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LOAN COMMITTEE

LC/M/77-15

December 1, 1977

Minutes of Loan Committee Meeting to consider "Zambia-Third Highway Project" held on November 16, 1977 in Conference Room E1208

A. Present

Committee:

J. Burke Knapp (Chairman)
H. van der Tak
M. Hattori
H. Adler

Others:

R. Goodman
N. Horsley
D. Jordan
M. Mason
G. Reese
J. Collell
R. Reid
M. Wiehen
C. Willoughby
G. Wiratunga
I. Sam

B. Issues

1. The meeting was called to consider the draft documents submitted to the Loan Committee, under cover of Mr. Wapenhans' memorandum of November 10, 1977, for approval to proceed with the processing of a proposed $22.5 million loan/credit for a third highway project.

2. The following issues emerged:

(i) whether or not the project is premature since a commitment has not yet been obtained from the Zambian Government to transfer the Mechanical Services Branch (MSB) from the Defense Division of the President's Office to a civilian administration, nor has the Government obtained any commitments for the provision of technical assistance for MSB;

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Regional Vice Presidents

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Senior Operations Adviser
Controller
Others in attendance

(ii) whether or not the proposed technical assistance for MSB will be sufficient to enable it to perform satisfactorily; and

(iii) whether or not filling the vacant Roads Department posts (three executive engineers and one chief materials officer) should be made a condition of effectiveness.

C. Discussion

3. The Chairman referred to the importance of strengthening MSB in order to have an effective road maintenance program and noted the potential difficulty of achieving this while MSB was under military leadership. He was concerned that a source for the substantial technical assistance required for the project had not yet been identified.

4. The Eastern Africa Region explained that a transfer to civilian control would certainly be preferable since it would facilitate recruiting suitable staff for strengthening MSB, obtaining technical assistance from bilateral sources and improving cooperation and coordination between MSB and other Government departments. However, the Region pointed out that the Government, from recent indications, would be very reluctant to make such a transfer, particularly since MSB had been placed under military leadership in 1974 following alledged charges of corruption and inefficiency under a prior civilian administration. The Region therefore had been examining whether or not it was possible to strengthen MSB, particularly with respect to technical assistance, without its necessarily being returned to civilian administration. The Region stated that while bilateral sources approached so far had been reluctant to consider such assistance as long as MSB was under military control, the Government argued that it should be able to obtain such assistance from Yugoslavia or other Eastern European countries. The Region recommended that the Bank continue to press for MSB's transfer to civilian administration, but be prepared to accept its continuation under military leadership, provided the requisite technical assistance is obtained. In any event, MSB would be required under a covenant of the loan/credit, to employ consultants to prepare a plan of action for improvement, including specific targets for organizational and operational effectiveness.

5. The Chairman noted that he was not particularly concerned whether or not MSB was under military leadership as long as it was engaged in civilian work only and was able to operate effectively, but agreed that the Bank should press for the return of MSB to civilian administration. The meeting agreed that, as a condition of Board presentation, the Government either should (i) obtain a commitment from a bilateral source to provide technical assistance or, alternatively, (ii) agree to use funds from the loan/credit for this purpose. The Region considered that Bank Group financing of technical assistance may now be more acceptable to the Government since half of the amount to be lent will be IDA.

6. The Chairman questioned whether, even with such technical assistance, MSB could be expected to perform satisfactorily, particularly since the Region was not insisting on filling vacant senior management posts in MSB. The Region explained that the steps proposed under the project to strengthen MSB represented only a first phase. The periodic road maintenance program proposed under the project only covers about 2,7500 km of the country's 19,000 km gazetted road network. Further, most of the vacant senior management posts were in the provinces. Since the proposed technical assistance would include engineers responsible for day-to-day management in the provinces, some of the senior

management functions could be performed by these experts until qualified Zambian staff were appointed. In addition, the introduction of civilian experts should improve cooperation and coordination between MSB and the Roads Department, should MSB remain under the Defense Division. The Region also pointed out that MSB itself recognized its inefficiency, and had requested the proposed technical assistance.

7. The Chairman also asked the Region to review whether or not filling the Roads Department vacant posts (three Senior Executive Engineers and one Chief Materials Officer) should be a condition of effectiveness, rather than a requirement to be met within six months after signing the Loan Agreement (as proposed).

D. Conclusion

8. The meeting agreed that the Region should review the adequacy of the conditions proposed in the loan/credit documents and prepare a memorandum to the Loan Committee on this subject.

Cleared by Messrs. Horsley (for Mr. Knapp)
van der Tak
Hattori

DJordan/IKSam:jmd

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LC/M/77-14

November 28, 1977

Minutes of Loan Committee Meeting to consider "India-Karnataka Irrigation Project" held on November 10, 1977 in Conference Room E1208

A. Present

J. Burke Knapp (Chairman)
W. C. Baum
M. Hattori
L. Nurick
E. Stern

Others

M. Blobel
R. Picciotto
H. van der Tak
R. Goodman
N. Horsley
R. Rowe
P. Ljung
F. Hotes
D. Goldberg
B. Alisbah
G. Tibor
I. Sam

B. Issues

1. The Loan Committee met on November 10 to consider the Issues Paper and the Decision Memorandum for the proposed Karnataka Irrigation Composite Project. The basic question at issue was whether IDA should support a four-year time slice of a large ongoing irrigation scheme which would be completed only about 10 years after the IDA financed portion had been carried out.

2. At the outset Mr. Knapp emphasized the soundness of the traditional practice of associating Bank Group financing with the full project implementation period. Hence, any departure from the practice would require careful examination.

C. Discussion

3. In examining the proposal of the Region, the Loan Committee considered the following questions raised by the Vice President, Projects Staff which he suggested should apply to any such "time-slice" operation:

(1) Are we getting in at an optimal time in terms of the influence we can exercise on project design and implementation?

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Others in attendance

(2) Is the four year period proposed for Bank Group financing the right order of magnitude (i.e. what are the tradeoffs between tieing up IDA funds for longer periods and staying with the project longer)?

(3) Is the construction period appropriate (i.e. is this a case of financial constraints or inappropriate construction dictating a slower pace of implementation than would otherwise be possible)?

(4) Is the overall rate of economic return for the <u>full</u> project satisfactory?

(5) Can we rely on the Government's commitment to complete the project expeditiously and soundly?

(6) What should be the attitude of the Bank Group towards financing later stages of the project?

(7) Is Bank Group financing of ongoing contracts contemplated?

4. With respect to the first question, the South Asia Project Staff explained that while the dams are nearly completed, the Association would be entering the project at the optimal time for influencing the design and implementation of the distribution system. They emphasized that in Indian irrigation projects this is the most critical entry period. They also pointed out that during appraisal the need for some minor modifications to the dams had been identified.

5. Regarding the second question, the Regional Vice President observed that by FY83, the undisbursed IDA pipeline in India was expected to reach a level of about $4.6 billion, even with a reasonably good disbursement performance. The size of the pipeline reflected essentially the growing size of the lending program for India. Contributing factors were the elminiation of program lending, and the restructuring of some of our traditional operations (e.g. Railways) both of which tended to lengthen the average disbursement period. He pointed out that, although there was good reason for the size of the undisbursed pipeline, it would no doubt draw increasing attention and comment in the coming years. While this should not prevent the Association from lending for projects with somewhat longer implementation periods than four-to-five years, a twelve-to-fifteen year disbursement period would be quite undesirable. The Chairman felt that in a situation where time-slice financing is warranted, four to six years would appear to be the right order of magnitude.

6. On the question of whether the construction period could be condensed, The Regional Projects Staff explained that the implementation program for the project is based on the assumption that labor-intensive methods would be used. The project would require a staff of about 1,800 engineering-trained personnel and a labor force of about 50,000. Experience from other projects on the Deccan Plateau indicates that it is extremely difficult to assemble and organize a labor force of more than 50,000 workers. Using capital-intensive construction methods would make it possible to speed up construction of the dams and the canal infrastructure. There are, however, two important reasons why this would

not be desirable in this case. Firstly, the design and implementation of on-farm works is a slow, time-consuming process which cannot be speeded up further, even with a larger input of engineering-trained personnel. Consequently, more rapid implementation of the infrastructure works would increase the lag between the time water becomes available and proper preparation of the land for irrigated agriculture. Indian experience has shown that this leads to a loss of potential benefits and the establishment of improper and wasteful farming practices that are difficult to break. Secondly, although capital-intensive construction of the irrigation infrastructure would permit a somewhat quicker build-up of agricultural benefits, the economic cost of mechanical work is, especially in this area which is characterised by large underemployment, substantially higher than the cost of labor-intensive work. An analysis undertaken by the staff indicated that the increased cost of the project, if executed through capital-intensive methods, would exceed the potential agricultural benefits from more rapid implementation.

7. Regarding the economic rate of return of the project, the Regional Staff explained that it would be of the order of 16% when including the costs and benefits for the full twelve to fifteen year project, including sunk costs. The Loan Committee agreed that this was the relevant consideration to take into account in reaching a decision on time-slice financing of a single, integrated project. The fact that the four-year time slice to be financed by IDA might itself have a satisfactory rate of return in this case was seen as no more than a happy coincidence which might not occur in other projects. The Regional Projects Staff emphasized the difficulty and arbitrariness of trying to attribute an economic return to the four-year time slice to be financed by IDA.

8. Regarding the reliability of the GOI and State Government's assurances to complete the project, the Region pointed out that our leverage in India is a function of the size of our lending program in the country and the high quality of our relationship with the Government of India. They emphasized that this does not mean that there are no problems regarding fulfillment of commitments in ongoing projects. It did, however, mean that such difficulties can be resolved through discussion and persuasion rather than the use of legal sanctions. In regard to the Karnataka project, the Region also pointed out that despite the size of the project, the financial burden upon the Karnataka Government beyond the period of the IDA project would be manageable. Without any further IDA financing, expenditures on the project beyond FY81/82 would amount to about 20% of total irrigation sector expenditures and less than 5% of the total projected State budget. The Karnataka Government has attached a high priority to completing the project as rapidly as possible.

9. Regarding our role in financing further stages of the project, the Chairman underscored the importance of avoiding giving the slightest impression to the Governments of India and Karnataka that we intend to provide future financing. While we could in any case not commit ourselves to do so, the value of the Government's commitment to complete the project would be greatly diminished if it were based on expectations of further IDA financing. On the other hand, the Loan Committee appreciated that this posture notwithstanding, it was possible, and perhaps even desirable that IDA finance further stages, provided GOI and Bank Group priorities remain broadly as they are now and provided implementation of the Karnataka project proceeds satisfactorily.

10. Regarding contracts, the Regional Projects Staff explained that the appraisal mission was not recommending the financing of any ongoing contracts under the proposed credit. GOI has requested this, but a review of the contracts had shown that they had not been awarded in accordance with procedures satisfactory to the Association. The Staff referred to ongoing efforts between GOI and the Association to develop mutually acceptable standardized documents and procedures for all irrigation projects. When this was accomplished, there would be a better case for considering the financing of some ongoing contracts in future irrigation projects with the preparation of which we had been associated. The Vice President, Projects Staff felt that, while in the right circumstances some financing of ongoing contracts tendered in accordance with Bank procedures could be included in future time-slice projects, these should be considered exceptional and the amounts involved kept small since this might add unnecessarily to the controversiality of time-slice financing.

D. Conclusion

11. In light of the above explanations, the Loan Committee approved the Region's proposals concerning the Karnataka project.

