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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

Mr Humphrey E1231

OFFICE MEMORANDUM

CONFIDENTIAL

TO: Operations Policy Sub-Committee

DATE: October 14, 1982

FROM: E. Bevan Waide, Director, CPD

SUBJECT: TUNISIA CPP: OPSC Review

File
WMH
10/19

1. Attached is the agenda and comments on major policy issues identified by CPD and PAB for consideration by the Sub-Committee. The suggested agenda items are:

(i) the relationship of the lending program to the country dialogue;

(ii) the level of lending;

(iii) country risks;

(iv) economic and sector work;

(v) the number of projects and reserve projects; and

(vi) cost sharing.

2. At the request of the Region, an addendum to the CPP on population issues is attached.

3. The Review Meeting will be held in Room E-1208 on Wednesday, October 20, 1982, at 11:00 p.m.

Attachments

cc: Regional Office: Messrs. Dubey
Picciotto
Bart
Bachmann
Fernandes
Vaurs
Finzi

cc: Messrs. Wuttke
Robless
Chernick

CONFIDENTIAL

TUNISIA CPP

Topics for Discussion

Tunisia's past record places it among the best performing Bank borrowers. Spurred by energy exports, the economy grew by 7 percent annually during the 1970s and per capita income reached $1420 by 1981. High levels of savings and investment were maintained. Moreover, the poor have shared some of the benefits of growth: absolute poverty was reduced and social services were improved. Relations with the Bank have been excellent.

The future is less sunny. As energy reserves are used up, the country is likely to become a net energy importer. The CPP notes that this will make further progress more difficult unless steps are taken to improve policies towards employment, regional development, exports, resource mobilization and public sector management. Linking all these concerns is the common theme that the pervasive distortions of the price and incentive structure must be eased. However, the CPP draws attention to the likely strong political resistance to reducing subsidies, holding down real wages or exposing protected industries to the breeze of competition.

1. Is the lending program designed to back up the principal concerns of the country dialogue?

The overriding focus of the country dialogue is a reformed structure of prices and incentives as a necessary condition for dealing satisfactorily with policies in the other problem areas. With a receptive government, structural adjustment lending would normally be an appropriate vehicle for carrying out the needed reforms. This is not proposed in the CPP because, it is argued, the Government is constrained to a gradual approach by political factors and the Bank's lending program does not afford adequate leverage. For the same reasons, sectoral lending is not proposed, even though there would be a strong case for it in both the agriculture and industry sectors. This puts the onus for policy reform on individual project conditions and we doubt whether this is a strong enough tool. We note, too, that project returns are likely to be sub-optimal when price distortions are severe.

If we accept that the lending program will not make use of the tools offered by non-project lending, the Bank must still be sure that reforms are being made, especially if Tunisia is to continue receiving a premium lending program. The CPP proposes to monitor a number of key indicators (paragraph 51) to evaluate future performance, including both policy actions and their impact on objectives and including relative returns in agriculture and industry, relative labor/capital costs and prices/labor costs relative to international levels.

Added to the illustrative list of indicators, we would suggest the monitoring of trade liberalization for industry, including tariff policies and the effective use made of foreign exchange allocations. The CPP does not specify the progress it expects to see in the indicators it will monitor and we would suggest that this be addressed in the postscript. The discussion should include a review of how much change in the proposed variables is sought, what would be a reasonable time frame for achieving this and any specific policy steps we expect to see (e.g., identify any subsidies which we believe the Government should eliminate). (CPD)

2. Is the proposed level of lending warranted?

Compared with the previous three years, Bank lending to Tunisia in FY80-82 jumped 89 percent. Annual per capita lending averaged $24.8, the highest for any borrower with the exception of some very small economies. In part, this reflected the Region's keenness to exploit the excellent dialogue they were building up during this period and to back up the economic and sector work with lending operations. And, indeed, this has had positive results. The Region acknowledges in the CPP that this level of lending cannot be sustained in the light of competing claims on Bank resources. It proposes a program of $740 million for FY83-87, equivalent to $22.8 p.c.p.a. Given present expectations of IBRD resouce availability, our view is that this amount is still too high relative to comparable countries; a program amounting to $700 million ($21.5 p.c.p.a.), more in line with countries such as Botswana, Ivory Coast, Jordan, Korea and Colombia, would be more equitable. This would represent an 11 percent premium over Tunisia's norm amount. The lower lending program could be achieved either by dropping one of the two highway projects, as these contribute relatively little to resolving the main policy concerns, or by cofinancing various projects. (CPD)

