for the import of raw materials for fertilizer manufacture. IFC has participated in two private sector fertilizer projects in India (Indian Explosives in Uttar Pradesh, and Zuari Agrochemicals in Goa). The Fertilisers and Chemicals, Travancore, Limited (FACT), the beneficiary of the proposed credit, is a public sector company, owned largely by the Government of India (GOI). It is located near the port of Cochin in Kerala in southern India. Cochin II was one of the two projects (the expansion of the Nangal plant of the Fertilizer Company of India was the other) first identified by a mission early in 1969 as being good prospects for IDA lending. The mission was prompted by Mr. McNamara's statement, in the course of his visit to India in November 1968, that he would be willing to recommend lending to efficient fertilizer manufacturers whether in the public or the private sector. A mission in mid-1969 studied the project and recommended fundamental changes in its design, including process selection. Following a period of discussion, FACT responded favorably to IDA's recommendations on this point and on a proposal for increasing performance at its existing facilities. A revised feasibility report was submitted in November 1970 and the project was appraised in December 1970 and February/March 1971.

Bank/IDA Lending Program

3. India's allocation from IDA for the current fiscal year is US\$245 million, of which US\$30.4 million has been approved for two credits (Agro-Aviation, US\$6 million, and Andra Pradesh Agricultural Credit, US\$24.4 million). Negotiation on a wheat storage project (US\$5.0 million) was suspended because GOI could not agree to international competitive bidding for construction of the silos. Negotiations have been completed for a Fourth Telecommunications Project (US\$78 million) and for a Second Power Transmission Project (US\$ 75 million) and these projects will be presented to the Executive Directors on April 20 and 27 respectively. The Loan Committee has considered proposals for the Haryana (US\$25 million) and Tamil Nadu (US\$35 million) agricultural credit projects, and we expect to begin negotiations for these projects in the last week of April and the first week of May. In addition, a revised appraisal report is being completed for the Pochampad Irrigation Project (US\$41 million). Obviously, if all of these projects are successfully negotiated before the end of May, consideration of one or two may have to be deferred to FY72 to keep within the IDA allocation. Appraisal work is well advanced on several other projects (including Nangal and other FCI fertilizer projects) for presentation in FY72.

4. A new economic report has been prepared by the Resident Mission in New Delhi assisted by members of the India Division and consultants, and is now under internal review. The report describes India's continuing recovery from the drought/recession era of the mid-1960's, albeit at a somewhat slower pace than in 1969/70. The shortfall of about 14 percent in actual, as compared with planned, foreign aid disbursements which occurred during the last two years probably played a part in the reduction of economic growth in 1970/71. Net aid disbursements fell by 35 percent in that year and regardless of the level of new commitments in 1971/72 a further decline in net aid is likely because of the mounting debt service and the drawdown of the non-project aid pipeline that has already occurred. Therefore despite the generally favorable progress of the last two years, India will require substantially more aid on concessionary terms than the amount (about US\$740 million) committed in 1970/71 in order to carry out its Fourth Five-Year Plan which ends in 1973/74 and have a reasonable level of undisbursed commitments at the start of the Fifth Plan. The report will recommend that well over half of new aid be in the form of fast disbursing program aid, including debt relief, and that this be supplemented by local currency financing which also provides free foreign exchange.

The Project

5. The Cochin Fertilizer Project would provide IDA financing in support of a second major expansion of FACT's fertilizer manufacturing facilities. The first stage expansion, known as Cochin I, is a 330,000 tons per year urea project financed partly with Italian credit and now substantially completed. The second stage expansion, which is proposed for IDA financing and known as Cochin II, has a design capacity of

485,000 tons per year of granulated, high analysis NPK fertilizers and 7,500 tons per year of cryolite, a chemical used in the manufacture of aluminum. The project will help to fill a widening gap between projected demand for and domestic production of fertilizers in India in this decade. Even with this project and other planned projects, the annual production shortfall for nitrogen and phosphates will be in the order of 800-900,000 tons per year for each.

6. The units of the project will be a phosphoric acid plant, a sulfuric acid plant, an NPK granulation plant, and the cryolite plant. The latter offers the additional benefit of recovering fluorine from the phosphoric acid manufacture and decreasing a potential pollution problem. FACT Engineering and Development Organization (FEDO), the planning and engineering arm of FACT, will be managing contractor for the project. FACT will have licensing arrangements with Prayon (Luxembourg) for the phosphoric acid plant, Chemiebau (Germany) for the sulfuric acid plant and Wellman-Lord (United States) for the NPK granulation plant. The borrower will be GOI who will relend the proceeds of the credit to FACT.

7. The economic benefits of the project derive from savings of foreign exchange achieved by manufacture, rather than import, of finished fertilizers. The project will operate on imported sulfur, ammonia, phosphate rock and potash (urea will be provided by Cochin I), and shows an economic rate of return of over 14 percent (paragraph 8.08) in comparison with assumed prices of similar grades of fertilizers procured internationally. The project would realize net annual foreign exchange savings of about US\$14 million at normal 90 percent production (paragraph 8.11).

8. Financially, the project is very profitable because of the high prices brought by manufactured fertilizers in the Indian market. Both the internal financial return of nearly 20 percent (paragraph 8.04) and the economic rate of return are very sensitive to relative changes in selling and raw material prices, or major delays in project execution.

9. The appraisal mission, accompanied by Mr. Fuchs, returned to India in February and March for discussion on procurement and financial matters with GOI and FACT. At that time GOI indicated that it would agree to procure all equipment through international competitive bidding (with a 15 percent level of preference for domestic suppliers), with the exception of items representing about 12 percent of the total value of all equipment, which GOI proposes to reserve for domestic suppliers. No item on the reserved list appears at this time to be critical to the timely completion of the project. GOI has agreed that if during the course of construction a delay in procuring any item would at that time appear to be critical, FACT will be able to switch to procurement from an international source. Therefore, I consider this proposal acceptable.

10. The report estimates that the total foreign exchange capital cost, including contingencies and working capital, would be US\$19.6 million, on the assumption that about 30 percent of items procured

under international competitive bidding would be supplied from Indian sources. The proposed IDA credit would be disbursed against: one hundred percent of the estimated cost of all items to be procured through international competitive bidding (US\$15.2 million); the estimated foreign exchange cost of imported components and raw materials for items reserved for domestic suppliers (US\$0.5 million); external technical assistance (US\$0.5 million); a portion of the engineering and equipment erection costs of FEDO (US\$1.8 million) including the foreign exchange costs of license arrangements (US\$1.3 million); and an unallocated amount equal to the foreign exchange contingency allowance (US\$2.0 million). Any savings will be disbursed against further FEDO engineering and equipment erection costs. (Paragraph 5.09 is being rewritten to reflect these revised estimates.)

11. If the foreign exchange contingency is not required, and if, as the appraisal report estimates, 30 percent of internationally-bid items are won by India, then the foreign exchange cost of items financed by the IDA credit would be about US\$12.9 million (excluding the foreign exchange cost of internationally-bid items won by Indian suppliers) and the element of financing of local currency expenditures would be about US\$7.1 million. On the other hand, if the contingencies are required and all internationally-bid items are procured externally, then about US\$19.5 million of the IDA credit would be used to finance expenditures in foreign exchange.

Issues

12. The one recommendation of the appraisal report which I expect to present the greatest difficulty during negotiations concerns the terms of relending the IDA credit to FACT by GOI (paragraphs 4.06 and 4.07). The report recommends that GOI relend the proceeds of the IDA credit to FACT on "terms consistent with the Bank Group's industrial lending" (paragraph ii), which is assumed in the report to be 9.5 percent. One point supporting a high rate of interest is the rate at which ICICI relends Bank funds for foreign exchange expenditures. GOI has told us that its current rate of relending foreign exchange to public sector entities is 7 percent and that it will not be able to change this policy. I support the recommendation in the appraisal report on this question, but I feel that we may have to go some way towards accommodating GOI's problems on this point. I recommend that the 9.5 percent rate be put forward as IDA's initial position on this issue but that IDA's team explore the matter further during negotiations, and that I return to the Chairman for a decision if I feel it necessary to make another recommendation.

13. Apart from the interest rate question, the only other points which I think may be difficult in negotiations are the other recommendations concerning GOI's financing of FACT, including the debt equity ratio and the provision of "overrun" funds and working capital. The draft report recommends that the present Managing Director of FACT be retained for at least another year. Obviously GOI will not be able to sign a covenant to that effect but we will obtain assurances that sufficient continuity will be maintained and that any successor will be suitably qualified.

Recommendation

14. I recommend that the borrower and the beneficiary be invited to negotiate the credit of US\$20 million on the basis of the recommendations set out in paragraphs 10.01 and 10.02 of the draft appraisal report, as qualified by the comments in this memorandum.

I. P. M. Cargill
Director
South Asia Department

Attachments

Population: 556 m
GNP Per Cap: \$76

IVa. INDIA - 5 YEAR LENDING PROGRAM

		(\$ millions)							
		Fiscal Year					Total	Total	
		1970	1971	1972	1973	1974	1975	1964-68	1969-73
Agric. Credit - Punjab	IDA	27.5							
Agric. Credit - Gujarat	IDA	35.0							
Agric. Credit - Haryana	IDA		24.0						
Agric. Credit - Tamil Nadu	IDA		35.0						
Agric. Credit - Andhra-Pradesh	IDA		24.4						
Agric. Credit - Mysore	IDA			25.0					
Agric. Credit - Maharashtra	IDA			25.0					
Agric. Credit - Unidentified	IDA			25.0					
Irrigation - Kadana	IDA	35.0							
Irrigation - Pochampad	IDA		40.0						
Irrigation - Tawa	IDA			46.0					
Irrigation - Jayakwadi	IDA			20.0					
Irrigation - Unidentified	IDA			20.0					
Agricultural Aviation	IDA		6.0						
Agric. Industry Unident.	IDA			10.0					
Agric. Unident. (7 projects)	IDA			150.0					
Agric. Unident. (7 projects)	IDA				165.0				
Agric. Unident. (7 projects)	IDA					165.0			
Grain Storage	IDA			5.0					
Telecommunications IV	IDA		78.0						
Telecommunications V	IDA			40.0					
Telecommunications VI	IDA				40.0				
Telecommunications VII	IDA					35.0			
DFC - ICICI VIII	IBRD	40.0							
DFC - ICICI IX	IBRD			40.0					
DFC - ICICI X	IBRD						40.0		
Education - Agric. University	IDA			20.0					
Education Unidentified	IDA						20.0		
Fertilizer - Nangal (Public)	IDA			20.0					
Fertilizer - Cochin (Public)	IDA		20.0						
Fertilizer - Debottlenecking	IDA			5.0					
Iron Ore - Marcona	IDA				40.0				
Industry - Tata Fertilizer	IBRD				25.0				
Industrial Imports VI	IDA	75.0							

(Contd.)

IVa. - INDIA - 5 YEAR LENDING PROGRAM

		(\$ millions)							
(Contd.)		1970	1971	1972	1973	1974	1975	1964-68	1969-73
Family Planning	IDA			15.0					
Power Transmission II	IDA		75.0						
Power Transmission III	IDA			60.0					
Power Unidentified I	IDA				15.0				
Power Unidentified II	IDA					15.0			
Power Unidentified III	IDA						60.0		
Highways II	IDA			30.0					
Railways X	IDA	55.0							
Railways XI	IDA			50.0					
Shipping	IDA			80.0					
Transportation Projects Unident.	IDA				60.0				
Transportation Projects Unident.	IDA					50.0			
Water Supply - Bombay	IDA			27.5					
Water Supply Unidentified I	IDA				15.0				
Water Supply Unidentified II	IDA					15.0			
Unallocated I	IDA			16.5					
Unallocated II	IDA				180.0				
Unallocated III	IDA					35.0			
Unallocated IV	IDA						40.0		
		<hr/>							
IBRD		40.0		40.0	25.0		40.0	189.0	145.5
IDA		227.5	303.4	500.0	500.0	320.0	320.0	591.0	1682.4
Total		<u>267.5</u>	<u>303.4</u>	<u>540.0</u>	<u>525.0</u>	<u>320.0</u>	<u>360.0</u>	<u>780.0</u>	<u>1827.9</u>
No.		6	8	19	8	6	6	13	44

3/11/71

Note: the IDA lending program
is to be adjusted to --

245.0 350.0 350.0 350.0 350.0

LOAN COMMITTEE

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April 13, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Turkey - Fruit and Vegetable Export Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated April 13, 1971 from the Europe, Middle East and North Africa Department, entitled "Turkey - Proposed \$10 Million Loan and \$15 Million Credit for Fruit and Vegetable Export Project" (LC/0/71-59).
2. Comments, if any, should be sent to reach Mr. Nijhof (ext. 4809) by 5:00 p.m. on Thursday, April 15.
3. It is planned then, if the Committee approves, to inform the Government and representatives of ABT that the Bank and the Association are prepared to begin negotiations for the proposed loan and credit on the terms and conditions referred to in the attached memorandum.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

Copies for Information:

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

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LC/O/71-59

April 13, 1971

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa Department

TURKEY - Proposed \$10 million loan and \$15 million credit for
Fruit and Vegetable Export Project

1. Attached for consideration of the Loan Committee is Appraisal Report PA-87, dated April 8, 1971, on a proposed \$10 million loan and \$15 million credit to the Government of Turkey for a Fruit and Vegetable Export project.
2. Other Bank and IDA operations contemplated for the near future are enumerated in the memorandum to the Loan Committee on the Education project (LC/O/7/-3a, dated March 19, 1971) and reference is made to the same document with regard to the economic position and prospects of Turkey.

The Project

3. Export promotion and institution building are among the major objectives around which the lending program for Turkey has been designed. Market studies have shown that excellent prospects exist for increasing exports in agriculture, especially fruits and vegetables to Europe. The project, which forms part of Turkey's export development program, is ambitious and complicated and requires a larger degree of coordination among ministries, the Agricultural Bank and sub-borrowers than has been the case so far; special attention has therefore been paid to organizational arrangements. The Bank/IDA finance would be largely channeled through the Agricultural Bank (ABT), with whom the Association recently entered into a Project Agreement for a dairy project. For both projects we would expect to have repeat operations in the coming five years through ABT. The agricultural credit survey incorporated in this project is also expected to pave the way towards lending in FY 1973 for ABT's general credit activities in addition to the specialized ones financed by the Bank so far.

Issues during negotiations

4. A recent Bank/IDA mission discussed the project in detail with the Turkish authorities in preparation of negotiations, and general agreement was reached on practically all points except the following two on which some differences of views exist.

Organization and Management

5. To avoid proliferation of project units and to meet our objective of institution building, the organization and management related to specific activities should ideally be placed in ministries or agencies under whose normal responsibility they fall. In the present context this would mean that the project be organized by the Ministry of Industry and Commerce on the one hand, and the Ministry of Agriculture on the other hand. However, at the time of the appraisal mission responsibility for activities covered by the project were spread over two separate ministries for Industry and Commerce and the S.P.O. The Agriculture Projects Department therefore concluded, and I agreed, that a division within the State Planning Organization would be best equipped to coordinate the export-related activities and provide the necessary technical assistance to sub-borrowers. However, the newly formed Government is reorganizing a number of ministries, and has combined the former Ministries of Industry and Commerce into one, which is, incidentally, headed by a former Bank staff member. We propose to review this question during negotiations and should it appear that this Ministry could handle the project, we would seek the Government's agreement to place the Project Unit there.

6. The Ministry of Agriculture has the authority and expertise to house the Citrus Extension Unit (C.E.U.) and I therefore concur with the proposal in the Appraisal Report that the C.E.U. be placed as an integrated unit under the Minister of Agriculture. A large part of the on-farm citrus development area lies within the area served by the Bank/IDA Seyhan Irrigation Project, and arrangements will be made, where appropriate, for the integrated Seyhan Extension Unit (also under the Ministry of Agriculture) to provide the on-farm development and part of the extension services within its boundaries. However, this unit is not empowered to operate outside the Seyhan perimeter, is mainly concerned with on-farm development, and has no particular citrus expertise; it is therefore not suitable to develop into a specialized extension unit for citrus in the entire area of this project, for which we need the separate C.E.U.

The Turkish authorities have not yet decided whether to place the latter under the Ministry of Agriculture or that of Village Affairs; this point will have to be discussed and arrangements satisfactory to the Bank agreed upon during negotiations.

Relending Rates

7. In the appraisal report it is recommended that the Agricultural Bank charge a uniform 10 percent interest to all categories of sub-borrowers under the project, namely for ferry ships, trailers, export-handling facilities and on-farm citrus development, but I wish to recommend, and Agriculture Projects Department concurs, that we should allow for some flexibility on this point during negotiations.

8. Following the general reform of the interest rate structure introduced concurrently with the devaluation measures and the stabilization program of August 1970, it is desirable that rates applied to sub-borrowers under the project fit as closely as possible in the pattern of rates now applicable to similar activities. The general effective rate to farmers is presently 9.5 percent, but we are of the opinion that 10 percent for citrus growers under this project is justified, because of the general shortage of funds and foreign exchange in particular, and because of the extensive technical assistance which is provided free to the farmers.

9. It is more difficult to determine the "normal" commercial rate for export-handling facilities, ships and trucks, because of (a) the multiple interest rate structure, (b) the complicated subsidy system based on whether an activity qualifies as a "privileged" industry or not, and (c) commitment charges and additional taxes which are in many cases levied on top of the interest rates. During negotiations we will have to ascertain what at this moment the exact rates and levies are for each particular sub-borrower. In any event, we would wish that they be charged a rate which corresponds as much as possible to the "normal" commercial rate. Comparison with TSKB rates may be appropriate, although it must be noted that the type of business is too risky for this institution, and that TSKB is short of funds anyway. TSKB's rate for export-oriented industries carrying their own foreign exchange risk is 10.5 percent, to which has to be added 0.5 percent commitment charge and 2.5 percent tax, making a total of 13 percent. Considering that the foreign exchange risk will be carried by the Government, and that the truck operators will realize a substantial rate of return, I recommend, and Agriculture Projects Department concurs, that truck operators should be charged a rate equal to TSKB's effective rate (13 percent). For export-handling facilities

and for ferry-ship operations, for which a lower rate of return has been estimated, I recommend, and Agriculture Projects Department concurs, that they be charged an effective rate of 10.5 percent inclusive of all taxes and commissions, which is the same as TSKB's basic rate. Such a rate would enable ferry-ships to operate under financial conditions somewhat closer to those prevailing for shipping in Europe than would be the case if a higher rate were applied. These percentages must be considered the upper limits which we would require, considering that this project is a first for Turkey and that we are particularly concerned to have qualified sub-borrowers participate.

Recommendation

10. I recommend that the Bank and the Association invite the Turkish Government and ABT to send representatives to negotiate a loan of \$10 million and a credit of \$15 million along the lines of the recommendations of paragraphs 7.01 through 7.04 of the appraisal report and of this memorandum.