Cleared with Messrs. Baum
Hattori
Nurick
Stern
Horsley (for J.B. Knapp)

BAlisbah/IKSam:jmd

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LC/M/77-13

November 9, 1977

Minutes of Loan Committee Meeting to consider "Laos-Agricultural Rehabilitation and Development Project" held on October 28, 1977 in Conference Room E1208

A. Present

J. Burke Knapp (Chairman)
W. C. Baum
A. Broches
M. Hattori
S.S. Husain

Others

S. S. Kirmani
M. Yudelman
R. J. Goodman
N. Horsley
D. C. Pickering
N. A. Gibbs
O. T. Price
B. S. Gray
L. Forget
N. M. Gorjestani
I. K. Sam

B. Issues

1. The meeting was called to consider the state of readiness, prospects for implementation and arrangements for supervision of the above project.

C. Discussion

2. In opening the meeting, the Chairman outlined the difficult setting for the proposed IDA operation in Laos. He mentioned that in connection with the United States' contribution to international finance organizations, including IDA, the President of the United States had given an undertaking to the Congress that the United States would oppose, among other things, IDA lending to Laos. In the face of a United States vote against the proposed credit, it was imperative to ensure that the project met usual IDA criteria, that it was adequately prepared, that there was a reasonable prospect of its implementation, and that there was assurance that IDA could supervise it. The Regional Vice President, East Asia and the Pacific, while agreeing with the Chairman, noted that IDA's international character required that if the normal lending criteria were met, the staff and the management should proceed

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Senior Operations Adviser
Controller
Others in attendance

with negotiations and, thereafter, with the presentation of the proposed project to the Board. The General Counsel reminded the meeting that under the Articles of Agreement neither the management nor the staff of the Bank Group could take account of political considerations in forwarding a credit for presentation to the Executive Directors. The Chairman agreed with these comments. The meeting then proceeded to address the issues.

3. State of readiness. The question was whether or not the project was well formulated and ready for implementation by IDA's normal standards. The Region noted that the Government had made satisfactory progress in project preparation (project directors and the chief provincial irrigation engineer had already been appointed and UNDP financing for the technical assistance component was in its final processing stage), and that the project was ready for implementation. The Chairman observed that a number of important sections of the project appraisal report (1593--LA dated October 3, 1977) dealing with preparation of designs and selection of irrigation schemes, provision of credit to farmers and implementation procedures were still incomplete. The Region noted that staff had recently obtained all the necessary information required to complete these sections. On the question of designs of irrigation schemes, the Region further noted that these were simple and that many schemes with similar designs had in the past been implemented in the country under USAID programs. Selection of the proposed 48 schemes with adequate water supply would not be difficult in that some 90 potential schemes had already been identified in the project area where water supply has been adequate. On the question of credit to farmers, the Region indicated that satisfactory arrangements for provision of credit to rice farmers and livestock fatteners had been worked out with the Government and that short term credit would be available through the National Bank of Laos at an interest rate of 6% per annum.

4. CPS observed that although the proposed project activities were simple, discrete and relatively easy to implement, it had had some reservations about procedures for approval of designs and monitoring and evaluation of irrigation schemes, and had made suggestions in that regard during an earlier review of the project. The Region noted that CPS' suggestions had been fully incorporated into the project and that IDA would approve standard designs and summary data forms of individual schemes prior to their implementation; also a monitoring and evaluation unit would be established. CPS confirmed that with the above modifications the project met the Bank's standards of project preparation.

5. Prospects for implementation. In view of the shortage of experienced technical cadres in Laos and the fact that the project would be IDA's first operation in the country, the question was whether or not the project could be effectively implemented. The Region noted that project activities were simple; competent staff were available in the implementing agencies; the irrigation department had experience in carrying out the proposed works; the livestock department also had experience in the activities proposed under the pig component, which would be linked to an ongoing UNDP pig breeding project; five technical assistance positions, financed by UNDP, to help implement the project and train additional local staff had been included; UNDP had agreed to advance contracting procedures and the expatriate advisers were likely to be recruited before an IDA credit is considered by the Executive Directors and signed; most of the construction would be carried out by force account; and, in view of the very difficult food situation brought about by two successive droughts and high

prices for paddy, it was reasonable to expect that farmers would be eager to participate in Government's programs to increase food production. In view of the above and the fact that signing of UNDP technical assistance project documents would be a condition of Board presentation and appointment of advisers a condition of disbursement, the Region indicated that it was confident the project could be effectively implemented.

6. The Chairman asked whether, in view of Laos' land-locked position, procurement would be a problem. The Region noted that although Thailand, through which the bulk of Laos' needs are imported, had recently placed an embargo on Thai exports to Laos, there was no hindrance to goods in transit through Bangkok. Recently, there had been delays in clearing transit goods for Nam Ngum Stage II Project but these had been resolved without major difficulty. It was observed that land-locked countries sometimes experienced similar delays in transporting imported goods. The Region also indicated that staff had discussed this problem with the Lao authorities who were confident there would not be undue delays in the movement of goods financed by an IDA credit through Bangkok. General Counsel observed that it was difficult to conceive of one Bank Group member holding up the transit of IDA financed goods to another Bank Group member and that the Bank would not countenance such action.

7. Since it was unlikely the Government would allow foreign firms to audit project accounts, these accounts would be audited by State Auditors. The question was asked whether procedures used by State Auditors would be acceptable to IDA. The Region indicated that although little was known about the procedures followed by State Auditors, staff would supply the Lao authorities with accounting and audit guidelines, and, if necessary, supervision missions would work closely with the auditors to improve the quality of audits.

8. Supervision. The Chairman asked whether IDA would have adequate rights to supervise project implementation. The Region noted that the project area, located in the Vientiane Plain, was secure and staff had travelled widely in the area on a number of occasions in the past year. IDA's supervision requirements had been fully explained to Lao officials in Vientiane and at the Annual Meeting and rather than opposing our requirements they had been welcomed as a demonstration of IDA's interest in helping Laos carry out the project successfully. The Region noted that as project identification and appraisal had progressed and contacts with Lao authorities had developed, an atmosphere of mutual confidence and understanding had been created. Moreover, the Lao authorities had become increasingly candid and forthcoming with information.

D. Conclusions

9. The Committee concluded that project readiness, and the arrangements for implementation and supervision met IDA's normal requirements and approved the inclusion of retroactive financing of about $60,000-80,000 from October 1, 1977, in the proposed credit and the establishment of a Special Disbursement Account to finance start up activities as proposed by the Region.

Cleared with Messrs. Knapp
Baum
Broches
Husain
Goodman

NGorjestani/IKSam:jmd

Form No. 60
(2-73)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LC/M/77-12

November 4, 1977

Minutes of Loan Committee Meeting to consider proposed Zaire Program Credit and Fourth Highway Project, held on October 17, 1977 in Conference Room E1208

A. Present

Committee:

J. Burke Knapp (Chairman)
I. P. M. Cargill
Warren C. Baum
Aaron Broches
Willi A. Wapenhans

Others:

M. Haq
C. Willoughby
N. Horsley
C. B. Harral
B. P. Kennedy
I. Smith
M. Melegari
T. Jones
H. A. Adler
M. H. Wiehen
R. Maubouche
S. C. Schott
B. Varon
J. Schwartz
I. Sam

B. Issues

1. The meeting was called to consider:

(i) a memorandum by Mr. Wapenhans dated October 12, 1977 regarding a proposed program credit to Zaire and

(ii) the Decision Memorandum regarding the proposed Zaire-Fourth Highway Project, dated September 21, 1977.

C. Background - Program Credit

2. During discussions with Mr. McNamara at the Annual Meeting, the Zairian delegation had requested the Bank Group to consider a program credit to Zaire in support of the Government's efforts at improving the country's economic management. Such a program credit would be used to meet most urgent needs

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for spare parts, raw materials, intermediary products and some equipment to help raise industrial production and agricultural processing from the present very low levels of capacity utilization (estimated at about 35%). The thrust of the credit would be towards import substitution industries as well as export oriented industries. While Mr. McNamara had expressed the Bank's sympathy towards Zaire's present situation, he had pointed out to the Minister that the Bank would find it difficult to justify a program credit to its Board in the absence of a sound investment plan. He would however instruct the staff to sketch out, together with the Zairian delegation, an economic recovery program by which Zaire could pull out of its present crisis situation. Subsequent to the discussions, the Eastern Africa Regional Management had written to the Zairian Government on September 30, 1977 emphasizing that Bank Group policy on program credit required the Government to have a well-conceived development plan which the credit will support. The letter, however, recognizing that Zaire does not presently have such a plan and that it was doubtful that it could be provided and appraised within the time constraint facing the Government, had offered as a substitute precondition, a medium term economic recovery program, including a close scrutiny of the measures the Government was taking to promote economic recovery and their internal consistency.

D. Discussion - Program Credit

3. The Chairman and other members of the Committee questioned the substitution of "an economic recovery" program for the requirement of a development plan, and emphasized Bank Group policy that a program credit could only be considered if the recipient country had an appropriate development program and if financial assistance could not be provided equally effectively through project financing. The Regional staff pointed out that the Zairian situation was analogous to Bangladesh's when the Bank Group had provided it with a program credit in the absence of a development plan. The Chairman said that the circumstances under which the specific Bangladesh program credit and others similar to it were approved were not applicable to Zaire's present situation. In those cases, the deterioration of the economies had been almost completely outside of normal managerial control; in Zaire's case, although seriously affected by continuing low copper prices, the economy had deteriorated very largely through past gross mismanagement of the public sector. The Chairman and other members of the Loan Committee stated that in the circumstances a program credit to Zaire would be an "aberration" of Bank Group policy. In any event, the Committee enquired what a program credit of US$25 million as proposed, even if complemented by US$15 million from the EEC Special Action Fund, could achieve in light of the fact that Zaire's external inflow requirement in 1978 was expected to rise to US$800 million.

4. The Eastern Africa Region explained that Zaire had recently taken a number of encouraging measures in support of improved economic management. Although Zaire's performance under the 1976 Stabilization Program agreed with the IMF had not been entirely satisfactory, performance had appeared to improve markedly during the 1977 Stabilization Program. Debt service control and tax collection had improved, budget expenditures had been kept under tight control and had been focused on priority sectors. Further, the Government was actively seeking to mobilize additional foreign exchange resources through a $250 million commercial bank loan being syndicated by Citibank and through the conversion of project-committed funds to the purchase of priority commodities.

The Government was pursuing its request to Japan to convert a $120 million bilateral commitment for a bridge construction to commodity assistance. Germany had already agreed to convert $10.0 million project assistance into commodity aid; the US was providing some balance of payment support (about $37 million in 1976-77) and other countries appeared favorable to this approach. Nevertheless, the Region pointed out that although these conversions would be helpful, and would supply urgently needed funds, the policy impact conditions that would be attached to program lending could not be expected to be pressed by bilateral donors as they did not possess the institutional capacity nor the political desire to exert a concerted influence on Zaire's economic management. The Bank and the IMF were the only institutions capable of playing an effective role in this field.

5. Development Policy Staff stated in support of the proposed program credit that such a credit could provide the Bank with the necessary influence to press Zaire to adopt and implement measures required for a successful economic recovery program. A Bank mission to Zaire should explore the chances of formulating a sound economic recovery program and, in particular, the possibilities for the establishment of effective public expenditure controls and improved management of the industrial sector. DPS was prepared to provide an economist to the Region who might be used to advise the Government in defining an effective recovery program.

