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LOAN COMMITTEE: 1971

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FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

December 1, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Indonesia - Third Technical Assistance Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 1, 1971 from the East Asia and Pacific Department, entitled "Indonesia - Third Technical Assistance Project" (LC/O/71-131).

2. Comments, if any, should be sent to reach Mr. Tolbert (ext. 4701) by 3:00 p.m. on Monday, December 6.

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

Dag F. Wittusen
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

CONFIDENTIAL

LC/O/71-131

December 1, 1971

LOAN COMMITTEE

Memorandum from East Asia and Pacific Department

INDONESIA: Third Technical Assistance Project

1. Funds available under the $2 million Technical Assistance Credit (No. 135-IND) and the $4 million Second Technical Assistance Credit (No. 216-IND) are now either fully committed or expected to be committed in the near future, and the Government of Indonesia has asked the Association for a third credit of $4 million. If approved, the proposed credit would be the seventeenth extended by the Association to Indonesia and would bring the total lending to $231.4 million.

2. The following commitments have been made against the previous technical assistance credits:

Credit No. 135-IND

Sub-Project	IDA Contribution (US$ equivalent)
1. Djatiluhur Irrigation Engineering	282,972
2. Sugar Projects Feasibility Studies	55,033
3. Seed Production - Project Preparation	67,000
4. National Fertilizer Study	521,200
5. Groundwater Exploration - Project Preparation	30,000
6. Evaluation Study of Rice Production Intensification Programs	208,000
7. Extension of Djatiluhur Project Engineering	125,966
8. Engineering Ferry Terminal South Sumatra	26,000
9. North Sulawesi Roads Engineering and Design	413,000
10. Medan-Padang Highway Feasibility Study1/	20,000
11. Consulting Services to Foreign Investment Board	30,000
Total Committed	1,779,171
Earmarked:	
12. Estates Management Study	150,000
13. Transmigration Study Lampung Province	30,000
	1,959,171
Balance	40,829
Total Credit Value	2,000,000

1/ Major part financed under UNDP Highway Services Project

.. Credit No. 216-IND

	(US$ equivalent)
14. Maize Feeder Road in South Sumatra - Feasibility Study	26,000
15. Sumatra Sawatambang-Lubuklinggau Highway - Detailed Engineering	2,100,000
16. West Java Electric Power Feasibility Study	500,000
Total Committed	2,626,000

Earmarked:

17. Feasibility Studies and Project Preparation - Water Supply Systems in Seven Cites	450,000
18. Bali Tourism Area Development Plan	150,000
19. Pekelan Sampean Irrigation Rehabilitation - Detailed Engineering (prior to effectiveness of proposed Irrigation Rehab. IV Credit)	300,000
20. Asahan Aluminum Smelter Project Advisory Services	200,000
21. Rehabilitation of Smaller Irrigation Projects - Feasibility Study	250,000
	3,976,000
Balance	24,000
Total Credit Value	4,000,000

As of November 15, 1971, $1,209,000 had been disbursed from Credit 135 and $1,063,000 from Credit 216.

3. The lending program in Indonesia already reflects the work carried out under the technical assistance credits. The preparation of the seeds production project (Item 3 above), for example, has led to a credit (No. 246-IND) and the exploration of groundwater resources (Item 5 above) will form part of the Fourth Irrigation Rehabilitation Project which we expect to present to the Executive Directors in January or February. Detailed engineering of the Trans-Sumatra Highway (Item 15 above) formed the basis of the Second Highway Project; the balance of that road will be financed under the Third Highway Project which will also include the construction of a road in North Sulawesi, the engineering and design for which is being financed from Credit 135-IND (Item 9 above). The West Java electric power feasibility study is intended to identify future power generating needs and the most efficient way of meeting them; this, in all likelihood, will be a gas based thermal plant, the financing of which we envisage in the FY73 lending program. Consultant services for water supply systems in seven cities (Item 17 above) are expected to lead in FY74 to the Association's first Water Supply project in Indonesia. The estates

management study (Item 12 above) fills a need recognized during the implementation of our estates projects and will facilitate further lending. Based on a UNDP financed master plan, the Bali tourism area development plan (Item 18 above) is intended to define a specific first-phase project for Bank Group financing.

4. The purpose of the new credit is to continue to provide the type of assistance given under the two previous technical assistance credits. As in the case of those credits, it will finance pre-investment planning, including detailed engineering and, as necessary, consulting and advisory services in the execution of projects. Although much of the work financed to date and to be financed in the future is directly related to projects already being financed by the Bank Group or being prepared with a view to such financing, some of it relates to projects and programs for which construction finance will be provided by the Government itself or other aid-givers. In a few instances, the existing and proposed technical assistance credits finance work by the Government which is preparatory to or associated with projects to be undertaken and financed by private investors.

5. The proposed credit would enable the Association to provide, in response to the Government's requests, further funds for high priority studies and engineering services, especially in the fields of agriculture and industry, where no alternative suitable or timely sources are in sight. The Government has made several requests for investigations and feasibility studies to help provide a policy framework in various sectors of agriculture, and has also requested a river basin study for the Pomali-Tjomal area which alone might cost \$500,000. In industry it is envisaged that feasibility studies would be carried out for a second fertilizer plant and for an indigenous integrated steel industry based on modern direct reduction processes -- as well as technical advisory services to help in the evaluation of offers, and, subsequently, review of implementation of a project for the exploitation of hydro-energy for aluminum production at Asahan in North Sumatra. We expect that the proposed credit would continue to finance, to an even larger extent than hitherto, the final engineering of projects which are specifically intended for Association financing where the use of those funds would substantially reduce the lead-time between project identification and appraisal and between approval and disbursement.

6. The proposed credit would in all essential respects follow the pattern used in the first two credits. The Government of Indonesia would contribute to the financing of the various technical assistance activities not less than 15 percent of the cost of the services concerned, including contributions in kind. In sub-projects committed so far, the Government's contribution has always exceeded 15 percent. Standard Association terms will apply to the credit since refinancing from a project credit - on which the normal ten year term of technical assistance credits is based - would be difficult to accomplish, because the credit is to finance studies related to

various projects some of which may be financed from other sources. The Director of the Bank's Resident Staff would continue to act for the Association in dealing with matters related to the selection and execution of sub-projects.

7. In assessing the need for the proposed credit, the Resident Staff has again reviewed the availability of technical assistance from other sources. Again it was found that despite the considerable technical assistance available from UNDP and bilateral sources, substantial additional technical assistance is still required for both planning and engineering of projects for which investment funds would be available once they have been prepared. Since some IGGI members are shifting their technical assistance from a grant basis to a loan basis, we might expect an even greater preference by Government for the use of IDA funds since they can be used for a wide range of activities, can be drawn upon quickly and can finance expertise available on an international basis. While we shall continue to make all efforts to incorporate funds in project credits to finance studies for future lending in the respective fields, there continues to be a pressing need for the funding of technical assistance activities which the credits would provide.

8. The Government, the Area and Legal Departments, and the Resident Staff see no need for a change from the form and substance of the two previous Credit Agreements. It is thus proposed that the new Credit Agreement follow substantially the provisions of the earlier agreements.

9. I recommend that the Government be invited to indicate to the Association its readiness to enter into a new Development Credit Agreement, covering a credit of $4 million, substantially similar to the Development Credit Agreements of December 27, 1968 and September 15, 1970, and be requested to nominate someone in the Embassy to negotiate with us the credit document.

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

Raymond J. Goodman
Director
East Asia and Pacific Department

POPULATION: 112.8M

GNP PER CAP: $ 100

IVA INDONESIA - 5 YEAR OPERATIONS AND LENDING PROGRAMS

(BY FISCAL YEAR - AMOUNTS IN $ MILLIONS)

OPERATIONS PROGRAM			1972	1973	1974	1975	1976
6-INS-AF-02	AGRIC.FISHERIES II	IDA		3.0			
6-INS-AI-04	IRRIGATION REHAB.IV	IDA	11.5				
6-INS-AI-05	IRRIG.REHAB.V	IDA		15.0			
6-INS-AL-01	LIVESTOCK	IDA		5.0			
6-INS-AP-03	AGRIC.ESTATES IV	IDA	12.0				
6-INS-AP-05	SMALLHOLDER RUBBER	IDA	4.0				
6-INS-AP-06	AGRIC.ESTATES V	IDA		10.0			
6-INS-AP-07	SUGAR INDUSTRY REHAB.	IDA		11.0			
6-INS-AX-02	AGRIC.UNIDENT.II	IDA			35.0		
6-INS-AX-03	AGRIC.UNIDENT.III	IDA				35.0	
6-INS-AX-04	AGRIC.UNIDENT.IV	IDA					35.0
6-INS-CC-02	TELECOMMUNICATION II	IDA		20.0			
6-INS-CC-03	TELECOMMUNICATION III	IDA					10.0
6-INS-DD-01	DFC I	IDA	10.0				
6-INS-DD-02	DFC II	IDA		10.0			
6-INS-DD-03	DFC III	IDA				20.0	
6-INS-EE-02	EDUCATION II	IDA	7.0				
6-INS-EE-03	EDUCATION III	IDA		5.0			
6-INS-EE-04	EDUCATION IV	IDA				10.0	
6-INS-IL-01	INDUSTRIAL ESTATES I	IDA		5.0			
6-INS-IL-02	INDUSTRIAL ESTATES II	IDA			5.0		
6-INS-IL-03	INDUSTRIAL ESTATES III	IDA					5.0
6-INS-IX-01	INDUSTRY UNIDENT.I	IDA				30.0	
6-INS-IX-02	INDUSTRY UNIDENT.II	IDA					30.0
6-INS-NN-01	POPULATION I	IDA	10.0				
6-INS-NN-02	POPULATION II	IDA			10.0		
6-INS-NN-03	POPULATION III	IDA					10.0
6-INS-PD-02	POWER DIST.DJAKARTA II	IDA	30.0				
6-INS-PP-01	POWER TJIREBON	IDA		30.0			
6-INS-PP-02	POWER UNIDENT.I	IDA			30.0		
6-INS-PP-03	POWER UNIDENT.II	IDA					30.0
6-INS-PP-04	POWER UNIDENT.III	IDA			30.0		
6-INS-QQ-01	BALI TOURISM	IDA		15.0			
6-INS-QX-01	TOURISM UNIDENT.I	IDA			10.0		
6-INS-QX-02	TOURISM UNIDENT.II	IDA					10.0
6-INS-TH-03	HIGHWAYS III	IDA	25.0				
6-INS-TH-04	HIGHWAYS IV	IDA		30.0			
6-INS-TH-05	HIGHWAYS V	IDA				30.0	
6-INS-TP-01	MARINE TRANSPORT I	IDA	10.0				
6-INS-TP-02	MARINE TRANSPORT II	IDA			30.0		
6-INS-TX-01	TRANSPORT UNIDENT.I	IDA				30.0	
6-INS-TX-02	TRANSPORT UNIDENT.II	IDA					45.0
6-INS-WW-01	WATER SUPPLY I	IDA			5.0		
6-INS-WW-02	WATER SUPPLY II	IDA				10.0	

POPULATION: 112.8M

GNP PER CAP: $ 100

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

OPERATIONS PROGRAM

			1972	1973	1974	1975	1976
6-INS-ZZ-03	3RD TECHNICAL ASSISTANCE	IDA	4.0				
6-INS-ZZ-04	TECH. ASSISTANCE	IDA			4.0		

	1964-68	1969-73	1972-76		1972	1973	1974	1975	1976
IBRD				IBRD					
IDA		509.9	781.5	IDA	123.5	159.0	159.0	165.0	175.0
TOTAL		509.9	781.5	TOTAL	123.5	159.0	159.0	165.0	175.0
NO		38	46	NO	10	12	9	7	8

LENDING PROGRAM (1/25/71)

	1964-68	1969-73	1972-76		1972	1973	1974	1975	1976
IBRD				IBRD					
IDA				IDA	90.0	90.0	90.0	126.0	126.0
TOTAL		371.5	522.0	TOTAL	90.0	90.0	90.0	126.0	126.0
NO		30	37	NO	8	8	7	7	7

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

B.1215

CONFIDENTIAL

LOAN COMMITTEE

November 30, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Nepal - Kathmandu Tourism Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated November 30, 1971 from the South Asia Department, entitled "Nepal - Kathmandu Tourism Project" (LC/O/71-129).

2. Comments, if any, should be sent to reach Mr. Abd El Aty (ext. 2703) by 5:00 p.m. on Friday, December 3.

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

Dag F. Wittusen
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

CONFIDENTIAL

LC/O/71-129

November 30, 1971

LOAN COMMITTEE

Memorandum from South Asia Department

Nepal - Kathmandu Tourism Project

1. I attach a draft appraisal report entitled "Appraisal of the Kathmandu Tourism Project" (No. PT-4, dated November 24, 1971), recommending that the Association make a credit of US$ 4.2 million equivalent to Nepal.

Background

2. The Association has made two credits to Nepal for a total of US$ 4.2 million. The first credit, for US$ 1.7 million, was signed in November 1969 for a telecommunications project; the second, for US$ 2.5 million, was signed in December 1970 and provided financing for highway maintenance, bridge reconstruction and the installation of porter-trail bridges. Both projects are progressing satisfactorily.

3. In addition to the proposed project, the Birganj/Gandaki Stage I irrigation project which primarily would consist of the development of an area served by an existing canal built by India, and the setting up of a groundwater irrigation scheme to serve as a pilot project, is scheduled for consideration towards the end of the current fiscal year. This project is being appraised at present. Another project, the establishment of a plywood factory at Hetauda, is also being appraised. No Bank loans have been made to Nepal nor are any contemplated, Nepal being regarded as an IDA country. The latest five-year lending program for Nepal is attached. The only change compared to the program agreed at the CPP review meeting last September is an increase of US$ 0.2 million in the amount for the proposed Tourism Project to reflect the recommendations in the attached Appraisal Report.

The Economy

4. The most recent economic report "Current Economic Position and Prospects of Nepal" (SA-7a) was distributed on June 26, 1969. A basic economic mission is scheduled for April, 1972. In terms of actual economic performance, there has been very little change over the past two years. Per capita income has remained stagnant at about $ 70 a year - one of the lowest among developing countries - and although a number of projects in the transport, power and agricultural sectors have been or are nearly completed, their impact has yet to be felt. In several sectors with which

Bank operations are concerned, e.g. agriculture, transportation and education, steps have been taken to bring about improvements in project preparation and implementation.

5. With 80 percent of Nepal's exports going to India and indications that external assistance may decline from present levels, the need to increase convertible earnings is urgent. Traditional merchandise exports, such as jute, musk and skins, to countries other than India, are unlikely to increase to any substantial extent. Although earnings from tourism have not been large so far, this sector is likely to be a good prospect for increasing the inflow of convertible exchange.

The Project

6. Nepal has many varied tourist attractions. Some 46,000 non-Indian* tourists visited the country in 1970, a steady increase of 37 percent a year since 1965, and prospects for further expansion are excellent. The main constraints on travel to Nepal have been shortage of facilities at Kathmandu Airport and the inadequate capacity of suitable hotel accommodation. A US$ 6.0 million Asian Development Bank project for the improvement of civil aviation facilities, including an expansion of Kathmandu Airport and extension of runways to permit the landing of jets, is now under way, leaving the lack of suitable accommodation a major bottleneck still to be dealt with.

7. The proposed project is designed to improve the position in this respect by financing the expansion of hotel accommodation in Kathmandu. The proposed project has two components, namely the remodelling and extension of the existing 90-room Hotel de l'Annapurna into a 241-room first-class hotel, and the construction of a new second-class hotel of 120 rooms, to be called the Yak and Yeti Hotel. These two sub-projects were selected because they were well suited to the prospective market and were the most advanced in preparation, the sponsors were able to provide the necessary equity funds, and satisfactory arrangements could be made for the management of the hotels.

8. The total cost of the project would be US$ 6.0 million equivalent. The proposed credit of US$ 4.2 million would cover the total estimated foreign exchange costs representing 70 percent of total project costs. The balance

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* Indian visitors are not shown in immigration statistics because free entry arrangements have been made between the two countries.

would be provided by the sponsors of the two sub-projects. Procurement would be on the basis of international competitive bidding. In the case of civil works, bidders would be prequalified. In evaluating bids for equipment and furniture, local manufacturers would be allowed a preference of 15% of CIF costs or the existing rate of duty, whichever is lower. It is believed that contracts likely to be awarded to local suppliers would be for furniture only. In the event that local suppliers win bids the foreign exchange costs would be reduced and would permit the financing of a small amount of local costs.

9. The proposed credit would be made to the Government of Nepal and on-lent to the hotel companies. The Nepal Industrial Development Corporation (NIDC), Nepal's development finance company, will act on behalf of the Government as a service agency for an appropriate annual fee to be agreed upon during negotiations. The Appraisal Report proposes to set the fee at 1 percent per annum for the ten years following the grace period and at ½ percent per annum thereafter for the rest of the life of the sub-loans. Technically, NIDC is a reasonably competent institution which, over the years, has acquired adequate qualified staff and considerable experience particularly in hotel development in Kathmandu. It has, however, suffered from accumulated arrears on some loans made to enterprises involving certain members of the Royal family. NIDC is currently taking steps to improve its debt collection record, but it is difficult to anticipate the degree of success it will have and it is doubtful that outside assistance in this respect would help resolve this problem. As a result NIDC could not be regarded as an appropriate sub-borrower although it is competent to act in the proposed capacity. The conclusion of -

(i) an agreement, prescribing the arrangements for channeling funds to the sub-borrower through NIDC, and for the supervision of the implementation of the sub-projects; and

(ii) subsidiary loan agreements with the hotel companies;

would be conditions of effectiveness of the credit.

10. At full operation the project would create about 500 new jobs and would yield about US$ 2.8 million equivalent net in foreign exchange earnings annually. This compares with total present annual foreign exchange earnings from tourism of less than US$ 2 million. The internal economic rate of return on the total investment is estimated at 19 percent.

11. The Appraisal Report recommends that the proceeds of the credit be relent to the beneficiaries for a period of 24 years including 4 years

of grace, and at a rate of interest of 7½ percent per annum, the rate at which the Government has financed other hotels in Nepal. The foreign exchange risk would be borne by the sub-borrowers. These terms are justified on project grounds. The financial rate of return on a DCF basis over the life of the sub-projects is expected to range from 8.6 - 10.8 percent for the Hotel de l'Annapurna, and from 7.2 - 9.2 percent for the Yak and Yeti Hotel, depending on varying assumptions about occupancy rates and the opening dates. The substantial difference between the financial and economic rates of return reflects mainly the weight of heavy indirect taxation. Returns on equity before taxes on profits range from 9.9 - 14.9 percent and 7.5 - 11.9 percent respectively, on the basis of the lending terms proposed (see paragraph 5.13 of the Appraisal Report).

12. Throughout preparation of the project, close consultation has been maintained with IFC. In view of the fact that no outside equity participation will be required and that, on country grounds, financing on IDA terms is more appropriate, IFC participation in financing the project is not proposed.

Recommendation

13. I recommend that Nepal be invited to negotiate an agreement for a US$ 4.2 million credit substantially on terms in keeping with the recommendations set out in Section 6 of the Appraisal Report.

I.P.M. Cargill
Director
South Asia Department

Attachment

Attachment

Population: 11.2 m.

Per Cap. GDP: about $70

NEPAL - ACTUAL AND PROPOSED LENDING
($ million)

		Fiscal years											
		Through 1969	1970	1971	1972	1973	1974	1975	1976	1977	Total 1964-68	Total 1969-73	Total 1973-77
Irrigation (Birganj/Gandaki Stage I)	IDA				7.0								
Irrigation (Birganj/Gandaki Stage II)	IDA							5.0					
Irrigation (Birganj/Gandaki Stage III)	IDA									5.0			
Forestry/Settlement I	IDA					3.0 1/							
Forestry/Settlement II	IDA								3.0				
Livestock	IDA								2.0 2/				
Telecommunications I	IDA		1.7										
Telecommunications II	IDA					2.0							
Telecommunications III	IDA								3.0				
DFC I	IDA					3.0							
DFC II	IDA									3.0			
Education I	IDA						3.0						
Education II	IDA								3.0				
Plywood Factory	IDA					2.5							
Pulp and Paper	IDA						3.0 3/						
Power distribution	IDA							5.0					
Power generation (Babai)	IDA									4.0			
Tourism I	IDA				4.2								
Tourism II	IDA							3.0 4/					
Tourism III	IDA									3.0 4/			
Highways I	IDA			2.5									
Highways II	IDA						7.0						
Highways III	IDA								5.0				
Water Supply I	IDA						3.0						
Water Supply II	IDA									3.0			
Operations Program	IDA					10.5	16.0	13.0	16.0	18.0		25.3	73.5
	No.					4	4	3	5	5		8	21
Lending Program	IDA		1.7	2.5	11.2	9.0	12.0	12.0	15.0	15.0		24.4	63.0
	No.		1	1	2	3	3	3	4	4		7	17
Asian Development Bank			6.3	6.8	8.0	8.0	10.0	10.0	12.0	12.0		29.1	52.0
IDA - gross disbursements			-	0.1	1.0	2.6	3.0	5.6	7.2	11.2		3.7	29.6
net disbursements			-	0.1	1.0	2.6	3.0	5.6	7.2	11.2		3.7	29.6
net transfer			-	0.1	1.0	2.6	3.0	5.5	7.1	11.0		3.7	29.2

1/ Timing of project will depend on extent of further preparatory work required
2/ Could possibly be moved ahead
3/ Amount notional: To be considered if current discussions with bilateral contributors not successful
4/ May take form of loan to DFC

South Asia Department
November 15, 1971

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/71-49

November 29, 1971

Minutes of a Special Loan Meeting to consider "Iraq - Lower Khalis Irrigation Project" held on November 17, 1971 in Conference Room A

1. Present: Messrs. Cope (Chairman), Williams, Broches, Chadenet, Benjenk, Wapenhans, Davar, El-Fishawy, Haynes, Loos and Wittusen (Secretary).

2. Issue: The meeting was called to consider Mr. Benjenk's memorandum of November 11, 1971 to Mr. Cope entitled "Iraq - Lower Khalis Irrigation Project: Objection by Iran" and attachments. Since the proposed project would use water partly drawn from rivers crossing the boundaries with Iran and Turkey, the Bank had informed Iran and Turkey accordingly. In reply, the Bank had received two communications from the Iranian Embassy objecting to the proposed project and a letter from the Iranian Agriculture Minister Rouhani indicating that Iran had plans to use fully the Diyala headwaters and that therefore Iraq should not rely on the availability of the headwaters for the proposed project. The issue for discussion was how the Bank should proceed in the matter.

3. Discussion: The meeting noted that:

(i) In view of the extremely unsatisfactory relationship currently prevailing between Iraq and Iran, the objection from Iran had been expected by both the Iraqis and the Bank. While it was most probable that the Iranian communications were sent because of political considerations, the Bank should initially consider the Iranian intention as bona fide, and ascertain whether the Iranian statements were true, but not allow room for tactics that would delay the Iraqi project.

(ii) Agriculture Projects Department stated that in the interest of moving ahead expeditiously with the project and to avoid possible controversy with Iran, the appraisal mission presently in the field had already been asked to investigate the possibility of re-designing the proposed project such as to make use of the

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

Tigris waters (since Turkey had not voiced any objection to the project) in case the Diyala waters became available in insufficient quantities. They felt, however, that it would be rather difficult for the members of the appraisal mission to visit Iran to evaluate the technical viability of the Iranian plan to use the Diyala headwaters, and suggested that Mr. Haynes might instead visit Iraq and Iran to ascertain the technical findings of the appraisal mission and to obtain information about the future Iranian plans to use the Diyala waters.

(iii) The Legal Department maintained that, under the Bank's policy, a mere objection against an agricultural project by one riparian was not sufficient reason for the Bank to abstain from financing it. Such an objection had to be substantiated by that riparian, demonstrating that the project would run counter to its own justifiable interests. Moreover, if in the past Iran had not used the Diyala headwaters and Iraq had, Iran was not legally entitled to the full use of these headwaters, contrary to Minister Rouhani's opinion. It was pointed out that on the basis of available figures, the annual flow of the Diyala into Iraq averaged five to six billion cubic meters, of which Iraq for years had been using nearly three billion cubic meters. Iraq's historical usage would therefore preclude Iran from making full use of the headwaters, even if it currently had plans for their use.