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

Attachment

Population: 35.7 million
Per Cap. Inc: \$237

Attachment 1

TURKEY - Five Year Operations Program through 1976
(\$ millions)

		Fiscal Years						Total	Total	Total
		1971	1972	1973	1974	1975	1976	1964-68	1969-73	1972-76
Livestock I - Dairy	IDA	4.5								
" II -	IDA		15.0							
" III - Dairy	IDA			10.0						
" IV -	IDA					20.0				
Fruit-Vegetables I	IBRD	10.0								
" I	IDA	15.0								
" II	IDA			15.0						
" III	IDA					20.0				
Irrigation Rehabilita-										
tion I	IDA		10.0							
" II Unidentified	IDA				15.0					
" III	IDA						25.0			
Irrig. Ceyhan-Aslantas	IBRD		55.0							
Agriculture Credit I -										
Unidentified	IBRD			15.0						
Agriculture Credit II-										
Unidentified	IBRD					20.0				
Agriculture Unident. I	IDA				25.0					
" " II	IDA						30.0			
DFCs - TSKB VIII	IBRD	40.0								
" IX	IBRD			40.0						
" X	IBRD					40.0				
- Second Co. I	IBRD				15.0					
" " II	IBRD						15.0			
Education I-Vocational	IBRD	12.0								
" II-Agricult.	IBRD			10.0						
IGSAS Fertilizer	IBRD	23.0								
Eregli Steel	IBRD		65.0							
Paper Mill - Forestry	IBRD			20.0						
Industry & Mining -										
Unidentified I	IBRD				40.0					
Industry & Mining -										
Unidentified II	IBRD						25.0			
Power - TEK I	IBRD	24.0								
" II Unident.	IBRD			35.0						
" III "	IBRD					35.0				
- Cukurova III -										
Supplementary	IBRD	6.5								
Urbanization I (incl.										
water & power)	IDA		15.0							
" II (incl.										
sewerage)	IDA			15.0						
" III	IDA					15.0				
Tourism I	IBRD		5.0							
" Unident. II	IBRD				15.0					
" " III	IBRD						20.0			
Railways I	IBRD		35.0							
" Unident. II	IBRD				40.0					
" " III	IBRD						35.0			
Program Loan	IBRD			40.0						
Operations program	IBRD	115.5	160.0	160.0	110.0	95.0	95.0	10.0	509.0	620.0
	IDA	19.5	40.0	40.0	40.0	55.0	55.0	54.0	111.5	230.0
Total		135.0	200.0	200.0	150.0	150.0	150.0	64.0	620.5	850.0
		7	7	9	6	6	6	3	27	34

LOAN COMMITTEE

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SEP 05 2014

April 12, 1971

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MEMORANDUM TO THE LOAN COMMITTEE

Turkey - Transmission Project, Turkish Electricity Authority

1. The Committee is requested to consider, without meeting, the attached memorandum dated April 12, 1971 from the Europe, Middle East and North Africa Department, entitled "Turkey - Proposed \$24 Million Loan to Turkiye Elektrik Kurumu (TEK)" (LC/0/71-56).
2. Comments, if any, should be sent to reach Mr. Bart (ext. 4807) by 4:00 p.m. on Wednesday, April 14.
3. It is planned then, if the Committee approves, to inform the Government and representatives of TEK 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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Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

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LC/0/71-56

April 12, 1971

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa Department

TURKEY - Proposed \$24 million Loan to Turkiye Elektrik Kurumu (TEK)

1. Attached for consideration of the Loan Committee is Appraisal Report (PU-69), dated April 5, 1971, on a proposed \$24 million loan to Turkiye Elektrik Kurumu (Turkish Electricity Authority or TEK). This loan would be the first for the newly established TEK; the Bank and IDA made previously five operations for power in Turkey, as well as a technical assistance grant of \$1.95 million in 1965 for reorganization of the power sector in Turkey.
2. Execution of most of the power projects for Turkey has been satisfactory. The construction period for the Keban Power Transmission Project (Loan 568-TU), which covers the most important line of the national grid to Ankara and Istanbul, has been prolonged to accommodate delays which have occurred in the building of the related Keban Dam Power Project (not financed by the Bank), but the Bank project is progressing satisfactorily. Part of the work on the Second Cukurova Power Project (Credit 59-TU) was originally substantially delayed because of a contractor dispute, but since 1969 progress has been satisfactory; it will be necessary to postpone the closing date by six months to December 31, 1971 to meet final contract payments. The Third Cukurova Power Project (Loan 623-TU) has consequently been delayed by one year and there have been cost overruns which have not, however, affected the viability of the project. The appraisal report related to a fourth loan to Cukurova Elektrik will be submitted shortly to the Loan Committee.
3. Other Bank and IDA operations contemplated for the near future are enumerated in the memorandum to the Loan Committee on the Education project (LC/0/7/-3a, dated March 19, 1971). Reference is made in the same document to the present economic position and prospects of Turkey.

The Project

4. The lending program for Turkey approved at the recent CPP review points to the need for the Bank to pursue its assistance to the power sector in order to continue the institution building effort which already caused the Government to create TEK; to seek adequate pricing policies which have so far not been given sufficient attention in the State Economic Enterprises; and to assist TEK in rationalizing its ambitious development program. The latter envisages investment in the order of \$1.3 billion during 1971-77, excluding distribution and village electrification which may require an additional \$250 million. Bank assistance for selected key projects in the program is contemplated. The Government has already approached the Bank to assist in organizing the financing of the large Elbistan thermal (lignite) project and the Karakaya dam and hydroelectric plant on the Euphrates. TEK's program is being tested on the computer model developed by the Bank for determining optimum investments in the power sector. The results of this test as well as of the review of the Government's energy policy requested by the Bank in connection with the Elbistan project will help identify the priority projects which could be considered for Bank financing. Meanwhile, two loans for power of \$35 million each have been tentatively included in the lending program for FY 73 and 75, in addition to the project discussed in the present paper, to the fourth Cukurova project and to the small power distribution project contemplated as one part of the multi-pronged approach to urban development in the Greater Istanbul area. The size of the lending contemplated for power in Turkey will be kept under review in the light of the relative importance of the Bank's objectives in this sector and in other sectors which may have competing claims on Bank resources.

5. The present project is a straightforward one and carries the development of the national grid a stage further by the construction of various links and additions which unite or strengthen existing installations. The works in this Project are substantially TEK's electricity transmission construction program for the period 1971-1974 and account for about 20 percent of the program. If the increase in tariff discussed below was implemented, TEK's internal cash generation in 1971-1974 would finance about 27 percent of the capital program leaving a substantial gap to be filled by other sources.

6. The creation of TEK and the reorganization of its accounts carried out under the Bank's technical assistance grant represent substantial progress. There are still, however, a number of issues which would weigh on the orderly long-term development of the power sector. Among these are the planning and construction of hydroelectric projects and the village electrification program which are mentioned in the Appraisal Report (paras. 6.04 - 6.07) and will be taken up during negotiations concurrently with the other recommendations mentioned in para. 8.02. The only ones which raise immediate policy issues are those related to tariff action and to procurement which are discussed below.

Project Issues

7. Tariffs. TEK's present tariffs, which are applied to its 1500 customers, mostly municipal authorities or private concessionaries responsible for distribution and large industrial plants, have averaged US \$0.01 per Kwh (at the current exchange rate) since March 1, 1967 when the previous tariff was raised by about 45 percent. No adjustments in tariffs have been introduced since that date although substantial increases would have been required to compensate for inflation prior to the August 1970 devaluation, for the latter's impact on costs (e.g. a 45 percent increase in fuel oil costs and higher construction expenditures and depreciation charges) and for the revaluation of assets undertaken at the time of creation of TEK.

8. Loan 568-TU (Section 2.11 of the Project Agreement) required that Etibank (TEK's predecessor) should earn on its power assets an annual return of 8 percent as from the fiscal year starting January 1, 1970, and provided that for the fiscal year in which the Keban hydro-electric project shall have been placed into service (then thought to be 1972) and for the two subsequent years the return shall not be less than 7 percent. The law establishing TEK which became effective in October 1970, also prescribed an 8 percent return as a statutory requirement without, however, providing for any relaxation after Keban is placed into service; the Ministry of Finance has recently confirmed to the Bank its intention to adhere to this provision of the TEK law. This provision makes it necessary to reconsider the reduction to 7 percent provided for by the Project Agreement. Moreover, TEK's cash generation requirements for the financing of its large expansion program would justify its continuing to earn 8 percent after 1974.

9. The Project Agreement (Schedule 2, para (ii)) further provided that any shortfall in the required annual return for a fiscal year shall be carried forward and added to the required return for the next fiscal year. The actual return earned in 1970 was 5.4 percent thus resulting in a shortfall of 2.6 percent, in relation to the stipulated 8 percent return. If the shortfall in earnings were to be made up in 1971 in accordance with the Project Agreement, then a 64 percent tariff increase would be required effective as of April 1, 1971. Such an increase would, however, be excessive since it would lead to substantial cash surpluses in subsequent years. The Appraisal Report (para. 7.16) recommends, and I concur, that TEK be allowed to make up the shortfall over a longer period of time. I propose that this relaxation of the provision of Loan 568-TU be notified to the Executive Directors concurrently with the proposed loan. A new rate of return covenant would be negotiated in connection with the proposed loan along the lines indicated in paras. 7.16 - 7.17 of the Appraisal Report and we would also seek agreement on periodic reviews and some automaticity in adjusting TEK's tariffs to cover increases in costs (para. 7.07 of the Appraisal Report).

10. The financial forecasts in the Appraisal Report assume that the 1970 earnings shortfall would be made up over the Project construction period. This, together with the 8 percent return requirement, would require a tariff increase of 48 percent effective from April 1, 1971. Although the previous Government had had a tariff increase of this magnitude under consideration since January of this year, this issue is obviously of some importance to the new Government which may need some time to decide upon it after defining its economic policies. In applying the requirement to recover the shortfall, we would wish to avoid creating a situation which would require a large increase this year and a reduction in the following year, but obviously we would not be prepared to accept a tariff action which would result in an unsatisfactory rate of return in this year or subsequent years over the Project period covered in the forecasts. For this reason, we propose that the Bank should invite negotiations, but that negotiations not be started until the Government has decided to implement the tariff increase in an amount and with a timing acceptable to the Bank.

11. Concern has been expressed in Turkey about the possible inflationary impact of a substantial increase in power rates. It is likely that most power distributors, which are bulk purchasers from TEK, would have to pass such increase on to their customers and, indeed, two major municipalities have recently increased their rates and the Government has tacitly permitted Cukurova Elektrik to enforce recently an increase of 50 percent in its retail rates, as allowed by its concession. The average wholesale tariff in Turkey is at present reasonably comparable to the respective rates in Europe. Furthermore, apart from certain specialized industries such as cement, fertilizers and eventually alumina, power accounts for only about 1-2 percent in the cost structure of most industries in Turkey and an increase in tariffs would have little impact on their prices. Nevertheless, the Bank cannot ignore the potential inflationary effect of a large adjustment in TEK's tariffs on industrial competitiveness and the costs of special large consumers but the need to introduce sound pricing policies in the public enterprise sector appears at this stage more important.

12. Procurement. Materials and equipment financed from the proposed loan would be purchased through international competitive bidding in accordance with the Bank's guidelines. Local manufacturers, principally of conductors and small transformers, would be allowed to compete, and TEK and the Government have requested preferential treatment for these local suppliers. If local suppliers win awards, the Bank loan would be used to finance the foreign exchange component only. Three alternative preference provisions are set forth in para. 4.06 of the Appraisal Report.

I recommend, and Public Utilities Projects Department concurs, that in keeping with current Bank practice, the "conventional" 15 percent preference proposed in alternative (i) be applied, leaving it to the Government to waive duties on imported components incorporated in local bids or not.

Recommendation

13. I recommend that the Bank invite TEK and the Government of Turkey to send representatives to negotiate a loan of \$24 million along the lines of the recommendation of paragraphs 8.01 through 8.04 of the Appraisal Report and in this Memorandum.

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

Attachment

Population: 35.7 million
Per Cap. Inc: \$237

Attachment 1

TURKEY - Five Year Operations Program through 1976
(\$ millions)

		Fiscal Years						Total	Total	Total
		1971	1972	1973	1974	1975	1976	1964-68	1969-73	1972-76
Livestock I - Dairy	IDA	4.5								
" II -	IDA		15.0							
" III - Dairy	IDA			10.0						
" IV -	IDA					20.0				
Fruit-Vegetables I	IBRD	10.0								
" I	IDA	15.0								
" II	IDA			15.0						
" III	IDA					20.0				
Irrigation Rehabilita- tion I	IDA		10.0							
" II Unidentified	IDA				15.0					
" III	IDA						25.0			
Irrig. Ceyhan-Aslantas	IBRD		55.0							
Agriculture Credit I - Unidentified	IBRD			15.0						
Agriculture Credit II- Unidentified	IBRD					20.0				
Agriculture Unident. I	IDA				25.0					
" " II	IDA						30.0			
DFCs - TSKB VIII	IBRD	40.0								
" IX	IBRD			40.0						
" X	IBRD					40.0				
- Second Co. I	IBRD				15.0					
" " II	IBRD						15.0			
Education I-Vocational	IBRD	12.0								
" II-Agricult.	IBRD			10.0						
IGSAS Fertilizer	IBRD	23.0								
Eregli Steel	IBRD		65.0							
Paper Mill - Forestry	IBRD			20.0						
Industry & Mining - Unidentified I	IBRD				40.0					
Industry & Mining - Unidentified II	IBRD						25.0			
Power - TEK I	IBRD	24.0								
" II Unident.	IBRD			35.0						
" III "	IBRD					35.0				
- Cukurova III - Supplementary	IBRD	6.5								
Urbanization I (incl. water & power)	IDA		15.0							
" II (incl. sewerage)	IDA			15.0						
" III	IDA					15.0				
Tourism I	IBRD		5.0							
" Unident. II	IBRD				15.0					
" " III	IBRD						20.0			
Railways I	IBRD		35.0							
" Unident. II	IBRD				40.0					
" " III	IBRD						35.0			
Program Loan	IBRD			40.0						
Operations program	IBRD	115.5	160.0	160.0	110.0	95.0	95.0	10.0	509.0	620.0
	IDA	19.5	40.0	40.0	40.0	55.0	55.0	54.0	111.5	230.0
Total		135.0	200.0	200.0	150.0	150.0	150.0	64.0	620.5	850.0
		7	7	9	6	6	6	3	27	34

EMENA DEPARTMENT
March 30 1971

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LOAN COMMITTEE

SEP 05 2014
WBG ARCHIVES

April 12, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Brazil - Santos Port Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated April 12, 1971 from the South America Department, entitled "Brazil - Proposed Bank Loan for Santos Port Project" (LC/0/71-57).
2. Comments, if any, should be sent to reach Mr. Carnemark (ext. 2770) by 4:00 p.m. on Wednesday, April 14.
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)

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LC/0/71-57

April 12, 1971

LOAN COMMITTEE

Memorandum from South America Department

BRAZIL - Proposed Bank Loan for Santos Port Project

1. Attached is Appraisal Report No. PTR-79 recommending a Bank loan of \$45 million to Brazil to finance the foreign exchange component of civil works and the procurement of equipment in the Santos Port Project.

The lending Program

2. Two loans, an \$8.4 million Bank loan for the Technical and Agricultural Education Project and a \$70 million Bank loan for the Salto Osorio Hydroelectric Project have been approved by the Board this fiscal year; two other loans, a \$22 million Bank loan for the Sao Paulo Water Supply Project and a \$15 million Bank loan for the Sao Paulo Pollution Control Project have been negotiated. A \$50 million Bank loan to Mineracoes Brasileiras Reunidas, S. A. (MBR) and a \$46 million Bank loan to Rede Ferroviaria Federal, S. A. (RFFSA) are shortly to be negotiated. The Santos Port loan is the last one for this fiscal year. The five-year lending program (fiscal years 1971-75) is attached.

The Economy

3. The recent Economic Report on Brazil (WH-203a) issued on January 22, 1971 indicates that in the last three years the Brazilian economy sustained rapid growth while the country's international liquidity position has been strengthened. Brazil continues to be creditworthy for substantial amounts of Bank lending.

Sector Objectives

4. Our lending in the transportation sector has two objectives -- first, to assist the Government in the reform of the transportation sector as a whole and second, to help in financing individual projects. In connection with the last two highway loans, we received from the Government Plans of Action outlining programs of reform and rehabilitation for various parts of the sector. The Plans of Action included specific measures for improving the management of the Port Sector. However, there has been some delay in the implementation of these measures. The loan documents will commit the Government to take specific measures to improve investment planning and utilization of resources in the entire Port Sector. The Government would covenant to undertake a program to

transform DNPVN into an agency responsible for policy formulation, investment programming and tariffs as well as becoming a holding company for Government participation in individual ports. The program would also include specific measures for decentralization of port management and introduction of accounting, costing and managerial information systems and training at major ports. A major consideration in future Bank lending for ports in Brazil would be the implementation of the program. A detailed study of the accounting and costing systems at the Port of Santos will also be undertaken and would be used as a basis for a unified tariff structure to be introduced in the port. Furthermore, the administration of the port would be reorganized to facilitate operational improvements.

The Project

5. The Government of Brazil has formulated a five-year development program (1971-75) for the Santos Port, costing about \$143 million. The Bank Project falls within this program and consists of the construction of corn and container terminals on the newly developed left bank of the estuary, rail and road access to these facilities, dredging equipment and related consulting services. Total cost of the Bank Project is estimated at \$78.5 million. The proposed Bank loan of \$45 million for a term of 25 years, including a five-year grace period, would finance equipment to be submitted to international competitive bidding and the estimated foreign exchange component of civil works and consulting services. Although the proposed loan would finance 57 percent of the Project, it would finance about a third of the program of which the Project is an integral part. Brazilian manufacturers of equipment would be given a 15 percent margin of preference and the Bank would finance the cost of such items, irrespective of whether the orders were placed with Brazilian or foreign sources. Much of the equipment included in the Project is not manufactured in Brazil. However, insofar as some orders are placed with Brazilian manufacturers, there may be a small amount of local expenditure financing. This is recommended on country grounds, as explained in paragraph 38 of the Country Program Paper on Brazil (November 9, 1970). Retroactive financing is recommended to reimburse up to \$500,000.00 of payments to management and engineering consultants incurred after September 1970.

6. The Bank loan would be made to the Government, with the National Ports Department (DNPVN) as executing agency for all port works. The Federal Railways (RFFSA) and Sorocabana (a railway owned by the State of Sao Paulo) would carry out related railway works. Conclusion of arrangements satisfactory to the Bank for the completion of railway works would be a condition of effectiveness. The overall port planning study would be carried out by GEIPOT (a unit within the Ministry of Transport dealing with transport coordination and studies).

Port Charges and Need for Bank Loan

7. Port charges in Brazil comprise mainly two parts. First, the tariff and second, the port improvement tax levied on imports and coastal shipping. 40 percent of the yield of the port improvement tax levied on traffic in a particular port is available for investments in that port, while the remaining 60 percent forms part of the general budget of DNPVN and is available for port investments throughout Brazil. Considering the tariffs in the Port of Santos and the 40 percent of the port improvement tax available for investments within the port, the level of the Santos Port tariffs yields a high return (paragraph 7.09 of the Appraisal Report). It will generate sufficient funds to meet local currency costs of the Bank Project and the full costs of the other parts of the development program. The 60 percent of the port improvement tax accruing to DNPVN would contribute to an accumulation of cash in the department unless investment programming and execution are improved or the tax rate lowered. A recent review of DNPVN's investment program made in connection with our general economic review indicates inadequate investment programming and under-utilization of resources available to the department. However, as explained above, the Project includes an overall port planning study which would focus particularly on formulating a future investment program for the sector.

8. Port charges, including the port improvement tax, would produce a rate of return of about 30 percent on revalued assets. These port charges are substantially higher on imports than on exports, and are therefore a part of the protective mechanism and increases the cost to Brazilian consumers. Furthermore, vis-a-vis road and rail transportation, the high port charges and other levies on coastal shipping constitute a penalty on this mode of transportation which may otherwise be a more economic means of transportation over longer distances. The Project includes a study of the tariff structure and other charges of the Port of Santos and assurances would be obtained during negotiations that new unified port charges, taking into account the cost of handling different kinds of traffic, would be introduced. A rate of return on capital invested would have to be defined in setting port charges and I would have preferred a covenant prescribing a rate of return after the tariff reform. However, the Transportation Projects Department feels that it is not necessary to prescribe a rate of return, but it is enough to require that the revised tariffs be set at a level (which could be lower than the current combination of tariffs and port improvement tax) sufficient to cover the cost of port operations and to generate a reasonable portion of future investment programs. 1/

1/ The Appraisal Report recommends a level of tariffs which would generate funds for the investments in the port. Since the level of investments may vary from year to year and since financing all investments from tariffs may lead to an unrealistically high level of tariffs, it is proposed, and Transportation Projects Department agrees, to limit the requirement to financing a portion of the future investment program.

9. Projections of the resources of DNPVN, on the basis of the present port improvement tax and the present national investment program indicate that the Department would have resources available for financing the proposed project entirely from its own resources. However, I am recommending a Bank loan on the grounds that a study of port tariffs and taxes would lead to a lowering of these charges or a distribution of surpluses by way of income tax or dividends to Government and that the proposed study of investment requirements would lead to a higher utilization of resources than presently projected. The loan is further justified at this time in terms of the contribution it makes to defining the future program for the port sector, including institutional reforms.

Recommendation

10. I recommend that the Bank inform the Government of Brazil that it is prepared to negotiate a loan of \$45 million under the terms and conditions set forth in the attached Appraisal Report.

Gerald Alter
Director

Attachment.