E. Conclusion - Program Credit

6. The Chairman concluded that given that the Regional management's letter of September 30 foreclosed requiring Zaire to prepare a development plan before a program credit could be considered, the Region should pursue its exploratory discussions with the Government with a view to determining whether a program credit could be justified. Such a credit would however have to be associated with a very clear and convincing program outlining in some detail policies with respect to the economic recovery program and the utilization of the credit. He did not think, however, that at best the necessary policy documents could be prepared by the Government of Zaire in time for a program credit to reach the Executive Directors before the end of FY78, as the Region had proposed.

F. Zaire-Fourth Highway Project - Background

7. The appraisal mission had proposed a project considered by the Region as the "absolute minimum" needed to prevent a serious deterioration of road transport in Zaire. The mission's proposal, which would cost about $77 million, represented a substantial reduction from the $110 million which the Zaire Bureau of Roads had proposed. The Decision Meeting agreed with the appraisal mission's assessment that the smaller project proposed met the most critical requirements for maintaining Zaire's most important national and secondary roads in a passable state and that any smaller project would result in severe deterioration of the existing infrastructure which would later have to be replaced at much higher cost. The foreign exchange component of the proposed project was estimated at about $54.5 million; while total available foreign financing was estimated at about $28.0 million, including an IDA credit of $20.0 million. In addition, it was proposed for foreign sources to finance the foreign cost of recurrent maintenance expenditures for spare parts and fuel estimated at $6.6 million and about $7.0 million of local costs. In all, foreign sources would be financing some $68.0 million, or about 89% of the total project costs.

G. Discussion - Fourth Highway Project

8. The Chairman raised the following matters for discussion: (i) the adequacy of the highway administration; (ii) the proposed recurrent cost financing; (iii) the budget needs of the highway administration and (iv) the possibilities for mobilizing additional external financing.

9. Adequacy of the highway administration: The Region stated that the performance of the highway administration had improved during the past years under the leadership of a Bank-seconded Director-General. Despite the substantial logistical problems in a vast country like Zaire, the highway administration had established reasonable effective control over its maintenance operations. Unfortunately, inadequate budgetary allocations had emerged as a major constraint to a further improvement of its performance.

10. Recurrent Cost Financing: The Chairman pointed out that it was the Bank Group's policy to consider the financing of recurrent expenditures only in special cases and certainly only when they were clearly incremental.

11. The Region said that the recurrent costs were incremental to what was actually being spent by the Bureau of Roads, and that financing of part of these expenditures was necessary to protect existing capital assets, increase their utilization rate and help the Bureau of Roads carry out its program and overcome its shortage of foreign exchange. Central Projects Staff commented that the financing of the recurrent expenditures on a declining basis seemed justified as a transitional measure on the ground of extreme poverty of the country, short-term budget constraints on highway operations and the need to protect the equipment acquired by the highway administration under previous credits and from other sources.

12. The Chairman observed that if the highway administration was allocated US$20.0 million for recurrent expenditures in 1977, he had great doubts that the Government would increase this amount to about the US$50.0 million per year required to maintain the road transport network in a passable state during the project period. Central Projects Staff said it could support a highway maintenance project as proposed if appropriate priorities were set for highway expenditures and if the availability of the required budget funds could be assured during the project period and on the higher level required thereafter. The Region said that the Government recently increased taxes on fuel and the Region would press the Government to introduce a further increase in road user charges. The legal documents would spell out the Government's obligations in this respect. It was noted that similar discussions in the context of other projects had resulted in some very substantial adjustments. The Region considered that through a gradual buildup of the budget resources during the expected economic recovery, the total local funds required for recurrent cost financing during the project period could be realized.

13. External Financing: The Chairman had expressed some doubts about Zaire's ability to mobilize the large amount of external financing required for the project. The Region responded that several development institutions had already indicated their intention to participate in financing the project. During the Annual Meeting the Saudi Fund for Development, BADEA, and the

African Development Bank had also expressed an interest and might participate. A donor meeting would be held in the near future to seek firm commitments so that the presently still wide foreign exchange gap could be covered. The Chairman had also questioned why it was Germany that was proposing to organize a coordination meeting with the Zairian Government on Zaire's transport sector needs. In reply, the Region pointed out that in view of its extensive support for this sector, Germany had made such a proposal during the Consultative Group meeting in June 1977. It was understood that such a meeting would be informal and would focus on better coordination of investments in transportation in general as well as on specific aspects of the proposed Fourth Highway Project.

H. Conclusion - Fourth Highway Project

14. The Chairman observed that the project contained elements of program lending, though linked to a specific sub-sector. However, he did not consider it appropriate at this time to elminate these elements from the project on the assumption that they could be included in the proposed program credit as prospects for such a credit seemed quite uncertain. He requested the Region to submit a memorandum explaining (i) the financing of 'incremental' recurrent costs for spare parts and fuel in the light of Zaire's defaulted obligation to provide budget funds for highway operations under the Third Highway Project, and (ii) the manner in which these funds would be financed in a declining proportion over the project period. He also stated that during further processing of the Fourth Highway Project a detailed financing plan should be established and satisfactory data obtained concerning the domestic budget funds available for road transport network maintenance during the project period.

Cleared with Messrs. Knapp
Cargill
Baum
Broches
Wapenhans

JSchwartz/MHWiehen/IKSam:jmd

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

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LOAN COMMITTEE

LC/M/77-11

August 1, 1977

Minutes of Loan Committee Meeting to consider "Iraq-Change of Project Description and Reallocation of Proceeds of Loan 925-IRQ Grain Storage Project" held on July 12, 1977 in Conference Room E1208

A. Present

Committee:

J. Burke Knapp (Chairman)
W. C. Baum
M. Hattori
L. Nurick
A. David Knox

Others:

A. Davar
H. Pollan
M. Yudelman
R. Dosik
N. Horsley
R. Frank
P. Naylor
T. Asser
W. Spall
J. Chevallier
E. Schertz
D. Mead
E. Njomo
I. Sam

B. Issues

1. The meeting was called to consider the following issues emerging from the draft documents submitted to the Loan Committee under cover of Mr. Pollan's memorandum of July 8, 1977 for approval of proposals recently negotiated in Washington with an Iraqi delegation to change the Project Description and to reallocate the proceeds of Loan 925-IRQ, Grain Storage Project:

(i) how continuation of the project could be justified in view of its present low economic return;

(ii) why the Bank did not cancel the portion of the loan allocated to finance the Baghdad silos; and

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Senior Operations Adviser
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Others in attendance

(iii) why a change in the Project Description was considered necessary by Iraq.

C. Background

2. The Grain Storage Project (Loan 925-IRQ for $40 million) was approved by the Executive Directors in FY73 and involves the construction of 14 silos, the expansion of four existing silos and the expansion of the import-transfer capacity of two port silos in Um Qasr and Basrah, respectively. The project also provides for a mechanized inventory control system, a grain marketing and pricing study and for personnel training, all to be financed by Iraq. The project has suffered from considerable delays and a 280 percent cost overrun with total project costs rising from $92 million at the time of appraisal to current estimate of about $351 million, as a result of inflation and changes in project design introduced by the Government.

3. Tenders for the first two silos under the project - Baghdad I and II - were called for in April 1976. Procurement difficulties arose as a result of the Government decision to award the contract for these two silos to the Iraqi State Construction Contracting Company (SCCC). The Bank's principal objection was that following bid opening for these silos the Government had requested a shortlist of four out of nine bidders to submit substantial changes in their offers. SCCC, orginially ranked seventh, then apparently reduced its price by 26 percent from $86.3 million to $63.7 million, on the grounds that unlike the foreign bidders, its original bid included import duties and other taxes which it was now eliminating; the contract construction period was also reduced from 41 months to 23 and 26 months respectively for Baghdad I and II silos, making it the lowest bidder. In spite of the objections by the Bank, the Government signed the contract with SCCC on November 4, 1976. The Bank, on February 28 and again on May 19, 1977, following an April supervision mission, informed the Iraqis that it could not disburse any funds against Baghdad I and II silos, but offered to reallocate funds originally earmarked for the Baghdad silos to other silos which would involve changes in the disbursement categories but not in the Project Description, provided Bank guidelines were fully complied with and the complete project was carried out in accordance with the Loan Agreement. During discussions in Washington with an Iraqi delegation between June 27 and July 1, 1977, the Bank reiterated its refusal to finance Baghdad I and II silos, and the Iraqis threatened to cancel the entire loan amount. After an impasse had apparently been reached, the Iraqi delegation modified its position and agreed that a reallocation was possible but only if the Project Decription was modified to refer to the five new silos and not to the 14 in the original description. As the negotiations resumed, however, the Iraqis insisted that reference to the expansion of four silos and to the import-transfer silos also be eliminated from the Project Description. The Staff explained that the Project Description consisted of four major Parts and that Part A consisted of four sub-parts; one sub-part provided for the construction of 14 new silos and this part was to be reduced to cover only the five selected silos; one sub-part provided for the expansion of four existing silos; and two sub-parts provided for construction and expansion of import-transfer capacity of two port silos. The position insisted upon by the Iraqi delegation was that only the sub-part covering construction of five new silos would remain in Part A of the Project

Description. The Bank delegation had stated to the Iraqis that inasmuch as the Bank was relinquishing rights to require execution of and to supervise the other Project facilities, the Government should commit itself to continue to carry out those portions of the Project. The Iraqi delegation had, after much discussion, agreed to recommend that the Government send the Bank a supplemental letter "informing" the Bank that the Project was "an important part of our [the Government's] long-term program to increase and improve grain storage and handling capabilities...." The Staff pointed out that the Iraqi delegation had refused to "confirm" such a program, and had also rejected all attempts to have the supplemental letter refer to some approximate figures for storage and handling capacity. The foregoing was all ad referendum to the Bank's Management and the Iraqi Government. Other parts of the project, dealing with technical assistance and institution building, were to be left unchanged.

D. Discussion

4. Iraq's commitment to the present silo construction program:

The Chairman wished to know why the Government intended to continue the silo construction program in view of the less than 3 percent economic rate of return as presently estimated. EMENA staff explained that at the time of project appraisal in 1973, the Government expected that increased grain storage and improved grain handling capability would, apart from producing economic benefits due to reduction in grain losses and demurrage charges, enable it to control 33 percent of the grain market with the objective of reducing suspected hoarding by traders and channelling more benefits to producers. Subsequently, its policy changed to one of controlling 100 percent of the market for this socio-economic purpose. Furthermore, the Government might have also decided that it would be in Iraq's strategic interests to build a sizeable strategic grain reserve capacity, to protect it against a possible cut-off of supplies. In addition, the Grain Board had been criticized for the delay in its construction program. In view of such considerations, it appears that Iraq had decided to complete the entire grain storage construction program despite a reduction in the economic rate of return from 14 to less than 3 percent.

5. Cancellation of the undisbursed portion of the Bank loan:

The Chairman asked why, in view of the project's low economic rate of return, we did not seize the opportunity to cancel the entire loan as threatened by the Iraqi delegation. The Region explained that the Iraqis had linked Bank financing of the Baghdad silo contracts with overall Bank/Iraqi relations. The effect of refusing to reduce the project scope, especially under the threat of cancellation of the full loan amount, could further aggravate the already tunuous relations with Iraq, since there was a real risk that Iraq might also cancel three on-going projects. This might have some repercussions in the Bank's relations with other Arab countries or OPEC in which Iraq has voice. It was noted that reaching a compromise position was further complicated by the fact that there was neither a lending program nor an 'offset' arrangement operation planned for Iraq. Moreover, the decision to agree to the Iraqi request to reduce the project scope was predicated on the contribution that the Bank has had so far in project implementation through the Bank's review of preliminary and detailed engineering design, resulting in substantial cost savings, which has been appreciated by the Government.