PAB shares this concern over the proposed increase in the lending program, arguing that the transfer of financial resources per se should not be a priority objective of the Bank's assistance strategy in the medium term. Tunisia has access to foreign private capital and is estimated, according to the CPP, to continue to receive considerable concessionary financial assistance from Arab countries. Moreover, despite the pessimism of the CPP (paragraph 64), the potential for cofinancing opportunities should be pursued further, in close coordination with IFC. Also, given the increasing complexity of some of the proposed projects, the recent slowdown in disbursements suggests that a less rapid expansion of the Bank's portfolio would be advisable. PAB therefore recommends a lending level for FY83-87 stabilized at the previously approved level of about $670 million. (PAB)

3. What country risks is the Bank taking in acting upon the recommended lending program?

Given the country's favorable balance of payments prospects in the medium term, Tunisia is creditworthy for the IBRD lending proposed in the CPP for FY83-87. In the longer term, however, Tunisia faces considerable downside risks as earnings from hydrocarbon exports will progressively decline. Its continued creditworthiness will hinge on the implementation of substantive structural reforms, especially with respect to export diversification, price reforms, domestic resource mobilization and employment generation. In our view, these downside risks need to be further evaluated. They relate not only to the balance of payments, but also to the administrative and managing capacity of the Government, as well as to the political feasibility of the major policy adjustments (e.g., increase in domestic resource mobilization) which need to be brought about and sustained. (PAB)

4. Is the high volume of planned ESW justified?

The volume of ESW is high, but justifiably so. We draw attention to paragraph 49 because, unlike so many other CPPs, it can refer to specific instances where past ESW has had an impact on policies. We fully support this program and our only suggestion would be to clarify how the proposed increase in cooperation with Tunisian institutions is to be implemented and financed. Will the proposed technical assistance loans be made available for this purpose? (CPD)

5. Is the proposed program too ambitious in terms of the number of operations?

The Region proposes 27 operations for FY83-87, as compared to 21 operations during FY77-81. Given the recent implementation problems, the question arises as to whether the country's absorptive capacity may not be overtaxed by too many operations. In this context, the inclusion of nine reserve projects in the operations program seems excessive and raises concerns about the cost effectiveness of the proposed lending work program. (PAB)

6. Cost sharing

In the absence of recommendations in the CPP, PAB proposes that the Bank's share in total project costs should not exceed 60 percent and that, given Tunisia's per capita income and its access to other financial resources, local cost financing should not be provided.

It is recommended that the next CPP review should be scheduled in two years.

Annex I compares the lending program for Tunisia in this CPP with programs approved earlier. Annex II presents a comparison of various country performance indicators.

Attachments

Tunisia

	FY79	FY80	FY81	FY82	FY83	FY84	FY85	FY86	FY87	Total FY79-83	Total FY82-86	Total FY83-87
Operations Program (No.)												
Approved, October 1981	4	6	6	6	6	6	3	4	..	28	25	..
Proposed, September 1982	4	5	6	5	6	10	9	6	5	26	35	36
Lending Program (No.)												
Approved, October 1981	4	6	6	4	6	5	5	5	..	26	25	..
Proposed, September 1982	4	5	6	5	6	5	6	5	5	26	27	27
Lending Program (Cur. $m)												
Approved, October 1981 a/	99.0	171.0	152.6	137.5	127.0	140.0	130.0	133.0	..	687.1	667.5	..
Proposed, September 1982	99.0	171.0	152.6	160.5	140.5	144.5	150.0	150.0	155.0	723.6	745.5	740.0
Lending Program (Const. FY82 $m)												
Approved, October 1981 a/	119.4	195.9	163.4	137.5	119.1	123.7	108.3	104.6	..	735.3	592.9	..
Proposed, September 1982	119.4	195.9	163.4	160.5	131.8	127.7	125.0	117.9	114.9	771.0	662.9	617.3
Commitment Deflator (FY82=100)	82.9	87.3	93.4	100.0	106.6	113.2	120.0	127.2	134.9			

NOTE: September 1981 Review Group Decisions: FY82-86 - IBRD $667 million (for FY82-83 - $264 million).

a/ In his review of the CPP updated memorandum of September 1981, Mr. Stern approved a total of $667 million for FY82-86 in October 1981. The annual phasing of the approved FY82-86 program is based on the Regional submissions of February 1982.

PABCP
10/4/82

COMPARATIVE COUNTRY ANALYSIS

Tunisia has achieved an impressive rate of growth in the past decade, both in terms of GDP and exports. Direct foreign investment in the petroleum sector is partly responsible for the high investment ratios during the last 6-8 years. Tunisia's economic progress is favorably reflected in the social indicators data, although the adult literacy rate is still below the average for middle income countries. On a per capita basis, Tunisia has and is slated to receive more Bank lending than the comparator countries.