Population: 93.3 m
GMP Per Cap: \$286

BRAZIL - 5 YEAR LENDING PROGRAM

		(\$ millions)							
		Fiscal Year					Total	Total	
		1971	1972	1973	1974	1975	1976	1964-68	1969-73
Land Settlement I	IBRD		10.0						
Agricultural Credit I	IBRD		20.0						
Land Settlement II	IBRD				30.0				
Agricultural Credit II	IBRD					30.0			
Agricultural Research in NE	IBRD			10.0					
Livestock II	IBRD						60.0		
DFC - Industrial Finance I	IBRD		12.5						
DFC - BNB II	IBRD			35.0					
DFC - Industrial Finance II	IBRD				50.0				
DFC - BNB III	IBRD					40.0			
DFC - Industrial Finance III	IBRD						60.0		
Education I	IBRD	8.4							
Education II	IBRD			20.0					
Iron Ore - MBR	IBRD	50.0							
Steel - USIMINAS	IBRD		40.0						
Steel - COSIPA	IBRD		50.0						
Steel - CSN	IBRD		70.0						
Iron Ore - North	IBRD				50.0				
Power - Salto Osorio	IBRD	70.0							
Power - Sao Simao	IBRD		75.0						
Power - Itumbiara	IBRD				75.0				
Power - Agua Vermelha	IBRD					75.0			
Power - Unidentified	IBRD						75.0		
Highways III	IBRD		100.0						
Highways IV	IBRD			100.0					
Sao Paulo Beltway	IBRD			60.0					
Highways V	IBRD					100.0			
Highways VI	IBRD						100.0		
Ports I - Santos	IBRD	50.0							
Ports II - Recife	IBRD		10.0						
Ports III - Rio	IBRD			15.0					
Railways I - MBR Link	IBRD	46.0							
Railways II	IBRD		50.0						
Railways III	IBRD				50.0				
Transportation Unidentified	IBRD				75.0				
Transportation Unidentified	IBRD					75.0			
Water Supply - Sao Paulo	IBRD	37.0							
	IBRD	261.4	437.5	240.0	330.0	320.0	295.0	291.1	1181.8
No.		6	10	6	6	5	4	10	28

LOAN COMMITTEE

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SEP 05 2014

April 12, 1971

WBG ARCHIVES

MEMORANDUM TO THE LOAN COMMITTEE

Colombia - Second Atlantico Development Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated April 12, 1971 from the South America Department, entitled "Colombia - Proposed Loan for Second Atlantico Development Project" (LC/0/71-58).
2. Comments, if any, should be sent to reach Mr. Flood (ext. 2191) by 4:00 p.m. on Thursday, April 15.
3. It is planned then, if the Committee approves, to inform the Government and representatives of INCORA 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
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Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

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SEP 05 2014

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LC70/71-58

April 12, 1971

LOAN COMMITTEE

Memorandum from South America Department

COLOMBIA: Proposed Loan for Second Atlantico Development Project

1. Attached is the draft Appraisal Report No. PA-84 recommending a Bank loan of US\$5 million to the Republic of Colombia for use by the Colombian Institute for Agrarian Reform (INCORA).

Lending Program

2. The proposed loan would be the final loan presented to the Loan Committee as part of the current year's lending program which comprises six projects. (See five-year lending program attached to the Memorandum to the Loan Committee of March 17, 1971 (LC/O/71-36) on the Second Bogota Water Supply Project.) Negotiations have been substantially completed on the Telecommunications II (US\$15 million), Caqueta Land Colonization (US\$8.1 million), Fourth Development Finance Companies (US\$40 million), Second Bogota Water Supply (US\$88 million), and Palmira Water Supply (US\$2 million) projects.

The Economy

3. This is covered in the Memorandum to the Loan Committee of December 11, 1970 on the Second Telecommunications Project (LC/O/70-128).

Background

4. The proposed loan would be the eighth for agriculture in Colombia (including the proposed Caqueta Land Colonization loan) and the fourth to be administered by INCORA. The first Bank loan for an INCORA project was the US\$9 million loan made in 1967 for the first Atlantico project, located in the southeastern portion of the Department of Atlantico, which involved principally irrigation works for about 3,900 ha., flood-protection and supplementary drainage works for an additional 6,000 ha., and feasibility studies for future stages of the works. The consultants retained by INCORA under this loan found that the salinity problem was more widespread than had been previously identified, and construction works were purposely slowed until the problem was resolved by the decision early in 1970, by the Bank and INCORA, to remove 900 ha. of marginal land from the area

originally identified for irrigation development and replacing it by 1,600 ha. (one-half to be fully irrigated and the other half to receive only supplementary irrigation during the rainy season) lying adjacent to the original lands. It was also decided at this time to reduce the scope of the studies for future stages (including the proposed Project) to include only a determination of the feasibility of dry farming development. The reason for this was to avoid the complexities involved in introducing an additional flow of water into an area with no natural outlet for surface water and an underlying saline groundwater. Execution of the first project is now proceeding normally, and it is expected that it can be completed by the original closing date of December 31, 1972.

The Project

5. The purpose of the Second Atlantico Project is to supplement the flood protection and drainage works being constructed under the first project in order to extend the area suitable for dry farming from 6,000 to 17,000 ha. INCORA already owns approximately 3,200 ha. of the Project area and would obtain the remainder from private landowners by way of either voluntary purchase or expropriation with compensation in accordance with the Agrarian Reform Law. The acquired lands would be sub-divided into lots of at least 8 ha. and distributed to a total of approximately 2,100 small farmers or farm workers from the surrounding areas. (Private landowners are legally entitled to retain a portion of their holdings, up to a maximum of 100 ha., but based on past experience in this area, few, if any, are expected to take advantage of this possibility.) The 8 ha. plot was chosen as the minimum necessary to permit the farmer to obtain a net farm income of at least US\$900 equivalent per annum at full development.

6. The Appraisal Report states that total Project costs are US\$9.32 million, of which the Bank would finance the estimated foreign costs of US\$3.3 million and US\$0.8 million of local costs. The US\$5.0 million Bank loan would also finance US\$0.9 million of interest during construction. With the proposed amount of financing for local costs (and interest during construction), the Bank's share of total Project costs would be 44 percent (49 percent of total financing requirements). I consider this an appropriate share if the Bank is to make a significant contribution to the Project, particularly as Project costs are defined rather narrowly; they do not include the additional seasonal agricultural credit required for the development of new cropping patterns by Project farmers, which would reach US\$2.73 million per season at full development. A country case for local currency financing is presented in the latest economic report (WH-200a of November 1, 1970). The external financing plan requires annual project loan commitments of about US\$300 million in the years 1971-75, and this

is not likely to be achieved through financing only the foreign costs of projects to which external financing can be attached. As for public sector finances, Bank financing of some local costs in Colombia has been handled in such a way as to complement domestic efforts to increase public savings.

7. About US\$1.6 million of the proposed loan would finance the cost of civil works (drains, roads, land preparation and buildings), US\$1.2 million would finance the CIF cost of imported equipment (vehicles, farm machinery, operation and maintenance equipment), US\$0.7 million would finance consulting services and training of INCORA personnel, and US\$0.6 million would remain unallocated and available to cover contingencies. International competitive bidding procedures would be followed in letting contracts for civil works and for equipment purchases. Because of the amounts involved, the draft Appraisal Report assumes that all civil works contracts will be awarded to Colombian firms. The cost estimates also assume that, because of the type of equipment involved, all equipment contracts would be awarded to foreign firms, even though at the request of the Government, local manufacturers would participate in the international competitive bidding under a 15 percent margin of preference. If, however, any equipment contracts are won by Colombian manufacturers, the ex-factory cost of the equipment, net of local taxes, would be eligible for Bank financing.

8. The proposed term of the loan is for 25 years including five years' grace. The useful life of project facilities has been assessed at 40 years; and we have agreed on country grounds to make loans to Colombia for infrastructure projects at a minimum of 25 years.

9. The Appraisal Report states that the economic rate of return of the Project is 19 percent. This assumes a zero opportunity cost for family labor, based on the considerable unemployment and under-employment that exists in the Project area and the nearby urban centers. If, however, family labor is costed at about US\$1 equivalent per day (the going rate for hired labor), the Project yields an economic rate of return of 13 percent, which is still acceptable. With regard to the recovery of Project costs from the ultimate beneficiaries, I agree with Agricultural Projects Department's recommendation that this matter be treated in the same way as it is being handled under the first loan, i.e., assurances would be obtained during negotiations that, upon completion of the study of Project farmers' repayment capacity currently underway by INCORA (and expected to be completed in early 1972), the Government would levy a charge on Project farmers sufficient to cover operation and maintenance costs of the Project and as much of the capital expenditures as feasible after consideration of the farmers' incentives and repayment capacity.

10. Another matter which I wish to call to your attention is the current controversy in Colombia over the agrarian reform program. It was conceived as a middle of the road reform program which would improve the lot of the small farmer without sacrificing production, and which would proceed fast enough (currently dealing with about 20,000 families annually) to offer some hope to the rural poor, but not so rapidly as to provoke too strong a reaction from property owners. However, in 1970, INCORA did provoke just such a reaction by moving to expropriate high value land in the region where landowners are most prosperous and most militant, namely the Cauca Valley. Meanwhile, left of center opinion intensified the controversy, by urging INCORA to accelerate its land redistribution activities and, in particular, to expropriate high value agricultural land more boldly (a viewpoint which had been reinforced by the recent International Labor Organization's report on the unemployment problem in Colombia). In an attempt to cool the controversy and to demonstrate to the public his concern for the problem, President Pastrana appointed a commission late in 1970 composed of representatives from almost all shades of the political spectrum to evaluate the agrarian reform program and agricultural development in general and to produce recommendations for improvement. The commission's report which emerged last February leaned somewhat to the right. Among the more important of its conclusions were that expropriation of adequately exploited land should be done only under very special circumstances and that a tax should be imposed on imputed income from agricultural lands (the latter idea originating with landowners who see it as an alternative to expropriation). Since little in the way of expropriation of adequately exploited land has taken place anyway, it is not expected that the report will bring about major changes in the agrarian reform program, but it does seem for the moment to have taken some of the steam out of the controversy. For the future, we expect INCORA's land redistribution activities to continue, in the midst of recurring attacks from both left and right.

11. We have already had some experience of the effects of such controversy on the institution and its programs. In early March, following publication of the commission's report, the Manager of INCORA was replaced by the present Manager, Dr. Barberena. A substantial number of INCORA's key personnel immediately resigned in support of the former manager. Most of them have since returned to their posts, but it is not yet clear how long they will remain. We are watching the situation closely. With regard to the Atlantico project, the project manager, to our knowledge, was not one of those who resigned initially and intends to remain. During negotiations of the proposed loan we would seek assurances that appointments to the post of project manager would be made only after consultation with the Bank.

12. Another problem which has arisen partly as a result of the controversy surrounding INCORA is its recent difficulty in obtaining from the Government budget the local funds required to support its investment programs. While this problem does not appear to have affected the first Atlantico project so far, there is currently a deficiency of approximately US\$2 million equivalent in the amounts required for the Agricultural Credit Project (Loan 624 CO). Before submitting the proposed loan to the Executive Directors, we would seek assurances from the Government that the contributions to which it is committed under Loan 624 CO are being brought up to date at a satisfactory rate. We would also seek agreement during negotiations on a timetable for the required budgetary contributions under the proposed loan.

Recommendation

13. I recommend that the Government and INCORA be invited to send representatives to negotiate a loan of US\$5.0 million for the Second Atlantico Development Project on the terms and conditions set forth in the Appraisal Report, suitably modified to include the measures proposed in paragraph 12 above.

Gerald Alter
Director

Attachments

LOAN COMMITTEE

DECLASSIFIED

SEP 05 2014

WBG ARCHIVES

April 8, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Nigeria - Fifth Highway Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated April 8, 1971 from the Western Africa Department, entitled "Nigeria - Fifth Highway Project" (LC/O/71-55).
2. Comments, if any, should be sent to reach Mr. Osgood (ext. 4524) by 4:00 p.m. on Monday, April 12.
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
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Copies for Information:

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

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LC/O/71-55

April 8, 1971

LOAN COMMITTEE

Memorandum from the Western Africa Department

Nigeria - Fifth Highway Project

1. Attached is an appraisal report (No. PTR-78) dated April 2, 1971 recommending a loan of \$16 million equivalent to the Government of Nigeria to assist in the financing of construction or reconstruction of roads in the Western State of Nigeria; technical assistance in carrying out feasibility studies and final engineering of Federal and State roads throughout Nigeria; and improvements in highway planning and maintenance.

2. One loan - for \$10 million equivalent to the Nigerian Industrial Development Bank - has been extended to Nigeria during FY 1971. A \$7.2 million loan for a cocoa project in the Western State and a rehabilitation program loan of \$80 million to the Federal Government have been negotiated and both loans are scheduled for Board presentation later this month. The lending program through FY 1976 is attached.

Background

3. Nigeria has a relatively well developed highway system, and few areas are seriously hampered in their economic development by lack of access. However, with the rapidly increasing density and weight of road traffic, many roads are now inadequate. Several road construction and improvement schemes are under way in Nigeria, some with Bank financial assistance, and further projects are being prepared. However, the only priority roadworks now ready for Bank lending are in the Western State, following their identification in 1965 under a UNDP-financed road survey, and final engineering under Loan 427-UNI. The proposed roadworks will substantially reduce transport costs over the roads concerned, and will thus contribute to economic development. In addition, the project recognizes Nigeria's overall, immediate needs in the fields of planning, project preparation and highway administration and provides for technical assistance in these fields.

4. Nigeria's Second National Development Plan (1970-74) provides for road investment to the value of £N166 million (\$466 million). About a third of the program is for the rehabilitation and reconstruction of roads damaged as a result of the war, and the Bank is participating in this work by means of the Highway Rehabilitation Loan (640-UNI, 1969) and the Transport Rehabilitation Loan (694-UNI, 1970). Some of the schemes for new construction - the Lagos-Ibadan, Ibadan-Ife and Jaredi-Kontagora roads, for example - are being prepared with Bank assistance. In parallel with new road construction there must also be improvements in highway planning, administration, maintenance and care of highways.

The Economy

5. An economic report, "The Current Economic Position and Prospects of Nigeria" (AW-22a), was circulated to the Executive Directors on January 29, 1971. A year after the surrender of the secessionists the chief legacies of the civil war facing the Nigerian economy are the need to restore vital infrastructure facilities and the scarcity of resources to finance rehabilitation and other development expenditures. Outside the eastern states - the area directly affected by hostilities - the economy has been little affected by the war: agricultural production was well maintained and industrial output, spurred by the adoption of war-time controls, expanded. There was, however, serious and widespread damage to the country's infrastructure, particularly in the transport sector, reflecting overuse and deferred maintenance of plant and equipment. Moreover, public and private investment (except in certain manufacturing lines) were severely curtailed during the war and the country's administrative structure suffered from the break-up of the four former regions into twelve states and the withdrawal of large numbers of trained civil servants from positions in the Federal Government and in the public authorities.

6. Nigeria's Plan anticipates that the rate of growth of real GDP will rise from less than 5 percent p.a. in 1971 to 9 percent p.a. in 1974. Petroleum production and manufacturing are expected to be the major growth sectors, while agricultural output, still the mainstay of the economy, is projected to rise only 2.4 percent per annum, or at about the same rate as population. Total planned investments of \$4.5 billion represent about 20 percent of GDP, almost evenly divided between the public and private sectors. The Government expects that nearly half of the anticipated private investment will come from abroad and that much of this will be concentrated in the petroleum industry. Government investment, on the other hand, is to be financed primarily (70 percent) from public savings. Projected

public capital inflows during the Plan period are, however, equivalent to nearly 20 percent of public planned investment. The emphasis in the first two years of the Plan period is largely upon reconstruction and rehabilitation with a view to restoring the country's productive capacity and overcoming losses and damage suffered during the war.

7. During the first two years of the Plan a continuing shortage of foreign exchange may well be the most critical factor affecting the Nigerian economy and this will almost certainly impose restraints on the level of investment and the volume of imports, particularly of consumer items. Nigeria's reserves are currently equivalent to less than two months' imports. Short-term liabilities to the private sector representing approved applications for foreign exchange, substantially exceed total reserves and have risen rapidly in recent months to £N143 million at the end of March. The Bank estimates that Nigeria will have a deficit on current and capital account of approximately \$200 million in its fiscal year beginning April 1, 1971 - without allowance for any reduction in short term liabilities - in contrast to a deficit of roughly \$300 million in the previous year.

8. Nigeria's external public debt currently is low and favorably structured: of the debt outstanding at the end of March 1970, only about 10 percent represented suppliers' credits. Debt service payments in 1970 are estimated at 7-8 percent of foreign exchange earnings (including net receipts of the petroleum sector). Hence, and in view of the expected rapid rise in foreign exchange revenues from petroleum, Nigeria is creditworthy for substantial amounts of borrowing on conventional terms.

The Project

9. The project consists of the construction of 63 miles and reconstruction of 53 miles of Trunk B (State) roads in Nigeria's Western State. Individual road segments vary in length from 7 to 24 miles and the construction periods range from 1 1/2 - 3 1/2 years, beginning in late 1971. In addition, the project provides for feasibility studies of about 1000 miles and detailed engineering of about 400 miles of Federal and State roads; support of improved Federal highway management, planning and maintenance; and for purchase of equipment for traffic counting and control of vehicle weights.

10. The total cost of the project is estimated to be \$25.7 million and the proposed loan would finance the foreign exchange component thereof, \$16.0 million or 62%. The basic construction cost

estimates amount to \$15.4 million to which has been added \$5.2 million for contingencies - 12% on quantities and 20% on prices. The latter amount, while high, is considered necessary in view of the sharp and continuing rise in construction costs in Nigeria since the end of the civil war. Supervision of construction is estimated at 6% of the construction cost or \$900,000. The foreign exchange component of construction is 60% and of supervision, 70%. The loan will provide \$2.5 million (out of a total amount of \$3.6 million) for consultant services in connection with feasibility studies and final engineering of new roads and for technical assistance in the area of highway administration and planning. Finally, \$600,000 is provided for equipment purchases in support of the technical assistance.

11. Included within the technical assistance is a road maintenance study to be carried out by consultants, Kampmann, Kierulff and Saxild A/S (KAMPSAX, Denmark). The Federal Government has negotiated a contract for this study with the consultants and this has been approved by the Bank. In view of the urgency of this study, it is proposed that up to \$300,000 be made available for financing expenditures in connection therewith retroactively to April 1, 1971.

12. The loan will be to the Federal Government which will make available to the Western State the loan proceeds required for road construction (including supervision). Execution of the construction works will be the responsibility of the Western State Ministry of Works and Transport and the execution of the remainder of the project will be carried out by the Federal Ministry of Works and Housing. The Western State Government will finance the local costs of road construction and the Federal Government will finance the local costs of the balance of the project. A project agreement between the Bank and the Western State and a subsidiary agreement between the State and the Federal Government will be required.

13. Contracts will be awarded on the basis of international competitive bidding in accordance with the Bank's usual procedures. Improving the project roads is expected to yield substantial benefits in the form of lower operating costs, time savings, and reduced maintenance requirements. The rates of return from the projected investments range from 16 percent to 26 percent for the individual roads.

14. Technical assistance is directed in large measure to improving federal highway administration and federal highway planning (paras. 3.05 and 3.09 of the Report). Regarding highway administration, it is not our intention to include a covenant in the proposed Loan Agreement requiring action on this issue, rather we will seek an assurance from Government - incorporated, perhaps, in a letter of intent - that it will propose to the Bank specific improvements in highway administration, and a timetable for their implementation, by perhaps December 31, 1971.

15. Regarding highway planning, we propose that the "standard" covenant (as for example in Loan 640-UNI) relating to the collection and recording of "technical, economic and financial information... required for proper planning of maintenance, improvements and extensions of the Federal highway system...." be included in the Loan Agreement, and that agreement be sought during negotiations on a specific timetable for implementation of these measures. Such agreement would be recorded in the minutes of the negotiations or in some other appropriate form.

16. A "non-standard" issue in the appraisal report is the recommendation that importation, manufacture and use of vehicles (other than special purpose vehicles) which are capable of imposing excessive axle loads on the roads be prohibited. We propose that the "standard" covenant in the Loan (again, as in Loan 640-UNI) that "The Borrower shall take such steps as shall be reasonably required to ensure that the dimensions and axle loads of vehicles using its Federal highway system... are consistent with the structural and geometric design standards of the roads...." be incorporated in the Loan Agreement, and that we seek - again possibly as a letter of intent - assurance from the Federal Government that it will act, within a specified time, to prohibit importation, manufacture and use of such vehicles.

Recommendation

17. I recommend that the Bank invite representatives of the Federal Republic of Nigeria and of the Western State to negotiate a loan of \$16.0 million for a term of twenty-five years, including a five-year period of grace, substantially on the terms and conditions set out in paragraph 6.01 through 6.03 of the Appraisal Report as interpreted in paragraphs 14-16 above.