6. Change in the Project Description:

The Chairman asked the Region why a change in the Project Description was necessary if, as the Iraqi delegation stated, the Government intended to carry out the silo construction program as contained in the Loan Agreement. No satisfactory rationale could however be given for the Iraqis' insistence on this arrangement, as none had been provided by them during the discussion held in Washington. However, the Region confirmed its belief that the Government would carry out the original program, but indicated that the Iraqis were rigid in their request for a reduction of the project. Following acrimonious debates and after having carefully weighed the merits and demerits of continued Bank assistance to Iraq in implementing the project, the Regional staff had acceded to the Iraqi delegation's request to change the Project Description since the Government expressed a general intention to complete its long-term grain storage program.

7. Decision

The Chairman stated that he had substantial reservations about the Bank's continued involvement in the project in light of the low economic rate of return. He also supported Mr. Baum's view that no basis had been established for departing from the Bank's policy on misprocurement by reallocating to other project components the funds which had been originally intended for the Baghdad silos; however, he did not want to disown the commitment made by the Bank staff on this matter. As for the proposed limitations to be introduced into the Project Description, he felt that these could not be justified in the light of the integrated character of the project as a whole and that we should insist on the maintenance of the provisions in the original Loan Agreement. He recognized, however, the Region's viewpoint that a delicate political judgment was involved and said he wanted to consult with Mr. McNamara on the matter and would inform the Region of the outcome.

POSTSCRIPT - August 29, 1977

Mr. Knapp subsequently informed the Region that Mr. McNamara had agreed to recommend to the Board that the Bank continue to finance the project on the basis of the revised Project Description if an assurance was received from the Iraqi Government that it was their policy and intention to complete the project as defined in the original Loan Agreement. On August 25 the Bank received a telex signed by the Iraqi Minister of Planning (in response to the Bank's request for the necessary assurance) in which the Iraqi Government requested the Bank "to cancel the unwithdrawn amount of the loan", and gave notice of its intention "to repay in advance of maturity the withdrawn amount of the said loan".

Cleared with Messrs. Knapp
Baum
Hattori
Nurick
Knox

ENNjomo/LNurick/IKSam:jmd

Form No. 60
(2-73)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LC/M/77-10

August 4, 1977

Minutes of Loan Committee Meeting to Consider "India-Orissa Irrigation Project" held on July 22, 1977 in Conference Room E1208

A. Present

Committee:

J. Burke Knapp (Chairman)
W. C. Baum
M. G. Blobel
A. Broches
M. Hattori

Others:

R. Picciotto
M. Yudelman
R. Rowe
A. A. Raizen
N. Horsley
G. Slade
F. Hotes
M. Singh
Ms. M. Nguyen
P. Ljung
M. Beutgen
I. Sam

B. Issues

1. The meeting was called to consider the following issues emerging from the draft documents submitted under cover of Mr. Blobel's memorandum of July 18, 1977.

(i) Time Slice Approach vs. Project Slice Approach, and partial funding;

(ii) Appraisal Competence of CWC's Appraisal Committee (AC)

C. Background

2. The major component of the project, as defined in the draft documents, consists of construction works for 20 to 35 medium irrigation projects (MIPs), about 10 of which would be on-going and 10 to 15 would be new projects. Disbursement from the proposed credit to finance construction works

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Controller
Others in attendance

under the project would be limited to five years. Since the construction of a typical MIP takes about five years, the proposed approach ("time slice") implies that, while all on-going and some new MIPs would be completed within the five-year slice, the majority of new projects would not be completed within this period and would therefore only be partially funded under the project.

3. Because of the relatively large number and small size of individual MIPs and because of institution building objectives, a central feature of the project as proposed is that appraisal (and routine supervision) of individual MIPs will be delegated to a special Appraisal Committee (AC) in GOI's Central Water Commission. Approval for financing under the credit would also be delegated for projects estimated to cost no more than Rs 70 million (US$7.8 million), subject to subsequent review by IDA of the appraisal report for each sub-project to be submitted by AC. The AC would be staffed and funded in accordance with project requirements as would be discussed and agreed during negotiations. In order to test the AC's appraisal competence, it was proposed that the first three MIPs, irrespective of cost, would, after appraisal by the AC, be sent to IDA for detailed review and approval. With this provision and the $7.8 million free-limit, about 40% of all MIPs under the project would be reviewed in detail, and decided upon, by IDA.

D. Discussion

4. The Chairman and Mr. Baum raised the question of whether the "time slice" approach was desirable because most of the new MIPs would not have been completed by the end of the five-year disbursement period. A possible alternative approach ("project slice") would be to include in the project only MIPs that would be completed during the disbursement period. One variant of this approach would be to retain the five-year disbursement proposed by the Region, but to limit the project to the 10 on-going and to those few new MIPs that could be started immediately and therefore be completed within five years from the approval of the credit. Another variant would be to retain the project composition as proposed by the Region, but to extend the disbursement period as necessary to complete all new MIPs (probably eight years). The Region responded that the 1975 analysis by IDA of Orissa's agricultural potential and development constraints had demonstrated the high priority of Orissa's development program for medium irrigation, and that it was desirable for IDA to be associated with this program on a basis which would minimize the effort involved in appraisal and follow up by IDA staff for each individual MIP. (Note: IDA will review the appraisal and supervision reports of each individual MIP.) At the same time, this situation provided an opportunity to: first, review in depth, and get fully involved in, the largest part of Orissa's irrigation sector in the near future and to make a major impact, statewide, on technical and economic standards applied in irrigation projects; second, build up a capable and responsible unit at the Center (New Delhi) that would have the potential to assume, gradually, responsibilities also for other smaller sized irrigation projects in other Indian States as well as Orissa. These objectives would be served best by the "time slice" approach because it would permit a larger number of new MIPs - and, therefore, a greater proportion of the State's total program of investment in medium-scale irrigation over the next five years - to be covered by the project. Uncertainty about the completion of those MIPs that would start late within the "time slice" would be minimized by a legal covenant by

which Orissa would undertake to complete the MIP's started under the project. In the Region's view, it would be feasible for Orissa to meet the financial obligation implicit in this covenant, so that an extension of the disbursement period to eight years or more, which would tie up IDA funds, was not warranted.

5. Consideration was given to the Appraisal Committee's capability of handling appraisal and supervision of MIPs in accordance with Bank standards. The Region explained that while a sufficient number of highly qualified irrigation engineers were available to the AC from CWC staff, agriculturalists and economists were not yet posted. However, staffing (and funding) of the AC with a high standard of professional competence was expected to be completed in the near future and would be discussed in detail during negotiations and recorded in the Agreed Minutes. With the AC's expected high professional standard, with the tightly drafted technical and economic criteria to be applied by AC, with a free limit of Rs 70 million, and with compulsory submission to IDA for approval of the first three MIPs irrespective of cost, it was felt that the risk involved in delegating responsibilities to the AC would be reduced to an acceptable level. The Vice President, Central Projects Staff, raised concern that the free limit of Rs 70 million was too high and that detailed IDA review of only the first three MIPs would not be sufficient to allow an evaluation of AC's competence. The Region suggested as a compromise that the number of MIPs to be submitted to IDA for review and approval initially should be raised to five and that, after the review of the fifth acceptable MIP, the free limit should be redetermined so as to ensure that about 40 to 50% of MIPs by number, and about 60% by cost, would be reviewed in detail and approved by IDA.

E. Conclusion

6. The Committee decided that the Region proceed with the project as proposed in Mr. Blobel's memorandum of July 18, 1977, except for the free limit and the number of initial MIPs to be reviewed by IDA, for which the Committee accepted the Region's compromise proposal outlined in para. 5 above.

7. It was further decided that at the gray cover stage more emphasis would be given, in the President's and Appraisal Reports, to the objectives and strategy underlying the proposed project. The sections dealing with risks and uncertainties would be expanded to cover in more detail the risk resulting from the delegation of appraisal and supervision responsibilities to AC. The reports would further clarify that MIPs with an economic rate of return below 12% would in no case be eligible for financing from the credit.

Cleared by Messrs. Knapp
Blobel
Broches
Hattori
Raizen/Baum

MPBeutgen/MBlobel/IKSam:jmd

LOAN COMMITTEE

LC/M/77-09

July 21, 1977

Minutes of Loan Committee Meeting to Consider a "Response to the EEC Proposal to Assist Somalia Settle a Dispute with the Contractor of the Afgoi-Baidoa Road Project" held on July 11, 1977 in Conference Room E1208.

A. Present

Committee:

Messrs. Knapp (Chairman)
Baum
Nurick
Hattori
Wapenhans

Others:

Messrs. Please, H. Adler, Bronfman, Morse, Horsley, I. Sam, Heininger, Asser, Kathuria, Agerschou, Kennedy, Myint, Del Buono

B. Issues

1. The meeting was called to respond to an EEC initiative calling on IDA to help attain and then finance the settlement of a dispute with the contractors of the Afgoi-Baidoa Road Project, jointly financed by IDA (Credits No. 74-SO and 123-SO) and the EEC's FED. FED's Commissioner, Mr. Cheysson, had written to Mr. McNamara to that effect (letter dated June 24, 1977).

C. Background

2. The Afgoi-Baidoa Road was substantially completed in March 1971 by a joint venture comprising Strabag Bau-AG (Germany), as principal, and Stirling Astaldi (UK) and the Impresit-Recci (Italy). Failure of the

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Senior Operations Adviser
Controller
Others in attendance

Government to satisfy various claims made by the joint venture and the Government's counter claims led the joint venture to refer the disputed matters to arbitration in accordance with their contract with the Government, and arbitration proceedings commenced in 1974 in Stockholm pursuant to the Rules of Conciliation and Arbitration of the International Chamber of Commerce. In September 1975, the arbitrators made their award pursuant to which Somalia was to pay the joint venture DM 533,880 with interest at 6% from July 18, 1971, Somalia Shillings (So.Sh.) 13,779,220 with interest at 6% from various dates in 1971 and DM 919,268 for the joint venture's arbitration costs. The above sums total $2.81 million equivalent but when accrued interest is added, the total as of early 1977 comes to about $5.1 million equivalent or DM 12.0 million. Under an insurance contract with Hermes, the West Government export insurance agency, the joint venture is entitled to claim from Hermes a portion of the amounts due from the Somali Government in the event the Somali Government fails to pay.

3. The Somali Government has refused to pay the amounts awarded on grounds that the works were not properly done and because it felt the arbitration award was inequitable. IDA staff inspected the road in January 1977 and found it to be in reasonable condition considering its age and level of maintenance. However, the Government continues to maintain that the award is unfair; its primary complaint seemed to be losing on procedural grounds.

4. Mr. Cheysson's view is that the FED and IDA should actively seek to promote a compromise solution including "providing adequate finance, if necessary" in view of the "impecunious state in which Somalia finds itself."

5. Mr. Cheysson's initiative following his meeting with President Siad Barre in May appears to overtake arrangements towards the resolution of the dispute which had been laboriously worked out by the Somali Government in close association with IDA. Furthermore, his initiative will have raised expectations in the Somali Government that IDA and FED would assist in meeting part of the claim. Up until now these expectations were not very great and, in fact, the Minister of Finance had asserted to IDA staff that the Somali Government could and would meet the claim out of its own resources once its deeply-held grievances relating to the arbitration award had been strongly presented and once a final attempt to reach a settlement had been undertaken.