4. Decision: On the basis of the above discussion, the meeting concluded that:

(i) Messrs. Davar and Haynes should visit Iraq as soon as possible to discuss with the appraisal mission its findings regarding the possibility of using more Tigris waters for the proposed project, and, thereafter, advise the Iraqi Government about the recent developments, discuss the possibility of more use being made of the Tigris waters and explain the Bank's possible approach towards the processing of the project for early Bank financing.

(ii) Messrs. Haynes and El-Fishawy would thereupon visit Iran to obtain from Agriculture Minister Rouhani all available information regarding the current use of the Diyala headwaters and intentions for their future use. The mission would also discuss the feasibility and timing of such development and explain the Bank's approach towards projects involving the use of rivers crossing international boundaries.

(iii) Prior to the mission's arrival in Tehran the Iranians should be advised that an unsubstantiated objections to a project in a country of a downstream riparian was by itself not a sufficient reason for the Bank to abstain from financing the proposed project.

5. Postscript: Subsequently, it was agreed that the Iranians would be informed of the Bank's response to the communications received from the Iranian Embassy, and that Messrs. Davar and Haynes should visit Iraq from about December 2 to 7 and Messrs. Haynes and El-Fishawy would visit Iran from December 7 to 13.

Dag F. Wittusen
Secretary

ADavar/DFWittusen:as

Cleared with: Messrs. Cope
Chadenet
Benjenk
Wapenhans
El-Fishawy

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

B- 1215

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LOAN COMMITTEE

November 29, 1971

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MEMORANDUM TO THE LOAN COMMITTEE

Costa Rica - Power and Telecommunications Projects

1. The Committee is requested to consider, without meeting, the attached memorandum dated November 29, 1971 from the Central America and Caribbean Department, entitled "Costa Rica - Proposed Loans for Power and Telecommunications" (LC/O/71-128).

2. Comments, if any, should be sent to reach Mr. Rassmuson (ext. 3880) by 5:00 p.m. on Thursday, December 2.

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

Dag F. Wittusen
Secretary
Loan Committee

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Mr. S. Aldewereld, Vice President
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Director of the Development Services Department
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Deputy Director, Projects
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LC/O/71-128

November 29 1971

LOAN COMMITTEE

Memorandum from Central America and Caribbean Department

COSTA RICA - Proposed Loans for Power and Telecommunications

1. Attached is a report entitled "Appraisal of Power and Telecommunications Projects of the Instituto Costarricense de Electricidad (ICE) Costa Rica", dated September 22, 1971 (No. PU-77), recommending Bank loans to ICE of $6 million for power and $16 million for telecommunications. The FY1972-76 lending program, reviewed by Mr. McNamara in March 1971, is also attached.

Background

2. The World Bank Group has made eleven loans to Costa Rica totalling $84.9 million and a credit of $4.6 million (net of cancellations). The proposed loans would be the fourth for power and the third for telecommunications to Costa Rica. The last two loans to ICE, of $12 million for power and $6.5 million for telecommunications, were signed in July 1969. The last loan to Costa Rica, of $15.7 million for a road project, was signed in April 1970. For FY1972 the lending program includes also a loan of $9 million for a second agricultural credit, appraisal of which is being completed.

3. As of October 31, 1971, a total of $24.7 million remained to be disbursed on four ongoing projects (in agriculture, power, telecommunications and roads). Considerable initial delays occurred in the agricultural project, principally due to availability of other funds; as a consequence, the closing date is expected to be postponed by about a year. The third power project (Loan 631-CR) is about 24 months behind schedule, and cost estimates have been increased by about 40 percent, due to serious tunnelling problems and late delivery of equipment. Consultants are now advising on the tunnelling difficulties. In the case of the highway project (Loan 664-CR), the Government has requested supplementary financing to cover a large cost increase in the construction of the highway, for which the civil works contract was awarded after full international bidding to a Venezuelan-Italian firm five months ago. A supervision mission scheduled for December 1971 will review this request.

The Economy

4. A report entitled "Current Economic Position and Prospects of Costa Rica" was distributed to the Executive Directors on July 20, 1971. It noted that in the 1960's Costa Rica had achieved a high rate of economic growth - an annual average increase of real GDP of about 6.5 percent - in a setting of political stability and democratically elected governments. The economy had been especially buoyant in the second half of the decade - with an annual average increase of real GDP of almost 8 percent - largely as a result of a major expansion in banana exports and rapid industrialization within the framework of the Central American Common Market (CACM). At the same time, there had been a sharp reduction in population growth rate from almost 4 percent in 1960 to around 3 percent in 1970, due in part to a Government-supported family planning program.

5. A marked improvement in Costa Rica's public finances and balance of payments took place between 1968 and 1970 following a rapidly deteriorating trend in the mid-1960's. Central Government current revenues increased by 71 percent, well outstripping the 41 percent increase in current expenditures. However, as investment increased by 24 percent in the same period, the overall deficit remained high and was financed mainly by domestic credit expansion in the form of the sale of bonds redeemable at sight. For the public sector as a whole, the 1968-70 period saw public savings increase from ₡32 million in 1967 to ₡210 million in 1970, increasing their share in GDP from 0.7 to about 3.5 percent. As a result, the financing of public investment by public savings rose from 10 to over 50 percent by 1970.

6. During 1968-69 the very large expansion in banana exports, coupled with a tightening of credit policies and the introduction of a dual exchange rate system, led to a considerable recovery in foreign exchange reserves, which stood at around $38 million when a change of government took place in May 1970. Already, however, imports were rising sharply, and during 1970 as a whole they increased by over 40 percent because of rising consumer incomes, easy availability of credit, exchange rate unification at the old parity at the end of 1969, and buying in anticipation of the expected imposition of a long debated 30 percent surcharge on imports from outside the CACM. As a result, net international reserves fell to $26 million, equivalent to four weeks of imports, by the end of 1970. At the same time, a further increase took place in the outstanding amount of public sector bonds carrying a repurchase guarantee - a source of potential instability in the event of a crisis of confidence. Increased government expenditures and rapid credit expansion to the private sector were indicated in the Bank report as the main underlying - and controllable - cause of the deteriorating situation.

7. Costa Rica's financial situation deteriorated further in 1971. A large increase in credit to the private sector and in the fiscal deficit, the latter due to rapidly expanding government expenditures and slower revenue growth, resulted in continued balance of payments pressures. By the end of May, net international reserves had decreased to $23.3 million, equivalent to around three weeks of imports. The Bank's concern over the fiscal and balance of payments situation was impressed on President Figueres in June, when the mission's draft economic report was discussed with the Government in Costa Rica. Shortly afterwards, on June 18, the Central Bank reintroduced the dual exchange system and imposed surcharges on non-essential imports from outside the Central American Common Market (CACM). These measures, however, affecting only around 40 percent of imports, have not been sufficient to correct the balance of payments deficit. Although by November 12 net international reserves had increased to $37.5 million, the $6 million IMF gold tranche had been drawn down, $10 million had been borrowed abroad at medium term, and a substantial amount of import payment arrears had also accumulated.

8. The continuing CACM crisis has added to the national difficulties. In January 1971 Honduras introduced duties on imports from CACM countries in protest over the inequitable distribution of benefits of the Common Market, de facto withdrawing from the Market. In June 1971 Costa Rica imposed a trade embargo on some regionally traded goods and El Salvador and Guatemala retaliated by imposing trade restrictions on Costa Rican goods. The difficulties between El Salvador and Guatemala on the one hand and Costa Rica on the other have since been settled, but the Honduras case remains unresolved.

9. From November 17-19 Mr. Gutierrez visited Costa Rica to impress upon President Figueres and officials of the Government and Central Bank the Bank's serious concern over the continuing deterioration of Costa Rica's finances and its negative impact on the country's creditworthiness. Mr. Gutierrez found full awareness of the seriousness of the situation and reached agreement with the Government on the urgency of launching an emergency stabilization program consisting initially of the following measures: (i) approval by Congress of a broad tax reform before the end of January 1972 yielding over ₡140 million of additional government revenues (or about 2 percent of GNP), coupled with measures to restrain the growth of public expenditures; (ii) quick approval of the law regulating the operations of private finance companies (financieras) and introduction of legislation to regulate and limit consumer credit; (iii) a restrained monetary program for 1972, possibly as part of an IMF standy-by arrangement; and (iv) a foreign exchange policy aimed at keeping the colon at a realistic rate of exchange, including accelerated transfers of payments for imports from the official to the free market. The present official rate of ₡6.65 per US dollar applies to 60 percent of imports, but the Government recognized

that a new and unified exchange rate would involve a substantial depreciation in relation to the ₡6.65 rate. President Figueres well understood that the Bank expects rapid action on the above measures if we are to proceed with the high level of lending to Costa Rica presently envisaged. The visit of Mr. Gutierrez stimulated the Government to send the Minister of Finance to Washington during the week of November 28, 1971, to discuss the stabilization program with the IMF and the other Washington-based agencies.

10. One of the conclusions of the last CPP review on Costa Rica was that "project lending should not be interrupted because of short-term fiscal and balance of payments problems so long as prospects remained favorable for continued rapid growth in the longer run". Although the recent deterioration in the country's finances is largely the result of fiscal mismanagement. We have been encouraged by the results of the recent visit of Mr. Gutierrez to Costa Rica, and so long as the Government carries out a stabilization program along the lines suggested above, I would not consider the situation so bad as to call in question Costa Rica's creditworthiness for the two proposed loans to ICE. Long-term prospects for economic expansion remain good, and although around $10 million medium-term borrowing took place during 1971, the structure of external debt still remains satisfactory (84 percent long-term) and debt service still absorbs quite a moderate proportion of external current account earnings (around 12 percent in 1970). However, we would not present the loans to the Executive Directors until we were satisfied that positive action had been taken to deal with the balance of payments situation.

The Project

11. For power, the project envisages the installation of two 15 MW gas turbines to generate energy in the dry season, two 1.5 MW diesel generators for the port of Limón, related power transmission facilities and engineering and management studies. Total cost is estimated at $7.8 million. A Bank loan of $6.0 million is proposed to cover the foreign exchange costs. For telecommunications, the project includes the expansion of the telephone network by 23,000 lines, extension of long-distance facilities, establishment of telex services, modernization of telegraph service, and engineering services. Total cost is estimated at $ 30.7 million, of which the proposed Bank loan of $16.0 million would finance the foreign exchange costs. Both loans would also cover the full cost of limited locally awarded contracts as detailed in paragraph 14 below (appraisal report 6.06 and 8.08). During negotiations, we would discuss a possible increase in loan amounts to take account of adjustments of exchange rates against the dollar. Neither loan would cover interest during construction. The appraisal report recommends amortization periods of 20 years for both loans, including four years of grace for power, and a grace period of 5 1/2 years for telecommunications; expenditures for the latter project are expected to continue into 1977.

12. ICE, a government-owned autonomous agency, has been our borrower since 1961. Both power and telecommunications operations are well run, although the rapid growth and the different nature of the two sectors have brought about certain problems and therefore the need for studies of the power sector and of the internal organization and management of ICE. I consider the needed improvements in the power sector to be of particular importance to ensure future efficiency. At present there are 57 public utilities and 120 auto-producers of energy, most of which are small, poorly regulated and inefficient. No national power sector program exists. This has led to duplication of facilities, lack of standardization and uneconomic tariffs. The project therefore provides for consultants services to study the power sector and ICE's organization.

13. Procurement would follow Bank Group international bidding procedures, except for switching and transmission equipment (amounting to about $2.5 million) for extending certain installations where direct compatibility is essential. This equipment would be purchased from five suppliers with whom the original contracts were placed as a result of international competitive biddings in accordance with Bank procurement procedures. It is recommended that the Bank should finance such equipment, since prices are based on the earlier contract prices and are consistent with international price levels for similar equipment.

14. In carrying out international competitive bidding on the present projects I propose that, as in the previous power and telecommunications loans to ICE (Loans 631 and 632-CR), suppliers in other Central American countries should be accorded a preference equal to 50 percent of existing import duties, so long as this does not exceed 15 percent of the CIF price. The same margin of preference would apply to procurement in Costa Rica. It is estimated that under these arrangements procurement in the Central American countries for telecommunications might amount to a maximum of $3.0 million, including procurement in Costa Rica of up to some $1.0 million. In power, purchases from Costa Rica may amount to $0.5 million, whereas no purchases of any significance are expected from the other Central American countries.

15. In the case of the power project, bids have already had to be invited for the gas turbine units and costs incurred for engineering studies in order to meet the construction schedule. We have informed the Executive Directors about this, and it is proposed that up to $0.6 million be reimbursed to ICE from the proposed loan for expenditures incurred from June 1, 1971.

16. ICE's financial position, which has improved considerably since the previous loans, is sound and is expected to remain so. It is estimated that the rate of return until the end of construction periods

will be over 11 percent for the power project, except for 1975 when it is expected to decrease to 9.3 percent, and over 15 percent for the telecommunications project. According to ICE's financing plan for 1972-76, about 40 percent of the funds required are expected to be generated from within the enterprise, 27 percent from future borrowings for the next power project, 16 percent from the Bank loans now proposed, 10 percent from local bond issues and the remaining 7 percent from already committed external loans. Restrictions would be maintained on the proportion of ICE's bonds to be issued with a repurchase guarantee. In recent years this proportion has dropped sharply.

Recommendation

17. I recommend that the Bank proceed to negotiate two loans to ICE of $6 million for power and of $16 million for telecommunications, with the guarantee of the Costa Rican Government, substantially on the terms and conditions proposed in the attached appraisal report.

E. Peter Wright
Deputy Director

Attachments.

POPULATION: 1.6M

GNP PER CAP: $ 450

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

OPERATIONS PROGRAM			1972	1973	1974	1975	1976
3-COS-AC-02	AGRICULTURAL CREDIT II	IBRD	9.0				
3-COS-AC-03	AGRICULTURE CREDIT III	IBRD			10.0		
3-COS-CC-02	COMMUNICATION III	IBRD	16.0				
3-COS-CC-03	COMMUNICATION IV	IBRD					10.0
3-COS-EE-01	EDUCATION I	IBRD			5.0		
3-COS-PT-01	POWER IV	IBRD	6.0				
3-COS-PT-02	POWER V	IBRD		20.0			
3-COS-TH-03	SAN JOSE HIGHWAY	IBRD			12.0		
3-COS-TP-02	PORT	IBRD				10.0	
3-COS-WW-01	SAN JOSE WATER SUPPLY	IBRD				10.0	

	1964-68	1969-73	1972-76
IBRD	25.0	85.2	108.0
IDA			
TOTAL	25.0	85.2	108.0
NO	2	7	10

	1972	1973	1974	1975	1976
IBRD	31.0	20.0	27.0	20.0	10.0
IDA					
TOTAL	31.0	20.0	27.0	20.0	10.0
NO	3	1	3	2	1

LENDING PROGRAM (3/23/71)

	1964-68	1969-73	1972-76
IBRD	25.0	101.8	107.6
IDA			
TOTAL	25.0	101.8	107.6
NO	2	8	9

	1972	1973	1974	1975	1976
IBRD	30.0	37.6	20.0	10.0	10.0
IDA					
TOTAL	30.0	37.6	20.0	10.0	10.0
NO	3	2	2	1	1

P & B 10/28/71

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/71-48

November 24, 1971

Minutes of Special Loan Meeting to consider "Turkey - Proposed $75 Million Loan for the Erdemir Steel Plant Expansion Project" held on November 11, 1971 in Conference Room B.

1. Present: Messrs. Cope (Chairman), Williams, Chadenet, Baum, Benjenk, Fuchs, M.L. Hoffman, Asfour, Bart, Basak, Becher, Billington, Cancio, El Darwish, Maiss, Nijhof, Southall, Speller and Wittusen (Secretary).

2. Issues: The meeting was called to consider the Europe, Middle East and North Africa Department's memorandum of November 9, 1971 to the Loan Committee entitled "Turkey - Proposed $75 Million Loan for the Erdemir Steel Plant Expansion Project" (LC/O/71-122) and the attached appraisal report (PI-13). The Chairman, complimenting the Industrial Projects Department on its excellent appraisal report, focussed the discussion on the following issues:

(i) the Government's protection and price policy;

(ii) whether the Government should be required to charge Erdemir a guarantee fee on the proceeds of the Bank loan; and

(iii) whether to lend to the Government or directly to Erdemir.

3. Protection and Price Policy: The meeting noted that:

(i) On completion of the project Erdemir's products would be afforded about 22% effective protection on domestic value added, according to the Government's policy on quantitative import restrictions. The level of protection would decrease by about 8% if Erdemir were to use 100% foreign iron ore and by another 6% if the undervaluation

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Deputy Director, Projects
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of European and Japanese currencies were taken into account. This was considered acceptable.

(ii) The key objective of the project, i.e. increasing the competitiveness of Turkish steel production, might be compromised, however, if Erdemir were allowed to increase its prices unduly under the protective cover of quantitative import restrictions.

4. Decision: In order to guard against undue protection and price increases, it was decided that an agreement from the Government on future steel import restrictions and domestic steel price increases should be negotiated along the lines suggested in para. 8(i)-(iii) of the Area Department's memorandum to the Loan Committee (cf. para. 2 above).

5. Guarantee Fee: The meeting noted that:

(i) The appraisal report recommended that the Bank lend directly to Erdemir but that the Government charge Erdemir a "guarantee fee" of 1.5% raising the cost of the Bank loan to Erdemir to 8.75%. Co-lender USAID, however, was apparently prepared to reduce or remove a similar fee on USAID funds if the Bank were prepared to do the same.

(ii) The Bank had required recent borrowers to add 2% to the interest rate when re-lending to industrial beneficiaries. It was suggested that the fee could be decreased to 1.5% in this case in view of the subsidized rates enjoyed by Erdemir's European competitors and in order not to encourage the Bank's co-lenders to demand a guarantee fee on their funds. But a lending rate of less than 8.75% to Erdemir, it was argued, was not justified by the Turkish interest rate structure and would be an undue subsidy, and waiving the fee altogether would set an unfortunate precedent.

6. Decision: On the basis of para. 5(ii) above, it was agreed to negotiate for a minimum guarantee fee of 1.5% on Bank funds and at the same time attempt not to cause the co-lenders to increase their relending rates.

7. Choice of Borrower: The meeting noted that:

(i) The Government had recently requested that, instead of lending directly to Erdemir, the Bank should make the loan to the Government for relending to Erdemir.

(ii) It was the Bank's policy to lend, whenever feasible, to the entity responsible for carrying out and operating the project. In addition to simplifying access to the entity and the project and giving the Bank direct sanction as creditor, direct lending was particularly advisable in this case, in order to protect the private status and efficient operation of Erdemir from Government encroachment.

8. Decision: For the reasons stated in para. 7(ii) above, it was agreed to lend directly to Erdemir.

9. Subject to the above decisions, the Chairman approved the Europe, Middle East and North Africa Department's recommendation that negotiators be invited for the proposed loan.

Dag F. Wittusen
Secretary

WNijhof/ASElDarwish/DFWittusen:as

Cleared by: Messrs. Cope
Chadenet
Benjenk
Fuchs
Cancio

cc: Participants

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

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LOAN COMMITTEE

LM/M/71-47

November 24, 1971

Minutes of a Special Loan Meeting to consider "Cameroon - Rice Irrigation Project" held on November 12, 1971 in Conference Room B.

1. Present: Messrs. Cope (Chairman), Williams, Baum, Adler, Cheek, Bartsch, Delaume, Duval, Otten, Storch and Wittusen (Secretary).

2. Issues: The meeting was called to consider the Western Africa Department's memorandum to the Loan Committee of November 9, 1971 entitled "Cameroon - Proposed Credit for a Rice Irrigation Project" (LC/O/71-123) and the attached appraisal report (PA-103). The Logone River constitutes the border between Cameroon and Chad at the point where the proposed project was located, and Semry, the organization to implement the project, would be drawing water for irrigation from the river. On August 20, 1970 Chad and Cameroon had concluded an agreement governing the use of the Logone River waters. This agreement defined certain hydraulic limits that would apply to such development projects as Semry. The Logone Agreement was valid for 10 years and was tacitly renewable if not cancelled by one of the governments one year before the formal expiration date of August, 1980. Since the life of the proposed project was 40 years, the Agriculture Projects Department maintained that the Logone Agreement should be extended from 10 to 40 years, in order to safeguard the water rights during the life of the project, and that this requirement should be a condition for Board presentation. The Bank had consequently urged that Cameroon request Chad to concur in extending the Logone Agreement's formal validity to 40 years. The Western Africa Department had taken the position

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that if Chad refused Cameroon's request, then formal extension of the Logone Agreement should not be a condition for Board presentation because the existing agreement appeared adequate in the light of political realities and, from a practical point of view, the possibility of developing projects in Chad which could jeopardize the water rights of Semry during the next 40 years was remote. The issue for discussion was therefore whether to insist on a formal extension of the Logone River Agreement before presenting the project to the Board of Executive Directors.

3. Discussion: The meeting noted that:

(i) The Agriculture Projects Department stated that little was known about Chad's intention to develop projects which would use the Logone River waters. It was known however that an irrigation project was under preparation which would develop about 5,000 hectares but this acreage would be too small to have any impact on the dry season water requirements of Semry. Only if Chad were to undertake a rice irrigation scheme covering 16,000 hectares or more would the water supply for Semry's dry season crop be inadequate. It was thought unlikely that Chad would develop an irrigation scheme of this size (and costing about \$30 million) within the next 15 years. Assuming, however, that Chad were to develop a 16,000 hectare project by one of the following dates, the rate of return on the proposed Semry project would vary as follows: 8% if Chad undertook the project in 1980, 10% in 1985, 11% in 1990 and 11.8% in 2000. To ensure dry season water supply for Semry, this meant that the Logone Agreement's formal validity should at least be extended from 1980 to 1985 lest the project become marginal, with extension to 1990 being more desirable.

(ii) The Projects Department also pointed out the possibility of Chad building dikes upstream for irrigation purposes which could cause increased flooding downstream, unless the Logone Agreement was extended. The Semry project included reconstruction of the Cameroon dike enabling it to withstand a flood of a 100-years frequency. However, the cost of additional protection for Semry (increasing the height of its dike and other improvements) would be about \$500,000, which, if undertaken after 1985, would not have a very significant effect on the project's rate of return.

(iii) The Western Africa Department emphasized the unlikelihood of Chad undertaking a 16,000 hectare irrigation scheme or any other large project affecting the river's flow enough to jeopardize the Semry project. Stating that the project would be exposed to a very small risk if the Logone Agreement was not formally extended for 40 years, the Department concluded that a maximum extension of 10 years would be sufficient to ensure an acceptable rate of return on the project.

(iv) The Area Department further stated that Cameroon and Chad had a good record of cooperation on matters of this kind (e.g. the Chari River Bridge). With reference to Article VIII of the Logone Agreement, the Cameroon Government had stated in its letter of May 10, 1971 that: "The two Governments have clearly indicated that they do not intend to limit their cooperation to the first 10 years. The denunciation clause is a usual safeguard in international treaties of this kind." To expect the two Governments to sign the 40-year treaty without the right of cancellation did not seem realistic.

(v) The Legal Department stated that international treaties governing water rights for 40 years and longer were not unusual and commonly included conditions governing the right of cancellation; the Logone Agreement's tacit renewal clause was also a common feature of river agreements.

(vi) Cameroon had reportedly sent a Presidential letter to Chad requesting extension of the Logone Agreement, but the Bank had received no confirmation of this.

(vii) Noting that an extension of the Logone Agreement was desirable, especially until 1990 to cover the marginal phase of the project, the Chairman stated that formal agreement or an amendment to the present agreement was not necessarily required, nor did he expected the parties to drop the unilateral denunciation clause in the present agreement, since it was a common safeguard in international treaties of this kind. What was important was for Chad and Cameroon to arrive at an understanding of the spirit in which the Logone Agreement was interpreted and of the mutual benefit of respecting each other's interests. Such an understanding should be required before the project was presented to the Board.

(viii) It was suggested a staff member be dispatched to the two countries to attempt to accelerate the achievement of an agreement between them but staffing constraints did not permit this in the near future.

4. Decision: The meeting concluded that:

(i) To safeguard the project, either a formal extension of the Logone Agreement, which was most preferable, or an understanding as outlined in para. 3(vii) above should be arrived at before presenting the project to the Board.

(ii) The Area Department was authorized to invite negotiators for the proposed project with this reservation in mind, which should be communicated to the Government at the time of invitation.

Dag F. Wittusen
Secretary

RStorch/DFWittusen:as

Cleared by: Messrs. Cope
Adler
Baum
Cheek
Delaume

cc: Participants

FORM No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/71-46

November 22, 1971

Minutes of a Special Loan Meeting to consider "Indonesia - Population Project" held on November 12, 1971 in Conference Room B.