Attachment

Roger Chaufournier
Director

Population: 66 m
GNP Per Cap: About \$70

4/6/71

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

			1971	1972	1973	1974	1975	1976
<u>OPERATIONS PROGRAM</u>								
7-NIR-AC-01	Agricultural Credit	IBRD			5.0			
7-NIR-AC-02	Agricultural Credit II	IBRD					10.0	
7-NIR-AL-01	Livestock	IBRD		5.0				
7-NIR-AL-02	Livestock II	IBRD				10.0		
7-NIR-AL-03	Livestock III	IBRD						15.0
7-NIR-AP-01	Cocoa - Western State	IBRD	7.2					
7-NIR-AP-02	Cocoa - Western State II	IBRD				15.0		
7-NIR-AP-03	Tree Crops	IBRD			10.0			
7-NIR-AX-01	Agriculture Unidentified	IBRD					25.0	
7-NIR-AX-02	Agriculture Unidentified II	IBRD						20.0
7-NIR-DD-02	DFC - NIDB II	IBRD	10.0					
7-NIR-DD-03	DFC - NIDB III	IBRD			12.0			
7-NIR-DD-04	DFC - NIDB IV	IBRD					12.0	
7-NIR-EE-02	Education II	IBRD		10.0				
7-NIR-EE-03	Education III	IBRD			25.0			
7-NIR-EE-04	Education IV	IBRD					20.0	
7-NIR-PH-03	Power V	IBRD				25.0		
7-NIR-PP-02	Power IV	IBRD		35.0				
7-NIR-GG-01	Rehabilitation Program Loan	IBRD	80.0					
7-NIR-II-01	Small-Scale Industry	IBRD			3.0			
7-NIR-IX-01	Industry Unidentified I	IBRD				10.0		
7-NIR-IX-02	Industry Unidentified II	IBRD						10.0
7-NIR-TH-05	Roads - V	IBRD	16.0					
7-NIR-TH-06	Roads VI	IBRD		20.0				
7-NIR-TH-08	Roads VII	IBRD			20.0			
7-NIR-TX-01	Roads - Unidentified I	IBRD					25.0	
7-NIR-TX-02	Roads - Unidentified II	IBRD						30.0
7-NIR-TA-01	Airports	IBRD					5.0	
7-NIR-TP-02	Ports II	IBRD			15.0			
7-NIR-TR-02	Railways II	IBRD				40.0		
7-NIR-XX-01	Unallocated	IBRD						25.0

			Total					
	1964-68	1969-73	1972-76					
IBRD	144.0	329.3	457.0	IBRD	113.2	70.0	90.0	100.0
IDA	35.5							
Total	179.5	329.3	457.0	Total	113.2	70.0	90.0	100.0
No.	6	19	27		4	4	7	5

LENDING PROGRAM (11/23/70)

IBRD	144.0	309.2	454.5	IBRD	98.6	65.0	89.5	100.0	100.0	100.0
IDA	35.5									
Total	179.5	309.2	454.5	Total	98.6	65.0	89.5	100.0	100.0	100.0
No.	6	16	27	No.	3	3	6	6	6	6

LOAN COMMITTEE

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SEP 05 2014

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April 7, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Ethiopia - Addis Ababa Water Supply and Sewerage Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated April 7, 1971 from the Eastern Africa Department, entitled "Ethiopia - Addis Ababa Water Supply and Sewerage Project" (LC/0/71-54).
2. Comments, if any, should be sent to reach Mr. Gassner (ext. 4023) by 4:00 p.m. on Friday, April 9.
3. It is planned then, if the Committee approves, to inform the Government and representatives of AWSA 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
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Executive Vice President (IFC)
Vice President (IFC)

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LC/0/71-54

April 7, 1971

LOAN COMMITTEE

Memorandum from the Eastern Africa Department

ETHIOPIA: Addis Ababa Water Supply and Sewerage Project

Introduction

1. The population of Addis Ababa, estimated at 750,000, is growing at about 6 percent a year. In spite of very low per capita consumption, there has been a serious water shortage in many parts of the city for a number of years. While the recently completed Lagadadi dam and pipeline project provides a major new source of water supply, it cannot be used effectively until the water distribution system within the city is improved. In addition, the absence of a public sewerage system threatens increasingly serious health and pollution problems.

2. The Government first approached the Bank on the water supply problem of Addis Ababa in 1963 but apparently lost interest for two years until the city was facing serious water shortages. Following renewed Government interest, we sent an exploratory mission in 1966 which recommended that the short-term requirements be met by accepting a German offer to finance a small reservoir, and that we would be prepared to work out a program for the study and preparation of the Lagadadi Project to meet longer term requirements. Because the Municipality believed that speed and the offer of financing outweighed all other considerations, further discussion was broken off and, against the advice of Bank staff, the Municipality awarded a turnkey contract for the Lagadadi Project without adequate study. However the then Lord Mayor, persuaded perhaps by the troubles he was having with Lagadadi and under pressure from the Ministry of Finance to avoid similar arrangements in the future, in due course came back to the Bank. In July 1969, the Bank made a technical assistance grant of US\$180,000 to help finance the cost of (i) a feasibility study and preliminary engineering for the Addis Ababa Water Supply and Sewerage Project; and (ii) a management study for the proposed Addis Ababa Water and Sewerage Authority (AWSA) to take over the functions of the Water Supply Administration of the Municipality.

3. Based on the findings and recommendations of the consultants, the Government submitted a request in November 1970 for a loan to help finance a project for improving and extending the water distribution system and constructing a first stage sewerage system. A Bank mission appraised the proposed project in December 1970. The attached Appraisal Report entitled "Addis Ababa Water Supply and Sewerage Project" (No. PU-68 dated March 24, 1971) concludes that the project would justify a Bank loan of \$9.5 million for a term of 25 years including a grace period of 5 years. I concur.

The Project

4. The water supply portion of the project includes the construction of about 100 km of primary distribution lines, 360 km of secondary pipes, three reservoirs and seven pumping stations. The project also includes provision for the purchase of water meters and maintenance equipment. The project would replace some of the old, small diameter mains, strengthen parts of the existing distribution network, improve water pressure in some of the higher parts of the city, and extend the supply to newly developed areas. The sewerage part of the project consists of the installation of some 150 km of major and minor sewers and the construction of a sewage treatment plant. This initial system, which will serve 110,000 people in the business center and the fastest developing residential and industrial areas, is part of a phased plan for providing a sewerage system for the entire city. Meanwhile, the project will also provide for the purchase of six specially equipped trucks and ancillary equipment to collect septic tank effluents from the unsewered areas for disposal at the sewage treatment plant. Finance is also provided for engineering services, management assistance and staff training for AWSA. The project is expected to be completed by the end of December 1975.

The Proposed Loan

5. The project is estimated to cost about \$11.2 million equivalent. The proposed loan of \$9.5 million would finance the estimated foreign exchange costs of \$7.9 million, estimated at 70 percent of total project cost, and \$1.6 million for interest and other charges on the loan during construction. The local currency expenditures, estimated at \$3.3 million, would be financed by AWSA from internally generated funds. The proceeds of the loan would reimburse the actual foreign exchange costs of imported goods and 50 percent, being the estimated foreign exchange component, of the cost of civil works contracts. The foreign exchange costs of engineering, management and staff training services would also be financed under the loan.

6. The above estimates of foreign and local expenditures assume that all pipe would have to be imported. However, it might be possible to set up a factory in Ethiopia at short notice to produce some of the pipes required for the project. If this should occur and if such a factory should submit the lowest bid in international competition, ^{/1} it is proposed that the full cost of such pipes be disbursed from the loan, since a reduction in the external financing to be provided would make it difficult for AWSA to maintain a sound financial position. The

^{/1} It is intended by the Government that AWSA shall be statutorily exempted from import duties. No preference for local suppliers in the evaluation of bids is recommended.

maximum local currency financing involved would be about \$1.2 million, which would be justified on country grounds (see para. 14). The proportion of the total project cost including interest during construction covered by the proposed loan would be 74 percent, which falls within the limit of 65-75 percent Bank/IDA financing accepted as appropriate for Ethiopia at the CPP review by Mr. McNamara on December 14, 1970.

7. The internal financial rate of return is estimated to be between 15 percent and 24 percent on the water supply portion of the project and about 12 percent on the sewerage portion of the project. The economic rate of return on the sewerage project is expected to be at least 13 percent.

8. In order to avoid delays in project implementation, the Municipality of Addis Ababa requested permission to engage consultants to proceed with detailed engineering of the project. With the concurrence of the Chairman of the Loan Committee, I informed the Municipality that, subject to the approval of the Executive Directors, we would be prepared to include in the proposed loan provision for retroactive financing of up to US\$100,000 to reimburse the foreign exchange cost of consulting services incurred after March 1, 1971 in connection with detailed engineering.

The Borrower

9. The borrower would be AWSA, which has been established by an Executive Order of the Emperor. AWSA is an organization of the commercial type with share capital and the power to pay dividends. The Municipality of Addis Ababa is the sole shareholder. The Government has submitted to the Parliament for approval a draft Proclamation which would provide AWSA with additional powers required to carry on its functions, including the power to borrow. IEG hopes that the Proclamation will be approved during the current session ending early in July; approval would be a condition of Board presentation.

Issues

10. To finance the Lagadadi project, the Municipality took on loans from the Istituto di Credito per le Imprese di Pubblica Utilita (ICIPU) in Italy, repayable over 10 years from completion of construction, amounting to US\$14 million equivalent. The history of this transaction and of an unresolved dispute with the contractor (see para. 11 below) is set out in Annex I to the Appraisal Report. Debt service from 1971 on requires about US\$1.6 million a year, which AWSA would be unable to meet from cash generation during the construction of the proposed Bank project. The necessity to obtain relief in some form has been discussed on a number of occasions with the Ministry of Finance and the Municipality. Their

explorations with the Italian Government have so far resulted, we are informed by the Municipality, in a moratorium from the lender up to June 1974. The Municipality has requested an extension up to December 1975. We propose to require as a condition of Board presentation that AWSA has been relieved from Lagadadi debt service payments during the proposed construction period, i.e. at least to December 1975, and that a reasonable repayment schedule would be followed thereafter. (The Appraisal Report has assumed for purposes of financial projections that repayments would be made over a 15-year period commencing June 1976, with an interest rate of 7 percent per annum.) To the extent that suitable terms could or had not been obtained directly from the lender, we would require the Government to undertake to provide or arrange to provide the necessary refinancing prior to Board presentation.

11. The water rate in Addis Ababa is one of the highest rates in a major African city. In normal circumstances, and assuming that AWSA obtains adequate relief from the present Lagadadi debt burdens, the present water rate and projected sewerage rates would lead to unnecessarily high cash generation. However, the financial projections do not make specific provision for the contingent liability arising from contractor's claims, totalling nearly \$4 million equivalent, over the engineer's certified amounts due to him. In view of the uncertainty of the timing and amount of the settlement, AWSA requires to generate and hold substantial cash balances. The balances projected by the end of the construction period should be adequate, but an assurance will be required that Government will provide additional funds to AWSA if the settlement is nevertheless beyond AWSA's resources.

12. The Order creating AWSA includes provision for the payment of dividends by the issue of shares to the Municipality unless the City Council (exercising its shareholder rights) resolves by a two-thirds majority that payment be in cash. In view of the contingent liability arising from the Lagadadi contractor's claims of the necessity of obtaining a moratorium on the Lagadadi debt during the project construction period and of the local currency requirements for the project, it is proposed that the payment of dividends during this period be restricted to issue of additional shares. In subsequent years, it is proposed that the payment of cash dividends in any year should take place only after a review of the possibility of reducing the level of the water and sewerage rates.

Lending Program

13. A \$9.5 million IDA credit for Education was approved on March 30. An IDA credit of about \$4.4 million for a dairy development project has been negotiated, and negotiations will start shortly on a proposed Bank loan of about \$6.5 million for a coffee processing project. Both these operations are scheduled for completion in FY71. The FY72-76 Lending Program for Ethiopia is attached.

Economic Situation

14. An Economic Report on Ethiopia (AE-9) was distributed to the Executive Directors on October 22, 1970, and summarized in my memorandum to the Loan Committee entitled "Ethiopia - Addis Ababa Dairy Development Project" dated November 24, 1970. The report concluded that Ethiopia retains some margin for further borrowing on conventional terms, but some softening of the blend would be desirable to keep the future debt burden within manageable limits. Ethiopia will have to raise substantial amounts of capital for a number of years, since even with a considerable increase in domestic resources, at least half of its public investment program needs to be financed externally. External financing limited to the foreign exchange costs of projects likely to attract foreign assistance will not provide the level of capital inflow required for an adequate level of investment. Accordingly some local expenditure financing is essential.

Recommendation

15. I recommend that the Bank invite the Government and AWSA to send representatives to negotiate a proposed loan to AWSA of US\$9.5 million equivalent for the Addis Ababa Water Supply and Sewerage Project, with the guarantee of the Imperial Ethiopian Government, substantially on the terms and conditions set forth in paragraphs 7.01 through 7.03 of the Appraisal Report.

Michael L. Lejeune
Director

Attachments

Attachment 1

[illegible]

LOAN COMMITTEE

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SEP 05 2014

WBG ARCHIVES

April 6, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Bolivia - Gas Pipeline

1. The Committee is requested to consider, without meeting, the attached memorandum dated April 6, 1971 from the South America Department, entitled "Bolivia - Gas Pipeline Loan" (LC/0/71-53).
2. Comments, if any, should be sent to reach Mr. Fajans (ext. 2353) by 1:00 p.m. on Friday, April 9.
3. It is planned then, if the Committee approves, to inform the Government that the Bank is prepared to renegotiate 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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The Economic Adviser to the President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

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WBG ARCHIVES

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LC/0/71-53

April 6, 1971

LOAN COMMITTEE

Memorandum from South America Department

BOLIVIA - Gas Pipeline Loan

Introduction

1. In July 1969, the Executive Directors approved a loan of \$23.25 million by the Bank to Compania Yacibol Bogoc Transportadores (YABOG) for the construction of a gas pipeline from Santa Cruz in Bolivia to Yacuiba on the Bolivian-Argentine border. The pipeline was regarded as an enclave project, in that the earnings from gas, to be transported through the pipeline and sold for dollars to Gas del Estado of Argentina under a 20-year contract, were to be payable into a bank account in New York and the service of YABOG's indebtedness was the first claim on that account. The Bank's loan was guaranteed jointly and severally by YABOG's two owners, YPFB (the Bolivian State Petroleum Corporation) and Bolivian Gulf Oil Company, which also undertook to finance any cost overrun; it was further guaranteed by the Republic of Bolivia, while Gulf Oil Corporation of the United States guaranteed the obligations of Bolivian Gulf. The Bank's loan was to finance half of the cost of the pipeline; the other half was to be financed by the New York State Common Retirement Fund (NYSCRF), which in June 1969 made a \$25 million loan to YABOG with the guarantee of Gulf Oil Corporation.

Nationalization of Bolivian Gulf

2. On October 17, 1969, before the conditions of effectiveness of the Bank's loan had been met, Bolivia nationalized the properties of Bolivian Gulf and terminated its concession. This act led to the disappearance of three important ingredients of the loan operation: the guarantee of U.S. Gulf; the overrun undertaking of Bolivian Gulf; and the organization and skills, on which the Bank had relied for ensuring the provision of gas for sale to Argentina. Moreover, the interruption of construction gave rise to additional costs, creating a gap in the financing; this gap was later greatly widened when the NYSCRF decided to cancel the \$11 million undrawn balance of its loan.

3. At the time of nationalization, the project was well underway. YABOG had signed the construction contract with Williams Brothers of the U.S. and placed orders for pipe with Ferrostaal of Germany, which subcontracted part of them to SIAT of Argentina. A Bank technical mission, which visited Bolivia in December 1969, determined that about 140 km (or 27%) of mainline pipe had been installed and the entire 20km-long lateral to the Naranjillos field built. Much foundation

work on the four major bridges had been carried out. About 150 km of pipe and substantial quantities of plate were stored in Argentina. Bridge components, and miscellaneous equipment and materials, were in the U.S., Argentina, Chile, Bolivia, or in transit.

4. After the Bolivian Government had confirmed to the Bank soon after nationalization ~~its~~ intention to indemnify Gulf, discussions began toward the reconstitution of the project. In December 1969, Argentina offered to give its guarantee for the Bank's loan in substitution for the guarantee of Gulf and subsequently to extend the date by which gas deliveries must start under the gas sales contract. In September 1970, at the request of the Bolivian Government and the Bank, the IDB agreed to consider a loan of about \$15 million to meet the gap in the financing plan. The problem of the management of the former Bolivian Gulf oil and gas fields at Caranda, Colpa and Rio Grande was resolved (see paragraph 12 below) after a series of meetings held with the Bolivian representatives in Washington in late 1970 and early 1971.

5. Meanwhile, discussions proceeded between Bolivia and Gulf on the indemnity issue. An independent consulting firm, Geopetrole, determined the amount invested by Bolivian Gulf under its concession at \$101.1 million. By virtue of a Supreme Decree issued on September 10, 1970, the Bolivian Government pledged itself to pay to Gulf, through a trustee, during the twenty years of the Gas del Estado contract, without interest, 25% of export proceeds from oil and gas produced in the Caranda, Colpa and Rio Grande fields, up to the amount determined by Geopetrole. A 22% tax, established by the same Decree and earmarked for YPFB exploration activities, reduced the amount to be collected by Gulf from Bolivia to no more than \$78.6 million. The Decree conditioned the payment of indemnity, inter alia, on the mobilization of the Bank's loan and the provision of additional funds (over and above the Bank and NYSCRF loans) required to complete the pipeline. Gulf entered into an agreement with the Government providing, inter alia, that it would finance any cost overrun on the pipeline project.

6. The Bolivian Government, YPFB and Gulf also reached agreement on the settlement of various outstanding claims and counterclaims, and this was ratified by the Supreme Decree of February 8, 1971. The net debt of \$11.1 million due to Gulf is to be paid by way of earmarking a part of the proceeds from crude oil exported from the Caranda, Colpa and Rio Grande fields. Most of this debt is expected to be repaid before indemnity payments start on January 1, 1973 (or three months after completion of the pipeline); the balance would be paid thereafter, with 10% of export proceeds from crude oil being used for this purpose. There remains unresolved a claim of about \$3.5 million of the Bolivian Ministry of Social Affairs against Gulf, relating to alleged unpaid social security taxes. This will soon be taken up in the Bolivian courts.

The Project

7. The project consists of the construction of a 530km-long high pressure natural gas trunk line from Santa Cruz to Yacuiba, a 20km-long lateral line to Naranjillos, which has been completed, and a number of river crossings, together with metering and regulating stations and other appurtenant facilities. The 140km-long pipeline to the YPFB gas field at Monteagudo, included in the original project, has been abandoned, because Bolivia's economic incentive for connecting YPFB fields with the pipeline system disappeared once the Bolivian Gulf fields, which have enough reserves to back up the gas sales contract, passed into the hands of YPFB. Given resumption of bridge construction in the immediate future and no unforeseen delays, the project could be completed by the end of 1971; otherwise, the end-1971 rainy season will postpone completion by at least another six months. Formerly, construction supervision was provided by Gulf. Under the reconstituted project it will be furnished by an independent firm of consultants acceptable to the Bank.

8. The original project cost was estimated at \$46.5 million, 10% of it representing the cost of the Monteagudo lateral. To date, about \$27.5 million has been spent on the project, most of it before the nationalization of Bolivian Gulf. This amount has been financed as follows:

	<u>\$ million</u>
NYSGRF loan	
Disbursed by trustee prior to Oct. 1969	9.7
In escrow, to be paid to Gulf to reimburse part of Gulf's expenditures	4.3
Balance of expenditures by Gulf	8.2
Williams Brothers-unpaid invoices	5.3
	<u>27.5</u>

The cost estimates are now being revised, taking into account price increases, financial and storage charges, and contractors' demobilization and remobilization expenses, and the project cost is presently put at about \$55 million. The bulk of the increase is due to the higher cost of the main civil works contract with Williams Brothers and the pipe purchase contract with Ferrostaal. The proposed revisions to the contracts will be submitted to the Bank and the parties concerned have been informed that we shall approve them only if price changes since the original contracts, which were awarded after international competitive bidding, can be fully justified in specific terms.

9. The project is to be financed by the Bank's \$23.25 million loan, the NYSCRF loan, which was reduced to \$14 million through cancellation, and the proposed IDB loan presently put at \$18.5 million. Any overrun would be covered by Gulf in accordance with its commitment to Bolivia. The advances made by Gulf and the unpaid invoices of Williams Brothers would be reimbursed out of the Bank and IDB loans. The two Banks would also reimburse YABOG for any expenditure on the project made out of an interim loan of \$10 million, which Bolivia expects shortly to arrange with the First National City Bank of New York (FNCB).