6. The Region, in a memorandum dated July 7 under Mr. Wapenhans' signature had outlined three possible responses to Mr. Cheysson's initiative:

(i) IDA should maintain its previous position by actively using its good offices to help bring about a settlement but would not contemplate any additional financial assistance to help meet the outstanding claim (IDA has already made one supplementary credit to finance cost overruns on the projects)

(ii) Management could present a second supplementary credit to the Board for the highway project to finance a portion of the claim, which, based on the cost sharing ratio of the original project cost, would amount to 76.5% of the disputed amounts found eligible. If this alternative is pursued, IDA could participate in financing the entire amount finally agreed to between Somalia and the joint venture, or could first eliminate certain elements of the claim (e.g. the joint venture's costs of arbitration, damages based on increased haulage costs resulting from Somalia's non-adherence to the contract and/or interest accrued on the amounts awarded). EEC officials believe a settlement of around DM8 million is possible; this would require IDA to approve a credit of about $2.5 million equivalent to finance 76.5% of that amount. If IDA agreed to finance its share of only those portions of the award which arise directly out of the contract (the exchange adjustment, the price adjustment and the return of amounts improperly withheld as liquidated damages), this would imply a credit of about $2.1 million; and

(iii) IDA could take the view that a second supplementary credit is not justified but that IDA would recognize the cost of the settlement to Somalia by making additional funds available during the fiscal year through other operations.

7. The Region recommended the first alternative.

D. Discussion

8. The discussion centered on whether IDA should propose a second supplementary credit and whether that would be in the best interest of Somalia. The view was expressed that most of the award amount would, as a cost overrun arising under the contract, in principle, be eligible for IDA financing. Such financing, nevertheless, would have to come out of Somalia's general IDA allocation and could not be considered additional. Furthermore, IDA's involvement in financing the award might be counterproductive in encouraging the contractor not to come to terms with Somalia or might encourage other contractors (such as the one currently building the Port of Mogadiscio, another project jointly financed by IDA and the EEC) to take claims to arbitration rather than to reach agreement with the Government.

E. Conclusion

9. The meeting agreed that the course proposed by the Region should be accepted because a second supplementary credit from IDA would not be in the best interest of Somalia and might weaken its bargaining position vis-a-vis the contractor.

10. Mr. Knapp undertook to inform Mr. McNamara of the substance of the above recommendation, especially since Mr. Cheysson's initiative appeared to interfere with the Government's earlier efforts (supported by IDA) to settle the dispute. (Subsequently, after being informed, Mr. McNamara agreed with the Loan Committee's recommendation.) Mr. Knapp further instructed the Region to prepare a reply to Mr. Cheysson's letter emphasizing IDA's reasons for not considering supplementary financing and left it to the Region's discretion whether IDA's staff should be represented at any or all of the meetings proposed to be held.

Cleared by Messrs. Knapp, Baum, Nurick, Hattori and Wapenhans

MDelBono/IKSam:jmd

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LC/M/77-08

July 1, 1977

Minutes of Loan Committee Meetingsto consider outstanding financial issues of TEK Second Power Transmission Project (Loan 1194-TU) held on April 11 and 14, 1977 in Conference Room E1208.

A. Present

Committee:

J. Burke Knapp (Chairman)
I. P. M. Cargill
W. C. Baum
A. Broches
A. D. Knox

Others:

M. P. Bart
D. Haynes
Y. Rovani
H. Pollan
A. J. Davar
R. Sheehan
J. Fish
A. Asser
V. Chang
N. Green
I. Mathai
A. Maffei
V. N. Rajagopalan

B. Issues

1. The meeting was called to consider the recommendations made by EMENA Region for declaring the TEK II Loan effective, and thereafter commencing negotiations for the Karakaya Project on the basis of proposals outlined in Mr. Bart's memorandum of April 4, 1977 and April 7, 1977, subject to satisfactory agreements being reached with Turkish Ministers visiting Washington on April 25, 1977.

C. Background

2. TEK and the Government had not met the covenants relating to the rate of return. While the Government had approved increases in tariffs by nearly 20 percent in May 1976, and again by about 10 percent in January 1977 effective April 1, 1977, they were not adequate to ensure a return of 8 percent in 1977 as agreed and the actual performance was likely to be

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Controller
Others in attendance

between 5 and 6 percent. The main difference was on account of treatment of Keban assets and revaluation of assets. The Government's proposals questioning the inclusion of the Keban dam in TEK's asset base were inconsistent with the requirements of the covenant and amounted to a request to the Bank for waiving such inclusion, as well as asset revaluation until the end of 1977. As the rate of return covenant focussed narrowly on TEK, in order to highlight more directly the need for raising adequate resources from power users for financing sector investments, the Region had proposed in the Karakaya project that Government undertake a sector financing study which would cover not only TEK, but other related institutions such as DSI and TKI, and formulate a policy for sector financing. The proposed sector financing study would build on the nationwide tariff study, already undertaken by TEK as part of the TEK II project.

D. Discussion

3. In response to the General Counsel's comment, the Region pointed out that the Budget Law provided the necessary authority for solving the accumulated receivables problem now. However, to forestall a similar situation in the future, the Region proposed that the Government acquire power to pay TEK, on behalf of municipalities, out of revenues due to and collected on the municipalities' behalf by the Treasury. This would be done by introducing legislation (need for which would have to be determined in the context of Turkish laws and practices or issuing a decree, as may be required under Turkish Law) before the end of the year. The Region suggested introduction of legislation before the end of the year because to do so earlier would be difficult, since the newly elected Parliament would convene only in November 1977. The Chairman felt that the Bank should press for adoption of such legislation or decree by December 31, 1977.

4. Central Projects felt that TEK's management and staffing situation was critical and the Bank should exercise its leverage in building TEK into an institution with competent management and adequate staff, including solution of problems of inadequate remuneration and incentives in TEK and State economic enterprises (SEEs) generally. It was noted that the problem had been recognized, and a special arrangement agreed upon, in the context of the Elbistan project, to recruit personnel on contract terms. The Minister of Energy had not merely approved recruitment on more liberal contract terms for the purpose of the Elbistan project, but also of more than agreed strength; however, adequate numbers of experienced personnel had not been attracted. Measures to overcome the staffing situation was also a key topic of discussions scheduled with Turkish ministers on the Elbistan project. The Region responded to a query by the Chairman that contract arrangements were appropriate for specific individual projects, but did not offer a viable method of resolving the institution's problem as a whole. Besides, the Government had to consider the implications of any such changes in TEK on the nearly 200 other SEEs employing over 2 million people, as well as on the Budget. Previous efforts of several Governments to effect needed changes in the personnel law relating to the whole SEE Sector had not met with success in Parliament, and further efforts to do so must await the outcome of the elections and the strength of the new Government. Meanwhile, TEK's training and recruitment policy appeared adequate, and TEK had undertaken, as part of TEK II project, a manpower study to determine its manpower needs and means of meeting them, and this study was expected to be completed in August 1977.

5. The Chairman doubted the likelihood of obtaining any undertakings from the Government at the present time, just prior to the elections, and their validity if such undertakings were obtained. For the same reason, he believed that the Karakaya project should not be negotiated until after the elections. The Region, however, noted that remedies such as suspension could always be applied, in the event of failure to perform. In the case of Karakaya, it was safer to start negotiations with the present Government, which had taken substantial steps to resolve difficult riparian issues with Syria and Iraq, which several previous Governments had strongly resisted. Besides, TEK had little to do with Karakaya, until the assets are transferred to it for operation after the facility had been constructed by DSI, which would take about 8 years.

E. Decision

6. As desired by the Chairman, the Region agreed to come up with revised proposals after discussions with the Turkish ministers, which would focus on the progress on major pending issues, including management, personnel, receivables and tariffs and transfer of Keban assets. The Chairman said he would be prepared to consider declaring TEK II effective upon concrete action by the Government on these points, or upon obtaining satisfactory assurances from the new Government after the elections that corrective steps would be taken by a certain date. While the appraisal report and loan documents for the Karakaya project could be released to the Government in order to illustrate the Bank's concerns and objectives, negotiations would be deferred until the above issues had been resolved.

Cleared by Messrs. Knapp
Cargill
Baum
Broches
Knox

VNRajagopalan/IKSam:jmd

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LC/M/77-07

May 11, 1977

Minutes of Loan Committee Meeting to consider "Congo-Second Railway Project" held on April 17, 1977 in Conference Room E1208

A. Present

Committee:

J. Burke Knapp (Chairman)
W. C. Baum
R. Chaufournier
P. Sella

Others:

X. de la Renaudiere
A. Gue
L. de Azcarate
M. S. Nanjundiah
D. King
D. Johnson
Isaac Sam
Mamadou Dia

B. Issues

1. The meeting was called to consider the recommendation made by Western Africa Region for Bank approval of the limited resumption of the Congo Railway Realignment (Ln. 1228-COB) subject to the terms and conditions suggested by the codonors' meeting held in Brazzaville from March 8 to March 10.

C. Background

2. On January 15, 1977 an armed commado group reportedly from the FLEC (Liberation Front of the Cabinda Enclave) attacked the site camp for the main tunnel of the railway realignment under the abovementioned project. Twelve workers were killed and three staff members of the contractor held hostages for two weeks. Equipment worth about US $1.0 million was destroyed. As a result all works on the realignment came to a halt and the contractor,

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Others in attendance

ASHFO - a consortium of Astaldi (Italy), Holzmann (Germany) and Fougerolle (France) - requested cancellation of its contract on March 7, 1977 invoking force majeure. In order to find a solution to this impasse, the Congolese Government convened a codonors'meeting on March 8 - 10, 1977. At the meeting ASHFO underlined that the request for cancellation was intended to set a deadline of four months (ending July 7, 1977) for renegotiation of its contract (before arbitration) in accordance with the general conditions of EDF contracts. They nevertheless empahsized that they were willing to remobilize the site camp and undertake limited resumption of works if adequate security arrangements (including military protection) were provided and if they would be compensated for such limited works program on the basis of a cost plus formula to be approved by the codonors. During the March 8 - 10 meeting, the codonors' representatives agreed in principle to such limited resumption of works during the four months interim period, subject to confirmation from their respective headquarters, and considered the four months as a reasonable intermediate period before a definite position about the future of the project could be taken. The establishment of such a position would require an assessment of the Government's ability to pacify the project area, the renegotiation of the contract with ASHFO, and the establishment of an acceptable financing plan for the renegotiated contract.

3. Preliminary estimates of ASHFO for the cost of civil works (including contingencies) under a renegotiated contract resulted in a 44 percent cost overrun. Apart from the risk associated with the security of the area, this cost overrun raises the issues of the economic viability of the project under the new conditions and the availability of funds to finance this cost increase. Assuming payments already made to ASHFO of about US$ 24.5 million (of which about US$ 7.0 million were disbursed from the Bank loan) as sunk cost, it has been estimated that the economic rate of return on the project under the revised contract would be 15 percent on a regional basis and 8 percent on a national basis which in the Region's view would still be acceptable. Insofar as the provision of funds was concerned, it was proposed that the principle of generating additional earnings through tariff increases should be established with the ATC and the Government. Subject to the abovementioned conditions and the Government payment of its contribution to the project, the Region recommended that the Bank give its approval to the limited resumption of works.