	TUNISIA	PORTUGAL	MALAYSIA	CHILE
Economic Structure				
Population 1980 (millions) d/	6.5 b/&c/	9.8 e/	13.9	11.1
GNP Per Capita 1980 d/	1420.0 b/&c/	2350.0 e/	1620.0	2150.0
% Agriculture in GDP 1980 d/	13.5 b/&c/	11.5 e/	24.0	7.0
% Industry in GDP 1980 d/	32.4 b/&c/	33.7 e/	37.0	37.0
Debt Service Ratio 1980 a/	13.9 b/&c/	10.2 e/	2.3	22.9
Economic Performance	1971-81 b/	1970-80 e/	1970-80 d/	1970-80 d/
Real GDP Growth Rate	7.4	3.6	7.8	2.4
Real Export Growth Rate	6.6	5.1	7.4	10.9
	1981 b/	1980 e/	1978-80 j/	1978-80 j/
Gross Domestic Investment/GDP	30.9	25.1	26.6	19.0
Exports and NFS/GDP	42.3	28.1	56.9	21.7
Resource Balance/GDP	-8.1	-14.3	5.8	-2.7
Gross Domestic Savings/GDP	22.8	10.8	32.4	16.3
Government Revenue/GDP	30.0	30.0	25.2	32.1 i/
Recent Social Indicators h/	1978-80	1978-80	1978-80	1978-80
Population Growth Rate	2.1	1.3	2.4	1.7
% Change in Crude Birth Rate (1960-80) d/	-28.6	-24.5	-30.6	-40.7
% Change in Crude Death Rate (1960-80) d/	-56.2	28.0	-52.9	-42.7
Infant Mortality Rate (per 1,000)	90.0	35.1	31.1	43.2
Life Expectancy (years)	60.2	70.8	64.2	67.1
Adjusted Enrollment Ratio:				
- Primary	102.0	117.0 f/	93.0	119.0
- Secondary	25.0	55.0 f/	52.0	55.0
Adult Literacy Rate	62.0	71.0 g/	58.5 g/	88.1 g/

Lending Program k/	TUNISIA FY77-81 b/	TUNISIA FY82-86 b/	PORTUGAL FY77-81 e/	PORTUGAL FY82-86 e/	MALAYSIA FY77-81	MALAYSIA FY82-86	CHILE FY77-81	CHILE FY82-86
Nominal IBRD $USM	579.1	745.5	602.0	799.0	581.0	900.0	176.0	400.0
p.c.p.a. Lending $US	17.8	22.9	12.3	16.3	8.3	12.9	3.2	7.2
p.c.p.a. Grant Equivalent $US	4.0	5.2	2.8	3.7	1.9	2.9	0.7	1.6
p.c.p.a. in Constant 1981 $US	21.0 L/	20.4 L/	14.2 L/	14.2 L/	9.8	11.4 m/	3.7	5.7

a/ World Debt Tables, December 1981.
b/ Tunisia CPP, September 1982.
c/ 1981 figures.
d/ World Development Report 1982.
e/ Portugal CPP, September 1982.
f/ 1977 figure.
g/ 1970 figure.
h/ Social Indicators Data Sheets, EPD, 1982.
i/ 1977-79 data.
j/ International Finance Statistics, IMF, April 1982.
k/ Review Group Decision figures for FY82-86, September 1981.
L/ Using constant 1982 US$.
m/ Using average 5 year deflator for FY82-86.

Country Assistance Division
Country Policy Department
October 14, 1982

Addendum

Tunisia CPP Review Draft of September 16, 1982

(Social Developments: insert before para. 6)

As an exception among Arab countries, Tunisia has pursued an active population policy since the 1960s. Recent estimates of the National Institute of Statistics clearly confirmed a slowing down in demographic growth, although not as pronounced as expected: in the 1960s the natural growth rate of the Tunisian population was about 2.8 per cent per annum, and the net rate 2.2 per cent; during the 1970s, the natural growth rate fell to 2.55 per cent, while migration abroad practically came to a standstill. Urban population grew at a very fast rate while rural population growth is close to zero. As a result, the rural population now accounts for less than 50 per cent of total population. Tunisia's overall population growth rate remains fairly high, even though one of the lowest among Arab and African countries. After more than fifteen years of operation, the family planning program has lost part of its dynamism, and an additional effort is needed through education and motivation campaigns and re-training of health personnel in outreach services. About 25 per cent of Tunisian women of reproductive age are practicing contraception, though the levels are higher in urban areas than in rural areas. While family planning services are readily available in urban and peri-urban areas, the Government is now confronted with the more difficult task of reaching rural populations. With the support of the Bank and USAID, it is implementing a policy aimed at integrating family planning in its basic health services delivery system. These actions are being supported by the on-going Health and Population Project and will be further strengthened in a follow-up project now envisaged for FY84 (para. 60).

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Members of the OPSC

DATE: October 12, 1982

FROM: E. Bevan Waide, Director, CPD

SUBJECT: CONGO CPP: Postscript

Attached for your information is the Postscript for the Congo CPP which was reviewed by the Committee on September 16, 1982.