10. The economic rate of return is presently estimated at approximately 21%. The rate of return on the original project, including the Monteagudo lateral, was 24%; without the Monteagudo lateral it would have been 33%. The relatively small difference between the present rate and the original one is a consequence of the abandonment of the Monteagudo line which partly offsets the increase in the cost of goods and services mentioned in paragraph 8. This rate of return assumes gas sales at the minimum volumes specified in the sales contract with Gas del Estado. However, the Argentine authorities have informed Bolivia that they expect to take substantial additional quantities for which both the gas reserves and the pipeline capacity will be adequate. Such additional purchases would increase the rate of return on the project.

11. YABOG will continue as borrower. Bolivian Gulf's shares in YABOG will be transferred to the Bolivian State, before or simultaneously with the effectiveness of the Loan Agreements with the Bank and IDB.

12. While the Caranda, Colpa and Rio Grande field facilities are not included in the project, the fields are the source of gas to be transmitted through the pipeline for sale to Gas del Estado. The transfer of responsibility for the management and operation of the fields from an experienced private oil company with worldwide interests to a far less experienced and often politically motivated government-owned entity made it necessary to work out arrangements to ensure that the fields be properly run. As it was politically unacceptable to the Government to vest the ownership of the fields in a separate company, it has been agreed with the Government that YPFB will set up a separately-managed Santa Cruz division, within the legal structure of YPFB. This division will shortly be created by a YPFB Board resolution, which will subsequently be ratified by legislation. The Santa Cruz Division will have a high degree of autonomy in commercial, financial and technical matters, including the right to enter into contracts, and all funds required for field operations will be segregated from other YPFB funds. The Division will be headed by a Bolivian manager approved by the Bank, who will report to a Management Committee. This Committee will consist of three high ranking YPFB officials, and a representative of the Bank will attend its meetings and participate in its deliberations without the right to vote. Moreover, the Division will enter into a contract with a leading firm of gas and petroleum

consultants, who will provide the head of the Division's operations department and some other experts, train Bolivian personnel on the job, and advise on the need for technical assistance by other specialized consulting firms. The consulting services will be discontinued only when and if the Bank so agrees.

Lending Terms

13. The terms of the NYSCRF loan of 1969 remain unchanged at 20 years life and 7% interest. The IDB proposes to lend ordinary capital funds, except for \$2 million of Argentine peso funds released for local currency expenditures on Bolivian projects; its loan would be for 20 years at 8.2% interest. The Bank loan will have to be renegotiated. It is proposed that it should have a term of 20 years, with a grace period extending to a date eighteen months after the earliest possible delivery of gas, i.e., until the middle of 1973 -- a grace period of about two years. Since the basic project is unchanged from that approved by the Executive Directors in July 1969, the interest rate on the loan would be maintained at 6-1/2%. The borrower would pay the commitment charge on the loan from September 20, 1969 (i.e. 60 days after the signing of the original Loan Agreement). IDB staff have indicated that they would be prepared to give up to 4 years grace in order to compensate Bolivia in some measure for the fact that the interest rate on the IDB loan is likely to be higher than that on our loan.

14. The Bank and the IDB would enter into an agreement providing for cooperation in the administration of their loans. It is proposed that the agreement follows broadly the pattern of the Memorandum of Understanding between IDA and IDB, signed in July 1964 in connection with the first ENDE power project. This Memorandum assigned to IDA the role of coordinator and, to avoid duplication, entrusted IDA with the review of matters of common interest to the parties.

Repayment Modalities

15. The tentative cash flow projection prepared by Bolivian officials for the Caranda, Colpa and Rio Grande fields shows, over the years 1971-1991, sales of gas at \$302 million, sales of crude oil exported through Arica at \$190 million terminating in 1985, service on the Bank, IDB and NYSCRF loans at \$96 million, and compensation to Gulf at \$78.6 million terminating in 1989. After allowing for operating costs, royalties and taxes, the net balance accruing to Bolivia is estimated at \$130 million. In the light of this projection, there should be little doubt about the self-liquidating nature of the project.

16. Payments for gas and oil would be made by the purchasers to a trustee, probably FNCB. The trustee would be responsible for an indemnity trust, through which indemnity payments to Gulf would flow, and a lenders' trust, through which all other sales proceeds would flow. Gas del Estado will make payments in dollars to the trustee, 25% of each payment being for the credit of the indemnity trust and 75% for the credit of the lenders' trust. Payments for oil would be deposited

in an escrow account, managed by the trustee, called the Bolivian crude oil account. YPFB would agree that all oil sold at Arica would be on terms requiring the purchaser or purchasers to pay the full price in dollars to the trustee. 1/ Beginning January 1, 1973, (or at Bolivia's option three months after the start of gas exports to Argentina) the trustee would transfer 25% of the oil sales proceeds to the indemnity trust and 75% to the lenders' trust. Prior to that date all of the oil sales proceeds will be paid to the lenders' trust.

17. The trust arrangements are now being negotiated in detail. As regards the Indemnity Trust Agreement, YPFB, U.S. Gulf, Bolivian Gulf and the FNCB would be parties. YPFB would irrevocably assign to the trustee, and the latter pay to an account opened in the name of Bolivian Gulf, 25% of the export proceeds from gas and oil produced in, or attributable to, the Caranda, Colpa and Rio Grande fields. On the first of every month, the trustee would deduct and pay over to YPFB the 22% tax created by the Decree of September 10, 1970; a day later, the balance would be paid to U.S. Gulf. The payments into the indemnity trust would begin on January 1, 1973, or at Bolivia's option three months after the start of gas exports to Argentina. Indemnity payments would cease 20 years after the first gas delivery, or when Gulf has received \$78.6 million, whichever occurs first.

18. As regards the Lenders Trust Agreement, YPFB, the Bank, IDB, the NYSCRF, the Central Bank of Bolivia, Gulf and the FNCB would be parties to it. It would be approved by the Governments of Bolivia and Argentina, and confirmed by Gas del Estado and YABOG. By this agreement, YPFB would irrevocably assign to the trustee (i) 75% (and after the indemnity has been fully paid, 100%) of the export proceeds from gas and oil from the Caranda, Colpa and Rio Grande fields and (ii) 100% of the export proceeds from any other gas transmitted through the pipeline. The trustee would open, within the lenders' trust, a number of accounts, the beneficiaries of which would be the Bank, IDB, NYSCRF, and, if necessary to cover a project cost overrun, Gulf or any lender brought in for that purpose by Gulf; Gulf in its capacity of creditor under the February 1971 claims settlement with the Bolivian Government; and the Central Bank of Bolivia as a trustee for the Santa Cruz division, YABOG and YPFB. The monies paid into the lenders' trust would be credited by the trustee in the following order of priorities: the three lenders (and any lender financing an overrun); Gulf as creditor; and the Central Bank. The prior claim of the lenders would be strengthened by the existence of a reserve account, in which would be deposited during the first two years of the arrangement (and subsequently held on deposit),

1/ Gulf is willing to purchase Bolivia's oil, but YPFB, in an effort to obtain the highest possible price, has solicited bids. It is believed that part of the oil will be sold to Peru, with the purchaser of the remainder not yet determined.

at the expense of payments to the Central Bank, the equivalent of the next succeeding semi-annual loan service instalments. On the other hand, whenever the funds in the Central Bank account fell short of the operating needs of the special division or YABOG, there will be provision that the lenders may instruct the trustee to release the necessary operating funds from their loan service accounts.

19. Should the funds in the lenders' trust fall short of loan service requirements, the Bank would turn for payment to the guarantors, Bolivia and Argentina. The Bolivian guarantee is being given pursuant to the Articles of Agreement, but Bolivia is not regarded as credit-worthy for Bank loans. Argentina has requested, however, that its guarantee should not hold it responsible for a default resulting from deliberate unilateral action by the Bolivian Government or from insurrection, revolution or war in Bolivia. The Bank accepted this kind of circumscribed guarantee from private investors in the case of the Algerian gas and Congo potash loans, and it seems reasonable to accept it in this case also. Preliminary discussions between Argentina, the IDB (which has requested an Argentine guarantee for its loan too) and the Bank are expected in the week beginning April 5.

Bolivia's Debt Record

20. Bolivia's debt record is spotty, not only because of the country's perennial financial difficulties, but also because of administrative inefficiency. The last two interest payments on the Bolivian dollar bonds were made after considerable delay. The next payment date was April 1, 1971, and there is as yet no indication that the funds have been transferred. The first sinking fund payment, due on or before December 31, 1970, was made on time but purchases of bonds in the market could not be made, failing specific instructions from the Government and owing to the delay in the payment of the October 1, 1970 coupon.

21. Bolivia is also facing a possible dispute over the amount of compensation with the U.S.-owned International Metals Processing Co., whose assets in Bolivia were nationalized in January 1971. We are investigating this matter and have reported on it separately. We believe that prospects for a reasonable settlement of the dispute are good, at least for the time being, and for this reason this matter should not cause us to hold up the pipeline loan.

Recommendation

22. I recommend that we proceed to renegotiate the gas pipeline loan on the terms and conditions described in this memorandum.

23. I also propose that no new appraisal report be prepared for consideration by the Executive Directors but instead the section on the project in the President's Report and Recommendation be substantially expanded.

Gunter K. Wiese
Deputy Director

Population: 4.8 m
Per Cap GRP:\$178

ANNEX 2

BOLIVIA - PAST AND PROPOSED LENDING THROUGH FY1976

(US\$ millions)																	
	Through 1963	1964	1965	1966	1967	1968	Fiscal years			1972	1973	1974	1975	1976	Total 1964-68	Total 1969-73	Total 1972-76
Agriculture																	
Livestock I	IDA				2.0												
Livestock II	IDA							1.4									
Livestock III	IDA							6.9									
Agriculture unidentified	IDA											5.0					
Livestock IV	IDA												7.0				
Mining																	
Minerals Development I (credit to private sector)	IDA									5.0							
Minerals Development II (credit to private sector)	IDA													8.0			
Power																	
ENDE I	IDA		10.0														
BPC I	IDA		5.0														
ENDE II	IDA						7.4										
Gas Pipeline	IBRD							23.2									
Transportation Railways	IDA									4.0							
	IBRD							23.2								23.2	
	IDA		15.0		2.0		7.4	1.4	6.9	4.0	5.0	5.0	7.0	8.0	17.0	24.7	29.0
	Total		<u>15.0</u>		<u>2.0</u>		<u>7.4</u>	<u>24.6</u>	<u>6.9</u>	<u>4.0</u>	<u>5.0</u>	<u>5.0</u>	<u>7.0</u>	<u>8.0</u>	<u>17.0</u>	<u>47.9</u>	<u>29.0</u>
No.		2			1		1	2	1	1	1	1	1	1	3	6	5
IBRD Loans Outstanding																	
- including undisbursed								23.2	22.6	21.4	20.2	19.0	17.8	16.6			
- excluding undisbursed								17.4	17.4	21.4	20.2	19.0	17.8	16.6			
IDA Credits Outstanding																	
- including undisbursed			15.0	15.0	17.0	17.0	24.4	25.8	32.7	36.7	41.7	46.6	53.5	61.3			
- excluding undisbursed			2.1	7.9	12.9	13.8	15.1	17.0	20.6	25.6	29.5	33.5	38.8	43.3			

Population: 4.8 m
Per Cap GNP: \$178

ANNEX 3

BOLIVIA - POSSIBLE EXPANDED LENDING PROGRAM THROUGH FY1976

	Through 1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	Total 1964-68	Total 1969-73	Total 1972-76
Agriculture																	
Livestock I	IDA				2.0												
Livestock II	IDA							1.4									
Livestock III	IDA								6.9*								
Forestry	IDA										3.0						
Agriculture I unidentified	IDA											5.0*					
Livestock IV	IDA												7.0*				
Agriculture II unidentified	IDA													8.0			
Mining																	
Minerals Development I (credit to private sector)	IDA										5.0*						
Minerals Development II (credit to private sector)	IDA													8.0*			
Power																	
ENDE I	IDA		10.0														
BPC I	IDA		5.0														
ENDE II	IDA						7.4										
BPC II	IDA								5.0								
ENDE III	IDA									7.0							
ENDE IV	IDA											7.5					
Gas Pipeline	IBRD							23.2									
Transportation																	
Railways I	IDA									4.0*							
Railways II	IDA											2.0					
Education																	
Education I	IDA								2.0								
Education II	IDA										5.0						
Education III	IDA												8.0				
	IBRD							23.2								23.2	
	IDA		15.0		2.0		7.4	1.4	13.9	11.0	13.0	14.5	15.0	16.0	17.0	46.7	69.5
	Total		15.0		2.0		7.4	24.6	13.9	11.0	13.0	14.5	15.0	16.0	17.0	69.9	69.5
	No.		2		1		1	2	3	2	3	3	2	2	3	11	12
IBRD Loans Outstanding																	
- including undisbursed								23.2	22.6	21.4	20.2	19.0	17.8	16.6			
- excluding undisbursed									17.4	21.4	20.2	19.0	17.8	16.6			
IDA Credits Outstanding																	
- including undisbursed			15.0	15.0	17.0	17.0	24.4	25.8	37.7	48.7	61.7	76.1	91.0	106.8			
- excluding undisbursed			2.1	7.9	12.9	13.8	15.1	17.0	20.6	27.6	36.5	46.5	59.3	71.8			

* Included in limited lending program (Annex 2)

LOAN COMMITTEE

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WBG ARCHIVES

April 5, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Mexico - Third Livestock and Agricultural Development

1. The Committee is requested to consider, without meeting, the attached memorandum dated April 5, 1971, from the Central America and Caribbean Department, entitled "Mexico - Proposed Third Loan for Livestock and Agricultural Development Project" (LC/0/71-51).
2. Comments, if any, should be sent to reach Mr. Meier (ext. 2632) by 1:00 p.m. on Thursday, April 8.
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)

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WBG ARCHIVES LC/0/71-51

April 5, 1971

LOAN COMMITTEE

Memorandum from the Central America and Caribbean Department

MEXICO - Proposed Third Loan for Livestock and Agricultural
Development Project

1. Introduction: Submitted for consideration by the Loan Committee is Report No. PA 82 recommending a Bank loan of \$74 million to Nacional Financiera, S.A., to help finance a project for the development of livestock and agriculture in Mexico. The proposed loan would be this fiscal year's only lending operation in Mexico, the change in administration in December 1970 having resulted in fewer projects in the pipeline.
2. The Bank has thus far made two livestock and agricultural credit loans to Mexico: one for \$25 million in 1965 (430-ME), which is fully disbursed, and the other for \$65 million in 1969 (610-ME), which is expected to be committed by June 1971, about a year ahead of schedule. To date, the Bank has made 25 loans to Mexico totaling \$999.1 million. The lending program envisages lending operations of about \$200 million per year for that country over the next five years.
3. Economic Situation: A report entitled "Current Economic Position and Prospects of Mexico" was distributed to the Board on December 1, 1970, and an analysis of recent developments was included in the Country Program Paper of March 1, 1971. It concluded that the new administration appears to be effectively tackling the country's major economic problems -- such as inadequate savings of the public sector, the widening balance of payments deficit, the rising external indebtedness and the sharp income differentials -- thereby restoring a sound basis for further satisfactory economic development. Mexico's economy will again be reviewed by a Bank economic mission in April/May 1971.
4. The Project: Under this third livestock and agricultural development project, again to be administered by a Trust Fund (FONDO) of the Banco de Mexico (BANXICO), medium to long-term credit is provided for farms, ranches and agro-industries through the private and public banking system under a rediscounting program. The project continues to pursue the same basic objectives of the first two Bank operations in the agriculture sector: (a) to increase the total flow of medium and long-term credit into the sector; (b) to make private banks conversant with medium-term lending to the sector, a domain they have traditionally shunned largely because of lack of know-how; (c) to encourage the processing of

agricultural and livestock products; (d) to train agro-technicians in evaluation techniques and extension of technical assistance; and (e) to strengthen FONDO, which through the simultaneous provision of credit and technical assistance helps to introduce new technologies (seeds, fertilizers, machinery) and improved management systems. More generally, the project would help increase the productivity of the agricultural sector. These objectives are clearly being achieved with the help of the previous loans. The number of participating banks has increased to 141 -- an increase of 26 in one year -- while the number of FONDO and FONDO-approved technicians is approaching 700 and farmers' credit applications have been increasing very rapidly, as indicated by commitment of the second loan in two years instead of the projected three years.

5. The organization of the FONDO, which has been strengthened considerably under the first two projects, is well equipped to appraise and supervise projects and extend technical assistance. Some reorganization proposals of the appraisal mission will help adjust FONDO's structure and operations to the rapidly increasing lending volume and thus provide for better technical assistance. The capital investment of the new project amounts to approximately \$190 million, excluding working capital requirements, which would be financed entirely by domestic sources. About 15% of the capital expenditures would be contributed by farmers and ranchers (20% in the case of agro-industrialists), 16% by participating banks, 39% by the Bank and 30% by FONDO; the latter's share is rediscounted with BANXICO, which finances it basically with mandatory deposits from the private banking system under decrees regulating minimum reserve requirements.

6. Presently effective interest rates to the ultimate borrower and rediscount rates are proposed to remain unchanged. At the same time the Appraisal Report recommends, however, to explore during negotiations the possibility of revising the rediscount rates to encourage even more fund participation by credit institutions. Under the Bank's second livestock/agriculture project the rediscount scheme was modified to favor producers operating on a small scale. For loans up to Mex\$ 500,000, beneficiaries pay an interest rate of 10%, while larger loans have an interest rate of 11%. ^{1/} Furthermore, up to 90% of

^{1/} Agro-industry loan rediscounts pay 1/2 of 1% more in both the smaller and larger loans.

small loans (up to Mex\$ 500,000) can be discounted with FONDO, while the maximum discount is 80% for loans between Mex\$ 500,000 and Mex\$ 1,500,000 and 70% for larger loans. This scheme has had a considerable impact on the size of loans granted as well as on the participation of banks. Along with the increasing participation of public banks, which serve mainly small farmers, the new discount rate scheme caused a decrease in average loan size from Mex\$ 185,300 (US\$ 14,800) in the first loan to Mex\$ 133,800 (US\$ 10,700) in the second one. Also, the participating banks' average direct contributions increased by 27%.

7. Besides two Bank loans, the FONDO received credits under the Alliance for Progress Program extended by AID and IDB's Special Fund, at rates between $3/4$ of 1% and 3.5% and for terms between 22 and 40 years. A new IDB credit of \$32 million is under negotiation. Loans under this Program are granted to the ultimate beneficiary at an interest rate of 7%; they are limited to a maximum of Mex\$ 150,000 and to borrowers with an annual gross income of not more than Mex\$ 100,000. Also, in the future these low-cost funds will be reserved for the lower-income farmers, while the Bank's funds may be used for any technically and financially feasible livestock/agriculture project.

8. The Appraisal Report recommends a Bank loan term of 11 years, including a grace period of four years, on the basis that the last loan would be fully collected at the end of 10 years while IBRD disbursements would be completed at the end of four years. The two previous agricultural/livestock loans, following the traditional pattern of our loans to Mexico, had a term of 20 years to maturity. A continuation of this pattern is particularly justified in view of recent developments. While in the past six years Mexico's outstanding debt and the debt service ratio have remained constant as a percentage of GMP, the high capital market interest rates of the past two years caused a shift in favor of medium to short-term borrowing. In June 1970 the outgoing administration issued a decree aimed at curbing public sector external borrowing at unfavorable terms. In support of Government's efforts to improve its maturity structure, a 20-year term would be appropriate for this loan, provided that revolving parts of the loan would be used for further medium-term lending for FONDO evaluated livestock/agriculture projects.

9. The Bank loan recommended in the Appraisal Report includes some local currency financing. This is justified on two grounds: The foreign exchange component of many high priority projects in Mexico is low because its industry has achieved a development level capable of supplying a large portion of the capital goods requirements. In addition, Mexico has virtually no access to concessionary external loans; there is

therefore an acute need for some local cost financing by international agencies to complement the Government's fiscal and balance of payments efforts. The foreign exchange component of the third project's investment cost is about \$50 million. In the proposed loan, \$24 million or 32% would cover local costs, which is in line with our two previous loans. However, Mexico's own foreign exchange resources would finance the foreign exchange component of the working capital, estimated at over \$8 million, as well as commitment fees and interest on the Bank loan during the disbursement period amounting to about \$16 million.

10. International competitive bidding is not appropriate for this project, because the many individual purchases would be small and diversified and local competition is on the whole satisfactory. For the import of breeding stock the Appraisal Report recommends that sub-borrowers be obligated to obtain quotations from at least three sources; for domestic purchases the sub-borrowers will be encouraged by FONDO to seek several bids from local suppliers.

11. Under the past two loans, Government repaid them from the Federal budget, thereby permitting the original Bank funds to be reused by FONDO. Government has indicated its intention to apply the same practice for the third loan.