D. Discussions

4. The Region reported that on the basis of recent information the July 7 deadline could be extended by about two months. This would enable all parties to obtain a better assessment of the new situation (which had been further complicated by the assassination of President N'Gouabi and the nomination of a new Government) and, moreover, ASHFO would utilize May and June to establish unit costs under the new conditions, which the Bank and codonors would review subsequently. It was suggested that the end of August/beginning of September would be a more realistic deadline. Therefore, the intermediate period and the project completion period (if works were to be resumed) would be longer than expected. There may also be a financing gap question which would need to be resolved. Central Projects staff pointed to the fact that the assumptions made for timber and manganese ore traffic projections during project appraisal now appear too optimistic. The timber traffic is not developing as expected

and the traffic of manganese ore is far below what had been assumed at appraisal. CPS staff further pointed out that the assumption made in the Region's memorandum about the economic rate of return of the revised project may be optimistic in light of the higher costs and lower traffic prospects, although allowing for sunk costs, the resumption (subject to security) would probably be justified. It was suggested that the revised project be reappraised, including the less costly alternative for improvement of the existing line, before a final decision is taken about the resumption of full scale work in September. The Region agreed to further discuss the issue with CPS during the intermediate period. In this respect the Legal Department suggested that the legal basis for the Bank not to continue financing the project after full scale resumption of work would warrant review.

E. Conclusion

5. The Committee approved the recommendation to go ahead with the limited resumption of works program on the basis proposed by the Region, with a new deadline of September 1, 1977 for the intermediate period. Resumption of full-scale activities on that or subsequent date would be contingent on the results of reappraisal and Legal Department's review of the options open to the Bank at that time.

Cleared by Messrs. Knapp
Baum
Chaufournier
Sella

MDia/IKSam:jmd

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LC/M/77-06

April 29, 1977

Minutes of Loan Committee Meeting to Consider "Indonesia-BAPINDO Project" held on April 7, 1977 in Conference Room E1208

A. Present

Committee:

J. Burke Knapp (Chairman)
I. P. M. Cargill
W. C. Baum
A. Broches
S. S. Kirmani

Others:

G. Votaw
D. Gordon
A. Raizen
W. Diamond
F. Howell
R. Powell
T. Dinh
M. Singh
M. Hattori
N. Horsley
I. Zincir

B. Issue

1. The meeting was called to consider the proposed loan of $75 million for BAPINDO in the light of the borrower's performance under Credit 310 of 1972 and Loan 1054 of 1974.

C. Background

2. Under Credit 310, the Indonesian Government and BAPINDO had agreed to a program of action requiring BAPINDO to adopt a new charter and a Policy Statement, the strengthening of management and greater autonomy, the engagement of foreign technical advisers selected by IDA, an increase in capital, proper auditing, write-off of uncollectible loans, substantial provisions for bad debts, internal reorganization, and reduction of surplus personnel and uneconomical branches. Further, the Government would relieve BAPINDO of liability on loans to 19 state enterprises. Improved appraisal was expected to prevent the future accumulation of bad loans. Two years later it was judged that the improvement that took place justified Loan 1054 of November 1974 for $50 million. At that time the bad debt and arrears situation had

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Controller
Others in attendance

only slightly improved, but this was attributed to pre-reorganization lending. Assurances were obtained for a further increase in authorized capital and measures designed to strengthen the autonomy of BAPINDO.

3. The experience to date documented in the draft appraisal report showed a serious deterioration in the arrears situation, necessitating write-offs of ever increasing loan principal since 1973. In 1975, 2 billion rupiahs of principal had to be rescheduled in addition to 3.5 billion write-offs, and another 4 billion had to be rescheduled during the first six months of 1976. As of June 30, 1976 principal and interest in arrears amounted to 56% of the total loans outstanding (compared to 29% in 1973). The arrears situation was apparently due in part to:

(1) the local legislation favoring the borrower rather than BAPINDO,

(2) the obligatory use of a government agency for arrears collection, and

(3) the unrealistically short amortization schedules for BAPINDO's borrowers.

D. Discussion

4. EAP Region staff pointed out that BAPINDO had made progress in reorganizing its internal departments, in accounting, audit, staff, training, expansion of activities and to some extent in appraisal and follow up. However, despite these improvements, the company still faced serious problems and its loan portfolio was unsatisfactory. These problems had been discussed with Government authorities, Bank Indonesia and BAPINDO in October 1976, and a comprehensive Program of Action was agreed as necessary to remedy BAPINDO's problems. The Regional Management had suggested that in order to ensure that the essential elements of the Program were implemented effectively, the proposed loan be split into two equal tranches and that the release of the second tranche be contingent upon satisfactory completion of specific objectives of the Program.

E. Decisions

5. The Committee decided that, in view of BAPINDO's serious problems, in particular the unsatisfactory situation of its loan protfolio, the amount of the loan should be reduced to $30 million. Future lending to BAPINDO will be subject to significant improvement of its financial situation.

6. The two-tranche approach was rejected. Instead, it was decided that the completion of the following items, most of which were included in the proposed Program of Action, should be made conditions of effectiveness of the $30 million loan:

(a) Financial arrangements have been made by the Government to enable all state enterprises borrowing from BAPINDO to repay to BAPINDO all their arrears of principal and interest.

(b) The Government has, in a way satisfactory to the Bank, relieved BAPINDO of any financial risk or exposure in regard to loans to state enterprises made at the Government's behest. Such arrangements could take the form of the transfer of such loans to a trust account fully funded by the Government and administered by BAPINDO, which would be appropriately compensated.

(c) The Government and BAPINDO undertake that in the future any loan to state enterprises made by or through BAPINDO at the Government's behest shall be made through a trust fund with full funding by the Government, and shall not subject BAPINDO to any exposure or risk.

(d) The Government has compensated BAPINDO for all losses on its outstanding raw cotton loan portfolio.

(e) BAPINDO undertakes not to engage in raw cotton financing in the future.

(f) A review of the operation of PUPN (the official loan collection agency through which all loan foreclosures and legal actions by state banks must be coursed) has been completed and a specific plan satisfactory to the Bank outlining remedial steps has been presented.

(g) BAPINDO has formulated and presented to the Bank a comprehensive plan to effectively deal with its continuing serious situation of arrears, which plan should include, inter alia, the following:

(i) an account-by-account general examination by BAPINDO's staff of the portfolio in arrears, beginning with the larger loans, to determine the repayment capacity of each borrower and to propose measures for dealing with problem loans; (ii) setting annual collection targets for each branch office or collection unit; (iii) monthly review by Board of Managing Directors with relevant staff of portfolio situation (e.g. evaluation of arrears; reschedulings; write-offs; collection performance in relation to targets; status of delinquent loans transferred to PUPM); (iv) monthly reporting by BAPINDO to its Board of Supervision on the portfolio situation as detailed above; (v) raising the penalty rate on interest in arrears up to 24% p.a.; and

(h) BAPINDO has submitted to the Bank a satisfactory plan to reduce its administrative costs in relation to its total assets, including the reduction of staff and closing of unnecessary branch offices.

(i) BAPINDO has undertaken to increase its provisions for doubtful accounts to a level of at least 5% of its total outstanding portfolio by December 31, 1977, after required write-offs of bad loans during the year.

7. The Committee further decided that the ceiling on individual subloans should be reduced to $3.0 million. The free limit would be $1.0 million as proposed, subject to an aggregate free limit of $10 million.

Cleared by Messrs. Knapp, Cargill, Baum and Broches

IKSam/IZincir:jmd

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

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LOAN COMMITTEE

LC/M/77-05

April 29, 1977

Minutes of Loan Committee Meeting to consider "Thailand-Accelerated Rural Electrification Project" held on April 6, 1977 in Conference Room E1208

A. Present

Committee:

J. Burke Knapp (Chairman)
W. C. Baum
A. Broches
V. C. Chang

Others:

S. S. Kirmani
G. B. Votaw
Y. Rovani
R. H. Sheehan
J. J. Warford
J. G. Davis
N. Horsley
D. M. Goldberg
F. H. Howell
J. Beach
B. K. Abadian
L. Helmers
N. A. Gibbs
M. Johri
D. Koromzay

B. Issues

1. The meeting was called to consider the economic and financial justification of the above project, the essential features of which are as follows. First, an economic analysis, in which project benefits are comprised mainly of cost savings, shows an internal economic rate of return of 12%, Second, the overall financial performance of the borrower, the Provincial Electricity Authority (PEA) is good. Third, however, the internal financial rate of return on the project (IFR), where expected revenues from project beneficiaries are used as a proxy for benefits, is negative, i.e. minus 5.5%. If approved, this would be the first power project financed by the Bank to show a negative internal financial rate of return.

C. Discussion

2. In view of the substantial economic benefits stemming from the pro-

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Controller
Others in attendance

posed project, the major question was whether or not, given the uses of which electricity would be put (i.e. commercial uses plus residential uses such as refrigeration and television), a greater financial contribution should be obtained from project beneficiaries. While the Bank policy paper on rural electrification recognizes the justification of using promotional tariffs as a temporary measure to stimulate load growth, the exceptionally low IFR suggested that in this case the degree of subsidization was excessive. There appeared to be no compelling social reasons for such a large subsidy (as might be the case for, say, a rural water supply project).

3. The Region observed that at the proposed tariff levels, PEA would recover all the operating and maintenance costs of supplying electricity to the project villages and between 60% and 70% of capital costs; this might be compared with irrigation projects where the Bank accepted a recovery rate of 30%-40%. CPS staff however stated that the standard of cost recovery for power projects has traditionally been higher because of the importance of price as a rationing device to control consumption, and the avoidance of wasteful use of energy.

4. The Region noted that in view of the uncertainty regarding the economic costs of supplying different types of consumers and different geographical areas with electricity, and the complexity of the economic and social objectives of pricing policy, it was intended to reach agreement during negotiations of the proposed Pattani hydroelectric project that a marginal cost-based tariff study of the entire power sector should be conducted. The study would, inter alia, focus on the scope for capturing more of the benefits to be generated by the rural electrification project.

5. It was also noted that an important characteristic of the power sector in Thailand is the policy of uniform tariffs for similar categories of consumers on a national basis. In effect, the higher costs of supplying power to consumers in PEA's service area are offset by lower costs in the Metropolitan Electricity Authority's (MEA) service area through EGAT's differential bulk tariff structure. Some uniformity of tariff policy is however always required: in previous Bank projects, the resulting cross-subsidization had often been hidden, but was undoubtedly always present.

6. CPS replied that while a system of charges could never be devised that would accurately reflect the different costs of supplying all consumers, and that therefore some degree of cross-subsidization is inevitable, the current situation was in fact one in which a departure from uniformity of charges was in part responsible for the low IFR. Thus, under PEA's other on-going rural electrification programs, villages were required to contribute 30% of the cost of connection to the grid, while under the ARE project no contribution was required. The immediate issue was therefore whether or not the relatively favorable treatment accorded this group of villages was justified. An integral part of the proposed tariff study would clearly be an analysis of the extent to which the charges for different consumer groups and different regions should reflect differential supply costs.

D. Conclusions

7. The Committee approved the recommendations to invite negotiations for the proposed loan for this project on terms and conditions proposed by the Region and requested that further elaboration of the financial implications of the project and a strengthened justification be prepared for the Board documents.