1. Present: Messrs. Cope (Chairman), Williams, Broches, Demuth, Chadenet, Kanagaratnam, Baldwin, Fontein, M.L. Hoffman, Alisbah, Asser, Bennett, Chang, de Silva, H. Jones, T. Jones, Riley, Sella, Street, Zaidan and Wittusen (Secretary).

2. Issue: The meeting was called to consider a memorandum of November 10, 1971 on the "Indonesia - Population Project" from Mr. Fontein to Mr. Cope, and attachments relating to the understanding reached between the Association and United Nations Fund for Population Activities (UNFPA) regarding the project. The proposed project was prepared and appraised in June, 1971 in cooperation with UNFPA, in order to coodinate international efforts in the population field. According to the understanding reached with UNFPA in July, 1971, the external financing for the project would be provided jointly by an IDA credit and a UNFPA grant, for which the Bank would be designated the executing agency. In implementing certain parts of the project the Government would be assisted by WHO, UNICEF, UNESCO, the Population Division of the UN, and the Population Council (a private foundation) within terms of reference agreed to by the Government, the Bank Group and the agencies. These agencies already had programs in Indonesia in related fields and their inclusion ensured the widest possible inter-agency cooperation.

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Executive Vice President (IFC)
Vice President (IFC)

3. After considerable progress had been made toward reaching final agreement with UNFPA, however, the Bank Group's relations with UNFPA had reached an impasse in recent weeks, raising serious doubts about the feasibility and desirability of the proposed cooperative approach. Contrary to the July understanding, UNFPA had failed to obtain the associated agencies' agreement on their role in the preparation and implementation of the project and the nature of their relationship with the Bank Group. Nor had it been possible to reach agreement with UNFPA on the financing and disbursement arrangements proposed in the appraisal report, and even the title of the project was disputed. Because of the difficulties experienced with UNFPA, the Bank Group had not yet entered into detailed discussions about the project with the associated agencies. The difficulties experienced with UNFPA were traceable, at least in part, to questions raised by some of the associated agencies, which appeared unhappy with the implications of having the Bank act as executing agency for the UNFPA grant, a role they normally assumed themselves. The issue for discussion was how to deal with the current impasse in the Bank Group's relations with the UNFPA.

4. Discussion: The meeting noted that:

(i) Considerable effort had gone into making this a cooperative inter-agency effort and the role of the associated agencies was important for the project; the Bank Group could therefore not easily abandon this approach. If it was to work, however, UNFPA and the agencies should recognize that the decision to have the Bank act as executing agency for the UNFPA grant meant that the Bank Group would have primary responsibility for preparing the project and for supervising its execution.

(ii) WHO was reportedly particularly unhappy with being subordinated to the Bank Group in the project and had complained that it had not been sufficiently consulted on the project.

(iii) The UN and UNFPA were major agencies in the population field, as was WHO in the closely-related health field. Consequently, it was important for the Bank, for both diplomatic and operational reasons, to build effective working relationships with these agencies.

(iv) The contractual relationship of the Bank Group with UNFPA and the associated agencies need not necessarily be that of an executing agency, although that would be preferable. Whatever the contractual arrangement, the objective should be to arrive at maximum cooperation on the project.

5. Decision: On the basis of the above discussion, the meeting concluded that:

(i) A meeting should urgently be arranged with the UNFPA management with the objective of continuing the joint approach to the project. In particular, the meeting should:

(a) attempt to reach agreement on the proposed financing and disbursement arrangements and other outstanding issues; and

(b) discuss the role of the associated agencies in implementing parts of the project and their relationship to the Bank Group, the Government and UNFPA, and seek agreement on the documentation necessary to define these relationships.

(ii) Soon after this meeting, assuming that agreement was reached to continue with a joint project, the Bank Group should meet separately with the associated agencies to agree on their respective roles in the project and define their terms of reference and relationship to the Bank Group, UNFPA and the Government. (Representatives of WHO had already made arrangements to come to Washington on November 19. This meeting would go ahead as scheduled even if it was not possible to arrange an earlier meeting with UNFPA.) If as a result of the meetings with UNFPA or the associated agencies it was decided to abandon a joint approach, however, the discussions with the associated agencies should aim at achieving their maximum cooperation in a Bank Group project.

(iii) Further action on the three project advisers, whom UNFPA had already agreed to finance with the Bank as the executing agency, should be postponed until after the meeting with UNFPA as proposed in para. 8 of Mr. Fontein's memorandum to Mr. Cope.

Dag F. Wittusen
Secretary

CRdeSilva/DFWittusen:as

Cleared by: Messrs. Cope
Broches
Chadenet
Kanagaratnam
Fontein

cc: Participants

FORM No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

B .1215

CONFIDENTIAL

LOAN COMMITTEE

November 16, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Botswana - Second Road Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated November 16, 1971 from the Eastern Africa Department, entitled 'Botswana - Second Road Project' (LC/O/71-127).

2. Comments, if any, should be sent to reach Miss Sato (ext. 2604) by 3:00 p.m. on Friday, November 19.

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

Dag F. Wittusen
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

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

CONFIDENTIAL

LC/O/71-127

November 16, 1971

LOAN COMMITTEE

Memorandum from the Eastern Africa Department

BOTSWANA: Second Road Project

Introduction

1. Attached is an Appraisal Report (No. PTR-95) dated September 30, 1971 recommending a \$2.0m IDA credit to the Republic of Botswana (Botswana) for a second road project which is estimated to cost \$6.1m. Botswana is able to provide only \$200,000, and the Swedish International Development Authority (SIDA) has agreed to provide the remaining \$3.9m needed to finance the project.

2. The proposed credit would be the third Bank group participation in road development in Botswana. In 1964, IDA provided a \$3.6m credit (Credit 63-BEC) for a first road development project. The \$32m Shashe Infrastructure Project Loan (776-BT) signed in June 1971 included provision for a road to the Shashe mining area and for improvements of parts of the North-South road which will be most directly affected by the mining development.

3. The FY 1972-76 Operations Program is attached. The lending program for FY '72 includes a livestock project which the SIDA is also considering financing jointly with IDA. The project has been appraised and the appraisal report has been prepared. Further processing is awaiting SIDA agreement to participate in negotiations.

Economic Situation

4. An economic report on Botswana (AE-4a) was distributed to the Executive Directors on October 31, 1969 and an up-dating memorandum (AE-18) on June 16, 1971.

5. Livestock dominates Botswana's economy contributing to 80% of total export earnings. Recently mining has emerged as an important new economic activity in the country. Traditional agriculture has been unable

to provide government with enough surplus to finance even the most rudimentary services. The recurrent budget had therefore to be subsidized through grants-in-aid from the U.K. Since 1967, the U.K. has on the average financed nearly 40% of the central government's recurrent expenditures and has provided grants and loans for most of Botswana's public investments.

6. Since 1969, however, the budgetary position and outlook have improved. Owing to increased receipts from customs duties following a revision of the Customs Union Agreement with Lesotho, South Africa and Swaziland the recurrent budget deficit decreased in spite of a rapid growth in recurrent expenditures. Large imports of capital goods for the new mining industry will continue to add further to government customs revenues and the budgetary position is expected to continue improving.

7. This year the first large-scale mining project reached full production - the De Beers diamond mine at Orapa in central Botswana. In 1973 in northeastern Botswana the Shashe copper/nickel project is scheduled to come into production. In addition to the Orapa and Shashe a number of other mineral deposits are being explored which could lead to further mining developments in the near future.

8. Although mining will significantly increase government revenues and national income (GNP per capita is estimated to increase from about \$100 in 1970 to about \$150 in 1975), its effect on employment will be relatively small. For a long time to come therefore agriculture will remain the mainstay of the Botswana economy.

Highway Sector

9. The geographical situation and physical features of Botswana create acute transport problems. The productive areas of Botswana are located in the periphery of the country with the Kalahari Desert occupying the center. This coupled with the low population density make road development and maintenance relatively costly and returns to investment in roads generally low.

10. There are only two main roads in Botswana: (i) a 670 km North-South road running the length of the eastern part of the country from the Southern Rhodesian border to South Africa and (ii) a 480 km East-West road between Francistown and Maun which was upgraded by the first road project financed by IDA in 1964. A third main road from Nata (on the East-West road) to the Zambian border may be constructed in the near future possibly with USAID finance.

11. The main economic activity - livestock and mining - is concentrated in the area served by the North-South road. Therefore, the National Development Plan 1970 - 1975 and a more recent Road Development Plan give priority

to the improvement of this road to bring the remaining poor sections of the road up to all weather standards. The U.K. has agreed to finance the improvement of a 144 km section north of Gaborone road to gravel standards. The government has recently also requested further assistance from the IDA to continue improvement of the North-South road. For this reason the Five-Year Lending Program includes (in addition to the present project) a $2.0m credit in 1975 for a Third Road Project.

The Project

12. The proposed project is the priority road project under Botswana's National Development Plan 1970 - 1975. It consists of:

(a) the reconstruction and paving of approximately 80 km of the North-South road from the South African border through Lobatse (where the abattoir serving Botswana's important livestock industry is located) and Gaborone (the capital) to the Botswana Agricultural College 9 miles north of Gaborone;

(b) consulting services for the detailed engineering and supervision of construction of the above work; and

(c) technical assistance to strengthen the staffing of the Roads Branch of the Public Works Department of the Ministry of Works and Communications. (This component may be deleted if Botswana succeeds in filling the posts through the OPAS program of UNDP.)

13. The estimated cost of the project is $6.10m ($5.05m in foreign exchange) and is broken down as follows:

		$ Millions	Local	Foreign
(a)	Reconstruction and paving	4.30	0.65	3.65
(b)	Consultants Services	0.46	0.10	0.36
(c)	Technical Assistance	0.20	0.10	0.10
(d)	Contingency Allowances	1.14	0.20	0.94
	Total	6.10	1.05	5.05

14. The project would be jointly financed by IDA and SIDA. Botswana will provide $200,000 covering 2% of the construction costs and the local costs of technical assistance. IDA would provide $2.0m and SIDA $3.9m to finance the balance of the project.

15. The Ministry of Works and Communications would execute the project with assistance from consultants. Construction would be carried out under a single contract let after international competitive bidding in accordance with IDA's standard bidding procedures.

16. The estimated internal economic rate of return for the proposed project is 19% - with the benefits derived primarily from savings to road users and reduced maintenance costs of the road. A comparison of potential savings from delaying construction by one year with first year benefits shows that the execution of the project is overdue. An analysis to determine the best level of road improvement indicates that the highest economic rate of return would be achieved if the proposed paving, as opposed to gravelling, were carried out immediately.

17. Despite substantial efforts to mobilize domestic resources Botswana is unable to meet its recurrent expenditure through domestic resources and is dependent upon U.K. grants-in-aid to finance recurrent deficits. At present all development expenditures have to be met from external sources as well (paragraph 6 of the Country Program Note of July 19, 1971). Under these circumstances, Botswana is unable to make a substantial contribution to the financing of projects, and external lenders would have to provide nearly 100 percent of project costs. In this project SIDA and IDA would jointly provide close to 97 percent of total project cost, including about $850,000.00 in local currency financing. This would be justified because of Botswana's precarious budgetary position.

18. To speed up the execution of the project, the Government provided for the cost of detailed engineering from October 1970 (estimated to be $220,000) prior to completing the financial arrangements. I propose these expenditures be eligible for disbursement under the proposed credit.

19. The terms and conditions of SIDA's participation will be set forth in a joint financing agreement between IDA, SIDA and Botswana which follows the general principles set forth in the June 3, 1969 letter agreement between the Bank, IDA and the Kingdom of Sweden. Under the proposed joint financing agreement, IDA would, inter alia, act as SIDA's agent in approving disbursement of funds provided by the SIDA credit.

20. Although the road to be reconstructed runs parallel to a railway passing through Eastern Botswana from South Africa to Southern Rhodesia, it is unlikely that there would be any significant competition between the two modes of transport, primarily because the railroad is a link between South Africa and Rhodesia with little service given to intermediate traffic between Lobatse and Gaborone. However, road-rail competition may be a more important factor on the long hauls between Gaborone to Francistown. Thus, before any further improvements are made to that portion of the North-South road, a preliminary study to determine the timing of proposed improvements should be carried out by the Ministry of Works. During negotiations assurances will be sought that such a study will be undertaken.

Recommendation

21. I recommend that the Association invite the government of the Republic of Botswana and representatives of SIDA to negotiate a $2.0m credit for a road project on the conditions set forth in paragraphs 6.01 - 6.04 of the attached Appraisal Report.

Michael L. Lejeune
Director

Attachments

Population: .6M
Per Capita Income: $100

BOTSWANA - PROPOSED LENDING PROGRAM THROUGH FY 1976

($ millions)

		1972	1973	1974	1975	1976
Livestock I	IDA	1.4				
Livestock II	IDA				2.0	
Education - Unidentified	IDA					2.0
Mining Infrastructure	IDA		1.0			
Roads Gaborone-Lobatse	IDA	2.0				
Roads III	IDA				2.0	

Eastern Africa Department

FORM No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

B. 1218

CONFIDENTIAL

LOAN COMMITTEE

November 16, 1971

MEMORANDUM TO THE LOAN COMMITTEE

El Salvador - Telecommunications Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated November 16, 1971 from the Central America and Caribbean Department, entitled "El Salvador - Proposed Bank Loan for a Telecommunications Project" (LC/O/71-126).

2. Comments, if any, should be sent to reach Mr. Gonella (ext. 4641) by 11:00 a.m. on Friday, November 19.

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

Dag F. Wittusen
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

CONFIDENTIAL

LC/O/71-126

November 16, 1971

LOAN COMMITTEE

Memorandum from Central America and Caribbean Department

EL SALVADOR - Proposed Bank Loan for a Telecommunications Project

1. Attached is a report entitled "Appraisal of the Second Telecommunications Project of the Administración Nacional de Telecommunicaciones (ANTEL)" (No. PU-78, dated October 20, 1971) recommending a Bank loan of $9.5 million to be guaranteed by El Salvador. The five-year lending program for El Salvador, reviewed by Mr. McNamara on September 9, 1971, is attached.

Background

2. To date, the Bank has made nine loans to El Salvador totalling $57.9 million (net of cancellations) and two IDA credits totalling $13.6 million. The last operation was an IDA credit for power of $5.6 million, signed in January 1971. No other operations are scheduled for FY1972. For FY1973 the lending program includes a loan for highways of $2.0 million, which will be appraised in January 1972, and a loan for power of $15.0 million (amount still tentative), which is scheduled for appraisal in April 1972.

3. On September 30, 1971, a total of $5.5 million remained to be disbursed on two loans, one of $2.8 million for highways (signed in December 1967) and the other of $4.9 million for an education project (June 1969). The IDA credit for power only became effective in October because of delays in obtaining Congressional ratification of the credit agreement. The highway project was delayed by institutional problems at the outset, the war with Honduras and adverse weather conditions, and the closing date of the loan has been extended from June 30, 1971, to December 31, 1972. The project, however, is now over 80 percent completed and work is progressing satisfactorily. Only a small part of the education loan has been disbursed, but we expect disbursements to pick up over the next few months. This project had to be substantially changed in May 1971 to conform to educational reforms introduced by the Government.

4. ANTEL, which would carry out the project now under consideration, received a $9.5 million Bank loan in 1963 to help finance the foreign exchange cost of telecommunications expansion in the country. The project was completed satisfactorily in December 1968.

Economic Situation

5. An economic mission visited El Salvador in March 1971. The mission's report (CA-12a) was approved by the Economic Committee without meeting on August 24 and circulated to the Executive Directors on October 20, 1971. It notes that the main long-term development problem for El Salvador remains the serious imbalance between rapidly growing population and scant natural resources. Given the small size of the Central American Common Market (CACM) and the problems it faces as a result of pressure from its poorer members to obtain a more balanced distribution of the benefits of Central American integration, the Government must make a major effort through public investment and supporting policies to foster the development of efficient agriculture and industry, able to compete outside the region. It is also urgent that the benefits of economic growth be better distributed in El Salvador, as they have been highly concentrated in the past, and health, nutritional and living standards of most of the population remain very low. However, it is very uncertain whether El Salvador will obtain a Government that is either dynamic or reform-minded in the next few years. Presidential elections are due in February 1972.

6. The medium-term outlook for the economy has a number of uncertainties. Export earnings are unlikely to expand rapidly in view of the prospects of the international coffee market. Full resumption of Common Market trade, which would permit the renewed growth of manufactured exports to the region (almost one-third of total exports) and spur private investment, is not in sight yet, although some progress has been achieved in recent negotiations. Assuming that the Common Market is functioning again by 1974 and the Government assumes a more active role in El Salvador's economic development, the economy might grow by about 4.5 percent annually. The projected growth of per capita income (1 percent a year) is still very modest, but even with fundamental changes in economic and social policies it is difficult to see any more satisfactory rate of economic growth being achieved in the foreseeable future.

7. Government finances have generally been kept in balance by keeping public investment down. However, the fiscal outlook improved considerably with the introduction of new tax measures last year, and public investment this year should be about 15 percent higher than in 1970, reaching just under three percent of GDP. Roughly three-quarters of this investment is expected to be financed from public savings. A tentative public investment program put together by the mission envisages investment rising to about 4.5 percent of GDP in the mid-seventies. The fiscal effort required to finance this program could be a substantial one in relation to the past performance, but would still be within the capacity of the economy. A variety of new fiscal measures have already been studied and offer a wide choice of means to achieve the necessary increase in government revenues. This will be a task of highest priority for the new Government when it takes office in mid-1972.

8. The balance of payments situation improved in 1970, thanks to a sharp increase in foreign exchange earnings from coffee. Net international reserves increased by \$15 million to \$52 million, or ten weeks current payments. In 1971 net international reserves are expected to decline slightly because of the weakening of coffee prices, but the Government is likely, as in the past, to follow cautious monetary and fiscal policies to maintain price stability and avoid foreign exchange difficulties. The existing stand-by arrangement with the IMF (\$14 million) extends to the end of calendar 1971. The Salvadoran authorities plan to request a new stand-by arrangement in July 1972, after the new Government takes office.

9. El Salvador has a low public external debt repayable in foreign currencies. As of the end of 1970 it totalled \$119 million, including undisbursed amounts. Most of the debt is due to international organizations and to USAID at long terms. The resulting level of debt service is low (about 4 percent of exports of goods and services in the next six or seven years) and leaves substantial room for new external borrowing.

The Project

10. A Bank mission appraised ANTEL's expansion program for 1971-73 in November 1970 and prepared a yellow cover appraisal report in March 1971. The processing of the proposed loan was, however, interrupted because the Salvadorans decided to deal directly with equipment suppliers in order to complete part of their telecommunications program before the 1972 elections. A Bank mission appraised a revised project in August/September 1971. The project now proposed for Bank financing excludes the part of ANTEL's program for 1971-73 which was carried out without international competitive bidding, but includes part of the expansion planned for 1974 and 1975. The amount of the proposed loan is accordingly higher than the \$6.5 million indicated in the last Country Program Paper.

11. The proposed \$9.5 million loan would be for 20 years, including a four-year grace period. The project would increase both local and long-distance telecommunications facilities and is part of ANTEL's 1971-1975 expansion program, which calls for fixed investments of \$20.3 million equivalent, including a foreign exchange cost of \$15.1 million equivalent. The proposed Bank loan would finance the foreign exchange cost of the project, the total cost of which is estimated at \$12.4 million, and possibly also a small amount of local costs. The proposed loan would not cover interest during construction. A detailed discussion of the project, its cost, and the financing plan for 1971-1975 is contained in paragraphs 3.02, 3.03 and 6.17 of the appraisal report. According to the financing plan for 1971-1975, the proposed loan would provide about 45 percent of the total funds required for the program (including working capital), 38 percent would be generated within the enterprise, and the

remainder would come from other sources. The internal financial rate of return of the project is estimated to be 19.7 percent.

12. Delays in expanding telecommunications facilities in the last few years have resulted in congestion of the network, poor service and a large unsatisfied demand for telephones in the capital's metropolitan area. The project aims at reducing the present deficiencies by removing the congestion in local and long-distance network and by meeting part of the expected new demand for telephones. On completion of the project, the telephone density will increase from the present 1.14 telephones per 100 persons to 1.3, which would still be considerably below the levels prevailing in such neighboring countries as Costa Rica (3.0) and Panama (4.2) and about the same as Nicaragua. Upon completion of the project, the demand for about 8,000 connections - out of a total expected demand of about 50,000 connections in the capital's metropolitan area - is still expected to remain unsatisfied. This gap between supply and demand cannot be closed during 1971-75 because of limitations in ANTEL's technical and administrative capacity.

13. An important aspect of this operation is the role which the Bank has performed, and will continue to perform, in strengthening ANTEL's organization. After completion of the first telecommunications project which the Bank financed, ANTEL ran into financial and technical difficulties mainly related to shortage of qualified staff. Various Bank missions visited ANTEL and stressed the need for considerable reorganization. They assisted ANTEL by specifically pointing out the weaknesses which required immediate attention. As a result ANTEL made substantial improvements, particularly in its financial management, technical maintenance organization and planning. The proposed project includes consultants' assistance to train ANTEL's staff in project preparation and planning for future expansion programs.

14. The appraisal report indicates that ANTEL is likely to accumulate surplus cash after allowance for debt service, operating requirements and requirements for future expansion. The Act setting up ANTEL in 1963, which was extensively discussed with the Bank at the time, sets out the conditions under which any such surplus shall pass to the Government, and there appears to be no need for any special covenant on this point to be included in the loan agreement, as presently proposed in the appraisal report (paragraph 6.19). However, I recommend that we seek ANTEL's commitment, in a supplementary letter, to consult with the Bank before deciding on any transfer of surpluses to the Government. The Public Utilities Projects Department agrees.

15. The appraisal report indicates that ANTEL has decided to curtail recruitment of non-technical personnel during 1972-1975 with the object of increasing productivity; and it recommends that we obtain assurances

that no increase in non-technical staff will be made during 1972-75 (paragraph 5.07). While agreeing to this as a starting position, I recommend, and the Public Utilities Projects Department concurs, that we should be flexible during negotiations and be prepared to accept other types of assurance that ANTEL will increase its efficiency, if an absolute prohibition on increasing non-technicalpersonnel proves unacceptable to the Salvadoran negotiators.

16. Procurement would follow Bank Group international bidding procedures, except for certain additions to existing equipment where compatibility is essential (about $0.6 million) for which prices would be negotiated with the supplier of the existing equipment. However, in accordance with the Central American agreement on fiscal incentives for industrial development, ANTEL must give preference (limited to 50 percent of existing import duties) to suppliers in other Central American countries. I propose that the Bank should, as in recent power and telecommunications loans to Costa Rica (Loans 631 and 632-CR) and in the proposed telecommunications loan to Guatemala, give recognition to this arrangement and extend the same preferential treatment to potential Salvadoran suppliers. I also recommend that the Bank be prepared to finance orders won by Salvadoran suppliers under these conditions. Since in no case will a preference equal to 50 percent of import duties exceed 15 percent, this would involve no departure from our normal rules with respect to domestic suppliers. It is expected that orders placed in Central America under the proposed arrangement should be quite limited in number and amount, not exceeding in any case $1.7 million, including possible procurement in El Salvador of up to some $1.0 million.

17. The timing for Board presentation of the proposed loan would be tentatively determined after the negotiations are completed. Legislative approval of the Guarantee Agreement is necessary and may be difficult to obtain. Since the Government cannot sign the Guarantee greement without Congress having first approved its negotiated text, we would not present the loan to the Board until the Government has obtained this approval.

<u>Unsettled External Debt</u>

18. Following nationalization of the Salvador Railway Company in 1962, the British bondholders had been pressing unsuccessfully for compensation and the Bank had on a number of occasions indicated its concern to the Salvadoran Government over the failure to reach a settlement of this issue. At the end of 1968 a mutually acceptable solution was found, under which about $250,000 are to be paid in government bonds to the British bondholders. Legal problems and the war with Honduras in mid-1969 have subsequently delayed completion of the transaction. The Government has told us in recent weeks that the last formalities are likely to be completed shortly. I do not consider that this should be made a condition of the presentation of the loan to the Executive Directors.

Recommendation

19. I recommend that the Bank proceed to negotiate a loan of $9.5 million to ANTEL with the guarantee of the Salvadoran Government, substantially on the terms and conditions proposed in the appraisal report and in paragraphs 14-16 of this memorandum.