12. Recommendation: I recommend that representatives of the Government of Mexico be invited to negotiate a 20-year loan of \$74 million at the Bank's standard lending rate, for the proposed third livestock and agricultural development project on conditions proposed in the Appraisal Report.

Edgar Gutierrez
Director

Attachment

Attachment 1

MEXICO - ACTUAL AND PROPOSED LENDING THROUGH FY-1976
(US\$ million)

		Through 1963	1964	1965	1966	1967	1968	Fiscal Years		1971	1972	1973	1974	1975	1976	Total 1964-68	Total 1969-73	Total 1972-76
Agriculture/Livestock Credit I	IBRD				25.0			65.0		75.0		75.0		75.0				
Agriculture/Livestock Credit II	IBRD																	
Agriculture/Livestock Credit III	IBRD																	
Agriculture/Livestock Credit IV	IBRD																	
Agriculture/Livestock Credit V	IBRD																	
Small Scale Agriculture I	IBRD											20.0						
Small Scale Agriculture II	IBRD													40.0				
Irrigation I and II	IBRD	27.5																
Irrigation III	IBRD				19.0													
Irrigation IV	IBRD						25.0											
Forestry I	IBRD											15.0						
Forestry II	IBRD														20.0			
Industry I	IBRD	0.5																
Industry II	IBRD									35.0								
Industry III	IBRD												40.0					
Industry IV	IBRD														50.0			
Power I to VI	IBRD	254.8																
Power VII	IBRD				93.4													
Power VIII	IBRD				16.6													
Power IX	IBRD						90.0											
Power X	IBRD							125.0										
Power XI	IBRD								125.0									
Power XII	IBRD											125.0						
Power XIII	IBRD														125.0			
Panuco Multi-purpose Project	IBRD														40.0			
Tourism I	IBRD									17.0								
Tourism II - Unidentified	IBRD														20.0			
Mexico City Airport	IBRD											40.0						
Highways I - III	IBRD	55.4																
Highways IV	IBRD		39.3															
Highways V	IBRD			32.0														
Highways VI	IBRD						27.5											
Highways VII	IBRD							21.8										
Highways VIII	IBRD								20.0									
Highways IX	IBRD											20.0						
Highways X	IBRD														20.0			
Ports I	IBRD									10.0								
Ports II	IBRD											15.0						
Railways I	IBRD	61.0																
Railways II	IBRD									30.0								
Railways III	IBRD														40.0			
Tehuantepec Isthmus (Transp.)	IBRD														35.0			
Water Supply I	IBRD											35.0						
Water Supply II	IBRD														35.0			
Operations Program	IBRD									75.0	237.0	185.0	200.0	250.0	250.0			1122
	No.									1	6	5	4	6	5			
Lending Program	IBRD	399.2	39.2	32.0	154.0	-	142.5	65.0	146.8	75.0	217.0	170.0	200.0	210.0	200.0	367.8	673.8	997.0
	No.	12	1	1	4	-	3	1	2	1	5	5	3	6	4			
IDB - gross disbursements				54.7	61.0	75.4	63.6	67.0	81.0	100.0	110.0	110.0	110.0	110.0	111.0			
IBRD o/s inc. undisbursed		343.0	384.7	399.9	515.8	513.8	516.6	606.2	768.6	816.8	1002.9	1138.1	1298.7	1464.0	1621.5			
exc. undisbursed		191.8	266.6	307.7	355.3	396.9	445.1	482.3	537.8	646.3	740.1	878.9	1054.5	1206.3	1353.1			
IBRD - gross disbursements		235.5	85.7	57.6	67.0	62.4	72.2	62.6	83.1	135.3	124.7	173.6	215.0	195.5	199.0			
- net disbursements		192.0	74.8	40.9	47.8	41.6	48.2	37.2	55.4	108.5	93.8	138.8	175.6	151.8	146.8			
- net transfer		129.7	62.4	25.7	30.5	21.0	25.2	11.3	25.2	70.5	49.0	85.8	113.1	77.6	60.9			

Central America and Caribbean
2/10/71

LOAN COMMITTEE

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SEP 05 2014

WBG ARCHIVES

April 5, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Yugoslavia - Bernardin Tourism Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated April 5, 1971 from the Europe, Middle East and North Africa Department, entitled "Yugoslavia - Proposed Loan for Bernardin Tourism Project" (LC/0/71-52).
2. Comments, if any, should be sent to reach Mr. Gregory (ext. 4716) by 1:00 p.m. on Thursday, April 8.
3. It is planned then, if the Committee approves, to inform the Government and representatives of EMONA 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)

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LC/0/71-52

April 5, 1971

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa Department

YUGOSLAVIA - Proposed Loan for Bernardin Tourism Project

1. Attached for consideration by the Loan Committee is a report entitled "Appraisal of the Bernardin Tourism Project" (PT-2), dated March 22, 1971, which recommends a Bank loan of \$10 million to help finance a tourism project.
2. The Bank has made 16 loans to Yugoslavia, totalling \$475 million. The proposed loan would be the second for tourism, the negotiations for the Babin Kuk tourism project having just been completed. Two more projects which are under consideration should lead to lending operations in FY 1971; they are a road project, and a multipurpose water project. The Five-Year Lending Program for Yugoslavia is attached. A recent Bank economic mission to Yugoslavia is now preparing its report. Its preliminary findings confirm Yugoslavia's creditworthiness for Bank lending.

The Project

3. The project will comprise a large integrated tourism complex at Portoroz on the northern Adriatic coast about 40 kilometers from Trieste. The proposed project is one of three submitted to the Bank by the Yugoslav authorities. It is similar in many respects to the Babin Kuk project which was considered by the Loan Committee on February 18, 1971 (see LC/17/71-4 of March 15, 1971), although substantially smaller. The issues raised are therefore also generally similar.

Financing Arrangements and Equity

4. During the discussion of the Babin Kuk project in the Loan Committee, the issue of the amount of "equity" capital to be supplied by the local partner was raised. The proportion of "equity" supplied by EMONA, sponsor of the Bernardin project, is about the same as in the Babin Kuk case. However, it should be noted that the western concept of equity and its relationship to risk does not have a precise equivalent in Yugoslavia, which makes comparative analysis difficult. This point is more fully discussed in paragraph 7.03 of the attached Appraisal Report, which notes that, in the Yugoslav context, the proposed financial structure is quite reasonable.

5. While the sponsor will provide about \$5.5 million, or 22 percent of total cost, as "equity", most of this will originate with the Ljubljanska Banka, Ljubljana. This bank will also provide the rest of the local financing as a long-term loan. Thus indirectly, the Ljubljanska Banka has the majority position in the venture. Because of the financial risk of this project, the Bank will insist that other medium- and long-term creditors, including the Ljubljanska Banka, be subordinated to the Bank loan.

Other Participation

6. The initially low financial, as against economic, profitability of the project is unattractive to other investors. IFC has indicated a lack of interest for this reason. A foreign partner is not needed for successful implementation of the project as the sponsor already has a strong management structure. Moreover, the sponsor expects to derive significant indirect benefits from the investment, and thus can be expected to provide satisfactory attention and interest to guarantee a successful operation. These benefits include a secure market for the sponsor's agricultural production and access to foreign exchange, for which a premium would otherwise have to be paid, because of the system of retention quotas presently in use in Yugoslavia.

Subsidies

7. The issue of subsidies was raised during the discussion of the Babin Kuk project and is further discussed in paragraph 7.06 of the attached Appraisal Report, which explains the reasons for the widespread use of subsidies for tourism in the Mediterranean basin. The Bernardin project differs from the Babin Kuk project in that both the Bank loan and the local loan would qualify for a Republic of Slovenia subsidy of 2.5 percent. The subsidy is necessary to provide an adequate financial cushion to the project, especially during the start-up phase. In the light of the low financial, but satisfactory economic, rate of return (see below), I feel the subsidy is acceptable in this particular case. We have informally raised the issue with the Government and they argue that to exclude the subsidy on the Bank loan would unduly penalize the project vis-a-vis competitors who all have access to subsidized funds. In any case, I do not think that we can reasonably request a borrower to forgo any benefit to which he is, by law, entitled.

Internal Economic Return

8. The best estimate of the project's internal economic return, as calculated in the sensitivity analysis of the appraisal report, is 13 percent, which is acceptable for Yugoslavia. This assumes a shadow rate of exchange of Din 18.0 to US \$1.0. This analysis is based on actual prices for other factors of production (basically labor and agricultural land) which, given present unemployment and underemployment of these resources, does not reflect their real (lower) economic costs. If the correct shadow wages and prices were used, the economic rate of return would probably be still higher.

Local Currency Financing

9. The proposed loan of \$10 million will cover \$9.1 million or 38 percent of the project cost plus \$0.9 million of interest during construction. The foreign exchange component is expected to lie between 24 and 38 percent of the project cost, depending on the success of Yugoslav manufacturing and construction firms in the bidding. Based on past experience, the most likely foreign exchange component will be \$6.9 million, or 29 percent of the project cost. Thus it is likely, as in the Babin Kuk project, that the Bank will finance about \$2.2 million of local costs. Some extent of local currency financing has been considered justified for previous projects in Yugoslavia.

Recommendation

10. I recommend that the Bank invite the Federal Government and EMONA to send representatives to negotiate a loan of \$10 million for the Bernardin tourism project substantially in accordance with Section 8 of the attached Appraisal Report.

M. P. Benjenk
Director

Attachments

Population: 20.5 m
GNP Per Cap: \$625

IVa: YUGOSLAVIA - 5 YEAR OPERATIONS PROGRAM
(By Fiscal Year - Amounts in \$ millions)

			<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
4-YUG-AT-02	Forestry II	IBRD			10.0			
4-YUG-DD-01	DFC I	IBRD		20.0				
4-YUG-DD-02	DFC II	IBRD			25.0			
4-YUG-DD-03	DFC III	IBRD					30.0	
4-YUG-II-04	Industry	IBRD		20.0				
4-YUG-II-03	Industry Modern. IV	IBRD				20.0		
4-YUG-PP-01	Power	IBRD		20.0				
4-YUG-QQ-01	Tourism I - Babin Kuk	IBRD	20.0					
4-YUG-QQ-04	Tourism II - Bernardin	IBRD	10.0					
4-YUG-QQ-02	Tourism III - Jaz	IBRD		15.0				
4-YUG-QQ-03	Tourism IV - Unidentified	IBRD				15.0		
4-YUG-TH-04	Railways	IBRD					30.0	
4-YUG-TH-05	Roads V	IBRD	35.0					
4-YUG-TH-06	Roads VI	IBRD			30.0			
4-YUG-TH-07	Roads VII	IBRD				30.0		
4-YUG-RR-01	Water Supply - Ibar	IBRD	45.0					
4-YUG-RR-02	Water Supply - Multipurpose II	IBRD			25.0			
4-YUG-WE-03	Infrastructure - Dubrovnik	IBRD		10.0				
4-YUG-XX-02	Unallocated II	IBRD			10.0			
4-YUG-XX-03	Unallocated III	IBRD				10.0		
4-YUG-XX-04	Unallocated IV	IBRD					15.0	

	<u>Total</u>							
	<u>1964-68</u>	<u>1969-73</u>	<u>1972-76</u>					
IBRD	<u>175.5</u>	<u>439.5</u>	<u>335.0</u>	IBRD	<u>110.0</u>	<u>85.0</u>	<u>100.0</u>	<u>75.0</u>
No.	5	19	17	No.	4	5	5	4
								3

P & B 3/10/71

Revised in accordance with latest timetables: EMENA 3/31/71

LOAN COMMITTEE

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SEP 05 2014

WBG ARCHIVES

April 1, 1971

B 1106

MEMORANDUM TO THE LOAN COMMITTEE

China - Fourth Railway Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated April 1, 1971 from the East Asia and Pacific Department, entitled "China - Proposed \$15.0 Million Loan to the Taiwan Railway Administration" (LC/0/71-50).
2. Comments, if any, should be sent to reach Mr. Kalim (ext. 2426) by 5:00 p.m. on Monday, April 5.
3. It is planned then, if the Committee approves, to inform the Government and representatives of TRA and TPB 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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Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

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SEP 05 2014

WBG ARCHIVES

CONFIDENTIAL

LC/0/71-50

April 1, 1971

LOAN COMMITTEE

Memorandum from East Asia and Pacific Department

CHINA - Proposed \$15.0 million Loan to
the Taiwan Railway Administration

1. Attached is an appraisal report (PTR 76, dated March 24, 1971) recommending a Bank loan of \$15.0 million to the Republic of China to finance the foreign exchange costs of: (a) the services of consultants to assist the recently created Transportation Planning Board (TPB); and (b) part of the Taiwan Railway Administration's (TRA) 1971-74 expansion program.
 2. A memorandum to the Loan Committee (LC/0/71-23, dated February 26, 1971) on the "Third Power Project" described recent economic developments in Taiwan. In essence, the trend towards fast economic growth, spurred largely by expanding industrial exports, remains strong. The government's development strategy aims at preventing infrastructure bottlenecks from impeding the progress of the dynamic private sector. The Bank's five-year lending program (copy attached) has been formulated with the objective of assisting the government's policy of rectifying past deficiencies in investment for transport, power and, more importantly, social services such as education, water supply and sewerage.
 3. The proposed Bank loan will be the fourth to benefit railroad development in Taiwan. The first loan (409-CHA) amounting to \$20.0 million (reduced to \$17.5 million after cancellations) was made in 1965 to cover TRA's most urgent requirements of motive power, rolling stock and other equipment during the 1966-70 period. However, traffic increased more rapidly than expected so that TRA had to buy additional equipment. Two further loans were extended to finance the enlarged investment program - a \$17.5 million loan (524-CHA) was made in 1966 and another of \$31.2 million (603-CHA) in 1969. Progress in the execution of all three projects is satisfactory. Loans 409-CHA and 524-CHA are expected to be closed by the end of June, 1971 and loan 603-CHA a year later. Disbursements on the first and second loans were rather slow on account of delays in land acquisition for a marshalling yard and the time-consuming nature of the government's procurement procedures. A supervision mission visited Taiwan in August, 1970 and agreed upon measures to simplify procurement which has speeded up significantly in recent months.
 4. Taiwan's economic activity is concentrated largely in its 375-km. long western plain in which 80% of the population lives. TRA
- 1/ Loan 524-CHA is expected to be closed before the proposed project is presented to the Board of Executive Directors.

enjoyed a quasi-monopoly in this transportation corridor during the last decade.^{1/} Taiwan's economy grew during this period at such a rate that the demand for transportation outstripped the supply. The Government is aware of the need to increase public investment in transport infrastructure and has taken several major decisions in this regard. The construction of a North-South Freeway running the entire length of the western plain has begun with the help of funds from the Japanese Government and the Asian Development Bank; the Bank has also been requested to finance the building of part of the freeway. The feasibility of constructing a third major port near the middle of the western coastline -- the two existing ones are at the north and south ends of the island at Keelung and Kaohsiung respectively -- is being seriously considered. TRA's future expansion plans are to be reviewed during the next few months after the results of a study (financed from the proceeds of Loan 603-CHA) on the merits of electrifying the western line become available.

5. The Government, recognizing that the transport sector was in a transitional stage and that there was a great need to scrutinize the massive investments contemplated, set up a Transportation Planning Board (TPB) in August 1970. The TPB will report directly to the Minister of Communications who will act as its chairman. It will review: pricing policies, transport regulations, comparative returns on investment in alternative modes of transport and the advisability of relaxing or tightening import restrictions on transport equipment. The Government believes that TPB's staff, though potentially able, lacks experience in the type of activity it will engage upon. The Government decided to retain a team of suitable foreign consultants to assist TPB for at least the first three years of its existence. It is estimated that this would cost about \$1,000,000 (\$800,000 in foreign exchange). The possibility of the United Nations Development Programme (UNDP) providing finance for this item was extensively discussed both with the Chinese authorities and the UNDP Resident Representative in Taipei. Both parties indicated that they would prefer the Bank to finance the cost of these services on account of its present and projected involvement in the development of the transport sector, the fact that the Bank could provide funds more expeditiously than the UNDP, and the latter's preference to use its relatively small allocation for Taiwan for other purposes. This decision has since been confirmed by UNDP headquarters in New York.

6. One of the initial tasks which we have suggested that TPB undertake consists of supervising and scrutinizing a study on the advisability of linking the western and eastern transport corridors of Taiwan.

^{1/} TRA also operates a small gauge line on the eastern coast. The east line operations though efficiently conducted yield a loss on account of the scarcity of traffic.

The Provincial Government has submitted a plan to the Executive Yuan (Cabinet) to build an 80km. rail link joining the TRA main western line to the narrower gauge eastern line; the gauge of the eastern line would subsequently be broadened and the two presently unconnected railway systems joined by a "round the island line". Preliminary figures indicate that the project would cost \$60.0 million equivalent. The scheme was forwarded to the National Government without any detailed economic analysis having been performed or any alternative ways of improving communications with the eastern region being considered. The magnitude of the Bank's present and proposed financial involvement in the transport sector, which could amount to about \$200 million by 1975, and our concern that expenditures on the sector yield maximum benefits prompted us to inform the Government that the scheme should not be embarked upon before it had been examined from an economic standpoint. The Government has informed us that arrangements for a study of the project have been made with the Japanese Railway Technical Services; we have asked the Finance Minister to let us have a copy of the terms of reference. The subject will be further explored during negotiations and it is intended that agreement be reached to the effect that the study would be fully discussed with the Bank; if a decision to embark upon the construction of the rail link is taken by the Government against the findings of the study, arrangements, satisfactory to the Bank, would be made to ensure that TRA would be financially insulated from the venture both in terms of capital and operating expenditures.

7. The proposed loan would also provide foreign exchange for expenditures TRA intends to undertake in 1972 and 1973 to streamline its operations. The necessity for these investments is not likely to be affected by either the major governmental decisions to be made in regard to the transport sector as a whole or the action taken on the findings of the railway electrification study. The main components of the project are track strengthening; the purchase of signalling, telecommunications and freight handling equipment; improvements to station and marshalling yards, workshops, depots and warehouses; and the acquisition of some specialized freight cars. The total cost of the project will be about US\$39.4 million equivalent with a foreign exchange component of about US\$19.0 million. The proposed loan would cover about 80% of the estimated foreign exchange costs for which financing was requested. TRA has enough funds of its own, which the Government will allow it to convert into foreign currency, to furnish the balance required (amounting to \$3.6 million).

8. TRA is a competently managed organization and its ability to carry out the project is not in doubt. Its planning capability is being improved with the help of consultants financed under Loan 603-CHA and should enable it to compete effectively with road transportation in future years. TRA's financial performance has been good; its cash generation has been sufficient to service all debt, steadily improve its working capital position and make a substantial contribution to investment requirements. TRA was required under the 603-CHA Loan

Agreement to achieve a 7% rate of return on its net revalued assets; this rate was attained in 1969 but fell slightly in 1970 largely because of a revaluation of TRA's land assets. The rate of return is, however, expected to improve and reach a level of 7.5% by 1974.

9. TRA's earnings would have been higher had it not been required to carry military personnel, Government employees and students at special "privilege" fares which are probably below the marginal cost of bearing this category of traffic; the same applies to military freight traffic. Roughly \$8 million of revenues were lost on account of these arrangements in 1969. It is intended to discuss their continuance during negotiations with the object of raising privilege rates and fares to the level of the relevant marginal cost.

10. Procurement of goods financed from the proceeds of the proposed loan will be on the basis of international competitive bidding. The foreign exchange component of total project cost was calculated on the assumption that the goods to be acquired from the proceeds of the Bank loan would be obtained from foreign firms. About \$2.34 million is expected to be disbursed for the purchase of rolling stock. However, two Chinese firms are equipped to manufacture some of this equipment. These firms are working at full capacity and unlikely to enter the bidding. In the improbable event that they do so and are awarded contracts, it is proposed that disbursement be made against the orders as if they had been won by a foreign firm. This would imply that a maximum of US\$600,000 of local currency expenditures would be covered in the proposed loan.

11. The financing of local expenditures was not considered justifiable in the past because the Government's efforts to mobilize domestic resources were regarded as inadequate. The Government has now taken steps to reform the tax system and public savings have started to grow as a result. Nevertheless the gap between public savings and investments is expected to widen during the next few years and is likely to exceed the foreign exchange costs of the projects included in the Government's investment program. For this reason, it was agreed at the review of the Country Program Paper last September that the Bank would finance some local expenditures in appropriate cases.

12. The project is soundly conceived and should make an important contribution to the development of China's transportation system at this critical stage. The weighted average economic return on quantifiable items is calculated to be about 18% which is satisfactory. The National Government will service that portion of the loan utilized for providing technical assistance to TPB; the remainder will be repaid by TRA.