Cleared by Messrs. Knapp
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Chang

JJWarford/IKSam:jmd

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(2-73)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

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LOAN COMMITTEE

LC/M/77-04

March 25, 1977

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WBG ARCHIVES

Minutes of Loan Committee Meeting to consider
"Egypt - Nile Delta Drainage II Project"
held on March 17, 1977 in Conference Room E1208

A. Present

Committee:

J. Burke Knapp (Chairman)
W. C. Baum
M. Benjenk
V. Chang
P. Sella

Others:

M. Paijmans
N. Horsley
D. Knox
D. Haynes
H. van der Tak
V. Humphrey
R. Krishna
U. Kiermayr
F. Kaps

B. Issues

1. The meeting was called to consider the issue of cost recovery with particular reference to:

(i) a 1973 decree and a 1977 law in Egypt which exempt farmers holding 3 feddans or less of drained land from paying land assessment tax, the mechanism for recovering operation and maintenance (O & M) costs related to field drainage installations; and

(ii) the possibility that as a result of the two laws cited in (i) above Egypt might already be in a technical default of covenants related to cost recovery under previous Bank/IDA financed drainage projects in Egypt.

C. Background

2. Recovery of investment cost for field drainage is provided for

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under an Egyptian law issued in 1971 in connection with the first IDA financed drainage project. Although delays have occurred in collections due to administrative inefficiency, investment costs are now being recovered from all farmers regardless of the size of their holding. The law however does not explicitly provide for the recovery of O & M costs, although provisions exist within it for reassessment for tax purposes of all land improved through field drainage installation. The Bank, under previous drainage projects, had accepted the interpretation that the reassessment tax on drained lands, irrespective of the size of the holding, could be used to recover the O & M costs of the field drainage works. It was discovered during the appraisal of the proposed project, however, that a Presidential decree issued in 1973 had exempted all landowners with less than 3 feddans from payment of the land tax. Thus, for this group of farmers (estimated to be 70% of all farmers in the project area and affecting 40% of the project area) the recovery of O & M costs through land reassessment tax is no longer feasible.

3. A further development occurred after the economic disturbances of January 1977 when a law was approved in a national plebiscite according to which:

> "Payment of taxes and public costs is a duty. Payment of taxes is not required of farmers whose property does not exceed three feddans and citizens whose annual income is less than £E500".

Although the English translation mentions specifically only the exemption of taxes for farmers under 3 feddans, the Region raised the possibility that the Egyptian negotiating team might confront the Bank with a much broader interpretation of this new law, i.e. the exemption from both land taxes and repayment of investment costs as well as any other charges for farmers holding less than 3 feddans. (The covenant proposed in the above project provides for investment recovery and the introduction of a surcharge on the annual investment cost recovery installment to cover O & M costs. It is proposed for this provision to apply also to the on-going Bank/IDA financed drainage projects).

D. Discussion

4. The Chairman inquired whether in view of the 1973 Presidential decree exempting some farmers from paying land tax the Egyptian Government was not already in default of covenants related to the recovery of O & M cost under any of the previous Bank/IDA financed drainage projects. The Region responded that clearly the exemption of some landowners from the land tax was contrary to the intent of the loan/credit agreements. An additional complication was the fact that although field drainage had been completed on some parts of the first and second projects and investment costs were being collected, albeit inefficiently, reassessments for land tax has been lagging, in some cases for as much as 4-1/2 years. Further, the 1973 law provides for a 1 year "grace period" before land tax although the loan/credit agreements did not specify a grace period. As to the 1977 law mentioned in para. 3 above, the Region commented that since the memorandum to the Loan Committee, Bank staff had held discussions with Egyptian Government officials during which the Egyptian

Minister of Finance explained that the provision referred to above applies only to exemption from paying the land assessment tax as distinct from paying any other costs. In his opinion, the law was therefore not in conflict with previous covenants under Bank/IDA agreements requiring the recovery of investment costs and it would also not prevent the introduction of a surcharge to recover O & M from farmers under 3 feddans.

E. Conclusion

5. The Chairman asked the Region to seek written confirmation of the Finance Minister's interpretation of the law and to proceed with the project as proposed in Mr. Benkenk's memorandum of March 11, 1977, namely that a surcharge on the annual cost recovery installment be introduced for all farmers including those holding 3 feddans or less. And, should the Egyptian Government indicate that the interpretation of the law does not allow recovery of investment nor of O & M costs (in the form of the surcharge), the Region should return to the Committee to seek further guidance. The Chairman noted that an earlier suggestion by the Region to have the recovery of investment and O & M costs from land owners of 3 feddans or less related to legislation following a socio-economic study to be undertaken under the Upper Egypt Drainage II project, which would determine the ability of the farmers to pay the surcharge as well as the recovery of investment costs including interest charges thereon, would leave Egypt in default of cost recovery covenants under earlier projects during the intervening period.

Cleared by Messrs. Knapp
Baum
Benjenk
Chang
Sella

FKaps/IKSam:jmd

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LOAN COMMITTEE

LC/M/77-03

March 11, 1977

Minutes of Loan Committee Meeting to consider
"Romania - Bucharest Glass Fiber Project"
held on February 23, 1977 in Conference Room E1208

A. Present

Committee:

J. Burke Knapp (Chairman)
W. C. Baum
M. Benjenk
V. Chang
P. Sella

Others:

M. Paijmans
N. Horsley
R. Hornstein
H. Fuchs
R. Dosik
S. El Darwish
H. E. Kopp
T. Asser
P. Heininger
A. Tsantis
E. T. Tortorelli
G. Becher
I. Sam
W. von Buelow

B. Issue

1. The meeting was called to consider the issue posed by the apparent availability of bilateral financing for the major project component, as reflected in Mr. Benjenk's memorandum of February 17, 1977.

C. Background

2. The main project component for which Bank financing is requested consists of a turn-key contract to supply know-how and machinery and equipment as well as training, erection supervision and start-up assistance. Procurement is in an advanced stage and bids have been called and evaluated, with contract signing expected within a month. Since contract signing will precede the Executive Directors' approval of the proposed loan, the Romanians had requested the bidders to include an offer for suppliers' credits to be utilized if a Bank loan were not forthcoming.

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Senior Operations Adviser
Controller
Others in attendance

3. Two offers of financing had been received, one from a U.S. firm and the other from a UK firm. The offer from the U.S. firm which included a preliminary commitment for EximBank financing at 9% interest for 10 years including three years of grace, did not seem to be relevant since the bid price submitted by the firm was nearly twice the price of the UK firm's bid. The UK supplier's financing offer would cover 85% of supplies to be procured from Britain amounting to US $11.3 million, plus a finance charge of US $2.5 million; terms of credit are 7-3/4% p.a. for 10 years including three years of grace, but if the nominal rate of 7-3/4% for the British bilateral credit is adjusted to take account of the US $2.5 million financial charges, it would result in an effective interest rate of 13.2%.

D. Discussion

4. Noting the analysis, the Chairman remarked that apparently suppliers' credits were available for financing of practically all imported equipment for industrial projects in Romania and raised the question whether the Bank should finance such projects at all. The Region responded that as a consequence of the Bank's lending approach to Romania, (given constraints such as the Bank's decision not to finance local costs, limitations concerning financing of interest during construction, and the requirement to present projects which attract international competition), we are pressed in the direction of projects with a maximum direct import component; yet these will often be potentially suitable for suppliers' credit financing. Industrial projects in particular were normally attractive for financing by suppliers' credits the terms of which for both the country and the project can however be quite onerous compared with standard Bank terms. The Region further pointed out a major justification for Bank lending to Romania (and indeed a major reason for Romania's membership in the Bank) was the provision of long-term funds at more favorable terms and conditions than offered by suppliers' credits. As to the Bank's contribution in Romania besides providing financing, the Region reported that the Bank's appraisal methodology, in particular in the industrial sector, was well received by the Romanians and that the Bank's analysis of industrial projects has had a significant impact on the design and execution of several projects.

5. Consideration was given to the Bank's financing only those parts of the foreign exchange costs of the project which were not covered by suppliers' credits. The Region argued that financing of this portion only by the Bank would still result in considerably higher total project cost for the Romanians. It was also felt that the main criterion for decision in this case should be the clearly less favorable if not "unreasonable" terms of British financing compared with Bank financing. The Vice President, Projects Staff supported the Region's recommendation to go ahead with the project on this basis. He raised concern, however, that similar but more complicated cases might come up in the future where the lowest bidder when suppliers' terms were taken into account was not the lowest bidder on the basis of the Bank's customary precedure for evaluating bids (which disregards financing terms) and for this reason the decision in this case might not constitute a precedent.

E. Conclusion

6. The Committee decided that we proceed with the project as proposed in Mr. Benjenk's memorandum of February 17, 1977.

Cleared by Messrs. Knapp, Baum, Benjenk, Chang and Sella

WVonBuelow/IKSam:jmd

LOAN COMMITTEE

LC/M/77-02

March 3, 1977

Minutes of Loan Committee Meeting to Consider Honduras Third Port Project held on February 11, 1977 In Conference Room E1244

A. Present

Committee

J. Burke Knapp (Chairman)
Warren Baum
Aron Broches

Others:

C. Willoughby
N. Horsley
A. Carmichael
S. van der Meer
G. Flood
H. Wyss
J. Newman
R. Vinekar
I. Sam
R. Vandendries
S. Weissman
C. Quijano

B. Issue

1. The meeting was called to consider CPS's concern that the economic rate of return for the proposed US$4.4 million San Lorenzo Port expansion component which is proposed for inclusion in the US$17.0 million Third Port Loan might be too low to justify Bank financing. The main documents before the Committee were the draft President Report for the Third Port Project, a memorandum from Mr. Flood to Mr. van der Meer, dated February 1, 1977, and a memorandum from Mr. van der Meer to Mr. Knapp, dated February 8, 1977.

C. Discussion

2. The memorandum from Mr. van der Meer to Mr. Knapp analyzes the economic cost to Honduras of expanding the San Lorenzo port as opposed to utilizing Puerto Corinto in Nicaragua for purposes of exporting projected

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Controller
Others in attendance

increases in sugar and molasses production. On the basis of the avoided costs of utilizing Corinto, the rate of return for the San Lorenzo expansion is estimated at 7.25 percent. CPS expressed the view that if this analysis were correct, the San Lorenzo expansion was not economic and should not be financed by the Bank. Theyindicated, however, that if it could be demonstrated that significant additional costs might be incurred by Honduras as a result of dependence on a port controlled by another country, this might serve to justify the project. Such a demonstration would require a probability analysis of the risk of disruption of Honduran utilization of Puerto Corinto, and the costs related thereto until such time as an alternative solution could be found.

3. CPS also pointed out that in order to accurately represent the economic implication of constructing San Lorenzo it should be compared in the project documents with all relevant alternatives including Corinto. It would be misleading if the documents reflected only Puerto Cortes on the Atlantic coast of Honduras as an alternative, and on this basis showed a relatively high rate of return for the project. The Chairman was in agreement that for purposes of the economic analysis, Puerto Corinto should be used as an alternative to San Lorenzo.

4. The LAC Region staff pointed out that the original analysis did compare San Lorenzo with Corinto, and with the original traffic forecast made during appraisal, San Lorenzo was the most attractive solution. Subsequent information and analysis, however, indicated that the traffic levels for sugar, as well as for lumber which will also be exported, would not be as high as projected earlier and San Lorenzo became marginal in comparison with the use of Corinto. The staff, therefore, sought to determine whether the Hunduran Government would be prepared to consider the use of Puerto Corinto. They were advised that the Government would not, and therefore took the view that since Corinto was not a feasible alternative for political reasons, the only other practical alternative, Puerto Cortes, should be the basis for comparison with San Lorenzo. The staff accepted the Honduran Government position on this matter in view of the fact that the Government was involved in negotiating the reentry of Honduras in the Central American Common Market (CACM) trade arrangements, and it believed that the injection of the San Lorenzo issue might complicate its efforts to achieve internal agreement on these matters. Also, it was the staff's understanding that the Bank did not insist on evaluating potential port projects on the basis of alternatives available in neighboring countries, if the country concerned objected to dependence on a foreign port.