Edgar Gutiérrez
Director

Attachment.

POPULATION: 3.5 m

GNP PER CAP: $283

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

OPERATIONS PROGRAM		1972	1973	1974	1975	1976	1977
Irrigation I (Olomega)	IBRD			8.0			
Irrigation II (Sonsonate)	IBRD					3.0	
Livestock I	IBRD				5.0		
Agriculture (unidentified)	IBRD						5.0
Communications II	IBRD	6.5					
Communications III	IBRD					10.0	
Education II	IBRD			5.0			
Education III	IBRD						5.0
Population	IBRD				4.0		
Power VI	IBRD		15.0				
Power VII	IBRD						6.0
Highways IV (North Transversal)	IBRD		5.0				
Highways V (San Salvador Expressway)	IBRD				4.0		
Highways VI	IBRD						5.0

	1964-68	1969-73	1973-77		1972	1973	1974	1975	1976	1977
IBRD	12.3	31.4	80.0	IBRD	6.5	20.0	13.0	13.0	13.0	21.0
IDA		5.6		IDA						
Total	12.3	37.0	80.0	Total	6.5	20.0	13.0	13.0	13.0	21.0
No.	2	5	13	No.	1	2	2	3	2	4
LENDING PROGRAM (1/18/71)										
IBRD	12.3	26.4	64.0	IBRD	6.5	15.0	13.0	14.0	14.0	8.0
IDA		5.6		IDA						
Total	12.3	32.0	64.0	Total	6.5	15.0	13.0	14.0	14.0	8.0
No.	2	4	10	No.	1	1	2	3	2	2

Central America & Caribbean Department
November 2, 1971

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

November 15, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Venezuela - Maiquetia International Airport Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated November 15, 1971 from the Central America and Caribbean Department, entitled "Venezuela - Proposed Loan to the Republic of Venezuela for the Maiquetia International Airport Project" (LC/O/71-125).

2. Comments, if any, should be sent to reach Mr. Wyss (ext. 4761) by 1:00 p.m. on Friday, November 19.

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

Dag F. Wittusen
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

CONFIDENTIAL

LC/0/71-125

November 15, 1971

LOAN COMMITTEE

Memorandum from the Central America and Caribbean Department

VENEZUELA - Proposed Loan to the Republic of Venezuela for the Maiquetia International Airport Project

Introduction

1. Attached for consideration by the Loan Committee is Report No. PTR-99 "Venezuela - Appraisal of Maiquetia International Airport Project", recommending a Bank loan of $17 million to the Republic of Venezuela, to help finance the foreign exchange cost of the proposed runway and related facilities.

2. To date, the Bank has made ten loans in Venezuela totalling about $330 million (net of cancellations), about 45 percent of which has been for electric power and the rest for roads (30 percent), telecommunications (20 percent), and water supply. The last loan in the amount of $35 million, made in June 1971 for a telecommunications project, is not yet effective mainly because of delays by the Borrower in reaching arrangements with official institutions for the collection of bills for past telecommunications services. IFC has committed $27 million to Venezuela since 1960, covering investments in five enterprises. The most recent operation was in January 1971 when IFC made a standby commitment of $2 million to purchase part of an issue of Consolidada de Cementos, C.A.'s bonds offered to the public by an underwriting syndicate headed by C.A. Venezolana de Desarrollo (CAVENDES), a private development finance company which IFC helped to establish.

3. Execution of Bank-financed projects has on the whole been satisfactory except for a water supply project in Caracas (Loan 444-VE) where, because of noncompliance with tariff covenants, disbursements were suspended for almost two years. The loan was closed at the end of August 1970, when the remaining balance of $4.2 million was cancelled. However, construction of the project has been completed.

4. Apart from the airport project, three other Bank loans are planned for FY72: a loan of $11 million for a livestock development project, a loan of $33 million for the first stage of the Caracas Metro project, and a $10 million loan for an education project. With the exception of the proposed loan for this project, for which legislation

already exists, all the loan operations require Congressional action which cannot be predicted with any precision. The Five-Year Lending Program (FY72-76) is attached.

Economic Situation

5. An economic report (Current Economic Position and Prospects of Venezuela, CA-5a) was distributed to the Executive Directors on October 12, 1970. An economic mission visited the country in September/October 1971 to reassess the situation and prospects of the economy in the light of the changes which have occurred since the end of 1971 in the fiscal and balance of payments situation as a result of increases in oil prices and in the taxation of petroleum company profits. Petroleum revenues will increase by almost \$500 million in 1971, by an additional \$250 million in 1972 and much smaller amounts thereafter. This will produce significant fiscal and balance of payments surpluses in 1971 and possibly in 1972 in spite of a rapid investment build-up in the public sector. The fundamental weakness of the Venezuelan economy, however, is unaffected by the boom in petroleum prices. Growth alternatives to petroleum must be developed to absorb the rapidly growing labor force. Petroleum output is anticipated to stagnate over the medium-run. Thus, the historical decrease in labor absorption in this sector will most probably continue. Furthermore, the uncertain outlook for oil output is such that fiscal and balance of payments difficulties experienced as recently as 1969/70 could recur as early as 1973-74 when public expenditures will have increased to the higher levels made possible by the new petroleum revenues. Diversification into resource-based industries such as steel, petrochemicals, basic aluminum and natural gas is underway. This will go some way to relieve the concentration of export earnings although the net foreign exchange benefit will initially be small. Thus, the mission confirmed the assessment of the medium-term economic situation contained in Loan Committee Memorandum LC/O/71-107, of October 5, 1971. For the longer-run, the likelihood of declining oil output in the late seventies, unless some new formula for investment in the sector is agreed in time, casts some doubt about the prospects of the economy at present levels of consumption.

6. For the continued growth of manufacturing, major public investments are justified in the "Core Region", which extends from just east of Caracas to west of Valencia and which accounts for roughly 70 percent of the nation's industrial production, three-quarters of all employment in industry and one-third of the total population. The advantages achieved in the "Core Region" through the availability of complementary industry and services, overhead facilities, a trained labor force and ready markets would be costly to duplicate elsewhere, and the development strategy outlined in the last economic report therefore recommended the establishment of an outward-oriented industrial base in this area. As annual commodity exports and imports surpass \$2.7 and \$1.8 billion respectively, and given the overall size of the economy, additional

infrastructural facilities, especially for local and international communications and transportation, will be needed mainly in the Core Region to permit further development of the economy.

The Project

7. This is the second airport project for which Bank financing is proposed. The project is part of a master plan for the development of the Maiquetia International Airport. Because of the different status of engineering and economic work on its various parts, the plan will be executed in two parts: the construction of a new runway, taxiways and associated facilities (Part I), and the construction of a terminal building complex and related facilities (Part II). The proposed project confines itself to Part I. A second project, which would comprise Part II, is tentatively scheduled for appraisal early in 1972. The $17 million loan now proposed would cover 90 percent of the foreign exchange cost of the first project which will cost about $53 million. The remaining 10 percent foreign exchange component would be financed by the Government of Venezuela to cover preliminary civil work expenditures let without international competition because of time constraints.

8. Bank participation in the project has a three-fold objective. First, it aims at providing an important infrastructure facility needed for the industrial and tourist[1/] development of the Core Region, thereby contributing to the diversification of the economy. The Maiquetia Airport constitutes the focal point from which the main domestic and international air routes radiate. In 1969 the Maiquetia Airport handled 95 percent of all international traffic of the country and 46 percent of total domestic passenger traffic, involving some 50,000 commercial aircraft movements and close to 1.3 million passengers. The Maiquetia Airport is thus one of the busiest in South America and the Caribbean Area. However, Caracas remains one of only two aviation centers in the world handling over half million international passengers a year which does not have an airport equipped with an Instrument Landing System (ILS).[2/] This guidance equipment, which is needed to meet the international safety standards for the operation of the current generation of jets, cannot be installed on the present runway due to terrain constraints. The new runway, which also will be longer than the existing one to permit departure of flights with longer stage lengths, will have a different orientation to the existing

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1/ The Bank is executing agency for a UNDP-financed master plan and feasibility study for the tourism development of the Los Caracas-Higuerote area, near the Maiquetia Airport.

2/ The other is Wellington, New Zealand.

one, thus avoiding the terrain obstructions and enabling the installation of an ILS system. The project will therefore produce benefits primarily in the form of improved safety in handling the increasing traffic at the airport.

9. Jet aircraft have used regularly the present airport facilities for a number of years, although the existing safety standards do not meet the recommendations of the International Civil Aviation Organization (ICAO) and the United States Federal Aviation Agency (FAA). Moreover, the International Air Transport Association (IATA) has recently drafted a policy stating that "ILS be installed and maintained in operation on all runways regularly used by international air services". Thus, the operation of Venezuela's principal airport involves greater risks than is generally accepted under present standards adopted on a worldwide basis, and the Government's plan to bring Maiquetia up to accepted standards appears justified. Serious accidents in aviation in general and at any particular airport occur too rarely to provide a statistically meaningful basis for calculating the economic rate of return on the proposed investment based on safety improvement. The Appraisal Report therefore has compared the cost of providing air services to Venezuela with the new runway facility with what the cost of providing equivalent services would be if the use of the existing airport were restricted to propeller aircraft operations which would meet safety standards. This is a somewhat academic calculation, but for what it is worth, it shows that the savings in aircraft operating costs and passenger time from having a jet airport yield a return of 17 percent on the investment. As this analysis was unable to assess the extent of the probable suppression of the traffic volume that would take place in the absence of the project and to estimate the ensuing losses to the Venezuelan economy, the real benefits of the project are likely to be greater than those estimated. The cost of the new runway is rather high because of extremely difficult terrain, which requires very heavy earth movements. However, the proposal has been carefully assessed against possible alternatives in other areas close to Caracas and alternative alignments on the Maiquetia site and has been proved to be much the cheapest solution.

10. The second objective of Bank participation is the establishment of a sound organizational structure for the operation of the airport facilities. Up until now, the airport has been managed by the Civil Aeronautics Board of the Ministry of Communications, but coordination between the various divisions of the Ministry at the airport, the headquarter units and other Ministries providing services at the airport has been ineffective. Because of diffused responsibilities and lack of a strong management, the level of service at the airport, as well as planning and financial management, have been deficient. The Government recognized the difficulty of making a major investment in the airport under these circumstances, and it is now in the process of setting up an "Autonomous Institute" (Aeropuerto Internacional de Maiquetia) as an Airport Authority,

in accordance with the provisions of a recently enacted law. In line with this objective, funds are proposed to be included in the project for management and accounting consultancy services to help the Authority to establish and implement sound financial planning and accounting methods, including the introduction of a management information system.

11. Institutional arrangements call for the Government to construct the airport project, through its Ministry of Public Works, and thereafter for the transfer of the present and newly constructed facilities to the Authority. By the time the Bank became involved in the project, enabling legislation to borrow had been passed by Congress, and the Government was considering legislation to establish the Authority. Although we would have preferred to make the proposed loan directly to the Authority, in line with our normal practice, this alternative has not proven practicable in the present case since it would have entailed the resubmission of the enabling legislation to Congress. Also, a special law would have had to be passed re-appropriating some $10 million of the Ministry of Public Works' 1971 budget to the Authority for the initial works on the project. The Government, which has a minority position in Congress, would have had great difficulty in securing reconsideration of this matter, since it would have involved a new round of political negotiations, the outcome of which would have been at best uncertain. In view of this, and considering that the execution of the project will be the responsibility of the Government, through the Ministry of Public Works, I endorse the proposal in the appraisal report that the Bank enter into a Loan Agreement with the Government and a Project Agreement with the Authority, since this arrangement will permit us to maintain a direct contractual relationship with the institutions responsible both for building and for operating the facilities. The Legal Department is in agreement with this proposal.

12. The third objective is the determination of levels of service (i.e., assuring that the size and design standards of the airport are in line with a reasonable forecast of demand) and the establishment of pricing policies scaled to the cost of providing these services at the airport in order to ensure that a substantial part of the project benefits would be recaptured by the Venezuelan economy. There is a tendency for public works in Venezuela to be over-designed, and for user charges to be set below the levels needed to recover costs. In the analysis of the data gathered during the appraisal mission, it became apparent that major additional work needed to be done before the proper size, phasing and design of the terminal building complex could be determined. Rather than delay the entire project by at least one year, it was agreed to split the project in two parts, as referred to in paragraph 7. The present project covers construction of the runway and taxiways for which engineering is underway, and includes funds for the design of the terminal. In addition, the Government is being asked to perform further technical and economic studies to determine the suitability of the design and timing of the terminal building and of the future user charges.

13. As to user charges, the Government has agreed to establish tariffs which will recover the investment made in the project during its economic life. However, not all of the revenues derived from the collection of user charges will accrue directly to the Authority. A departure tax which is paid by all Venezuelan residents will be collected by the Government in accordance with the provisions of the existing law which established this tax. The conversion of the departure tax into a charge payable directly to the airport would have required a change in the law for which it is unlikely that Congressional approval would have been obtained. Instead, about 60 percent of the total tax collected per passenger will be treated for accounting purposes as income of the airport, and the Authority will set up a pro forma accounting system, under which the rate of return and other tests of financial performance will be established as a basis for determining the levels of user charges for operating the airport. In view of the rather small cash operating requirements of the airport, cash surpluses accruing from all user charges other than the departure tax will be transferred to the Government as a retribution of its investment in the project. These transfers will more than cover the service of the proposed Bank loan. The Authority will be required, however, to maintain such cash levels as shall be needed for its operation.

14. The appraisal report also recommends retroactive financing of about $1.5 million, to cover the first part of the main earth moving contract ($1 million), and the engineering and consulting services performed before signing of the proposed loan ($0.5 million). Since such works are an important and integral element of the project, and their delay would be critical for the timing of the construction of the new runway, I recommend that the Bank agree to retroactive financing of these activities.

15. Venezuela's favorable fiscal and balance of payments situation justifies somewhat harder terms for Bank lending to the public sector than would be appropriate on project grounds alone. It is accordingly proposed that this loan should have a term of 15 years, including 3 years of grace, instead of the 20 years which would be normal for a project of this sort. This reduction of term has already been built in into the appraisal report.

Recommendation

16. I recommend that the Bank invite the Republic of Venezuela and the Maiquetia Airport Autonomous Institute to negotiate a loan of $17 million on the terms and conditions set out in the appraisal report.

Edgar Gutierrez
Director

Attachment.

Population: 9.7 million

GNP per cap: $950

IVa VENEZUELA - 5-YEAR OPERATIONS AND LENDING PROGRAMS

(By fiscal year - amount in $ millions)

Operations Program			1972	1973	1974	1975	1976
3-VEN-AL-01	Livestock I	IBRD	11.0				
3-VEN-AL-02	Livestock II	IBRD			15.0		
3-VEN-AX-01	Agriculture unidentified	IBRD			10.0		
3-VEN-CC-03	CANTV Expansion II	IBRD			20.0		
3-VEN-EE-01	Education	IBRD	10.0				
3-VEN-EE-02	Education II	IBRD			15.0		
3-VEN-II-01	Industry I	IBRD		30.0			
3-VEN-IX-02	Industry unidentified II	IBRD				20.0	
3-VEN-PM-03	Guri Power Transmission	IBRD		15.0			
3-VEN-QQ-01	Tourism I	IBRD			15.0		
3-VEN-QX-01	Tourism unidentified	IBRD					20.0
3-VEN-TA-01	Airport (Maiquetia)	IBRD	17.0				
3-VEN-TA-02	Airport (Maiquetia II)	IBRD		13.0			
3-VEN-TH-05	Highways IV	IBRD				20.0	
3-VEN-UT-01	Caracas Metro	IBRD	33.0				
3-VEN-UT-02	Urban Transportation	IBRD					35.0

	1964-68	1969-73	1972-76		1972	1973	1974	1975	1976
IBRD	202.3	215.0	299.0	IBRD	71.0	58.0	75.0	40.0	55.0
IDA				IDA					
Total	202.3	215.0	299.0	Total	71.0	58.0	75.0	40.0	55.0
No.	6	10	16	No.	4	3	5	2	2
Lending Program (9/2/71)									
IBRD	202.3	191.0	280.0	IBRD	50.0	55.0	55.0	60.0	60.0
IDA				IDA					
Total	202.3	191.0	280.0	Total	50.0	55.0	55.0	60.0	60.0
No.				No.					

P & B - 10/28/71

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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LM/M/71-45

November 12, 1971

Minutes of Special Loan Meeting to consider "Sierra Leone - Integrated Agricultural Development Project" held on November 8, 1971 in Conference Room B.

1. Present: Messrs. Cope (Chairman), Williams, Baum, Cheek, McIvor, Blinkhorn, Cole, Denness, Nissenbaum, R.E. Rowe, Sukkar and Wittusen (Secretary).

2. Issues: The meeting was called to consider the Western Africa Department's memorandum of November 4, 1971 to the Loan Committee entitled "Sierra Leone - Proposed Integrated Agricultural Development Project" (LC/O/71-119) and the attached appraisal report (PA-104). Sierra Leone's economic and financial position had deteriorated considerably in the past year due to a recession in the world diamond market, political instability and imprudent fiscal and debt management. In addition, Sierra Leone had a poor record of performance on current Bank Group projects. The issues for discussion were therefore:

(i) whether the current economic and political situation warranted further investment by the Bank Group at this time;

(ii) whether the proposed project was too complicated, given the country's internal difficulties and poor performance in the past; and

(iii) whether the heavy dependence on foreign management for the project was necessary and justified.

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Committee:

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

3. Economic and political situation: The meeting noted that:

(i) Recognizing that there were risks involved, the Western Africa Department nevertheless thought that the current economic and political situation warranted continued Bank Group investment in Sierra Leone. A measure of stability had been restored and key Government officials seemed sincerely anxious to proceed with the development tasks at hand. Discussions with the Sierra Leonean delegation during the recent Annual Meeting had produced a letter of understanding, subsequently confirmed by the Finance Minister, which declared that the Government would:

(a) establish a national economic advisory committee to coordinate economic policy-making,

(b) declare a moratorium on short/medium term debts, and

(c) intensify efforts to improve the tax system and to reduce extra-budgetary expenditures.

The Government had been informed that presenting the proposed project to the Association's Board of Executive Directors would depend on satisfactory progress in the execution and implementation of these policy understandings.

(ii) Regarding the performance of the borrower, the Government had been informed that satisfactory progress in resolving the managerial, financial and institutional problems of the Electricity Corporation which presently were holding up the implementation of the second power project would be a prerequisite to negotiation of the proposed project.

4. Complexity of the proposed project: The meeting noted that:

(i) The project was complicated and the Government was required to fulfill a multitude of conditions to ensure proper project implementation. The Chairman, referring to the borrower's poor performance in the past, questioned whether the project was not overly ambitious.

(ii) The Agriculture Projects Department explained that virtually every aspect of the proposed project represented an enlargement or an improvement of an activity already underway in Sierra Leone. The project was based on familiar agricultural practices and techniques, and the Department expressed confidence in the capacity of the farmers to carry out the project, provided they were led by good management.

5. Dependence on foreign management: The meeting noted that:

(i) The Ministry of Agriculture had recognized management as a key problem and had itself requested expatriate management in order to get the project going. The project included management training and the objective would be to replace expatriate management with Sierra Leoneans as quickly as possible.

(ii) It was suggested that, instead of recruiting foreign managers individually as proposed, it might be simpler to engage a management firm.

6. Decision:

(i) On the basis of the above discussion, the Chairman approved the Western Africa Department's recommendation that negotiators be invited for the proposed credit subject to the Government satisfying the conditions outlined in para. 3 above and described more fully in the Department's memorandum to the Loan Committee of November 4, 1971.

(ii) The possibility of engaging a management firm, as suggested in para. 5(ii) above, should be explored.

Dag F. Wittusen
Secretary

TABlinkhorn/DFWittusen:as

Cleared by: Messrs. Cope
Baum
Cheek
McIvor

cc: Loan Committee
Participants

FORM No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

B. 1215

CONFIDENTIAL

LOAN COMMITTEE

November 11, 1971

MEMORANDUM TO THE LOAN COMMITTEE

New Zealand - Development Finance Company

1. The Committee is requested to consider, without meeting, the attached memorandum dated November 11, 1971 from the East Asia and Pacific Department, entitled "New Zealand - Development Finance Company of New Zealand" (LC/O/71-124).

2. Comments, if any, should be sent to reach Mr. Riddell (ext. 2273) by 5:00 p.m. on Tuesday, November 16.

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

Dag F. Wittusen
Secretary
Loan Committee

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Committee:

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

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LC/O/71-124

November 11, 1971

LOAN COMMITTEE

Memorandum from East Asia and Pacific Department

NEW ZEALAND - Development Finance Corporation of New Zealand

1. There is attached for the consideration of the Committee a Report - "Appraisal of Development Finance Corporation of New Zealand" dated November 10, 1971. The report recommends that a Bank loan of US$8.0 million equivalent be made to the Development Finance Corporation of New Zealand ("DFCNZ") on the normal terms and conditions for loans to development finance companies to cover the major part of its external capital requirements for the next two years.

Background

2. Loans amounting to US$96.0 million were made to the Government of New Zealand between 1963 and 1965 financing projects for power generation, railways and port development all of which have been successfully executed. In FY 1971 a US$16.0 million loan was made to help finance the modernization of the New Zealand Railways.

3. As of September 30, 1971 the amount of loans held by the Bank net of cancellations, sales and repayments was US$95.0 million.

4. The proposed loan (the first to the DFCNZ) would be the sixth to New Zealand and the second in the lending program of $30-40 million over three to four years agreed to by the Bank in 1969. This program was conceived as support for New Zealand's effort to restructure its economy and lays particular emphasis on the development of industrial efficiency and competitiveness in world markets. As part of this program a further loan, also to the DFCNZ, is tentatively planned for FY 1974.

The Economy

5. New Zealand, with a per capita GNP of US$1,860 (1969), is a marginal case of eligibility for Bank loans. At the request of the New Zealand Government, however, the Bank agreed to a modest lending program to help finance the restructuring of the country's economy. The restructuring will emphasize the diversification of New Zealand's exports and the markets in which they are sold. This effort will require capital investments of an order which cannot be satisfied domestically.

The Bank's lending program is in recognition of New Zealand's difficulties in raising the required amount of capital in world markets and is predicated on the government continuing to make maximum use of all other overseas sources of credit. In the year to June 30, 1971 US$130 million were raised by the government largely in Europe. At that date New Zealand's foreign exchange reserves amounted to US$514 million, equivalent to over five months' imports at the current rate.

6. The most recent economic mission to New Zealand in October 1970 reported that although the balance of payments was likely to be a less serious constraint on New Zealand's long-term economic prospects than was previously believed, shortage of labor and slow growth in industrial productivity would be much more critical. In 1970 and 1971 New Zealand has been affected by "cost push" inflation which has caused a price rise of 10% on an annual basis, the result at least in part of substantial wage demands. New Zealand has also been confronted in 1971 with the successful negotiation in Luxembourg of the terms for the U.K.'s entry into the E.E.C. and the resulting loss of unrestricted entry into the U.K. market of its agricultural products. The possibility of this loss had haunted New Zealand since the first British overtures to the E.E.C. in 1961. Although the provisions both for the transition period of five years and for the future of New Zealand - E.E.C. trade are considered not unfavorable, the need for diversification both of its products and its markets is now underlined if New Zealand is to maintain its projected rate of growth.

7. A major objective, therefore, of New Zealand's economic policy is to promote manufacturing industry particularly businesses whose products are competitive in world markets. The growth rate projected for manufacturing output is 6.0% annually for the next five years compared with an annual rate of increase for GNP of 4.2% for the same period. This policy is one which successive Bank missions to New Zealand have endorsed and encouraged, pointing to it as a means of reducing New Zealand's dependence on pastoral exports and the consequent vulnerability of its balance of payments to swings in global demand for these products.

8. Although the government has long recognized the need to restructure the economy, energetic steps were not taken in this direction until the recession of 1967-68 and the devaluation of the New Zealand dollar. The reduction in domestic demand and the added competitiveness of New Zealand's manufactures stimulated exports. A start has since been made in dismantling import licensing behind which a multitude of small business ventures have grown up many of which are not justifiable economically. Recently, the government has made a commitment to shift to tariff protection, based on a more rational appraisal of New Zealand's real interests.