13. I agree with the conclusions and recommendations of the appraisal report. I propose, subject to the Loan Committee's approval, to invite the Republic of China, TRA, and TPB to send representatives

- 5 -

to Washington to negotiate a \$15 million loan for a 15-year term
(including three years' grace).

Raymond J. Goodman
Director
East Asia and Pacific Department

Attachments

Population: 13.1 m
GNP Per Cap: \$250

CHINA - FIVE-YEAR LENDING PROGRAM

(\$ millions)

		Fiscal Years					Total	Total	
		1971	1972	1973	1974	1975	1976	1964-68	1969-73
Agric. Mechanization I	IBRD		20.0						
Agric. Mechanization II	IBRD				20.0				
Agric. Mechanization III	IBRD						20.0		
Telecommunications II	IBRD		16.5						
DFC - CDC V	IBRD		18.0						
DFC - CDC VI	IBRD				20.0				
DFC - CDC VII	IBRD						20.0		
Fishery Education	IBRD		2.5						
Power III	IBRD	55.0							
Thermal Power	IBRD				20.0				
Tourism	IBRD			10.0					
Highways I	IBRD			30.0					
Highways II	IBRD					30.0			
Port Development	IBRD			30.0					
Railways IV	IBRD	15.0							
Railways V	IBRD			20.0					
Railways VI	IBRD					20.0			
Sewerage - Taipei I	IBRD			20.0					
Sewerage - Taipei II	IBRD						20.0		
Water Supply - Taipei									
Regional	IBRD				30.0				
	IBRD	<u>70.0</u>	<u>57.0</u>	<u>110.0</u>	<u>90.0</u>	<u>50.0</u>	<u>60.0</u>	<u>106.7</u>	<u>389.7</u>
No.		2	4	5	4	2	3	7	16

East Asia and Pacific Department
March 30, 1971

LOAN COMMITTEE

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SEP 05 2014

WBG ARCHIVES

March 31, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Greece - Groundwater Development Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated March 31, 1971 from the Europe, Middle East and North Africa Department, entitled "Greece - Proposed Loan for a Groundwater Development Project" (LC/0/71-49).
2. Comments, if any, should be sent to reach Mr. Siebeck (ext. 4707) by 1:00 p.m. on Monday, April 5.
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
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Directors, other Departments
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Vice President (IFC)

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LC/O/71-49

March 31, 1971

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa
Department

GREECE - Proposed Loan for a
Groundwater Development Project

1. Attached for consideration by the Loan Committee is an appraisal report, entitled "GREECE - Groundwater Development Project" (No. PA-83) dated March 12, 1971. It recommends a Bank loan of \$25 million for this project. This would be the fourth loan to Greece, and the first for agricultural development. Two previous loans were made for industrial lending to a development finance company and one for education. An economic mission has just returned from Greece and is preparing its report, which will be distributed to the Executive Directors at the beginning of June and, in any case, before presentation of the proposed loan. The mission reports that economic growth continued at a satisfactory rate during 1969 and 1970, amounting to about 8 percent annually, without any significant pressure on prices. The mission's preliminary findings confirm the country's credit-worthiness and the proposed project's priority for its overall development. The current operations program for Greece is attached.

2. The proposed project provides for deep well irrigation of some 40,000 hectares in the Thessaly plain and is part of a country-wide long-term irrigation development program of which the Bank may finance further parts in the coming fiscal years. The project further provides for hydrogeological studies to be made by consultants in the project area as well as in other potential groundwater development areas in Macedonia and Thrace.

Issues

3. The project should raise no major issues. Agreement has now been reached with the Government on all suggestions put forward by the appraisal mission, and would be confirmed during negotiations. This includes:

4. Procurement: Almost all deep well drilling in Greece is presently executed by force account. The Government accepted that drilling on force account be limited to 600 out of 1600 wells to be financed under the project and to an additional 35 exploration wells. The balance would be open to international competitive bidding. In order to render bidding attractive for foreign firms, we would require the Government to have drilling contracts for at least 500 wells each. Individual road and drainage contracts would have a minimum size of \$1.7 million. Out of a total project cost of \$50 million equivalent, contracts for an estimated total of \$43 million would be tendered on the basis of international competitive bidding.

5. Under Greek law, local manufacturers would be entitled to a preference margin of 30 percent for equipment and supplies required for the project. However, the Government has agreed to reduce the preference level for the purposes of the Bank project to 15 percent, or to a level equal to the prevailing import duties, whichever is lower.

6. Land consolidation: Fragmentation of land holdings is a constraint to agricultural development in Greece. Much of the effort in land consolidation to date has been concentrated on the Thessaly plain, where average farm size is larger than in the rest of the country, and already about half of the project land has been consolidated into single units. The Government has agreed that project wells would only be drilled on consolidated lands. It is expected that consolidation would progress in step with project implementation and will be completed before 1974.

7. Water charges: It is suggested that farmers repay to the Government without interest 75 percent of overall investment cost. This would be in line with present practices and would suffice to recover over 25 years the capital expenditure for the wells, pumps and sprinkler equipment, leaving the cost of roads and drains to the Government. Farmers' annual payments including operation and maintenance cost would amount to about \$97 per hectare, which would be high but still within the farmers' payment capacity. However, repayments would be scaled down during the first two years after completion of a well, to coincide more closely with the rate of agricultural development.

Recommendation

8. I recommend that the Bank invite the Government to send representatives to negotiate a loan of \$25 million for this project on the lines indicated in Chapter VIII of the Appraisal Report.

M. P. Benjenk
Director

Attachment

Population: 8.7 M.
GNP Per Cap: \$700

GREECE - 5 YEAR OPERATIONS PROGRAM

(By Fiscal Year - Amounts in \$ Millions)

		<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
Irrigation I	IBRD	25.0					
Irrigation II	IBRD		15.0				
Irrigation III	IBRD			10.0			
Livestock	IBRD			10.0			
Agriculture Unidentified	IBRD						10.0
DFC - NIBID III	IBRD		20.0				
DFC - NIBID IV	IBRD				20.0		
DFC - NIBID V	IBRD						12.0
DFC - HIBD	IBRD					20.0	
Education I	IBRD	13.8					
Education II	IBRD			18.0			
Education III	IBRD					15.0	
Roads I	IBRD		4.5				
Roads II	IBRD				15.0		
Roads III	IBRD						10.0
Totals							
<u>1964-68 1969-73 1974-76</u>							
IBRD		<u>12.5</u>	<u>136.3</u>	<u>102.0</u>			
No.		<u>1</u>	<u>9</u>	<u>7</u>			
IBRD		<u>38.8</u>	<u>39.5</u>	<u>38.0</u>	<u>35.0</u>	<u>35.0</u>	<u>32.0</u>
No.		<u>2</u>	<u>3</u>	<u>3</u>	<u>2</u>	<u>2</u>	<u>3</u>

March 29, 1971

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LC/O/71-48

March 30, 1971

LOAN COMMITTEE

Memorandum from South America Department

BRAZIL - Proposed Bank Loans for MBR Iron Ore
and Railway Projects

1. Attached are Appraisal Reports No. and No. PTR-77 recommending two Bank loans totalling \$96 million to assist in the financing of the MBR Iron Ore Project consisting of mining installations, a deep water sea terminal and a railway link. The Appraisal Report of the MBR Project is in draft stage and it will be revised before Board presentation. Some of the recommendations in this memorandum vary from recommendations in the Appraisal Report, but have been agreed upon by the Departments concerned. The proposed loans would be:

(i) \$50 million to Mineracoes Brasileiras Reunidas, S.A. (MBR), a private Brazilian corporation; and

(ii) \$46 million to Rede Ferroviaria Federal, S.A. (RFFSA), a publicly owned railway corporation encompassing all federal railways in Brazil. The loan to MBR would be the first Bank loan for an iron ore project in Brazil. The loan to RFFSA would be the first one to that entity, but there have been two other railway projects financed by the Bank in 1952 and 1953 to the Central do Brasil, which is now part of the RFFSA system.

The Lending Program

2. An \$8.4 million Bank loan for the Technical and Agricultural Education Project, a \$70 million Bank loan for the Salto Osorio Hydroelectric Project; a \$22 million Bank loan for the Sao Paulo Water Supply Project and a \$15 million Bank loan for the Sao Paulo Pollution Control Project have been negotiated. The Appraisal Report for the remaining project for this fiscal year - the Santos Port Project - is currently being reviewed and a memorandum to the Loan Committee will be submitted within the next few days. The five-year lending program (fiscal years 1971-75) is attached.

The Economy

3. The recent Economic Report on Brazil (WH-203a) issued on January 22, 1971 indicates that in the last three years the Brazilian economy sustained rapid growth while the country's international liquidity position has been strengthened. Brazil continues to be creditworthy for substantial amounts of Bank lending.

A. The MBR Project

4. The project consists of the installation and utilization of equipment to mine MBR's Aguas Claras orebody near Belo Horizonte, and the construction of a new ocean terminal at Sepetiba Bay to export a minimum of ten million tons of high grade iron ore (over 60 percent Fe content).

5. Ownership of the operating company, MBR, disregarding intermediate holding companies, is the Antunes Group, 41 percent; Hanna Mining Company (U.S.), 25 percent; Japanese steel and trading companies, 10 percent; and others, 24 percent. The Antunes Group and Hanna are the sponsors of the project.

6. MBR, which is already successfully exploiting several smaller iron ore mines near the Aguas Claras property, has entered into long-term ore sales agreements to sell annually seven million tons of Aguas Claras ore to five Japanese steel companies, 1.3 million tons to British Steel Corporation and .7 million tons to SOMISA in Argentina. These contracts for nine million tons plus a further one million tons for spot sales account for the initial planned minimum production level of ten million tons. Sale of roughly seven million tons annually, the amount contracted for by the Japanese steel companies, is essential to MBR's financial success.

7. The total cost of the project is estimated to be \$155 million (including interest during construction), of which up to \$86 million would be the foreign exchange component. The proposed Bank loan of \$50 million for a term of fifteen years, including a three year grace period, would finance about 32 percent of total costs. A maximum of about 14 percent of the Bank loan would represent local expenditure financing, and is recommended on "country" grounds discussed in paragraph 38 of the program paper on Brazil (November 9, 1970). All equipment, bulk construction materials and civil works financed by the Bank would be subject to international competitive bidding. Brazilian suppliers of equipment and materials would be given a 15 percent margin of preference in bid evaluation, and the Bank would finance the full cost of such items, irrespective of whether the orders were placed with Brazilian or foreign sources. The Bank's participation in civil works contracts would be limited to their foreign exchange content.

B. The Railway Project

8. Transport of iron ore from the mine to the ocean terminal (640 km) is to be provided by RFFSA. A fifteen-year transport contract between RFFSA and MBR has been signed covering the movement of a minimum of nine and maximum of fifteen million tons per annum. The project covers the provision of locomotives, cars and railway facilities required for annual shipments of twelve million tons. The total cost of the project is estimated at US\$133.2 million. The proposed Bank loan of US\$46 million will finance the cost of equipment (excluding the locomotives which will be financed by the U.S. Eximbank) to be purchased under international competitive bidding in which Brazilian suppliers will participate with a 15 percent margin of preference, and the foreign exchange cost of engineering and supervision services. Although the extent of local expenditure financing is difficult to assess and would depend upon the award of equipment contracts, our estimate is that about 50 percent of the Bank loan would represent local expenditure financing. The Appraisal Report recommends a Bank loan with an eighteen-year maturity including a three-year grace period.

Bank Participation and Project Benefits

9. Brazil's capital requirements are large. Official and international agencies can provide only a part of these requirements. In addition, Brazil will have to obtain substantial amounts from private sources in the form of debt and equity financing. Brazilian policies have, in general, welcomed the participation of foreign capital in domestic industry. In the extractive sectors, in the past there has been a certain amount of controversy on the desirability of foreign participation and foreign capital has been shy in participating in such ventures. Since 1964, however, the Government has adopted a clear policy permitting foreign participation in mining projects with a majority Brazilian control. The Bank's role in financing the two projects is to provide resources for a venture with substantial benefits for the economy (see paragraph below), to help mobilize substantial foreign private participation and to lend support to the Government's policy. The readiness of the Bank to participate in the two projects has been crucial for the sponsors of MBR in obtaining Japanese equity participation and an untied loan of \$50 million from Japanese steel mills and trading companies. The Bank has already proposed to the Government and the Sponsors that the Government charge a 2 percent guarantee fee on the Bank loan to MBR. This provision would be incorporated in the Guarantee Agreement. The cost of the Bank loan to the MBR would then be close to the cost of money from commercial sources.

10. The economic return on the combined MBR and Railway projects is of the order of 20 percent. The benefits to the Brazilian economy from the two projects will be substantial even at the modest export level of ten million tons per year. Net foreign exchange earnings after allowing for debt service, dividend payments and the foreign exchange component of operating costs, would average about \$50 million per annum. At this level of sales about 82 percent of net financial benefits will accrue to Brazil, 61 percent to the Brazilian Government through various taxes and 21 percent to Brazilian shareholders. These estimates do not include benefits for RFFSA resulting from profitable traffic. Without putting equity in the MBR project, the Government is a silent partner and a major beneficiary from it.

11. In a number of projects of this nature, the Bank has required guarantees from the principal shareholders to cover interest and principal on its loans. Since Brazil is creditworthy and the MBR and RFFSA projects are not enclave projects, iron clad personal guarantees of Sponsors need not be a sine qua non for Bank lending. Rather, the question is how the benefits, the costs and the risks of the projects should be shared by the Sponsors, the Government and the Railways. The Government will be a major beneficiary of the project and can reasonably be expected to assume some of the repayment risks arising because of the absence of personal guarantees of repayment of the Bank loan by the Sponsors. It is, therefore, intended to negotiate arrangements whereby the financial liabilities of the Sponsors as regards completion of the MBR project, service of external loans to MBR, and fulfillment of MBR's minimum obligations to RFFSA, would be limited to the net assets of MBR and to certain additional amounts. (See paras 17 and 18 below).

Principal Issues for Negotiations

Railway Freight Contract

12. Although the Government would derive substantial income from the project, the financial risks of RFFSA, an autonomous corporation, should be evaluated independently. The Freight Rate Formula agreed between MBR and RFFSA fixes freight charges in U.S. dollar terms for the duration of the contract, fifteen years, but does not make allowance for deterioration in the value of the dollar over that period. The Government's policy is to readjust the exchange rate by the difference in the increase in prices in Brazil and in the internal markets of its major trading partners. Consequently, for a given tonnage of ore transport, RFFSA's costs are likely to increase more rapidly than its receipts. Even if iron ore prices kept pace with inflation in the developed countries, under the existing contract, RFFSA would not be adequately compensated, since the level of iron ore prices is an insignificant factor in the negotiated formula by which RFFSA's freight rate for MBR is computed.

13. The Bank has proposed to MBR that the freight rate be adjusted every four years to reflect changes in the value of the U.S. dollar. MBR has indicated that it accepts the principle of a periodic review of freight rates and has promised to submit a specific proposal during loan negotiations.

14. The ore transport contract provides for minimum annual shipments of nine million tons of ore unless excused by force majeure. Under the project arrangements RFFSA would be providing a service to MBR and most of its investments would be captive. Its contract with MBR is not a profit sharing arrangement. Hence, it should not be required to share MBR's commercial risks, a possibility under the existing force majeure clause. The force majeure clause between MBR and RFFSA includes the following provision:

"any other facts, whether unforeseeable or unavoidable, beyond the control of the contracting parties which may prevent or delay, either totally or partially, the compliance with the obligations printed herein".

During negotiations it is proposed to seek assurance from MBR that it would not invoke force majeure in respect of commercial risks which the present broad language of the force majeure clause may permit. With this assurance, the transport contract between RFFSA and MBR could be regarded in effect as a "Take or Pay" type of contract. Other recommendations in respect of security are based on the assumption that this assurance will be obtained.

Iron Ore Sales Contracts

15. MBR, which is already successfully exploiting several smaller iron ore mines near the Aguas Claras property, has entered into long-term ore sales agreements to sell annually seven million tons of Aguas Claras

ore to five Japanese steel companies, 1.3 million tons to British Steel Corporation and 700,000 tons to SOMISA in Argentina. These contracts for nine million tons plus a further one million tons for spot sales account for the initial planned minimum production level of ten million tons per year. Sale of roughly seven million tons annually, the amount contracted for by the Japanese steel companies, is essential to MBR's financial success. Each of these contracts provide for periodic re-negotiation of the sales price on terms that are likely to favor MBR. The existence of such favorable long-term contracts, particularly those with the Japanese, provides the principal financial basis upon which the project is recommended.

16. The ore sales contracts between MBR and Japanese steel mills have a somewhat wider force majeure clause than is normally acceptable to the Bank and might be construed to excuse performance by the parties on account of adverse commercial circumstances. Specifically, the force majeure clause in the MBR contract with the Japanese steel mills includes the following provision:

"orders or acts of civil or military authority or other causes, whether or not of a similar nature (i.e., similar to listed Acts of God), reasonably beyond the control of Buyer and Seller".

If this phrase were invoked to justify non-performance of these contracts, MBR would have to have sufficient liquidity, and/or sufficient support from the Sponsors, to meet its obligations until it could arrange to sell its ore to other purchasers.

Sponsors' Obligations

17. The Sponsors would be obligated to assure that MBR has adequate working capital to maintain a minimum liquidity level to enable MBR to service its debt and meet its minimum obligation to RFFSA during a hypothetical sales recession of four years during which revenues would drop 50-60 percent, or a total sales stoppage of 12-18 months. When the Appraisal Report was prepared, it assumed that some accommodation between RFFSA and MBR would be reached during difficult sales periods and concluded that a \$20 million working capital would be appropriate; however, the assurance with respect to the RFFSA contract expected as described in paragraph 14 above would require somewhat higher payments by MBR and a \$30 million limit now seems desirable.

18. The Sponsors would be obligated to make available, on terms acceptable to the Bank, all funds necessary to complete the MBR project, including funds needed for cost overruns. They would, however, have the option to abandon the project upon repayment of the Bank's loans to it and to RFFSA in the event completion is found impossible. This undertaking would probably require a shareholders' agreement entered into by the Antunes Group and Hanna.

19. The Sponsors are aware that the Bank must have a pari passu position with respect to all real security and priorities. The Bank would, of course, obtain a mortgage. Since the Japanese lenders to MBR have a "priority", viz, they will receive 60 cents per ton for ore shipped under the Japanese iron ore purchase contracts, some means must be devised to provide the Bank with an equivalent. During negotiations assurance would be obtained that an acceptable equivalent mechanism would be set up to secure service on the proposed Bank loan to MBR.

20. The Bank would also require a number of other undertakings: accelerated prepayment of Bank loan by an amount equal to any gross dividend payments in excess of \$5 million per year; equal repayment if other debt is prepaid; limitation on dividends and on technical assistance payments to Hanna unless certain liquidity tests are met; actual payment of Sponsor's equity before draw-down of the Bank loan; and insurance and other standard covenants.

Ecology

21. The ecological implications of the project were examined by a special mission and its findings are in Annex 5-2 to the Appraisal Report on MBR. Of the recommendations listed in paragraph 4.11 in the MBR Appraisal Report, there are only two with which the Bank should concern itself in connection with the project. First, ships bringing ore might discharge slops into the sea thereby endangering marine life on which the livelihood of some of the local population depends. This might also pollute the nearby beaches which are used for recreation. Brazilian regulations forbid the discharge of slops in the vicinity of harbors and beaches. These regulations would be reinforced by obtaining during loan negotiations assurances from MBR that it would install facilities to receive slops from ships. Second, during operations MBR would accumulate a substantial amount of fines at the mines. Installation of a pelletizing plant at Sepetiba Bay to utilize these fines may cause significant detriment to the local environment. MBR's current plans are either to locate a pelletizing plant at the mines or to export fines. During negotiations assurance would be obtained that, in the event MBR decided to locate a pelletizing plant at the Sepetiba terminal, MBR would consult the Bank and seek approval of the Government.

Recommendation

22. I recommend that the Bank inform MBR and RFFSA and the Government of Brazil that it is prepared to negotiate a loan to MBR of \$50 million for the Iron Ore Project and a loan to RFFSA of \$46 million for the First Railway Project on terms and conditions listed in the attached Appraisal Reports and as modified in this paper.