5. The Chairman expressed concern about this interpretation of Bank procedures regarding the use of neighboring countries' ports and asked CPS to review the examples of this procedure cited in a footnote of the memorandum from Mr. Flood to Mr. van der Meer. CPS stated that, in some of the cases cited, the use of a neighboring port might have been more economic than the construction of a new port; however, in some cases, this was probably not true, and in other cases it had not been investigated, perhaps because it was not a realistic alternative. Each case must therefore be examined on its merits.

6. The Chairman agreed that it was understandable that Honduras might be reluctant to become dependent on Nicaraguan port facilities for export of an important commodity; however, he requested a further explanation as to why a Honduran request for the use of Puerto Corinto should be a sensitive matter in

the context of the ongoing Common Market negotiations. He pointed out that from the Nicaraguan point of view, permission to allow the use of Puerto Corinto would not be viewed as an additional concession to Honduras since in all likelihood Nicaragua would be pleased to have Honduran business to utilize capacity at Puerto Corinto. The LAC Region staff stated that while this might be true, given their lack of information about the status of arrangements for restructuring the CACM, they were not in a position to judge the effect that raising this issue might have. They stated that they had recently been advised that preliminary agreement had been reached on Honduran reentry, and the Hondurans were now determining how this very politically sensitive matter might be presented to the Honduran public so that it would have the best chance of acceptance. A Honduran decision to utilize Puerto Corinto in Nicaragua might make it more difficult to gain acceptance since the use of Corinto would very likely be opposed by the economically-important sugar investors for whom it would mean higher costs, and by other interests in southern Honduras.

7. Finally, the Chairman noted that only additional sugar and molasses and lumber traffic had been included in determining the rate of return. He inquired as to whether projections could be made for additional traffic which might be forthcoming in the future, in view of the fact that the Government apparently placed high priority on the development of the southern region which will be served by this port. The LAC Region staff replied that while the Government was indeed planning development projects for this area which had priority in view of its population density and large number of agrarian reform settlements, it was still too early to make concrete projections of possible future export traffic. One major question that had to be resolved was the availability of water and this was to be studied shortly.

8. CPS also noted that the cost of truck transport utilized in the economic analysis of San Lorenzo was 2-1/2 US cents per ton kilometer, and raised the question whether this was not too low, especially since it should include the cost of road maintenance.

D. Conclusion

9. It was agreed that the economic analysis for the San Lorenzo component would be reconsidered, particularly in regard to the traffic forecasts and transport cost estimate utilized, and the LAC Region staff would then review this matter with CPS to determine whether on the basis of a revised economic analysis including, if needed, a risk and probability analysis of the costs that might result from reliance on a port in another country, a case could be made for Bank financing of the San Lorenzo component.

E. Postscript

10. A revised economic analysis which reflected increased transport costs based on the inclusion of road maintenance expenses, the inclusion of the residual value of the proposed San Lorenzo improvements, and a portion of possible savings in ship turn around time, indicated a rate of return of more than 11 percent. On this basis the Loan Committee approved the inclusion of the San Lorenzo component in the proposed loan. (see Memo to Files of 2/22 by Mr. Weissman).

Cleared by Messrs. Knapp
Baum

SWeissman/IKSam:jmd

Form No. 60
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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LC/M/77-01

January 25, 1977

Minutes of Loan Committee Meeting to consider "Ethiopia - Grain Storage and Marketing Project" held on January 10, 1977 in Conference Room E1208

A. Present

Committee:

W. Baum (Acting Chairman)
A. Broches
R. Goodman
H. van der Tak
W. A. Wapenhans

Others:

M. Yudelman
N. Horsley
D. Pickering
T. M. Asser
H. Rothenbuhler
H. Adler
P. C. Loh
C. Walton
K. Krishna
J. Mullan
R. Liebenthal
P. Hansen
K. Myint
I. K. Sam

B. Issues

1. The meeting was called to consider the issues emerging from the draft documents submitted to the Loan Committee under cover of Mr. Wapenhans' memorandum of December 30, 1976 requesting approval to resume negotiations for the proposed $24 million credit for the Grain Storage and Marketing Project. The issues concerned the proposals relating to:

(i) AMC management and staffing;

(ii) grain pricing;

(iii) warehouse construction program;

(iv) AMC financial viability;

(v) passage of Ethiopian Grain Board legislation; and

(vi) AMC's role in retail trade.

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COMMITTEE

Senior Vice President, Operations (Chairman)
Vice President, Finance
Vice President and General Counsel
Vice President, Projects Staff
Regional Vice Presidents

OTHERS

President
Vice President, Development Policy
Senior Operations Adviser
Controller
Others in attendance

C. Discussion

2. Country Relationship and Strategy. The Eastern Africa Region's representatives drew attention to (i) Ethiopian sensitivities which made it difficult to negotiate the proposed project in June 1976; (ii) the background of difficulties with the government stemming from the transfer of the Bank Resident Representative, which was interpreted as a downgrading of the mission's status, and the fact that when IDA financing of the second coffee project (taken over by FED) became unnecessary, the corresponding funds were not transferred to finance cost over-runs on the Amibara project due to Bankwide shortfall of IDA resources; (iii) the recent CPP management review which acknowledged the high risk of operations in Ethiopia but which approved a strong commitment to pursue as supportive a program as possible for the country's development strategy; (iv) developments since the CPP review which indicate a more settled situation in Ethiopia resulting from the conclusion of the Government's review of its ministries, programs and organization and from the appointment of ministers and senior officials politically more acceptable to the authorities.

3. Project Implementation. The Region indicated that, based on supervision reports for all sectors, there have been considerable problems in project implementation in Ethiopia over the last 18 months, although the overall situation has not deteriorated. In agriculture, however, the problems were somewhat more acute than in other sectors. The implementation of some previously well-run agricultural projects has deteriorated as a result of the process of reorganization that followed the broad policy reforms, the loss of some competent managers, security problems in some project areas and land reform. Certain politically motivated appointments have, on occasion, adversely affected staff morale. On the other hand, improvements have recently become evident in management; ministers and senior officials appear more confident and a clear improvement has become apparent in decision making.

4. AMC Management and Staffing. The meeting discussed whether the revised proposal for individually appointed key AMC personnel instead of a management consultant firm (as proposed earlier) would ensure that all the management and technical assistance requirements were fully met and what assurances would be needed with regard to the appointment of such personnel. CPS staff pointed out that the arrangement to appoint key personnel on an individual basis would not provide the technical backup services (software support in the form of systems planning, training and recruitment) which would have been provided by an outside management firm. The Region explained that during negotiations the Ethiopians strongly objected to an outside consultancy firm because it was expensive and would rule out the use of personnel on offer under bilateral assistance. Moreover they stated that it would be unacceptable to entrust the management of AMC, which is the major instrument of Government with respect to grain production and distribution, to an outside organization. Furthermore, the Ethiopians stated that they had competent individuals who could fill many of the key positions, as demonstrated over the last year by the successful performance of AMC which is being managed largely by Ethiopians with only one expatriate manager. The Ethiopians are now agreeable to submit CV's of proposed key staff to the Association for consultations and discussion before these vacancies are filled. They had agreed to the addition to the list of key staff of a cost accountant as proposed by Bank staff. The Region felt that in the present circumstances this was a more effective way of filling key positions, with staff who would enjoy the confidence of the Government. They would be further reinforced by personnel such as the German expatriate chief engineer and planning officer

proposed to be transferred from the Relief and Rehabilitation Commission to AMC.

5. It was agreed that as a condition of Board presentation, staff with qualification and experience satisfactory to the Association would have been designated to the seven agreed management positionsof AMC, and that successor appointments to these positions with qualified and experienced staff would be made after consultation with the Association. It was also agreed that to ensure availability of the most important technical assistance services originally to be provided by the management consultancy team, provision should be made for at least two individual experts to cover such services as systems planning and training.

6. Pricing. The Region pointed out that there was no disagreement about the need to provide adequate producer incentives except that we had previously tried to relate these to quantitative formulae. The Ethiopians felt that specific ratios were arbitrary and unnecessary. They proposed a covenant which recognized the need to provide adequate producer incentives and agreed to inform IDA of price changes. It was agreed that IDA's original position was unnecessarily rigid and that the Ethiopian proposal was acceptable, given the fact that producer prices were already higher than what would have emerged from the formulae originally proposed, and the strength of the country's commitment to rural development as evidenced by land reform. However, in view of the critical importance of price incentives, the Chairman concluded that there should be a specific covenant providing for periodic consultations between the Association and Ethiopia on the adequacy of prices and incentive systems.

7. Warehouse Construction. The original IDA proposal required annual approval of AMC's construction program, to which the Ethiopians objected. It was agreed that the revised proposal for Ethiopia to submit, prior to Board presentation, a detailed 4-year construction program satisfactory to IDA was an adequate if not preferable alternative. However, it was decided to strengthen the provision such that IDA agreement would have to be obtained for AMC's annual construction program for any year if the cumulative volume of storage capacity constructed in the preceding years deviated by more than 25% from the target in the 4-year program. Accordingly, it was also agreed to require that other substantial deviations from the 4-year program including changes in location, would likewise necessitate IDA agreement to the subsequent annual construction program.

8. AMC Financial Position. It was noted that reliance on a side-letter or a letter of intent from the Ethiopian Minister of Finance with respect to the covering of AMC losses by the government as proposed by the Region, would not be sufficient. Instead of this, it was decided that the credit documents should provide that AMC is to operate in accordance with commercial principles; so that trading margins could be adjusted to cover any trading losses arising from its regular operations, and that the other covenants concerning AMC's finances should be strengthened to include reimbursement of losses incurred as a direct result of Government prices or stabilization policies, as proposed by the Region at the meeting.

9. EGB Legislation. The Chairman indicated that, in accordance with Bank Group policy, the enactment of legislation should only be a condition of

effectiveness in cases where we had seen the draft legislation and were reasonably sure that it would be passed in satisfactory form, so that its enactment was merely a formality and a matter of time. It was therefore agreed that the promulgation of EGB legislation be a condition of Board presentation and not credit effectiveness.

10. Retail Outlets. It was decided to replace the provision on AMC retailing in Section 4.04(i) of the draft Credit Agreement by a statement of intent in the preamble to the agreement to the effect that AMC would undertake retail trading only under special circumstances and provided the government would make adequate resources available to it for this purpose.

D. Conclusions

11. Subject to the modifications noted above, the Committee approved the recommendation to resume negotiations on the terms and conditions proposed by the Region. The Chairman further noted that:

(i) the paragraph on procurement in the President's and Appraisal Reports needed to be revised;

(ii) that there was not much room for further concessions by the Association in the negotiations since the Association had already moved substantially from its original position to take account of the sensitivities of the Ethiopian authorities who might likewise be expected to accept some compromise solutions;

(iii) that the President's Report should refer more frankly to the risks associated with the project, particularly the uncertainties associated with pricing, the Government's problems in implementing other projects in the agricultural sector, and the problems of lending in a high risk country. However, it was agreed that the Association should be willing to take these risks because of the crucial contribution which this project could make to the development of the agricultural and rural sector.

Cleared by Messrs. Baum
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van der Tak
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