The Project

9. The appraisal report identifies a gap in the structure of institutional financing for the industrial sector which the DFCNZ could effectively fill. This would involve the provision of large-scale lending in the 8-15 year-term range for projects with high economic priority. The amounts involved in such lending would often be too large, the term too long and the interest rates too low for the finance companies in New Zealand, and the risks involved would be considered excessive by the life insurance companies and trading banks which traditionally have been the principal institutional sources of industrial finance. Though the government has recently authorized the creation of merchant banks, they are not expected to play a leading role in the provision of venture capital for a number of years to come.

10. The Bank has been closely associated with the steps recently taken by the government to expand the DFCNZ. In the period since it started in 1965, the DFCNZ has had only a minor impact on New Zealand industry with an outstanding portfolio of NZ$7.5 million at the end of June 30, 1971. As a result of a report by the DFC department in 1969 a number of changes were made in the DFC Act in 1970, including the removal of the restriction which made it a lender of last resort. The report also recommended that its board and management be strengthened and that its policies become more aggressive. In this way, it was hoped that DFCNZ would be freed to play a more substantial role in the promotion of the development of industry in New Zealand.

11. In order to develop sound guidelines for financial management, the DFC will adopt a policy statement satisfactory to the Bank. Its terms will be agreed upon during negotiations and its adoption by the Board of the DFCNZ will be a condition of effectiveness. The appointment of the new competent managing director, effective November 1, will do much to ensure that its policies will be actively carried out.

12. The government has agreed to take further measures designed to enlarge DFCNZ's role. The equity base (NZ$1.8 million at the end of FY 1970-71) is no longer adequate to support the forecast scale of operations. The Guarantee Agreement will include an undertaking that the maturity of the existing subordinated government loan (NZ$1.75 million) will be deferred until after the repayment of the Bank loan and it will thus be eligible to be treated as equity in computing the contractual debt/equity limit. Initially, a limit of 4:1 is suggested. In addition, on account of the inability of the existing shareholders to subscribe additional equity because of the pressure on them from government to make funds available elsewhere, the government has agreed to provide DFCNZ with an additional NZ$4.0 million in subordinated loans.

This will exceed the present limit on government subordinated loans to DFCNZ of NZ$4.0 million by NZ$1.75 million, and thus will also require an amendment to the DFC Act. The enactment of this amendment which has already been introduced in Parliament will be a condition of presentation of the proposed loan to the Executive Directors.

13. Estimates agreed with DFCNZ indicate that commitments in the five years to June 30, 1976 will amount to approximately NZ$54 million of which about NZ$26 million (US$29 million) will be for foreign currency loans. Foreign loan commitments through calendar 1973 are forecast at US$9 million. The DFCNZ has recently borrowed US$1 million in Eurodollars; the remaining foreign exchange resource gap of US$8 million would be filled by the proposed Bank loan. The major recipients of DFCNZ loans in future are expected to be the meat and forestry processing industries, and tourism. In the case of the Eurodollar loan, DFCNZ is presently carrying the foreign exchange risk. During negotiations, a method to protect itself against this risk will have to be agreed upon.

14. The Bank loan would help finance the capital imports of the DFCNZ's borrowers over the next two years. Items eligible for such financing would be (1) direct imports; (2) the foreign exchange cost of items bought "off the shelf" from New Zealand importers and (3) the foreign exchange content of goods manufactured in New Zealand. Percentages to be used for the calculations of (2) and (3) will be agreed upon during negotiations.

Recommendation

15. I agree with the recommendations of the Appraisal Report and recommend that the Government of New Zealand and the DFCNZ be invited to send representatives to Washington to negotiate a Bank loan of US$8.0 million for the DFCNZ project on the terms and conditions set forth in the attached report.

Attachment

Douglas J. Fontein
Deputy Director
East Asia and Pacific Department

Population ('000): 2,820
Per Capita GNP : US$1,860

NEW ZEALAND - OPERATIONS AND LENDING PROGRAMS THROUGH FY 1976
($ millions)

		1972	1973	1974	1975	1976	Total 1964-68	Total 1969-73	Total 1972-76
Industrial Finance I	IBRD	8.0							
Industrial Finance II	IBRD			15.0					
Operations Program	Total	8.0	-	15.0				24.4	23.0
	No.							2	2
Lending Program	Total	8.0	-	15.0			102.8	24.4	23.0
	No.						4	2	2

East Asia and Pacific Department
11/9/71

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

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LOAN COMMITTEE

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November 9, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Cameroon - Rice Irrigation Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated November 9, 1971 from the Western Africa Department, entitled "Cameroon - Proposed Credit for a Rice Irrigation Project" (LC/0/71-123)

2. Comments, if any, should be sent to reach Mr. Storch (ext. 4743) by 1:00 p.m. on Monday, November 15.

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

Dag F. Wittusen
Secretary
Loan Committee

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Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
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Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/O/71-123

November 9, 1971

LOAN COMMITTEE

Memorandum from the Western Africa Department

Cameroon - Proposed Credit for a Rice Irrigation Project

Introduction

1. Attached is an appraisal report (PA-103) on a rice irrigation project in Cameroon. The total project cost is equivalent to approximately US$6.9 million, with a foreign exchange component of $3.7 million. The proposed IDA credit would be $3.0 million, or 43 percent of total costs. Co-lenders would be FAC ($1.1 million) and the Caisse Centrale ($1.0 million); the Government would finance the remaining $1.8 million, i.e., 26 percent of total costs. This project would be the third Bank Group operation in agriculture in Cameroon. A cocoa project is currently under preparation for FY73.

2. The Bank Group's commitments in Cameroon now total $67.1 million covering seven projects in four sectors. As can be seen from the attached copy of the lending program, our current strategy focuses on transport, with the agricultural sector ranking second in the amount of assistance to be received. Emphasis on agriculture is appropriate since 80 percent of Cameroon's population earns its livelihood from agricultural pursuits and the Government's planning gives priority to rural development. For FY73, besides the cocoa project, we are preparing projects in education, roads, and port development.

The Economy

3. G.D.P. growth during the five years up to 1969/70 has been estimated at about 5.3 percent per annum in real terms. This is a healthy margin above population growth of 2.2 percent per annum. Exports and imports both average about 21 percent of G.D.P. The balance of trade for 1970/71 showed a deficit of 4.4 billion FCFA compared to the 1969/70 surplus of 5.6 billion FCFA. The overall balance of payments nevertheless showed improvement and net foreign assets at the end of the first quarter of 1971 were 20 percent in excess of the level a year earlier.

4. Cameroon's 1971/72 budget is balanced with revenue and expenditures each estimated at 45.3 billion FCFA, an 18 percent increase over the previous year. Recurrent expenditures will take 38.6 billion FCFA of budget revenues while the remainder, 6.6 billion FCFA, is allocated for investment. The increase in public investment has been 30-33 percent in each of the past three years; the additional funds are generated from

increases in public savings. Although this performance in public finance is impressive, it should be recognized that Cameroon is nevertheless a poor country -- per capita income is about $140 per year and a substantial proportion of the population continues to depend wholly or in part on subsistence agriculture. Continuing with its ambitious goals, the Government's Third Five-Year Plan calls for total investment of about $520 million in the public sector, with foreign borrowings expected to cover roughly 50 percent of this amount.

The Project

5. Rice consumption is low in comparison with other African countries: about 17,000 tons per year or 2.9 kg per capita. Urban centers in the south are the main markets for rice. Urban population is increasing by 7 percent per year, and so is rice consumption, thereby following the trend in evidence in other African countries. Some 7,000 tons of rice are produced domestically, of which about 70 percent is grown in the Yagoua district in Northern Cameroon. From this area 1,000 tons of rice are exported each year to nearby markets in the Central African Republic, Northern Nigeria, and Chad. Cameroon imports far exceed exports, however, as around 11,000 tons of rice are imported annually in the south to satisfy urban consumption. The proposed project would cover nearly one quarter of future domestic requirements and also permit an expansion in rice exports.

6. The project is in Cameroon's biggest rice-growing area, the Yagoua district, located along the west bank of the Logone River. At this point the Logone constitutes the border between Cameroon and Chad. Flooding, drainage, climate, and soils are favorable to the growing of rice, as has been amply proven by the "Secteur Experimental de Modernisation Rizicole de Yagoua" (SEMRY). Established by the Cameroon Government in 1957, SEMRY operates irrigation works and provides extension services; it buys, mills, and markets the rice produced on irrigated blocks covering about 4,300 ha.

7. The proposed project would provide a controlled water supply for SEMRY and would consist of the following:

(a) reinforcement of the 49 km Logone dike and improvement of a parallel road;

(b) construction of the Guerleo intake control structure;

(c) construction of four pumping stations;

(d) rehabilitation of irrigation and drainage networks to serve 1,300 ha;

(e) construction of new irrigation and drainage networks to serve 3,000 ha;

(f) on-farm development works on 3,000 ha; and

(g) construction of a rice mill and storage facilities.

The project would also finance the purchase of farm machinery and expansion of the management and extension services offered by SEMRY. A consulting firm would be engaged to assist in the design, construction, and supervision of civil works and on-farm development works. The internal economic return, with project life assumed as forty years, would be 12 percent; this includes all costs, except for adjustments in taxes and subsidies.

8. Overall responsibility for project implementation would rest with SEMRY which, in April of 1971, was decreed to be a semi-autonomous project authority directly responsible to the Ministry of Planning. SEMRY's experience, legal authority, management, and staff are adequate to carry out the proposed project.

9. Total project costs are estimated at $6.9 million; the foreign exchange component would be $3.7 million, or 54 percent of total costs. Included in the local currency costs of $3.2 million is approximately $800,000 in import duties and indirect taxes, i.e., 12 percent of total project costs. There are two co-lenders, FAC and Caisse Centrale, who participated in the appraisal mission and who are prepared together to lend 31 percent of the funds required for the project. The tentative financing plan for this joint lending operation has recently been revised and would be as follows*:

	US$			Percent of
	Local	Foreign	Total	Total Cost
IDA	0.3	2.7	3.0	43
FAC	0.1	1.0	1.1	16
Caisse Centrale	1.0	-	1.0	15
Government	1.8	-	1.8	26
	3.2	3.7	6.9	100

10. The total IDA credit of $3.0 million would finance 43 percent of the project. The credit would cover the estimated foreign exchange costs ($2.7 million) of civil works, on-farm development, rice mill, and

* Paras. 4.22 to 4.27 in the attached appraisal report do not reflect the latest version of the joint financing plan.

equipment; the credit would also cover $0.3 million of local costs on some of the related civil works contracts. This modest local currency financing by IDA (4 percent of total project costs) is justified in view of SEMRY's tight financial position and the $1.8 million contribution of the Government which amounts to 16 percent of total project costs net of taxes.

11. Procurement would be in accordance with Bank/IDA guidelines for the cost of (i) imported equipment ($1.1 million); and (ii) civil works contracts ($2.9 million) for the construction of the rice mill, storage facilities, and the irrigation system including dike and road. The construction of related buildings, costing a total of $110,000, would be tendered locally since the amount involved would not invite international competition. On-farm development works would be carried out on force account by SEMRY with equipment purchased under the credit. All IDA funds would be disbursed within three years of effectiveness.

12. FAC's grant of $1.1 million would finance consultants' services and all expatriate personnel over a five-year period. The loan from Caisse Centrale would cover part of SEMRY's own contribution to the project as well as the local cost of personnel expenditures for reasearch and extension services.

13. The project would not alter the ecological situation. Bush clearing would not be required, and the use of pesticides would be limited by SEMRY to the minimum quantities needed for an adequate pest control program. Shistosomiasis (bilharzia) is highly prevalent in the project area, and malaria is endemic. The Bank has employed an environmental consultant to examine the consequences which the project would have on public health. His findings were that the breeding grounds for malaria would be reduced, whereas the effect of the project on controlling bilharzia would be beneficial in some ways and adverse in others. The consultant's recommendations on public health measures to be taken by the Government would be covered in negotiations.

Issues for the attention of the Loan Committee

14. Although no difficulties of substance are anticipated with the co-lenders, FAC and Caisse Centrale, a final meeting on aid coordination has to be held just prior to negotiations, in order to confirm the financing plan and other aspects of joint participation.

15. On August 20, 1970, Chad and Cameroon concluded an agreement governing the use of the Logone River waters. This agreement defined certain hydraulic limits that would apply to such development projects as SEMRY. The Logone Agreement is valid for ten years and will be tacitly renewed if it is not canceled by one of the Governments one year before the formal expiration date of August 1980.

16. In accordance with the Logone Agreement, the Government of Cameroon in a letter dated March 12, 1971, duly informed the Government of Chad about Cameroon's intention to proceed with the SEMRY project, giving the probable dates when the work would begin and forwarding copies of the engineers' plans for dike reconstruction. The Government of Chad did not respond nor was it obliged to do so. The SEMRY project, as designed, complies in all points with the articles of the Logone Agreement.

17. It is the position of the Agriculture Projects Department that the formal validity of the Logone Agreement should be extended to 40 years, without the right of cancellation by either Cameroon or Chad. It would be a condition of presentation to the Board that the Logone Agreement would be amended to ensure an adequate dry-season water supply to the project during its estimated 40-year life and that the régime of the river would not be changed so as to increase the flood levels. In its present form the Logone Agreement gives no assurances that further projects would not be implemented (during the 30 years following August, 1980) which could affect SEMRY's water supply.

18. We have discussed this matter with the Government of Cameroon on several occasions and have even gone so far as to furnish a draft of the kind of letter which the Cameroon and Chad Governments could exchange for prolonging the Logone Agreement's formal validity to 40 years. Cameroon has promised to send a presidential letter to this effect to Chad on October 29.

19. It is the position of this Department that, if the Chad Government refused Cameroon's request, then formal extension of the Logone Agreement should not be a condition for Board presentation of the SEMRY project. The existing agreement, having ten-year formal validity and tacit renewal thereafter, is adequate and realistic given the political circumstances of developing countries. In any case, no legal agreement could be absolutely binding between two sovereign states for forty years if their respective interests dictated cancellation; furthermore, it is very doubtful that the two Governments would sign an agreement relinquishing all rights to cancellation over such a long period. From a practical point of view, it is highly unlikely that Chad, given the very limited possibilities for development along the Logone River, could undertake a project which would in fact prejudice the water rights of SEMRY during the next forty years.

20. A Loan Committee decision on the differing viewpoints of the Area and Projects Departments on the Logone Agreement is needed.

Recommendation

21. I recommend that the Federal Republic of Cameroon be invited to send representatives to negotiate a credit of $3.0 million for this project on the terms and conditions set forth in sections 8.02 and 8.03 of the attached appraisal report, with section 8.01 to be revised if necessary in view of the Loan Committee decision requested in para. 20 above.

Bruce M. Cheek
Deputy Director

Attachments: Appraisal Report
Lending Program

November 8, 1971

GNP PER CAP: $ 140

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

OPERATIONS PROGRAM			1972	1973	1974	1975	1976
7-CAM-AI-01	SEMRY RICE	IDA	3.0				
7-CAM-AL-01	LIVESTOCK	IDA			3.0		
7-CAM-AN-01	FOOD CROP STORAGE	IDA			3.0		
7-CAM-AP-03	COCOA	IBRD		2.0			
7-CAM-AX-01	AGRICULTURE UNIDENT I	IDA					5.0
7-CAM-DD-01	DFC I	IBRD			3.0		
7-CAM-DD-02	DFC II	IBRD				5.0	
7-CAM-EE-02	EDUCATION II	IDA		7.0			
7-CAM-EE-03	EDUCATION III	IDA				6.0	
7-CAM-II-01	MINING UNIDENT.	IBRD					5.0
7-CAM-PP-01	POWER	IBRD			10.0		
7-CAM-QQ-01	TOURISM	IBRD			2.0		
7-CAM-TH-03	ROAD-DOUALA-PONT	IDA		14.0			
7-CAM-TH-05	ROADS	IBRD			8.0		
7-CAM-TH-06	ROAD CAMEROON-S.CHAD	IDA			8.0		
7-CAM-TH-07	MINING TRANSP.	IDA					8.0
7-CAM-TP-02	PORTS II	IDA		12.0			
7-CAM-TR-02	CAR-CAMEROON RAILROAD	IBRD				12.0	
7-CAM-UX-01	URBAN DEVELOPMENT	IDA			5.0		
7-CAM-WW-02	WATER SUPPLY II	IDA				5.0	
7-CAM-WW-03	WATER SUPPLY III	IBRD/I					10.0

	1964-68	1969-73	1972-76
IBRD	7.0	42.1	52.0
IDA	11.6	55.0	84.0
TOTAL	18.6	97.1	136.0
NO	2	12	21

	1972	1973	1974	1975	1976
IBRD		2.0	23.0	17.0	10.0
IDA	3.0	33.0	19.0	11.0	18.0
TOTAL	3.0	35.0	42.0	28.0	28.0
NO	1	4	8	4	4

LENDING PROGRAM (11/ 5/70)

	1964-68	1969-73	1972-76
IBRD	7.0	46.1	29.0
IDA	11.6	41.0	58.0
TOTAL	18.6	87.1	87.0
NO	2	12	15

	1972	1973	1974	1975	1976
IBRD		2.0	8.0	2.0	17.0
IDA	3.0	19.0	13.0	15.0	8.0
TOTAL	3.0	21.0	21.0	17.0	25.0
NO	1	3	4	4	3

P & B 10/28/71

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

November 9, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Turkey - Erdemir Steel Plant Expansion Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated November 9, 1971 from the Europe, Middle East and North Africa Department, entitled "Turkey - Proposed $75 Million Loan for the Erdemir Steel Plant Expansion Project" (LC/O/71-122).

2. Comments, if any, should be sent to reach Mr. Nijhof (ext. 4809) by 5:00 p.m. on Friday, November 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.

Dag F. Wittusen
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)

CONFIDENTIAL

LC/0/71-122

November 9, 1971

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa Department

TURKEY - Proposed $75 million loan for the Erdemir Steel Plant Expansion Project

1. Attached for consideration by the Loan Committee is the Appraisal Report (PI-13) dated October 15, 1971, on the Erdemir Steel Plant Expansion Project (Erdemir). The proposed loan would be the first direct Bank lending operation in Turkey's industrial sector where Bank assistance has since 1950 been channeled through eight loans and credits made to the Industrial Bank of Turkey (TSKB). Four other operations are planned for FY 1972 in the fields of irrigation (a $20 million rehabilitation project was submitted to the Loan Committee on October 22), livestock ($15 million), fertilizer ($23 million) and urban development in Istanbul ($25 million). The five-year lending program is attached.

2. The findings of a Bank mission which visited Turkey in April 1971 were reported in a "Memorandum on the Current Economic Position and Prospects of Turkey" (EMA-40a) dated July 19, 1971. Reference to the current economic situation is also made in the Turkey CPN dated September 8, 1971.

Background

3. The project for which financing from the Bank - as well as from Eximbank and USAID - is sought aims at doubling to 1,800,000 tons of ingot equivalent the capacity of Erdemir's plant, which was completed in 1965 and now has a capacity (in place or under construction) of 900,000 tons. The project also provides for an increase from 500,000 tons to 915,000 tons of Erdemir's production of flat steel products, in which the company specializes. The project is Stage I of Erdemir's expansion plans. Stage II is contemplated for the mid-1970's and would expand further rolling facilities when the market justifies it.

4. When the project was first submitted to the Bank in 1969, our position was that serious consideration would be given to the project only if the expansion proposals would make it possible for the finished product to be sold locally at prices not much higher than landed import prices in Turkey. The expansion was expected to reduce the plant's high initial cost per ingot ton produced resulting from both uneconomic size and procurement of most of the equipment from the suppliers - founders (Koppers, Westinghouse and Blaw Knox). However, the expansion appeared to necessitate considerable financial restructuring of the Company's heavy debt burden to make it creditworthy for the proposed substantial new borrowing. In agreement with AID, the main lender for the initial plant, the Bank agreed with the Government and Erdemir that a comprehensive study of the project covering the key issues involved should be carried out. The study (by U.S. Steel Engineers and Consultants, Inc.) was received in the Bank in November 1970 when the Government formally endorsed Erdemir's application for parallel financing by the Bank and Eximbank with, possibly, a small AID share in the financing. The study, together with the impact on Erdemir's operations of the August 1970 devaluation of the Turkish lira, confirmed that, provided substantial changes were introduced in the company's financial structure, the expansion appeared justified on technical and economic grounds and would make it possible to maintain prices for domestically produced steel at an acceptable level in comparison both to prices in major producing countries and to import prices in Turkey.

5. The basic features of the project which have a bearing upon the Bank's participation in its financing are brought out in the attached Appraisal Report. This memorandum is intended to highlight and comment upon the following key issues: (a) Erdemir's competitive position; (b) financial and corporate structure; and (c) parallel financing arrangements.

Project Issues

6. Erdemir's competitive position. The Appraisal Report projects that flat steel demand in Turkey will grow at the rate of 10-11 percent over 1970-80 (Annex I, para 27) against an actual growth of 13 percent per year in 1967-70. These projections assume a cumulative growth in GNP of 7 percent per year over the decade, as well as increased competitiveness of the Turkish steel-using industries in both the domestic and export markets, especially vis-a-vis the members of the European Economic Community (EEC) to which Turkey is associated. However, a growth rate for GNP of less than 7 percent - and for flat steel demand of less than 10 percent - cannot be ruled out considering Turkish economic and political conditions and their impact on private sector activity and variations

in total output, especially agricultural production (a bumper crop in 1971 is, however, likely to result in an 8 percent growth in GNP). Considering this, the project allows for a shortfall in relation to the projected growth rate for steel. The crucial year for Erdemir would be 1976 when the plant will reach its full Stage I capacity for flat steel. The projected sales in that year (870,000 tons) assume that the market would grow in 1970-76 at the rate of 8.8 percent annually, that imports would continue to be regulated through quotas, and that the small flat steel production at the existing Karabuk plant would be discontinued. Demand for flat steel in 1980 as projected in the Appraisal Report would be substantially above the flat steel capacity of Stage I, thus leaving ample room for imports or for an early implementation of Stage II.

7. Erdemir prices at the exchange rate prevailing before the August 1970 devaluation were substantially higher than those of equivalent imports and its output was sold under the protection primarily of quantitative restrictions on imports. The present expansion project would lower Erdemir's costs of production and sale from $161 per ton in 1972 to $126 in 1976 (para 8.01). Assuming that Erdemir prices remain at the level established by the 25 percent increase introduced in July 1971 ($161 per ton) and that world market prices remain also at their 1971 level ($144), i.e. are not increased following currency revaluations, the excess of average domestic over average import prices would be about 12 percent representing an "effective" protection on domestic value added of 22 percent, an acceptable level for Turkey (para 10.06). The level of effective protection would be substantially reduced if account were taken of the possible effect of revaluation of currencies on European and Japanese export prices (para 10.09). While the present competitive position in the European and Japanese steel industries is not likely to allow an increase in export prices in the immediate future, it is likely that upward price pressures on export prices will occur in the longer run. Any future devaluations of the Turkish Lira would reduce further the protection.

8. The project has been conservatively tailored to meet future demand at prices reasonably close to import prices. The domestic market for flat steel products has so far been sheltered by import duties ranging up to 30 percent and, more importantly, by strict quantitative restrictions. Turkey's association agreement with the EEC provides for a gradual relaxation over twenty-two years of duties and quotas for imports from the EEC area. These provisions are not expected to affect in the early part of the transition period products for which Turkey will need time for competitive adjustment, especially steel products and steel-using manufactures. The quantitative restrictions would thus remain the key feature of the protective system in coming years. While these restrictions would be necessary for some period to help Erdemir establish itself in the market and to protect it especially against dumping, they

should not allow Erdemir to increase its prices unduly lest the key objective of the project be lost. I therefore propose, and Industrial Projects Department concurs, that the following points should be discussed during negotiations: (i) clarification of the timetable for and extent of the relaxations of import duties and quotas for steel products provided for under the agreement with the EEC; (ii) agreement with the Government to review the system of import quotas and duties for steel products at the end of the construction of the project; and (iii) agreement on Erdemir's pricing policy including an undertaking that real prices (before the production tax) will not be altered without consultation with the Bank during the construction and start-up period of the project.