Gerald Alter
Director

Attachments:

Population: 93.3 m
GMP Per Cap: \$286

BRAZIL - 5 YEAR LENDING PROGRAM

(\$ millions)							
		Fiscal Year				Total	Total
1971	1972	1973	1974	1975	1976	1964-68	1969-73
	10.0						
	20.0						
			30.0				
				30.0			
		10.0					
					60.0		
	12.5						
		35.0					
			50.0				
				40.0			
					60.0		
8.4							
		20.0					
50.0							
	40.0						
	50.0						
	70.0						
			50.0				
70.0							
	75.0						
			75.0				
				75.0			
					75.0		
	100.0						
		100.0					
		60.0					
				100.0			
					100.0		
50.0							
	10.0						
		15.0					
45.0							
	50.0						
			50.0				
			75.0				
				75.0			
37.0							
<u>260.4</u>	<u>437.5</u>	<u>240.0</u>	<u>330.0</u>	<u>320.0</u>	<u>295.0</u>	<u>291.1</u>	<u>1180.8</u>
6	10	6	6	5	4	10	28

LOAN COMMITTEE

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March 29, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Tunisia - Highway Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated March 29, 1971 from the Europe, Middle East and North Africa Department, entitled "Tunisia - Proposed \$24 Million Loan for a Highway Project" (LC/0/71-46).
2. Comments, if any, should be sent to reach Mr. Julin (ext.4708) by 1:00 p.m. on Thursday, April 1.
3. It is planned then, if the Committee approves, to inform the Government that the Bank is prepared to begin negotiations for the proposed loan on the terms and conditions referred to in the attached memorandum.

David Pearce
Secretary
Loan Committee

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Committee:

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

Copies for Information:

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

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LC/O/71-46

March 29, 1971

LOAN COMMITTEE

Memorandum from the Europe, Middle East and North Africa Department

TUNISIA - Proposed \$24 Million Loan
for a Highway Project

1. Attached for consideration of the Loan Committee is Appraisal Report No. PTR-75, dated March 16, 1971. It recommends a Bank loan of \$24 million to finance the foreign exchange component (estimated at about \$22.8 million) of a \$41.7 million highway project and to refund the highway engineering loan (S2-TUN) of \$850,000 of 1968 under which the proposed project was prepared.
2. This would be the twelfth Bank loan to Tunisia, bringing total Bank lending to \$106.3 million (net of cancellations and refundings) in addition to seven IDA credits totalling \$47.8 million. The current five-year operations program is attached.
3. The Bank Group's previous lending to Tunisia's transport sector consists of two loans of \$7.0 and \$8.5 million respectively in 1964 and 1968 for port development and a loan and credit of together \$17 million in 1968 for a railway project. Following the above-mentioned engineering loan, the proposed operation would be the first highway project. Its main objectives are, on the one hand, improvement or construction of selected roads and bridges as well as strengthening and reorganizing highway maintenance operations and, on the other hand, improvement of the institutional arrangements for transport coordination and an overhaul of existing road transport regulations and the road user taxation system.

Project Issues

4. Transport Coordination

At present, there are no satisfactory arrangements for the formulation of policy and the coordination of operations and investment for the transport sector as a whole. These functions devolve on a number of government entities with no permanent formal machinery for guiding or coordinating their activities and decisions. This shortcoming has been discussed with the Government by several Bank missions. The Tunisian

authorities have in the past virtually denied the existence of a transport coordination problem, but are now taking steps to improve the necessary institutional framework. The Bank has discussed with the Government the functions which should be discharged by the entity that will be established eventually for the purpose of transport coordination and policy formulation. Since delicate political issues are involved, we have not expressed any firm view on the specific institutional or organizational solutions that might be adopted. The Government is preparing a proposal in this respect for discussion during the loan negotiations when we expect to reach agreement on satisfactory transport coordination arrangements and a plan for their implementation.

5. The Appraisal Report recommends that submission to the Bank of the proposal to establish a transport coordinating agency should be a condition of inviting negotiations (para. 2.08 and 6.01). In view of the progress made by the Tunisians in recent weeks in working out this proposal all departments concerned agree, however, that it would be sufficient to receive this proposal at the start of negotiations.

Transport regulations and road user charges

6. Road transport in Tunisia is subject to severe and, in many cases, excessive restrictions which have remained virtually unchanged for more than twenty years. These restrictions include such measures as tight control over entry into the road transport industry, licensing of private carriers and interdiction for such carriers to pool or contract vehicles, prohibition to carry certain products on routes parallel to railways, and fixed minimum tariffs. While these regulations are in practice frequently contravened and there is little evidence of distortion in the current distribution of traffic between road and rail, they create an unnecessary administrative burden and have probably had an inhibiting effect on the development and efficiency of road transport.

7. The existing road user taxation system was introduced already under the French administration and has evolved in a rather arbitrary manner. Current road user charges appear to bear little relationship to actual costs imposed on the road network, and are unnecessarily complex. A simplification and rationalization of the tax system would therefore be called for to secure an economic allocation of traffic to the least cost modes and vehicle types.

8. In previous years, the Government has been reluctant to repeal or revise road transport regulations and taxation. In accordance with the recent reorientation of economic policies, however, it has started to consider the possibilities of easing restrictions and modifying the tax system in the transport sector and is likely to have a number of proposals on specific aspects at the time of negotiations. During negotiations, the Government and the Bank would discuss these proposals and agree upon those to be implemented immediately. Furthermore, agreement would be

reached on the terms of reference for studies by consultants on the road transport regulations and the taxation system in general, as well as on consultation with the Bank on the implementation of the recommendations emanating from these studies.

Participation of partly Government-owned enterprises in bidding

9.. The Government recently decided to discontinue execution of highway construction works under force account and to use contractors for such works. To make use of existing equipment and personnel and to ensure a larger element of competition, the Government decided to establish a construction company. The Government's share in its capital would be 38 percent; autonomous state-owned enterprises would contribute a further 16 percent and the remainder would be made up by subscriptions from private firms or firms in which the Government has a minority interest. Discussions have taken place with a potential foreign partner to participate in this company but have not yet materialized in an agreement. Another partly state-owned construction firm (with a minority state participation) is already operating in competition with private firms for the construction of buildings. Both enterprises are likely to participate in the prequalification of bidders for the proposed project, the former for highway works and the latter for bridge construction.

10. The Bank has been afforded suitable opportunities to review and comment on the articles of incorporation of the new highway construction company and on the conditions under which it would operate. During loan negotiations, we would discuss with the Government and agree on the specific conditions under which the partly Government-owned enterprises would be eligible to participate in pre-qualification and bidding. The main principles would be that they would not enjoy any kind of privilege over their competitors or any subsidies, and that they would be sufficiently independent from the Ministry of Public Works to avoid potential conflicts of interest, since the Ministry would be in charge of project execution and may also be the representative for the Government's share in the companies.

Recommendation

11. I recommend that the Bank invite the Government of Tunisia to negotiate a loan of \$24 million for a highway project on the terms and conditions proposed in Chapter 6 of the Appraisal Report and in this memorandum.

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

Attachments

Population: 4.9 m
GNP Per Cap: \$230

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

			1971	1972	1973	1974	1975	1976
4-TUN-AC-01	Agricultural Credit I	IBRD	5.0					
	"	IDA	3.0					
4-TUN-AC-02	Agricultural Credit II	IBRD				15.0		
4-TUN-AI-01	Irrigation	IBRD			5.0			
4-TUN-AF-01	Fisheries	IBRD		2.0				
4-TUN-DD-04	DFC - SNI IV	IBRD		10.0				
4-TUN-DD-05	DFC - SNI V	IBRD				10.0		
4-TUN-DD-06	DFC - SNI VI	IBRD						10.0
4-TUN-EE-04	Education IV	IDA					10.0	
4-TUN-IM-01	Phosphate Mining	IBRD			5.0			
	"	IDA			5.0			
4-TUN-MM-01	Family Planning	IDA	4.8					
4-TUN-PP-01	Power	IBRD		10.0				
4-TUN-QQ-01	Tourism Infrastructure I & Sewerage	IDA		7.0				
4-TUN-QQ-02	Tourism Infrastructure II & Sewerage	IBRD				10.0		
4-TUN-TH-02	Road Construction I	IBRD	24.0					
4-TUN-TH-03	Road Construction II	IDA						15.0
4-TUN-TL-01	Pipeline	IBRD	7.5					
4-TUN-TR-02	Railroads II	IBRD			10.0			
4-TUN-WA-01	Sewerage I	IBRD			4.0			
	"	IDA			4.0			
4-TUN-WW-03	Water Supply I	IBRD						5.0
	"	IDA						5.0

Total								
	1964-68	1969-73	1972-76					
IBRD	34.0	123.3	94.0	IBRD	36.5	20.0	24.0	35.0
IDA	19.0	53.8	57.0	IDA	7.8	9.0	18.0	15.0
Total	53.0	177.1	151.0	Total	44.3	29.0	42.0	50.0
No.	5	19	16	No.	4	4	5	3

LOAN COMMITTEE

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SEP 05 2014

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March 29, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Democratic Republic of Congo

1. The Committee is requested to consider, without meeting, the attached memorandum dated March 29, 1971 from the Eastern Africa Department, entitled "Democratic Republic of Congo - Proposed IDA Credit for a River Transport Project" (LC/0/71-47).
2. Comments, if any, should be sent to reach Mr. Moreau (ext. 3615) by 1:00 p.m. on Thursday, April 1.
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)

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LC/0/71-47

March 29, 1971

LOAN COMMITTEE

Memorandum from the Eastern Africa Department

DEMOCRATIC REPUBLIC OF THE CONGO

Proposed IDA Credit for a River Transport Project

Introduction

1. In June 1969, the Association made a credit of \$6.0 million, in a joint operation with UNDP, for highway technical assistance and rehabilitation work. This was the first Bank Group operation in the Congo since independence. About the same time, work was started on a study of ports and river transport, financed by the UNDP with the Bank as executing agency. That study forms the basis for the river transport project now under consideration.

2. The river transport study was designed to assist the Government in planning and implementing measures to increase the efficiency of ports and of the river transport system, with particular stress on improving the management, organization and operations of the two public agencies involved, the "Office d'Exploitation des Transports du Congo" (OTRACO) and the "Service des Voies Navigables et de la Marine" (SVN).

3. The consultants' recommendations on organization contained in the first phase of the study, completed in August 1970, have already resulted in decisions by the Government (a) to restructure OTRACO in order to centralize responsibility for programming and control but at the same time to decentralize responsibility for operations, and (b) to split SVN, which was a department of the Ministry of Transport, into two autonomous operational agencies, the "Régie des Voies Maritimes", which would be responsible for the Congo River estuary, and the "Régie des Voies Fluviales", for the inland waterways and lakes, leaving in the Ministry of Transport a small unit that will be responsible for general policy matters. Revised Statutes of OTRACO and for each of the Régies incorporating these decisions were signed by President Mobutu on January 26, 1971, and are expected to be published shortly.

4. In the second phase of the study, due to be completed in December 1971, the consultants will assist in implementing these organizational changes and will elaborate the preliminary feasibility studies of the individual projects in the investment program they had outlined under the first phase.

The Project

5. Attached is a report dated March 8, 1971, entitled "Appraisal of a River Transport Project - Democratic Republic of the Congo", No. PTR-72. The individual components of the proposed project have been selected from those items in the investment program that are at a sufficiently advanced stage of preparation by the consultants, and are considered to be within the present capabilities of OTRACO and the two new Régies.

6. The proposed project, to be carried out over a two-year period, comprises (a) the rehabilitation of navigational aids, dredging facilities and equipment in the Congo estuary; (b) the improvement of navigation on the Kinshasa-Port-Francqui route; (c) the rehabilitation of OTRACO's river fleet; (d) the provision of experts to fill key positions in OTRACO and the two Régies; and (e) a study of the "Voie Nationale", the main transport route from the Katanga mineral belt to the estuary of the Congo River.

7. The Voie Nationale is at present a combination of rail and river links. Katanga traffic also moves across the Angolan, Tanzanian and Zambian borders. The study is intended to establish an economically and technically sound plan to improve and expand the capacity of transport links to carry increased traffic from the Katanga to the Atlantic entirely within Congolese territory and to compare the cost of various alternative routes, including those which run outside the Congo. The Government has agreed to defer a decision to build a railway linking Port-Francqui with Kinshasa, which would bypass the Kasai River section of the Voie Nationale, until this study is completed.

8. The total cost of the project is estimated at \$13.0 million. The estimated foreign exchange component is \$7.0 million, which is the amount of the proposed credit. Approximately \$1.8 million would be on-lent to OTRACO on commercial terms and about \$4.8 million to the two Régies in the form of a Government equity contribution (\$2.0 million to Voies Maritimes and \$2.8 million to Voies Fluviales). The balance of \$0.4 million would be applied by the Government to the foreign cost of the Voie Nationale study. The local currency cost of the sub-projects to be carried out by the Régies and of the Voie Nationale Study would be financed from the Government budget. Local costs of work to be carried out by OTRACO would be financed out of OTRACO's internally generated funds.

9. The main economic benefits of the project would result from the increased navigability of both the Congo estuary and the Kasai River, resulting in faster ship turn-around time which, added to the rehabilitation of OTRACO's river fleet, will enable the Congo to meet the increase in river traffic expected over the next three years. These improvements will be required even if construction of the Port-Francqui-Kinshasa railway were to be undertaken; construction of the railway would not therefore affect the economic rate of return. The expected economic rates of return for the three major components of the project are 12 percent over a period of 20 years for the rehabilitation of the Congo estuary; 21 percent over

a period of 10 years for the improvement of navigation on the Kasai River; and over 100 percent for the rehabilitation of OTRACO's river fleet, which involves essentially deferred maintenance.

10. The Appraisal Report recommends, and I concur, that the enactment of OTRACO's revised Statutes, and of the two Régies' Statutes, and the acceptability of these Statutes to the Association, be made a condition of presentation of the proposed credit to the Board. I believe that this condition can be satisfied in time for presentation of the proposed credit to the Executive Directors in May.

11. The proposed credit provides for the cost of staffing ten key positions in OTRACO and the two Régies for two years. Efforts are currently under way in the Congo to locate suitable persons to fill the top executive positions in these agencies and it is possible that some of them can be provided under bilateral technical assistance, in particular Belgian and French. While I support the recommendation that we stand ready to finance all ten positions, we will encourage the Congolese to secure as many staff as possible on a bilateral basis. I propose that we agree with the Congolese negotiators on the amount corresponding to each position by which we would reduce the credit allocation prior to approval and retain the right to cancel thereafter in the event that any of the positions are in fact filled under bilateral assistance.

Issues

12. Procurement. The Appraisal Report recommends, and I concur, that contracts for the procurement and construction of project items be awarded in accordance with Bank Group guidelines except for (i) contracts to rehabilitate existing dredgers, for which a substantial proportion of spare parts and equipment will have to be purchased from the builders through negotiated contracts, and (ii) contracts for the overhaul of OTRACO's river fleet; part of this overhaul will be carried out by OTRACO itself, but the balance will have to be done by a privately owned shipyard in Kinshasa which is the only practicable alternative to OTRACO's own facilities upstream from the rapids on the Congo River. The contracts which would be excluded from international competition by these two exceptions are estimated to amount to about \$3.4 million, of which IDA would finance \$1.3 million, or about 19 percent of the proposed credit.

13. Retroactive Financing. The Government has requested that the proposed credit finance the foreign exchange cost of the Voie Nationale Study, the contract for which was signed on February 8, 1971. The study is expected to start at the end of March. Assuming credit approval by the end of May, the amount of retroactive financing would be about \$200,000.

14. Restrictions on Other Investment. As noted in paragraphs 4.02 and 4.03 of the Appraisal Report, financing for other parts of the investment program has been secured and substantial offers are in sight. OTRACO and the Régies are believed to be under considerable temptation to embark on parts of the program before they are fully studied. We have already

urged that decisions not be taken prematurely and I strongly support the recommendation that we should obtain an undertaking from the Government that OTRACO and the Régies would not go ahead with investments to which the Association objected. I should note, however, that an effective assurance may not be easy to obtain, given the relatively small amount of the proposed credit, or easy to enforce given the various pressures in Kinshasa. This is a subject, not necessarily confined to this project, that may well call for early attention from the Consultative Group for the Congo, the first meeting of which will begin on May 6.

The Lending Program

15. The FY1971-76 Lending Program is attached. We are still in the early stages of a lending program for the Congo. The primary emphasis in project preparation has been, and will for some time remain, focussed on the rehabilitation of the transport sector. A highway project based on preparatory work under the first highway credit is being appraised, and will lead to a series of highway projects over the next five years. In May 1970, the Association made a first credit of \$5.0 million to finance SOCOFIDE, a newly established development finance company; a follow up credit is likely in the next fiscal year. A first education project is under appraisal. Efforts to give investment in agriculture the importance it requires have so far led only to inconclusive results; to provide a firmer basis for identification and preparation a sector review mission will go to the Congo in April.

The Economy

16. In preparation for the first meeting of the Consultative Group for the Congo, an economic mission visited the country in May-June 1970. The report, 'The Congo's Economy: Evolution and Prospects' (Report No. AE-13a, in three volumes) will be distributed shortly.

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

18. This rapid economic development, combined with high copper revenues, has led to an increase in Government revenue from Z 204 million in 1963 to Z 315 million in 1970, and to the generation of budgetary savings amounting to Z 53 million last year. Consequently, the volume of public investment financed through the budget more than doubled between 1963 and 1970. At the same time, foreign exchange reserves rose to their highest level ever, \$261 million, in mid-1970.

19. Although the impact of the recent fall in copper prices (from US 72 cents/lb. in January 1970 to US 46 cents/lb. in January 1971) began to be felt in the second half of last year, the full effect of this sharp drop in prices will not be felt before 1971, when Government receipts are forecast to fall to Z 273 million or by about 13 percent. In an effort to maintain public investments while keeping the overall budgetary deficit as small as possible, the Government has taken various administrative measures to reduce current budget expenditures. Much, however, will depend on the restraint exercised by the Presidency in incurring extra-budgetary current expenditure.

20. The medium-term prospects for the Congolese economy nevertheless continue to be promising, largely because any fall in public investment in the next five years will probably be compensated by an increase in private foreign investment as well as by increased foreign aid. Consequently, our economic mission expects that the country will continue to develop at a yearly rate of 6-7 percent.

21. Because the bulk of the Congo's post-independence foreign aid has been given in the form of grants, its present foreign debt is fairly low (\$328 million), with debt service representing only 3 percent of export earnings. However, in view of the general uncertainties in the country, and in the light of its present poverty (per capita GDP \$100), only IDA lending is contemplated for at least the next several years.

Recommendations

22. I recommend that the Association invite representatives of the Democratic Republic of the Congo to negotiate the proposed IDA credit of \$7.0 million equivalent, substantially in accordance with the terms and conditions summarized in paragraphs 7.01, 7.02 and 7.03 of the Appraisal Report.

Michael L. Lejeune
Director

Attachments

Population: 15.4 m
GNP Per Cap: \$90

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

			<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
<u>OPERATIONS PROGRAM</u>								
8-CØK-AF-01	Lake Fishing	IDA		3.0 ^{/1}				
8-CØK-AP-01	Rubber Development	IDA		3.7				
8-CØK-AD-02	Cotton Development	IDA		5.0 ^{/1}				
8-CØK-AL-02	Livestock				5.0			
8-CØK-AX-03	Agriculture Unidentified I	IDA				20.0		
8-CØK-AX-04	Agriculture Unidentified II	IDA					10.0	
8-CØK-AX-05	Agriculture Unidentified III	IDA						15.0
8-CØK-CC-01	Communications	IDA				10.0		
8-CØK-DD-02	DFC II	IDA		7.0				
8-CØK-DD-03	DFC III	IDA				10.0		
8-CØK-DD-04	DFC IV	IDA						15.0
8-CØK-EE-01	Education I	IDA		7.0				
8-CØK-EE-02	Education II	IDA					15.0	
8-CØK-QQ-01	Tourism	IDA						15.0
8-CØK-UU-01	Special Project - Urban	IDA					10.0	
8-CØK-TH-03	Highways II	IDA		17.0				
8-CØK-TP-02	River Transport	IDA	7.0					
8-CØK-TH-04	Highways III	IDA			15.0			
8-CØK-TH-05	Highways IV	IDA					35.0	
8-CØK-TX-03	Transportation Unidentified	IDA			25.0			
8-CØK-WW-01	Water Supply	IDA				10.0		
8-CØK-XX-01	Unallocated	IDA						15.0
Total								
	<u>1964-68</u>	<u>1969-73</u>	<u>1972-76</u>					
IDA	105.7	208.7		7.0	42.7	45.0	50.0	70.0
No.	12	21		1	6	3	4	4
<u>LENDING PROGRAM (12/7/70)</u>								
IDA	82.0	135.0		10.0	36.0	25.0	14.0	30.0
	10	13		1	4	3	2	2

P & B 3/10/71

^{/1} Since March 10, 1971, this operation has been scheduled for FY 1973.