9. Another matter which bears upon Erdemir's competitive position relates to the supply of iron ore. The Appraisal Report (paras 5.02 - 5.03 and Table 16) stresses the financial advantages which Erdemir would derive from the use of imported iron ore. While I concur in the recommendation that we should seek the Government's agreement to allow Erdemir to conclude long-term contracts with foreign suppliers for part of its ore requirements, I feel that the economic aspects of use of domestic iron ore should not be overlooked despite its lower quality and the resulting cost penalty to steel plants. From a balance of payments viewpoint, the project with the use of domestic ore for all but 500,000 tons of Erdemir's requirements entails foreign exchange savings of the order of \$60 million per year; the exclusive use of foreign ore would reduce these savings to \$45 million. I therefore recommend, and Industrial Projects Department agrees, that we should seek during negotiations the Government's undertaking to carry out a technical and economic study of the means whereby the production and transport of domestic iron ore could be improved to make it more competitive with imported ore. Such a study would be of importance for Erdemir and for the Karabuk and Iskenderun steel plants as well.

10. Financial and corporate structure. The financial reorganization described in paras. 9.01 - 9.05 of the Appraisal Report would put Erdemir on an acceptable financial footing; it would in particular prevent that the debt/equity ratio and the debt service coverage (Tables 25 and 26) reach unsatisfactory levels during the early stage of operation of the project. In January 1971, financial arrangements somewhat different from those now foreseen were agreed upon in principle by the former Government, and envisaged the conversion of TL 460 million of Government debt into non-voting equity (which would not have changed the legal/corporate structure of the Company) as well as a new Government loan of TL 450 million in the form of subordinated non-cumulative income debentures. Simultaneously, AID had agreed in principle to defer repayments due in the coming

years on some of their previous loans without, however, postponing the final maturities. The new Government which took office last March in Turkey did not endorese the prior agreement for conversion of debt into equity unless it acquired the corresponding voting rights. Both the Bank and AID felt that, given the trend towards nationalization in the new Government, an increase in its share in Erdemir's equity would substantially increase the danger that the Company be converted into a State Economic Enterprise with the accompanying risks to management and efficiency. This arrangement was, therefore, not further pursued.

11. The financial reorganization now envisaged, i.e. the increase in Erdemir's prices approved in July 1971, the Government's agreement to convert its previous main loan of TL 485 million into a 30-year loan with a grace period of seventeen years and to extend a new TL 200 million loan in the form of 7 percent convertible debentures with the same amortization, as well as the rescheduling and subordination of other smaller Government and AID loans, will ease Erdemir's tight financial situation in the next eight to ten years. The situation would be improved further if AID were to consent to subordinating the debt service on its main previous loan of TL 1,656 million (AID Loan A - See attached revised Table 22) so as to give the new loans of the Bank, Eximbank and AID senior ranking in servicing during the possibly difficult initial period of the project. Although AID has so far declined to consider this, I believe that it would be desirable to reduce the Bank's exposure until about 1980; therefore, we intend to request AID to accept this subordination in servicing during this period.

12. It is recognized that under present capital market conditions in Turkey an increase in Erdemir's share capital would not be subscribed by the existing private shareholders, nor by new private investors, thus leading to increased Government control over the Company. Also for the long-term a capital increase would not be required for primarily financing purposes since further expansion of the plant beyond Stage II could be largely financed from retained earnings. Of greater importance than a capital increase is the need to confirm the status of Erdemir which, despite a majority equity ownership by Government, has been established and operated as a private concern, thus serving as an example to the generally inefficient State Economic Enterprises. For that purpose, the Government should be required not to alter Erdemir's present legal status, which enables it to operate as a private corporation, without the Bank's prior consent; nor shall the Company amend its Founders' Agreement and its Articles of Association without such consent, except for the changes in the Board of Directors recommended in the Appraisal Report (para 2.10).

13. Parallel financing arrangements. The financing plan proposed for the project is the result of long discussions with the Government and possible sources of foreign loans in the course of which the Bank's primary concern was to ensure that Erdemir's expansion would be carried out at the least possible cost. Attempts were made to increase the share of untied finance and to broaden the sources of tied aid so as to ensure procurement under the best possible conditions; both the European Investment Bank and Kreditanstalt fuer Wiederaufbau were approached by the Bank but declined to participate in the project in view of their other commitments in Turkey. The possible impact of the currency realignments which may take place during the procurement period cannot be assessed yet. US procurement is likely to prove more competitive than in the past but Erdemir may pay a penalty and would not correct its initial handicaps if the project were financed entirely with tied funds. In any case, AID and Eximbank would not be in a position to finance a larger share of the project than now envisaged. The Bank's participation in the project is therefore essential, and not only to fill the financing gap but also ensure a sound expansion.

14. The procurement procedures envisaged in paras. 7.02 - 7.05 of the Appraisal Report would enable Erdemir to make the best use of the proposed external financing. AID's agreement to finance the lowest US bids emerging from international competitive bidding would, in particular, substantially reduce the impact of tied aid on the project. The Controller's Department has objected to the latter arrangements on the grounds that it may create a possible shortfall in the event that some of the AID funds remain unused, and that the review of invitations to bid, bid evaluations and contract award, when shared between AID and the Bank, may constitute a source of dispute. I believe, and Industrial Projects Department concurs, that workable arrangements can be reached with AID and Erdemir in this regard, especially to prevent a shortfall in the use of the AID funds, and recommend to proceed on the basis outlined in the Appraisal Report. Procurement procedures will have to be agreed upon with AID prior to negotiations with Erdemir. It is anticipated that special arrangements will be required to satisfy both the Bank's guidelines and AID's policies, e.g. as regards shipping and insurance. We intend to propose that the Bank should have the overall responsibility for supervising international procurement for the items to be financed alternatively under the AID and Bank loans until the Bank loan is exhausted.

Recommendation

15. I recommend that the Bank invite the Government of Turkey and Erdemir to send representatives to negotiate loan and guarantee agreements along the lines of the recommendations contained in paragraphs 11.01 and 11.02 of the Appraisal Report and in paragraphs 8, 9, 11, 12 and 14 of this memorandum.

Dieter Hartwich
Deputy Director

Attachment

TURKEY - Proposed Lending Program 1971 - 1977

($ millions)

		Fiscal Years								
		1971	1972	1973	1974	1975	1976	1977	Total 1969-73	Total 1973-77
Agricultural Credit I	IDA			20						
- " - II	IDA					25				
- " - III	IDA							30		
Fruit-Vegetable I	(IBRD	10								
- " - I	(IDA	15								
- " - II	IDA				20					
- " - III	IDA						30			
Irrigation Rehabilitation I	IBRD		20							
- " - II	IBRD				20					
- " - III	IBRD						15			
Ceyhan-Aslantas	IBRD			55						
Lower Firat	IBRD						50			
Livestock I	IDA	4.5								
- " - II	IDA		15							
- " - III	IDA				20					
- " - IV	IDA						25			
Agriculture Unidentified I	IBRD				20					
- " - II	IBRD						20			
- " - III	IBRD							15		
DFCs - TSKB VIII	IBRD	40								
- " - IX	IBRD			45						
- " - X	IBRD					50				
- " - XI	IBRD							60		
DFCs - Second Co. I	IBRD				15					
- " - II	IBRD						15			
Education I	IBRD	13.5								
- " - II	IBRD			10						
- " - III	IDA					10				
Industry - IGSAS Fertilizer	IBRD		23							
- Erdemir Steel	IBRD		70							
- Paper Mill-Forestry	IBRD			25						
Industry & Mining Unident. I	IBRD				30					
- " - II	IBRD						25			
Power - TEK I	IBRD	24								
- " II Elbistan	IBRD				50					
- "III Lower Firat	IBRD					45				
- " IV Unidentified	IBRD							20		
- Cukurova IV	IBRD	7.0								
Tourism I	IBRD			5						
" II	IBRD				15					
" III	IBRD						20			
Railways I	IBRD			35						
" II	IBRD					40				
" III	IBRD							40		
Urbanization I (incl. water & power)	IDA		25							
" II (incl. sewerage)	IDA			20						
" III Unidentified	IDA					20				
" IV "	IDA							25		
Operations Program	IBRD	-	113	175	150	135	145	135	456	740
" "	IDA	-	40	40	40	55	55	55	111.5	245
	Total	-	153	215	190	190	200	190	567.5	985
	No	-	5	8	8	6	8	6	23	36
Lending Program	IBRD	94.5	100	120	100	85	95	95	388	505
" "	IDA	19.5	40	40	40	55	55	55	111.5	245
	Total	114.0	140	160	140	140	150	150	499.5	750
	No	6	4	7	7	5	6	5	21	30

ERDEMIR

Proposed Debt Restructuring
(TL Million)

	Amount Outstanding as of Dec. 31/70	Rate of Interest %	Last Principal Repayment Due Year	Proposed Restructuring
Foreign Exchange Loans				
Unchanged Loans:				
1. AID - Loan B	472.7	5.75	1981	-
2. Chase - Debentures	15.0	7.0	1971	-
3. French Loan	6.2	6.0	1980	-
4. AID - Interim Expansion Loan 1/	116.3	5.75	1988	-
5. AID - Sinter Loan 1/	13.6	6.0	1985	-
Restructured Loan:				
AID - Loan A	1,656.1	5.75	1986	Deferral of principal repayments totalling TL 193.5 million and due in 1972 and 1973 and amortization over remaining loan period.
Turkish Lira Loans				
Unchanged Loan:				
GOT - Dividend Advance 2/	5.9	-	-	-
Restructured Loans:				
1. GOT - Construction Loan	484.6	5.75	1986	Consolidation into 30 years with 17 years of grace (repayments commencing 1988) and capitalization of interest until 1976.
2. AID - Cooley Loan	119.0	8.0	1986	Deferral of principal repayments and capitalization of interest to 1976 and amortization over remaining loan period. Subordination of debt service.
3. GOT - Special Fund	96.2	6.65	1986	
4. GOT - "G" Fund	26.9	8.0	1986	
5. GOT - Interim Expansion and Sinter Loan	3/	7.0	1985	

1/ Loan repayable to GOT in TL on US$ equivalent.
2/ Dividend Advance repayable to GOT if company declares dividend of 10% or higher.
3/ Loan of TL 75 million not drawn down as of December 31, 1970. Withdrawals commenced in 1971. Interest payments will be deferred for 5 years and principal repayments for 3 years, i.e. both will commence in 1976.

Industrial Projects Department
October 14, 1971

TABLE 22

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/71-44

November 8, 1971

Minutes of Special Loan Meeting to consider "India - Haryana Agricultural Credit Project" (Credit 249-IN) and "India - Tamil Nadu Agricultural Credit Project" (Credit 250-IN) held on October 29, 1971 in Conference Room B.

1. Present: Messrs. Cope (Chairman), Williams, Broches, Chadenet, Ripman, Votaw, Wapenhans, Cabezas, House, Kraske, Scott, Spall, Thomas, Walden and Wittusen (Secretary).

2. Issues: The meeting was called to consider three memoranda on the procurement procedures in the Haryana and the Tamil Nadu Agricultural Credit Projects, Mr. Thomas's memorandum to Mr. Scott dated October 22, 1971, Mr. Scott's memorandum to Mr. Nurick dated October 26, 1971, and Mr. Votaw's memorandum to Mr. Cope dated October 28, 1971. The date of effectiveness of the two projects had been postponed by one month to October 30, 1971 to allow the Government sufficient time to comply with certain conditions. These conditions had now been fulfilled but a new problem had arisen in the form of a recent Government of India Order, the "Tractors (Distribution and Sale) Control Order, 1971," whose provisions appeared to conflict with the procurement procedures which had been agreed upon during negotiations. Mr. Scott's memorandum, supported by a note from Mr. Broches, advised that the provisions of the Tractors Control Order might lead to the suspension or cancellation of all or parts of the credits, and recommended that the date of effectiveness of the projects be further postponed in order to allow the Government time to clarify or rectify the situation. Mr. Votaw's memorandum on the other hand, recommended that the best interests of these projects would not be served by a further postponement. The issues for discussion were:

- 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)

(i) whether the provisions of the Tractors Control Order were in conflict with the agreed procurement procedures and, if so

(ii) whether to postpone further the date of effectiveness of the projects to allow the Government time to clarify or change its position, in order to avoid any future suspension or cancellation of the credits.

3. The Tractors Control Order (TCO): The meeting noted that:

(i) The wording of the TCO was inprecise and its intention unclear in several aspects. Without further clarification it was uncertain, although likely in the opinion of the Legal Department, that it would prevent the State Governments from complying with the procurement procedures defined in the Credit Agreements.

(ii) The TCO defined a tractor by referring to a list of 30 specific models. The listing of specific brands was in conflict with the agreed procurement procedures, which stated that the procurement of tractors should be limited only by a prequalification of suppliers by reference to their manufacturing status in India.

(iii) The TCO conferred wide discretionary powers on State Controllers, including the imposition of quotas, which could be exercised in contradiction of the agreed procurement procedures.

(iv) Mandatory provisions of the TCO included maintenance of a register of applicants to be served on a strict order of priority, registration of applicants with defined dealers and the deposit by the applicants of Rs. 500 for each application in a Post Office Savings Account. Each of these provisions appeared to conflict with the agreed procurement and distribution procedures which provided, inter alia, for the channeling of applications through the Agro-Industries Corporations and Banks, the allocation of tractors to IDA beneficiaries irrespective of dealers' priorities, and the down-payment by applicants of 25% of the retail price of the tractor.

(v) The TCO provided for the exemption of certain classes of applicants from its provisions but it was unknown to the Association whether these exemptions could, or would, be applied to IDA beneficiaries.

4. Postponement of Effectiveness: The meeting noted that:

(i) The date of effectiveness of the two projects had already been postponed once, and both the Association and the Government of India were anxious to avoid further delay. The South Asia Department therefore favored declaring the credits effective now and at the same time pursuing discussions with the Government to resolve the procurement issue.

(ii) The tractor components in the combined credits amounted to $22 million out of a total amount of IDA financing of $60 million. Even if the Government remained in violation of the agreed procurement procedures and the tractor components had to be cancelled from the credits, it was maintained that the other elements of the projects would still remain viable.

(iii) A recent supervision mission had reported that Central and State Government officials had noted conflicts between the TCO and the agreed procurement procedures, and that the Central Government was preparing amendments to the TCO exempting tractors financed by IDA.

(iv) The Legal Department, noting that the Association was not legally required to make the credits effective while the borrower was in default under the Credit Agreements, maintained that it would not be appropriate to make the credits effective while a question of this importance was unresolved.

(v) Postponement of effectiveness did not necessarily imply deferrment of implementation of the projects but only of disbursement. In neither project would the authorities be in the position to request disbursement for several months.

5. Decision: The meeting concluded that:

(i) On the basis of para. 3 above, there was much uncertainty about the TCO and its possible conflict with the agreed procurement procedures.

(ii) Therefore, on the basis of the arguments advanced in para. 4(iv) and (v) above, the date of effectiveness of the two credits should be postponed by one month until November 30, 1971.

(iii) The Association should request the Government of India to clarify the effect of the TCO and, in case the TCO remained in conflict with the agreed procurement procedures, press the Government to remove any provisions which conflicted with the agreed procurement procedures.

(iv) The outcome of the discussions with the Government of India should be reviewed during the third week of November, 1971.

6. Postscript: Shortly after the meeting a telex message was received from the Department of Economic Affairs, New Delhi, stating that, after consultation with the Ministry of Law, it was their opinion that the TCO involved no breach of covenant. However, to remove all doubt, it was the Government's intention to introduce an amendment exempting from the TCO all tractors imported under Government and State government schemes. In view of this assurance and after consultation with Messrs. Broches, Chadenet, Votaw and Wapenhans, Mr. Cope agreed that the credits could become effective forthwith. Cables declaring them effective were sent on November 2, 1971.

Dag F. Wittusen
Secretary

AHHouse/DMThomas/DFWittusen:as

Cleared by: Messrs. Cope
Chadenet
Scott
Votaw
Wapenhans

cc: Loan Committee
Participants

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

November 8, 1971

MEMORANDUM TO THE LLOAN COMMITTEE

Korea - Yong San Gang Irrigation Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated November 8, 1971 from the East Asia and Pacific Department, entitled "Korea - Proposed $33 Million Bank Loan and $15 Million IDA Credit for the Yong San Gang Irrigation Project" (LC/0/71-121).

2. Comments, if any, should be sent to reach Mr. Baig (ext. 2387) by 5:00 p.m. on Thursday, November 11.

3. It is planned then, if the Committee approves, to inform the Government that both 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.

Dag F. Wittusen
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

CONFIDENTIAL

LC/O/71-121

November 8 , 1971

LOAN COMMITTEE

Memorandum from East Asia and Pacific Department

KOREA - Proposed $33 Million Bank Loan and
$15 Million IDA Credit for the Yong San Gang Irrigation Project

1. Attached is an appraisal report (PA-109) dated October 25, 1971 recommending a Bank loan of $50 million to help finance the first stage of the Yong San Gang Irrigation Project. The proposed loan was expected to cover the foreign exchange costs, amounting to $43.6 million, and interest during construction, estimated at $6.4 million, of the total project cost of approximately $84 million.

2. Since the appraisal report was written it was decided that $15 million of IDA funds could be allocated for this project. As a consequence, interest during construction would be only $3.4 million on the assumption, which I support, that the IDA funds would be disbursed before the proceeds of the Bank loan. The foreign exchange cost of the project, together with interest during construction thus amounts to $47.0 million. With Bank Group finance restricted to these two elements, as was our original intention, a Bank loan of $32 million and the IDA credit of $15 million would suffice.

3. However, the attached appraisal report does not take into account the possible effect of a de facto revaluation of various currencies, especially the Japanese Yen, in which some of the project expenditures are expected to be made. Currency fluctuations may raise project costs, but not by more than $1.0 million. For this reason I recommend that we proceed on the basis of making a Bank loan up to $33 million and an IDA credit of $15 million and make a final decision on the amount of the loan during negotiations, when we may have a more accurate estimate of the effects of various currency adjustments.

The Economy

4. An economic mission visited Korea in June-July of this year; its report was distributed to the Executive Directors on September 24, 1971. Korea had one of the most impressive records among the developing nations of economic growth during the sixties, and especially in the latter part of the decade when GNP in real terms increased at an average annual rate of more than 11%. Industrialization and a rapid expansion of the economic infrastructure played a leading role in this growth. Agricultural

output, while fluctuating widely with the weather, has progressed satisfactorily by international comparisons, but it has been far outdistanced by industrial expansion. In this rapid growth process, the structure of the economy was transformed from the sluggish agricultural-rural pattern of the immediate post-Korean War years to the dynamic semi-industrialized urban pattern of the present. The per capita income of the population (now 32 million) rose from about $115 in 1965 to $222 in 1970. Income improvements have been unevenly distributed, however, mainly because production in agriculture has lagged behind that in industry.

5. Heavy investment has been required to sustain Korea's economic growth with the investment rate of the economy ranging between 25% and 30% of GNP in the last five years. This has been well beyond Korean saving capabilities, even though during that period the national saving rate has doubled to 16% of GNP in 1970. The problem has been reflected both in heavy and increasing reliance on external capital inflows and chronic difficulties in financial management to meet the investment requirements of the rapidly expanding economy.

6. Following rapid price increases in 1968 and 1969, Korea, under a series of Standby Agreements with the IMF, undertook to limit drastically the scope for domestic credit expansion and to curb the inflow of foreign loans with short and medium-term maturities. The Government has observed these ceilings and consequently, credit expansion has been contained and the structure of Korea's external debt has improved somewhat. Even so, debt service for this year is expected to absorb 21% of foreign exchange earnings.

7. The Government recognizes the need to maintain monetary stability and to keep debt service within manageable limits. The recently announced Third Five-Year Economic Development Plan (1972-76), which was reviewed by the economic mission, proposes substantial expansion and structural change in agriculture and industry and a very large increase in exports within a stable financial framework and a manageable balance of payments. The Plan would maintain a still high but somewhat slower, GNP growth rate of 8.6% a year, a decline in the rate of increase in investment and imports, large increases in domestic saving, and declining net capital inflows within a more or less constant level of gross foreign capital requirements. Debt service is likely to remain at the present level of about 21% for most of the decade. While these are high ratios, they should be manageable for a country with the growth capabilities and consequent favorable economic prospects of Korea. However, to ease the impact of past heavy reliance on medium and short-term debt, and because Korea is still a relatively poor country, assistance on IDA terms continues to be appropriate.

<u>Bank Lending Program</u>

8. As the attached five-year lending program indicates, we intend to support the Government's efforts to develop agriculture while at the same time continuing our past support for infrastructure development. To

date the agricultural sector has received a $45 million Bank loan to help finance an irrigation project and a $7.0 million IDA credit for a dairy beef project. An IDA credit of $10 million for agricultural credit is scheduled for later this year. In view of Korea's continued need for credit at concessional rates, we are planning to provide IDA funds in an amount equal to about one quarter of total Bank Group lending over the next five years.

The Project

9. The Yong San Gang is one of four river basins which are to be developed with large-scale irrigation works under the Government's All Weather Farming Program. The main objective of this program is to boost cereal production through more effective use of Korea's water resources and promote diversification into high value crops. The Government has become very concerned about Korea's growing foodgrain deficit (estimated at one million tons this year) and the extent to which rural incomes are lagging behind those in urban-industrial areas. It is looking to this river basin development, in conjunction with a policy of high support prices for rice and barley, to stimulate grain production and raise rural incomes. The proposed project will provide assured irrigation to 33,000 hectares in a drought-prone area in the southwest portion of the country. It would consist of the construction of dams, reservoirs, irrigation and drainage systems, land consolidation, on-farm development and service roads. The project was prepared with assistance from the IBRD/FAO Cooperative Program and a Japanese team of consultants, Sanyu Consultants International, who have prepared a master plan for the ultimate development of 100,000 hectares in the Yong San Gang river basin. The proposed loan and credit would also provide for the preparation of a feasibility study for the second stage of this plan.

10. With its emphasis on development of both river basin land with rice and uplands with fruits, vegetables and other specialty crops, the proposed project will contribute in an important way to the Government's agricultural development program and is expected to more than double the income of the 45,000 farm families involved. As existing farm holdings are presently fragmented and of irregular shape, they would be consolidated and arranged into uniform tracts to permit efficient use of the irrigation system. At present in the project area, some 24,000 hectares are cultivated with a rice-barley rotation and an additional 9,000 hectares, mainly uplands, are cultivated with vegetables and other crops. Because of the practice of double-cropping, the total area cultivated is presently 50,500 hectares. Rice is the predominant crop, accounting for about half the cropped area and nearly 80% of the value of production. Following completion of the project, the area under rice will remain the same but output will rise as a result of an assured water supply and better drainage. With the increase in the cropping intensity, the total area cultivated will rise to 60,000 hectares. The area cultivated with barley will decline while the area under fruits, vegetables and other specialty crops will rise appreciably to 23,000 hectares. The project is expected to yield an economic rate of return of 13%.

11. As was the case in the Pyongtaek-Kumgang project (Loan 600-KO), water rates charged to the farmers benefiting from new or improved irrigation and reclamation projects would cover the full costs of operation and maintenance (including the cost of agricultural extension services) as well as the repayment of 40% of the capital cost with interest at 3.5% over 35 years. These rates are established by law and related Presidential decrees. On this basis the recovery of project costs would amount to about $100 per hectare per year. These charges are high in relation to similar projects in Korea, but they are justified in view of the high capital cost of the project and I recommend that we again accept the established practice.

12. The Agricultural Development Council (ADC), which has overall responsibility for implementing the project, would be the borrower of the proposed IDA credit and Bank loan. Local expenditures would be met through Government budgetary allocations to ADC while foreign exchange costs would be met initially by the ADC who would be later reimbursed from the Bank Group, except where direct payments would be made by the Bank Group to foreign suppliers or consultants. Following completion of the project, the ADC would operate and maintain the dams and main irrigation and drainage systems while the Land Improvement Associations (LIA's), who presently manage the small partially irrigated areas, would retain responsibility to manage and maintain the systems at the farm level. While the ADC is a competent organization it is not presently geared to administer both the Pyongtaek-Kumgang and the Yong San Gang projects as well as discharging its other functions. I therefore agree with the report's recommendation to engage an experienced consulting firm in order to ensure rapid and sound implementation of the project.

13. Contracts for civil works, equipment, materials and supplies required for the project would be awarded on the basis of international competitive bidding. The tendering of contracts for civil works would be the responsibility of ADC. The tendering of contracts for equipment, materials and supplies would be the responsibility of the Office of Supply of the Republic of Korea (OSROK) which is presently performing similar functions satisfactorily under Loan 600-KO. Because of their procurement by OSROK, equipment, materials and supplies imported under the project would be exempt from customs duties. While the Government has not requested that preference be given to domestic suppliers in evaluating bids for these items, I recommend that we agree to such a request should it be made at the time of negotiations in view of the fact that these items would normally be subject to duty. The estimated foreign exchange costs of the project ($43.6 million) were calculated on the assumption that local contractors would win all civil works contracts since Korea has a large and highly competitive construction industry and that foreign bidders would win the contracts for equipment, materials and supplies. In the event that local bidders would win contracts for the latter, it is estimated that up to $2 million of the proposed credit and loan would be used for local expenditures on account of value added locally. The case for local expenditure financing in Korea has been made in the past and rests on its satisfactory savings performance, particularly the rapid growth and high level of public savings, combined with a scarcity of high priority projects with large foreign exchange components.

14. At $2,500 per hectare, the capital cost per hectare of the proposed project is high by comparison with most other Bank-financed irrigation projects; but with its balanced approach, the present project is well conceived and should receive our support. However, our present rather limited information about the potential of the remainder of the Yong San Gang basin suggests that there may be only very limited scope for the kind of diversification with high value crops that is possible in the present project; the remainder of the basin would essentially be a rice monoculture. Given the likely large capital expenditures required to develop the remainder of the basin, the next stage may not be as attractive as the present project. The feasibility study to be financed under the present loan should provide sufficient information for a more informed judgement about the merits of further development in the Yong San Gang basin.

15. While endorsing the Government's increased emphasis on agricultural development, the recent economic mission to Korea expressed some concern about the policy of pushing towards rice self-sufficiency with a Government-supported rice price considerably higher than the international price. Dependence on excessively high rice prices to increase production and farm income may keep marginal rice lands from better alternative uses and impede the ability of the agricultural sector to meet the rapidly growing demand for non-cereal primary products. In view of these possibly adverse effects on resource allocation in agriculture, and the apparent high capital costs associated with the four river basins development program, there is a need for a review of the Government's present agricultural investment strategies, both within existing rice-growing areas and for the uplands.

16. A survey of the agricultural sector is presently being undertaken by the University of Michigan, financed by U.S. AID. The scope of the survey will be comprehensive in the sense that all major sub-sectors within agriculture will be examined and it will provide some guidelines for future investment in agriculture. However, we understand from discussions with the team leader that time and manpower constraints are such that the survey will not be able to consider the merits of alternative investment strategies within rice-growing areas and in uplands in a manner that would provide adequate guides for our own future investment program in agriculture. The Agriculture Projects Department has agreed to schedule a sector mission for Korea in the early part of FY 1973. The findings of the sector mission, together with those of the feasibility study provided for in the presently proposed loan, will provide an adequate basis for determining our future lending strategy for Korean agriculture.

17. I agree with the recommendations of the appraisal report and propose that the Government of Korea be invited to send representatives to Washington to negotiate an IDA credit of $15 million on the usual terms, and for the reasons given in paragraph 3, a Bank loan of up to $33 million for a term of 30 years, including a six-year grace period.

Attachment

Douglas J. Fontein
Deputy Director

POPULATION: 31.3

GNP PER CAP: $ 222

IVA KOREA - 5 YEAR OPERATIONS AND LENDING PROGRAMS[a]

(BY FISCAL YEAR - AMOUNTS IN $ MILLIONS)

OPERATIONS PROGRAM			1972	1973	1974	1975	1976
6-KOR-AA-01	AGRICULTURE-SEEDS	IDA		4.0			
6-KOR-AC-01	AGRICULTURAL CREDIT I	IDA	10.0				
6-KOR-AC-02	AGRICULTURAL CREDIT II	IDA			10.0		
6-KOR-AC-03	AGRIC.CREDIT 111	IBRD					15.0
6-KOR-AF-02	FISHERIES 11	IBRD				10.0	
6-KOR-AI-02	YONG SAN GANG-IRRIGATION	IBRD	50.0				
6-KOR-AI-03	IRRIG. II YONG SAN GANG	IDA				20.0	
6-KOR-AL-02	LIVESTOCK II	IDA			10.0		
6-KOR-AN-01	WARHOUSES	IBRD		5.0			
6-KOR-CC-01	TELECOMMUNICATIONS	IBRD				15.0	
6-KOR-DD-04	KDFC IV (DFC)	IBRD		35.0			
6-KOR-DD-05	KDFC V (DFC)	IBRD				30.0	
6-KOR-EE-02	EDUCATION II	IDA		15.0			
6-KOR-EE-03	EDUCATION III	IBRD					15.0
6-KOR-PP-01	POWER-HAPCHUN DAM	IBRD			20.0		
6-KOR-PT-01	THERMAL POWER	IBRD			30.0		
6-KOR-QQ-01	TOWRISM	IBRD		10.0			
6-KOR-TH-03	HIGHWAYS II	IBRD			25.0		
6-KOR-TH-04	HIGHWAYS III	IBRD					40.0
6-KOR-TP-01	PUSAN PORT EXPANSION	IBRD		20.0			
6-KOR-TP-02	PORT DEVT. 11	IBRD					20.0
6-KOR-TR-04	RAILWAYS IV	IBRD		20.0			
6-KOR-TR-05	RAILWAYS V	IBRD			20.0		
6-KOR-UT-01	URBAN TRANSPORT	IBRD				30.0	
6-KOR-WE-01	SEWERAGE	IDA					20.0
6-KOR-WW-01	WATER SUPPLY	IBRD			20.0		

	1964-68	1969-73	1972-76		1972	1973	1974	1975	1976
IBRD	5.0	329.5	430.0	IBRD	50.0	90.0	115.0	85.0	90.0
IDA	11.0	69.3	89.0	IDA	10.0	19.0	20.0	20.0	20.0
TOTAL	16.0	398.8	519.0	TOTAL	60.0	109.0	135.0	105.0	110.0
NO	2	17	26	NO	2	7	7	5	5

LENDING PROGRAM (3/22/71)

	1964-68	1969-73	1972-76		1972	1973	1974	1975	1976
IBRD	5.0	277.0	302.0	IBRD	47.0	55.0	65.0	65.0	70.0
IDA	11.0	78.3	98.0	IDA	18.0	20.0	20.0	20.0	20.0
TOTAL	16.0	355.3	400.0	TOTAL	65.0	75.0	85.0	85.0	90.0
NO	2	16	21	NO	4	4	5	4	4

[a] As reported by P & B 10/28/71.

East Asia and Pacific Department
November 3, 1971

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

November 5, 1971

MEMORANDUM TO THE LOAN COMMITTEE

India - Eleventh Railway Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated November 5, 1971 from the South Asia Department, entitled "India - Eleventh Railway Project" (LC/0/71-120).

2. Comments, if any, should be sent to reach Mr. Kraske (ext. 2847) by 5:00 p.m on Wednesday, November 10.

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

Dag F. Wittusen
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
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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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LC/O/71-120 SEP 02 2014

November 5, 1971 WBG ARCHIVES

LOAN COMMITTEE

Memorandum from South Asia Department

India - Eleventh Railway Project

1. I attach a draft appraisal report entitled "Appraisal of an Eleventh Railway Project" (No. PTS-96 dated October 5, 1971) recommending that the Association make a credit to India of US $75 million equivalent.

Background

2. This would be the Bank Group's eleventh lending operation to Indian Railways (IR). The total of the previous six loans and four credits since 1949 to IR amounts to US $631 million, of which about US $125 million has been repaid. The last credit to IR (US $55 million) was approved in 1969, and disbursements have been completed. Other Bank Group lending for transportation in India comprises three loans and one credit for the ports of Calcutta, Madras and Bombay (US $82 million), one credit for roads (US $60 million) and one loan for civil aviation (US $5.6 million now fully repaid). In addition, through the six industrial imports credits approved between 1964 and 1970, a total of about US $130 million has been provided to assist local production of commercial vehicles. A shipping project (US $80 million), and a second highways project are currently under consideration.

Bank/IDA Lending Program

3. During the current fiscal year, three credits to India totalling US $64 million (Pochampad Irrigation, Cochin Fertilizer and Grain Storage) have already been approved which, together with the proposed credit for Gorakhpur Fertilizer Expansion Project (US $9 million) and this credit, would bring the total of IDA commitments to US $148 million by the end of calendar year 1971. A Bank loan of US $60 million for ICICI was signed on October 27, 1971. The lending program for the balance of the year is entirely on the IDA side and includes about US $100 million for agriculture and related sectors - US $70 million for agricultural credit in Mysore and Maharashtra, US $13.5 million for wholesale markets in Bihar, and US $20 million (or more) for Nangal fertilizer. Another US $247 million is envisaged for: family planning (US $12 million); industrial imports (US $75 million); shipping (US $80 million); IDBI (US $20 million); and power transmission (US $60 million). A copy of the latest version of the five-year lending program is attached.

The Economy

4. The April 1971 economic report on India indicated that growth during 1970/71 was likely to be marginally below the estimated 5.3 percent for 1969/70. The report was optimistic that continued growth at around 5 percent can be maintained. This compares favorably with the much lower trend rate of 3.5 percent experienced over the preceding decade, which of course included the recession years of 1966 to 1968. An important potential constraint on future growth, however, is the rapid decline in net aid disbursements, which has resulted from the combination of stagnant or falling commitments, the drawdown of the non-project aid pipeline and mounting debt service obligations.

5. Since the economic report was written, an additional burden has been placed on India's financial resources by the influx of refugees from East Pakistan. Apart from the social and administrative cost inherent in the refugee problem, the budgetary costs may require a reduction in development outlays if substantial humanitarian assistance is not forthcoming from the international community. Thus, the need for rapidly disbursing development assistance has become even more urgent than was indicated in the economic report.

The Project

6. The project consists of new and on-going works in IR's investment program for the three years beginning April 1, 1971 (which complete India's Fourth Five-Year Plan), and is a continuation of the previous IDA financed railway project, which covered the first two years of the Plan. It will enable IR to meet projected increase in demand for freight and passenger traffic of 4 percent and 3 percent per annum respectively and to continue modernizing the system to the extent permitted by the availability of funds. The three-year investment program will cost approximately US $1,084 million equivalent, of which 40 percent is for diesel and electric locomotives as well as rolling stock, 42 percent for track renewal and line capacity work, 6 percent for electrification and the balance will be for various minor works. Foreign exchange expenditure of US $170 million equivalent (16 percent of total project cost) included in the project would be devoted primarily (84 percent) to the purchase of raw materials and components required for local manufacture of locomotives and rolling stock. Bilateral loans and credits will provide US $58.3 million and US $11.7 million will come from the Government's other foreign exchange resources. Toward the balance of US $100 million (or 59 percent of total foreign exchange requirements), US $25 million has already been made available by drawings against the Tenth Railway Project (IDA Credit 162-IN) during April to September 1971 and US $75 million would be met from the proposed credit.

7. Procurement under the credit will be by international competitive bidding except for a limited number of components for equipment manufactured in India under license and for certain items which have to be procured from particular sources to facilitate standardization; the total amount for such exceptional items exempted from international competitive bidding is US $17 million.

8. Economic evaluation of the project,as a whole, has not been possible because of the very large number of sub-projects and the uncertainties of the future traffic and capacity. Nevertheless, after making reasonable assumptions regarding these factors, an attempt at an overall evaluation indicates that the program would produce an economic rate of return of about 10 percent. Evaluation of three large sub-projects shows rates of return between 10 and 20 percent, although in one case - electrification of major trunk lines - the return is a mere 6 percent. The evaluation of the electrification project may understate its economic benefits, since several factors which might have improved the electrification results could not be taken into account for lack of certain data. In any case, it would be wrong to argue that the Indian Railways should not complete the electrification projects which are already well under way.

9. The management of IR continues to be sound and the rate of equipment utilization compares favorably with large railway systems in Europe and America. Financial results are satisfactory, with a rate of return on average capital-at-charge at 4.7 percent in 1969/70 and 4.4 percent in 1970/71. Revenues from freight and passenger traffic have been rising at an average rate of 6.4 percent per annum from 1966/67 to 1970/71. However, operating expenses, especially wages, have also risen sharply in these years; they increased by as much as 9.6 percent in 1966/67 and have since gone up by about 7 percent annually on the average. Thus, the operating ratio, i.e. operating costs as a percentage of gross revenues, has risen from 79.5 percent in 1965/66 to 84.4 percent in 1970/71 and net revenues have been insufficient to cover the dividend which IR is obligated to pay to the Government. The main reasons for the increase of the operating ratio have been the unexpectedly slow growth of profitable freight traffic at the same time as passenger traffic, which is subsidized by other operations, has grown steadily. Furthermore, IR has not been able to compensate fully for wage and other cost increases through upward adjustments of rates because of the opposition by the Parliament.

10. An operating ratio of 80 percent was agreed as an appropriate target figure for IR's performance under the last railway credit (162-IN). On July 1, 1971, IR increased its rates and these adjustments should result in the operating ratio declining to about 80 percent by the end of IR's fiscal year 1973, provided that substantial further increases in salaries and wages, likely in 1972, are covered by further rate adjustments as proposed for the next Budget (to be presented in February 1972).

11. In assessing IR's financial performance, IR's role in the economy must be taken into account. IR's dividend to the Government represents about 3 percent of the Government's total current and capital receipts. IR also generates sufficient internal resources to finance 48 percent of its capital expenditures. More importantly, IR retains a vast labor force (about 1.35 million); a large number of these employees are clearly redundant, and more would be made so if IR had a free hand in adopting a higher level of mechanization. In addition to the payroll cost of this labor, IR has to provide social services to its employees and their families (about seven million people). These requirements are essentially social and political. During negotiations we propose to ask IR to identify in their annual accounts the cost of these "welfare payments" as well as the financial burden imposed on IR through the operations of unremunerative rail services. Data required to provide this information on an annual basis are available from IR's accounts (Annex 14 of the appraisal report).

12. The appraisal report deals at length with the vexed question of transport coordination and the closely related issue of long-term investment planning in the transport sector. These questions have been the subject of discussions with the Government on several occasions in recent years, including the last three negotiations for railway financing. The Government is aware of the need for effective transport planning and coordination and of our keen concern to see progress in this area. Railway planning has up to now been carried out in five-year stages and has, consequently, been concentrated on short-term development. The proper determination of long-term objectives and investment priorities requires a corporate plan looking forward about fifteen years, as a framework for more specific five-year investment plans. IR has already agreed to embark on the preparation of such a long-term investment plan, and the details of next steps in this process would be discussed during negotiations. We will also discuss the steps to be taken by other agencies of Government to ensure effective coordination between different transport services and more balanced long-term investment programs for the different modes. I understand that the Government is sending the Special Assistant of the Minister of Planning, who has the rank of a Joint Secretary, as a member of the negotiating team. This should enable us to reach an understanding on what needs to be done in the area of general transport policy and planning.

13. There is an element of retroactive financing proposed in the project, to which I should like to draw your attention. At the time when the proposed railway project was first scheduled, it was envisaged that disbursements of the proposed credit would follow immediately on the previous credit (162-IN), which was closed on September 30, 1971. But, we were unavoidably delayed in completion of the appraisal. As a result, some expenditures on items included under the proposed credit will almost certainly be incurred before the credit is signed. The Government may, therefore, ask us to consider a small amount of retroactive financing, and I propose we should agree to such a request, if it is made.

Recommendation

14. I recommend that representatives of the Government be invited to negotiate an agreement for a US $75 million credit substantially along the lines of the recommendations made in the appraisal report.

Gregory B. Votaw
Deputy Director
South Asia Department

Attachments

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

INDIA - FIVE-YEAR LENDING PROGRAM

		($ millions)								
				Fiscal Year				Total	Total	Total
		1972	1973	1974	1975	1976	1977	1964-68	1969-73	1974-77
Agric. Credit - Mysore	IDA	40.0								
Agric. Credit - Maharashtra	IDA	30.0								
Agric. Credit - Uttar Pradesh	IDA		25.0							
Agric. Credit - Bihar	IDA		30.0							
Agric. Credit - Punjab II	IDA		30.0							
Agric. Credit - Madhya Pradesh	IDA		30.0							
Irrigation - Pochampad	IDA	39.0								
Irrigation - Tawa	IDA		43.0							
Irrigation - Jayakwadi	IDA		20.0							
Irrigation - Pamba	IDA		15.0							
Irrigation - Krishna	IDA		30.0							
Irrigation - Kuttiyadi	IDA		5.0							
Grain Storage	IDA	5.0								
Bihar Marketing	IDA	12.5								
Apple Processing	IDA		9.0							
Lake Chilka Fisheries	IDA		10.0							
Agric. Unidentified	IDA		25.0							
Agric. Unidentified (7 projects)	IDA			165.0						
Agric. Unidentified (10 projects)	IDA				270.0					
Agric. Unidentified (10 projects)	IDA					270.0				
Agric. Unidentified (10 projects)	IDA						270.0			
Telecommunications V	IDA		40.0							
Telecommunications VI	IDA			40.0						
Telecommunications VII	IDA				40.0					
Telecommunications VIII	IDA					40.0				
Telecommunications IX	IDA						40.0			

INDIA - FIVE-YEAR LENDING PROGRAM

($ millions)

(Continued)		1972	1973	Fiscal Year 1974	1975	1976	1977	Total 1964-68	Total 1969-73	Total 1974-77
Education - Agric. Universities	IDA		20.0							
Education Unidentified	IDA				20.0					
DFC - ICICI IX	IBRD	60.0								
DFC - ICICI X	IBRD			50.0						
DFC - ICICI XI	IBRD					50.0				
DFC - IDBI	IDA	20.0								
Fertilizer - Cochin	IDA	20.0								
Fertilizer - Nangal	IDA	20.0								
Fertilizer - Gorakhpur	IDA	9.0								
Fertilizer - Tata	IBRD			25.0						
Iron Ore - Marcona	IDA		40.0							
Industrial Imports VII	IDA	75.0								
Industrial Imports VIII	IDA		75.0							
Industrial Imports IX	IDA			75.0						
Industrial Imports X	IDA				100.0					
Industrial Imports XI	IDA					100.0				
Industrial Imports XII	IDA						100.0			
Industry - Unidentified	IDA		20.0							
Industry - Unidentified	IDA			20.0						
Industry - Unidentified	IDA				20.0					
Industry - Unidentified	IDA					20.0				
Industry - Unidentified	IDA						20.0			
Family Planning	IDA	12.0								
Power Transmission III	IDA	60.0								
Power - Unidentified	IDA			15.0						
Power - Unidentified	IDA				60.0					
Power - Unidentified	IDA					60.0				
Power - Unidentified	IDA						60.0			

INDIA - FIVE-YEAR LENDING PROGRAM

		($ millions)								
				Fiscal Year				Total	Total	Total
(Continued)		1972	1973	1974	1975	1976	1977	1964-68	1969-73	1974-77
Water Supply - Bombay	IDA		30.0							
Water Supply - Unidentified	IDA			15.0						
Water Supply - Unidentified	IDA				15.0					
Shipping I	IDA	80.0								
Shipping II	IDA		80.0							
Highways II	IDA		30.0							
Railways XI	IDA	75.0								
Transportation - Unidentified	IDA			45.0						
Transportation - Unidentified	IDA					55.0				
Tourism - Unidentified	IDA				10.0					
Tourism - Unidentified	IDA					10.0				
Unallocated	IDA				20.0		50.0			

	IBRD	60.0		75.0		50.0		159.0	140.5	125.0
	IDA	497.5	607.0	375.0	555.0	555.0	540.0	591.0	1,727.9	2,025.0
	Total	557.5	607.0	450.0	555.0	605.0	540.0	750.0	1,868.4	2,150.0
	No.	15	21	15	18	17	15	11	51	65
Note: the IDA lending program is to be adjusted to --		375.0	375.0	375.0	540.0	540.0	540.0		1,373.4	1,995.0

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

November 4, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Sierra Leone - Integrated Agricultural Development Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated November 4, 1971 from the Western Africa Department, entitled "Sierra Leone - Proposed Integrated Agricultural Development Project" (LC/O/71-119).

2. Comments, if any, should be sent to reach Mr. Blinkhorn (ext. 4788) by 1:00 p.m. on Wednesday, November 10.

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

Dag F. Wittusen
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

Copies for Information:

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

CONFIDENTIAL

LC/0/71-119

November 4, 1971

LOAN COMMITTEE

Memorandum from the Western Africa Department

SIERRA LEONE: Proposed Integrated Agricultural Development Project

Introduction

1. Attached is an Appraisal Report (No. PA-104), dated September 13, 1971, recommending a Credit of US$5.7 million equivalent to the Government of Sierra Leone to help finance an integrated agricultural development project in the Eastern and Southern provinces of the country. The proposed credit would be the Bank Group's first lending for agriculture in Sierra Leone. The project was appraised in February/March 1971. Distribution of the appraisal report was deferred pending discussions with the Sierra Leone delegation to the Annual Meetings on the Bank's economic policy and other conditions for proceeding with this project (see paragraphs 3 and 14 below).

2. Bank Group lending to date has totalled US$17.9 million. Attached is a proposed lending program for 1972-1977 which has been prepared for the Country Program Review to be held in November. In January 1970, a credit of US$3 million was approved for an education project, progress on which is generally satisfactory. The last Bank Group operation was a US$3.5 million credit and a US$3.7 million loan in October 1970 for the construction of the Bo-Kenema road and the procurement of highway maintenance equipment. This project has encountered difficulties. Tenders received for road construction are well above original cost estimates and, in the case of highway maintenance equipment, the Government has not complied with the Bank's procurement guidelines in the tendering process and in the proposed award of contracts. The Bank is reviewing these problems in detail in the field with the help of consultants. Even if a satisfactory solution can be found, the project will be substantially delayed.

3. The power sector is another problem area. The second power project for which the Bank provided a loan of US$3.9 million in August of 1968 is almost completed, although behind schedule. The Electricity Corporation has experienced managerial, financial and institutional problems caused by government interference in day-to-day management, arrears on government accounts, difficult labor relations and an acute shortage of senior engineering and accounting staff. The Bank has repeatedly pressed for remedial action by the Government. The problems

were discussed again at the Annual Meetings, and the Government has been informed that progress in resolving these issues would be a prerequisite to negotiation of the proposed Integrated Agricultural Development Project.

The Economy

4. Sierra Leone's economic and financial position has deteriorated considerably in the past year due to a recession in the diamond market, political instability and imprudent fiscal and debt management. Declining budget revenues, on account of the diamond recession, coupled with sharp increases in current expenditures, due to higher defense and police outlays necessitated by political instability, led to a budget deficit on current account for the first time in several years. Development expenditures dropped sharply and were almost entirely financed by domestic and external borrowing. The new wave of supplier credits represents a breach of understanding with the Government, reached in September 1970, to limit new short and medium term external borrowing to US$2 million per year. As a result, external debt service payments, together with internal debt service, will continue to exert a heavy burden on the budget, absorbing close to 20 percent of estimated current revenues in 1971/72.

5. Despite the deteriorating fiscal position and the increase in short-term indebtedness, Sierra Leone's balance of payments position remains basically sound. The decline in diamond exports contributed to a larger current account deficit in 1970, but the net foreign capital inflow was sufficient to cover this deficit, making it unnecessary to draw significantly on foreign exchange reserves.

6. Economic and financial prospects over the next several years seem moderately favorable at best, even if internal and external financial management improves. The diamond market is slowly recovering and the political situation seems to be stabilizing. GDP is expected to grow at an average annual rate of about 3 percent over the next years, compared with an annual population growth rate of 2.4 percent. The most important constraints on growth are the limited export prospects, a low public savings potential and shortage of identified and prepared projects.

7. While constraints such as the limited export prospects are largely beyond the control of the Government, there is considerable scope for improved policy performance in most other respects. In fact, Bank lending is conditional upon satisfactory action by the Government in external debt management, in mobilizing domestic resources, in centralizing economic decision-making and in mounting a serious planning effort. The Government is expected formally to confirm its intentions in these respects prior to negotiations (paragraph 14). Further Bank Group lending will depend upon satisfactory implementation of these key policies.

The Project

8. Sierra Leone is giving priority to agricultural development so as to decrease dependence on imported food and to increase production of export crops. The Government aims to diversify and expand smallholder cropping and to stimulate agricultural development in new areas. The proposed project is designed to support this strategy by providing a model for agricultural development, which would help increase production and improve living conditions for about 4,000 subsistence farm families among 50,000 families living in an area of 1.5 million acres in the Eastern and Southern provinces. The project would establish a national institution to provide agriculture credit, project management services and to prepare agricultural projects. In addition, the project would provide funds for the preparation of a similar agricultural project in the northern part of the country.

9. Specifically, the proposed project would include:

(a) Establishing a National Agricultural Development Authority (NADA), responsible to the Minister of Agriculture, to execute the project through a special management unit. NADA would provide agricultural credit and prepare and implement future agricultural development projects.

(b) Planting 710 acres of oil palm to complete a 2,000-acre estate already started by the Ministry of Agriculture, and the first 4,500 acres of a 10,000-acre timber plantation.

(c) Providing smallholders with credits for pesticides, fertilizers and improved high yielding planting materials to clear and bring into rice production up to 13,500 acres of inland swamp, and to plant up to 3,750 acres of cocoa and 2,235 acres of oil palm.

(d) Training project farmers in efficient rice, cocoa and oil palm production techniques.

(e) Constructing a new palm oil mill and 40 small rice mills.

(f) Preparing a feasibility study for an agricultural development project in the north.

10. The proposed project is considered by the Bank to be the best method for providing immediate benefits and for laying a sound basis for continued agricultural development. By full development, it will provide the local market with substantial import substitutes at competitive prices: 9,400 tons of milled rice, 4,200 tons of palm oil, 600,000 cubic feet of timber logs annually, and annual exports of 1,200 tons of cocoa

and 900 tons of palm kernels. Net foreign exchange benefits are estimated to amount to a net present value of almost US$10 million over the 25-year life of the project.

11. The estimated rate of return to the economy is 17%, when no cost is attributed to family labor and hired labor is shadow priced. Costing hired labor at its actual price reduces the rate of return to 14%. Some 4,000 families, comprising about 20,000 people, would benefit from higher incomes under the project. In addition, the project would demonstrate the benefits of improved agricultural techniques, show the value of supervised credit, and integrate agricultural production with essential processing and marketing facilities. Rural employment would be increased at a time when opportunities in mining, particularly alluvial diamond mining, are declining.

12. Estimated project costs total US$7.5 million equivalent; the foreign exchange costs are estimated at US$3.1 million, or 41% of total cost. The proposed credit would finance 76% of project costs, covering all of the foreign exchange costs and 58% of local expenditures. Given Sierra Leone's savings capacity, this percentage of local expenditure financing is reasonable. The remaining 24% of project costs totalling US$1.8 million would be met from government budgetary allocations of US$1.5 million and subscriptions to NADA's equity of US$180,000 by the Bank of Sierra Leone and US$120,000 by the Sierra Leone Produce Marketing Board. Over the four years after completion of the six-year project development period, the Government would have to provide some $1 million in order to bring all cocoa and oil palm acreages and cleared swamps into full development. In addition, the Government is financing recurrent costs for extension services in the project area amounting to US$150,000 a year. Project costs do not include taxes on imported goods. Should the Government require payment of import taxes on items included in project costs, the cost of such taxes would be an additional Government contribution to total project costs. This issue will be discussed with the Government during negotiations.

13. Procurement through international competitive bidding is estimated to total about US$1.8 million. Other purchases amounting to about US$0.7 million would be subject to local competitive bidding with tendering procedures acceptable both to IDA and the Government. The remaining US$5 million includes US$2.0 million for on-farm costs; US$2.3 million for project administration and services; US$0.70 for contingencies and NADA head office costs.

Issues

Economic Policy Measures

14. In September 1971, following a brief economic mission to Sierra Leone, this Department recommended to the Chairman of the Loan Committee, and he concurred, that we proceed with the proposed credit and with any further lending for that matter, only under the condition of improved economic performance. We proposed a program of specific policy measures which was discussed with the Minister of Finance during the Annual Meeting and in principle agreed upon. These policy understandings are: (a) economic policy coordination; (b) limitation of short and medium term external borrowing with an initial freeze of six months on the contracting of any new external debt with maturities of up to 12 years; (c) mobilization of government savings through enforcement of tax collection and tightening of budgetary controls; and (d) development planning leading to the formulation of broad development policy guidelines and the establishment of appropriate planning machinery.

15. We have informed the Government that proceeding with the proposed credit will depend on satisfactory progress in the execution and implementation of these policy understandings. The invitation for negotiations will be issued only after a formal letter has been received from the Government confirming these understandings. Before presentation to the Board, we intend to review with the Government progress in the implementation of key policies.

Project Management

16. Efficient project management is critical to the success of the proposed project. The failure of past agricultural development projects in Sierra Leone is largely related to the lack of local managerial experience. For this reason, the appraisal report recommends the employment of seven expatriates in key positions of both NADA and the project unit, for at least five years. In view of present circumstances in Sierra Leone and the need to build up an important institution and to provide effective management, this judgement is correct. However, if suitably qualified Sierra Leoneans were available for any of the key positions, they would be considered for appointment.

Rice Corporation

17. In 1965, the Government established the Rice Corporation to engage in the production, importation and distribution of rice at controlled prices. The Corporation has a consistent record of failure because of mismanagement and political interference. The Corporation has also incurred substantial losses on milling and marketing of domestic

rice production since its three large mills operate only at about 25% capacity due to poor location. The appraisal report recommends that the Rice Corporation be closed, and that assurances to that effect be obtained during negotiations. Importation of rice should be taken over by the more efficiently operated Sierra Leone Produce Marketing Board, while plans for future milling operations would be prepared in cooperation with NADA.

18. The appraisal report stipulates one condition to be met prior to negotiations: the preparation of a marketing plan satisfactory to IDA covering Sierra Leone Produce Marketing Board's millgate purchase and wholesale distribution of all project-produced palm oil. Agreement on this point was reached during discussions of the appraisal report and related issues with the Government in August. Subject to receiving confirmation from the Government on the economic policy understandings and satisfactory action on the Electricity Corporation, negotiations could start in late November.

Recommendation

19. I recommend that the Association invite representatives of the Government of Sierra Leone to negotiate a credit of up to $5.7 million on the terms and conditions set forth in paragraphs 9.02-9.04 of the appraisal report, after the conditions in paragraph 9.01 and those outlined in paragraphs 3, 14 and 15 have been met by the Government.

Bruce M. Cheek
Deputy Director

Attachments: Appraisal Report (No. PA-104)
Lending Program

SIERRA LEONE : ACTUAL & PROPOSED LENDING THROUGH FY 1971
($ million)

Population : 2.6 million
Per Capita GDP : $166

		Fiscal Year 1971	1972	1973	1974	1975	1976	1977	Total 1964-68	Total 1969-73	Total 1973-77
Integrated Agric. Dev. I	IDA		5.7								
Rhombe Rice	IDA				6.0						
Integrated Agric. Dev. II	IDA					4.0					
Agriculture Unidentified	IDA						4.0				
Agriculture Unidentified	IDA							3.0			
Education I	IDA										
Education II	IDA					5.0					
Power I (King Tom)	IBRD										
Power II (King Tom Expansion)	IBRD										
Roads I (Bo-Kenema)	IDA	3.5									
" I " "	IBRD	3.7									
Roads II (Freetown-Waterloo)	IDA				3.0						
" " "	IBRD				6.0						
Roads III Unidentified	IBRD						4.0				
Operations Program	IBRD		-		6.0	-	4.0	-		7.6	10.0
	No.		-		1	-	1	-		2	2
	IDA		5.7		9.0	9.0	4.0	3.0		12.2	25.0
	No.		1		2	2	1	1		3	6
Lending Program	IBRD	3.7	-		6.0	-	-	-	3.8	7.6	6.0
	No.	1	-		1	-	-	-	1	2	1
	IDA	3.5	5.7		3.0	10.0	4.0	4.0	-	12.2	21.0
	No.	1	1		1	1	1	1		3	4

Western Africa Department
November 3, 1971

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

November 4, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Ghana - Education Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated November 4, 1971 from the Western Africa Department, entitled "Ghana - Proposed Education Project" (LC/O/71-118).

2. Comments, if any, should be sent to reach Miss Mortimer (ext. 4785) by 5:00 p.m. on Tuesday, November 9.

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

Dag F.Wittusen
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

Copies for Information:

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

CONFIDENTIAL

LC/O/71-118

November 4, 1971

LOAN COMMITTEE

Memorandum from the Western Africa Department

GHANA - Proposed Education Project

1. Attached is an Appraisal Report (No. PE 37) dated October 26, 1971, recommending a credit of up to US$8 million to the Government of Ghana to help finance improvements in and selective expansion of the education system. The proposed credit would be the second of three Bank Group operations expected in Ghana in the current fiscal year. A sugar rehabilitation project was considered by the Loan Committee on August 31st, 1971 and is scheduled for negotiation towards the end of November 1971. A road rehabilitation project is currently being appraised. On June 21, 1971 IDA approved a credit of US$7.1 million for the expansion of power distribution facilities, the only Bank Group operation in Ghana in FY 1971.

2. The proposed credit for the education project would be the first for Ghana in this sector. Attached is a table summarizing a proposed 5-year lending program for the period FY 1973-77. It is intended to submit this program for the approval of the President in connection with the next country program review for Ghana in December 1971.

THE ECONOMY

3. An economic mission visited Ghana in April 1971 and its report is almost completed. It is designed primarily as background documentation for the next debt conference between Ghana and her creditors, probably early in 1972. The report focuses on balance of payments prospects, Ghana's debt situation, preparation of a medium-term development plan, sectoral development strategies, as well as on recent developments and performance during the last year. Discussions of the draft report were held in Ghana in mid-September.

4. The conclusions of the mission confirm that Ghana's balance of payments position continues to be a major constraint on development. The recent fall in cocoa prices has exacerbated the situation and further declines are forecast; in addition debt service payments remain heavy. Moreover, the Government's attempt last year to eliminate cumbersome

licensing restrictions on imports led to a substantial increase in imports. At the same time, the Government has made progress towards promoting new exports as well as import substitution. The short term balance of payments outlook remains exceedingly tight, however.

5. In announcing the budget for FY 1972, the Government outlined a number of important policy measures designed to promote agricultural production, to diversify exports and control imports, to raise additional revenues and to check the growth of current expenditures. An increase in the discount rate from 5½ to 8 percent plus various other monetary levies supplement the Government's action on the fiscal and balance of payments side. They conform largely to the measures recommended by the Bank and bilateral donors in connection with the Consultative Group Meeting last December. They are an encouraging sign after a period of indecision in economic management.

6. In the longer term, Ghana's export growth will be slow and its large external financing requirements will have to be met to a great extent by external loans on concessionary terms. Ghana remains only marginally creditworthy for lending on conventional terms in the absence of far-reaching arrangements for rescheduling its medium and long term debts. Local currency financing for Ghana also remains amply justified on balance of payments grounds, and, in view of falling revenues which follow a fall in the cocoa price, on budgetary grounds.

THE PROJECT

Background

7. Ghana's education system, based on the British model, is one of the more developed in Africa. The mainstream of the system is a six-year primary school followed by a four-year middle school during which pupils may try at the end of each year, if they wish, to enter secondary school. The successful candidate then spends five years in secondary school which may be followed either by two more years to reach university entrance or vocational training at a polytechnic college. Those who do not get into secondary school either end their education or may enter a technical institute (craft training), a farm institute, a vocational training centre, or a commercial education course.

8. Enrolment ratios are high up to the end of elementary education and general academic standards on the whole good. The quality, however, declined during 1960-65 when primary education was made compulsory and enrolment more than doubled. In the last five years, Ghana has made considerable efforts to provide the requisite corps of trained primary school teachers and can now afford to scale down teacher training facilities.

9. At the secondary level problems of quantity and quality co-exist; growing social demand for secondary places (there is room for only 11 percent of candidates for secondary entrance) conflicts with an incipient lack of effective demand for the kind of secondary school graduates which the present system produces. A substantial re-orientation of secondary education is planned to attack these problems, but the Government's simultaneous attempt to expand enrolment is on a somewhat ambitious scale, given the current lack of information on manpower demand. However, financial constraints may in fact prevent the expansion from being carried out on the scale envisaged by Government. Related to the re-orientation effort is a parallel attempt to expand and improve the technical and vocational training subsector which has so far been neglected and is relatively ineffective, partly because of the diffused and uncoordinated proliferation of small technical institutions.

10. Like many other countries Ghana has found education costs rising fast and absorbing an increasingly disproportionate share of public funds, estimated at 26 percent of recurrent expenditures in 1970/71. Part of the problem is simple lack of financial control and inadequate budgeting techniques. The University subsector is particularly open to criticism in this respect, but improvements could also be made at the pre-university levels. Review of financial procedures and of competing uses for scarce funds is overdue and provision for such studies is made in the project. In addition, the Government has introduced a Student Loan Fund at the university level to reduce maintenance grants, and is pledged to restrict the number of locations for new school buildings and re-building.

11. A second contribution to high expenditure is the lengthy period taken by the average student to complete his education to secondary school leaving standard: on average, a child does six years of primary school, three years of middle school, which is basically a continuation of primary level curricula, and five years of secondary school (assuming no repeating) to reach "O" level standard. Another two years to achieve university entrance makes 16 years in all. Improvement in primary education should make it possible to take middle school out of the upward progression and reduce the overall length to ten or eleven years, with consequent improvements in efficiency. The Government has in fact now announced its intention to initiate a major reform of the education system; the five-year lower secondary cycle would be reduced to four years and, eventually, all admission to secondary school would be directly from primary school. The middle schools would thus be eliminated as a path to secondary schools and would be reoriented toward practical training appropriate to a terminal cycle of schooling. These objectives are commendable and the project will include technical assistance to aid the planning required to execute the reform.

Project Components

12. Against this background the project has been designed to include the following components addressed mainly to the problems of primary school teaching quality and to technical education at various levels:

(a) Primary teacher training - twelve colleges (including one to be constructed under the project) will be improved to form the nucleus of the new, consolidated teacher training system. Fellowships will be included to train instructors in the teaching of modern reading-teaching methods, at present a major weakness in Ghanaian primary education.

(b) Secondary technical schools - five new secondary schools and three converted institutions will be established to form the nucleus of the re-orientation of secondary education away from purely general education. Technical assistance for setting up the new curricula has been requested from the U.K.

(c) Polytechnics - three existing polytechnics will be equipped with facilities for providing technician training. Technical assistance is included to help upgrade the polytechnic teachers and the technical teachers required for the new secondary schools.

(d) Technical institutes - two existing technical institutes will be equipped with new facilities and equipment to provide various types of craft training to students not entering secondary school. This exercise will consolidate craft training for juveniles in two institutes and eliminate present unsatisfactory courses being provided in the other five institutes, which will be converted to a number of other educational purposes.

(e) Vocational Training Centres - the existing Accra Technical Training Centre and a new one to be built with Canadian aid in Kumasi will be supplemented by the construction of a new center at Takoradi and the conversion of a technical institute in Tamale to a vocational training center. These centers will give training in various trades to adults in day classes or evening classes and to students not entering secondary school. The Takoradi Center will also serve as an experimentation base for new trade training programs and trade standards being devised by the Government with the assistance of an ILO/UNDP vocational training project, a second phase of which has been requested from the UNDP which would cover the training of counterparts for the new center.

(f) Facilities for teaching agriculture, including farm equipment will be provided in fourteen secondary schools which have the necessary land.

(g) Five farm institutes will be provided with equipment to enable them to give short, residential courses to practising farmers. This is a pilot project for Ghana with important prospects for future expansion. Technical assistance to organize the courses is included.

(h) Mobile skill promotion units - six of these will be provided to the National Service Corps, a public organization devoted to promoting self-help projects mainly in the rural areas, to enable it to give on-the-job craft training in the course of projects which it supports. This is a pioneering scheme both for Ghana and the Bank. Technical assistance will also be provided in this case to help organize the use of the units and complete the training of the instructors who will use them.

(i) Education systems study - a comprehensive review of pre-university and university education finance with a view to economizing and streamlining financial procedures, is considered a necessity to the continuous improvement and selective expansion of the education system. To this end two studies will be carried out.

(j) Educational Reform Planning - technical assistance for the planning of the proposed educational reform is included.

Project Implementation

13. The project will be administered by a project unit in the Ministry of Education. The Ministry of Agriculture would appoint a part-time liaison officer to deal with the farmer training courses, for which it is responsible, and the National Service Corps will deal directly through the Project Unit.

14. All contracts for construction and for supply of furniture and equipment would be subject to international competitive bidding. Bidding by Ghanaian and locally based foreign firms is very likely for construction and furniture contracts. In this case the domestic manufacturers would be accorded a margin of preference equal to the existing rate of customs duty or 15 percent of c.i.f. prices, whichever is the lower.

Financing

15. Total project cost, excluding duties and taxes, is estimated at US$13.7 million including foreign exchange costs of US$7.5 million or 55 percent of total cost. The proposed IDA credit of US$8 million would finance 58 percent of total project cost. It is expected that other agencies will provide an amount of up to US$800,000 representing the foreign exchange cost of the technical assistance component. This would bring total external financing to 64 percent of total project cost.

The U.K., Canada and UNDP have expressed interest in financing various parts of the technical assistance requirements; the arrangements Ghana will make with these donors will be confirmed at negotiations.

16. On the assumption that the entire amount of US$800,000 would be provided from these sources, the proposed credit would finance 90 percent of the foreign exchange costs, and 21 percent of the local costs. This level of local currency financing is modest and well justified on balance of payment and budgetary grounds. If, on the other hand, financing for part or all of the technical assistance fell short, it is proposed to cover these costs out of the proposed credit. In the extreme case of no external financing except from IDA, the credit would cover the full foreign exchange costs of US$7.5 million and only 8 percent of local costs. The Government's contribution would then be correspondingly more onerous, namely, 42 percent of total cost, which would warrant reconsideration of the size of the credit to make up for any shortfall from other sources.

ISSUES

Reform of the Education System

17. The central issue is the securing of a reform of the system which will both shorten the period taken to complete the whole upward progression and also replace the current middle school with suitable terminal education for those leaving primary school but not continuing to secondary school. The Government agrees on the need for such a reform and has made some initial proposals (see above paragraph 9). The elements specifically regarded as crucial for the project are two:

(a) That the reform as it affects secondary schools would not leave the project schools at this level requiring substantial alteration when built; and

(b) That the restriction of secondary school entrance candidates to those in the last year of primary school (and not those in middle school) take place within the fastest feasible space of time, estimated to be 1975. This measure is regarded as the easiest and most obvious improvement to the economic and educational efficiency of the system available to the Government and one which we should promote energetically.

18. To guard against the first contingency, the Government has been requested to bring to negotiations a statement, to form the basis of an agreed letter of intent, of the nature of the proposed reform and the timetable for its implementation. If, as expected, the proposal is to reduce secondary schooling from five to four years, project schools can

be built essentially as designed at present. On the other hand, if the course were to be three years, for example, the project secondary schools as presently designed would need substantial alterations. The Government letter of intent agreed upon at negotiations would have to be signed before Board presentation. The Government is not expected to find difficulty in describing the proposed new structure but may object to setting too detailed a timetable at this juncture, in view of uncertainties which may have to be resolved only at the planning stage, and of the Government wish for extensive public debate on the reform.

19. On the second issue, the elimination of middle school candidates from secondary school entrance, the basic principle is agreed. However, the timing proposed in the Appraisal Report is based on an immediate effort to improve the education of children who will be halfway through primary school at the beginning of the 1972/73 academic year, so that by 1975 they will be ready to take secondary school entrance in the last year of primary school without entering middle school. The Government has held the view that to achieve this quality of primary school leavers one must start with children at the beginning of their schooling not in the middle. However, in September of this year the speedier alternative was put to the Ministry of Education for consideration and our negotiating position will be based upon it. A specific assurance will be sought that Government will work for the 1975 deadline.

Education Systems Studies

20. These two studies are of the utmost importance to rationalizing and containing the growth of educational expenditure. The financing for the studies has been included in Ghana's five-year program request to UNDP, but as this has not yet been approved by the Governing Council, provision for them has been retained in the project costing. However, if UNDP accepts the request, as seems probable, the studies will be withdrawn from the credit. At the same time, we will request that the studies project, which would probably be executed by UNESCO, be declared a Special Interest Project for the Bank, so that the conditions of consultation and provisions for review and implementation of findings mentioned in the appraisal report will be fulfilled.

RECOMMENDATION

21. I recommend that the Association invite representatives of the Republic of Ghana to negotiate a credit of US$ 8 million on the terms and conditions set forth in paragraphs 6.01 through 6.05 of the appraisal report. Should the expected bilateral and UNDP financing not become available for some items, I would recommend that the credit be increased

to a figure which would ensure a total external contribution to the project of US$8.8 million, as described in paragraph 16 above.

Bruce M. Cheek
Deputy Director

Attachments: Appraisal Report No. PE 37
Lending program

GHANA - ACTUAL AND PROPOSED LENDING THROUGH FY 1977
($ Million)

Population: Per Capita Inc:		Through 1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	Total 1964-1968	Total 1969-1973	Total 1973-1977
Cocoa I Eastern Region	IDA								8.5										
Cocoa II Ashanti Region	IDA												10.0						
Cocoa III Brong Ahafo Region	IDA															10.0			
Sugar Rehabilitation)	IDA										8.0								
)	IBRD										8.0								
Sugar Expansion	IDA													10.0					
Agriculture - Oil Palm	IDA											5.0							
Annual Crops I	IDA											6.0							
Annual Crops II	IDA												5.0						
Livestock Development	IDA												2.0						
Agriculture - Unidentified I	IDA													10.0					
Agriculture - Unidentified II	IDA															10.0			
Rural Development - Unidentified	IDA														5.0				
Agricultural Credit	IDA														8.0				
Fisheries I	IDA								1.3										
Fisheries II	IDA													3.0					
Industry (NIB)	IBRD												4.0						
Industry (NIB) II	IBRD															6.0			
Industry - Unidentified	IDA														5.0				
Power - Volta I	IBRD	47.0																	
Power - Volta II	IBRD							6.0											
Districts Dist. - ECG I	IDA						10.0												
Distribution - ECG II	IDA									7.1									
Distribution - ECG III	IDA											8.0							
Distribution - ECG IV	IBRD															4.0			
Power Generation	IBRD													8.0					
Telecommunications I	IBRD											10.0							
Telecommunications II	IBRD														8.0				
Highway Engineering	IDA								1.5										
Road Rehabilitation I	IDA										10.0								
Road Rehabilitation II	IDA													10.0					
Feeder Roads - Unidentified I	IDA												5.0						
Feeder Roads - Unidentified II	IDA															5.0			
Port Improvement	IBRD												4.0						
Education I	IDA										8.0								
Education II	IDA												8.0						
Education III	IDA															5.0			
Water Supply I	IDA								3.5										
Water Supply II	IDA											10.0							
Water Supply III)	IDA														10.0				
Sewerage)	IDA														5.0				
Population	IDA												2.0						
Operations Program	IBRD	47.0						6.0			8.0	10.0	8.0	8.0	8.0	10.0		24.0	44.0
	IDA						10.0		14.8	7.1	26.0	29.0	32.0	33.0	33.0	30.0	10.0	77.9	157.0
	TOTAL	47.0					10.0	6.0	14.8	7.1	34.0	39.0	40.0	41.0	41.0	40.0	10.0	101.9	201.0
	NO.	1					1	1	4	1	3	5	8	5	6	6	1	14	30
Lending Program	IBRD	47.0						6.0			8.0	5.0	5.0					19.0	10.0
	IDA						10.0		14.8	7.1	26.0	25.0	25.0	30.0	30.0	30.0	10.0	72.9	140.0
	TOTAL	47.0					10.0	6.0	14.8	7.1	34.0	30.0	30.0	30.0	30.0	30.0	10.0	91.9	150.0
	NO.	1					1	1	4	1	3	4	5	4	4	4	1	13	21
IBRD Gross Disbursements		3.30	16.60	13.87	9.30	3.52	0.10	0.24	0.12	0.93	3.77	1.37	3.23	6.48	9.04	10.61			
Net disbursements		3.30	16.60	13.87	9.30	3.52	-0.57	-1.16	-0.36	-0.63	2.07	-0.43	1.33	4.46	6.90	8.35			
Net transfers		3.00	15.96	12.51	7.23	1.52	-3.25	-3.79	-3.96	-3.18	-0.43	-2.96	-1.31	1.58	3.56	4.43			
IBRD/IDA Gross Disbursements		3.30	16.60	13.87	9.30	3.52	0.10	4.38	4.36	4.21	11.68	12.19	21.84	27.50	33.87	36.92			
Net Disbursements		3.30	16.60	13.87	9.30	3.52	-0.57	2.98	2.88	2.56	9.79	10.20	19.75	25.29	31.54	34.47			
Net transfers		3.00	15.96	12.51	7.23	1.52	-3.25	1.58	1.36	0.93	7.17	7.50	16.85.	22.01	27.63	29.79			

Western Africa Department
November 3, 1971