Attachment

Confidential

COUNTRY PROGRAM PAPER

THE CONGO

Postscript of the OPSC Review

70. A meeting of the Operations Policy Sub-Committee (OPSC) chaired by Mr. Stern reviewed the Congo Country Program Paper on September 16, 1982.

Country Assistance Strategy

71. The Regional staff reported the results of consultations held with senior Congolese officials since preparation of the CPP as part of the Bank's expanded economic dialogue. A review of 1983 budget proposals and of public finance policy proposals for FY84-86 suggests that the Government is taking a considerably more prudent approach to macro-economic management than suggested in the Congo's 1982-86 Plan. The Government intends to adopt a policy which sets a 30 percent ceiling on the ratio of annual debt service to Government current receipts; it is also proposing little or no real increase in operating and investment budgets for the 1983-86 period. Final estimates of current receipts for 1983 and agreement on the composition of expenditures are, however, still required. The Bank supports the Government's current posture, and a mission is scheduled to visit Congo in late October or November to review these budgets.

72. The OPSC agreed that the Government's efforts to adjust its investment and borrowing targets to available resources enhanced the prospects for Congo's continued creditworthiness for the proposed level of Bank lending for FY83-87; but the performance of the oil sector, the success of the Government's export diversification efforts and its control over expenditures would be decisive in the medium and long run.

73. The OPSC questioned whether the proposed lending program adequately sought to bring about a diversification of the Congo's export structure and increased import substitution, particularly in agriculture. The Region pointed out that agriculture was actively supported by other agencies like the ADB, FED, and CCCE. Very weak institutions in the sector and Government's heavy emphasis on state farming, coupled with an already highly urban, service-oriented economy, were also responsible for the very limited focus on agriculture proposed in the CPP. The OPSC underscored the importance of the sector work envisioned to review the Congo's state farm experience in order to identify the most appropriate form of Bank support for agriculture in the outer years of the period.

74. Members of the OPSC suggested that a Third Education Project, which supports better human resource planning and development, be included in the lending program in view of the serious mismatch between those general skills supplied by the existing education system and the technical skills needed for economic growth. The Region noted that an education project included in earlier drafts of the CPP had been withdrawn pending more careful study of those employment-related education issues prior to

the identification of a project. Provision has been made in the proposed technical assistance project for an intital study of the principal constraints to and means of increasing labor absorption in the economy. This is expected to be an effective first step in preparation for a dialogue with senior Government officials on employment policy issues.

75. The OPSC agreed that in consultation with the Government performance criteria relating to external debt management and public finance should be set; they should be applied in a pragmatic manner to encourage moderation in the Government's investment and borrowing programs.

Lending Program

76. The meeting approved the FY83-84 lending program of $42.5 million and also agreed with the CPP's proposal that the level and composition of the FY85-87 lending program now set at $65 million be reconsidered in light of a thorough review of the situation at the end of calendar 1983.

77. Finally, the OPSC agreed that Bank financing of up to 50% of total project costs was appropriate though a higher share would be acceptable for population, health, and technical assistance projects.

Western Africa Region
October 6, 1982

FORM NO. 75
(9–78)

THE WORLD BANK

ROUTING SLIP	DATE: October 5, 1982

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	INITIAL		SIGNATURE
	NOTE AND FILE		URGENT

REMARKS:

The attached Country Program Paper on PORTUGAL is scheduled to be discussed at the OPSC meeting on Tuesday, November 16, 1982 at 3:30 p.m. in Room E1208. The meeting will be chaired by Mr. Stern.

FROM: C. L. Robless	ROOM NO.: D1348	EXTENSION: 75533

REVIEW DRAFT
FOR OPERATIONS POLICY SUB-COMMITTEE
CONFIDENTIAL

Country Program Paper

PORTUGAL

September 30, 1982

Distribution

Operations Policy Sub-Committee
Senior Vice President, Operations
Regional Vice Presidents
Vice President, Operations Policy Staff
Vice President, Energy and Industry Staff
Vice President, Economics and Research Staff
Assistant General Counsel, Operations
Director, Programming and Budgeting Department

Other Attendance
Executive Vice President, IFC
Director, Country Policy Department
Chief, Country Assistance Division, CPD
Chief, Country Program Review Division, PAB

For Information

Directors, Operations Policy Staff
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CONFIDENTIAL
REVIEW DRAFT

September 23, 1982

COUNTRY PROGRAM PAPER

PORTUGAL

			FY77-81	FY82-86	FY83-87
1980 Population:	9.8 million	IBRD(TW)	602	799 a/	908
1980 per capita GNP	$2350	IDA	-	-	-
		Total	602	799	908

Current Population
Growth Rate: 1.3%

	FY77-81	FY82-86	FY83-87
No. of Loans/Credits	13	14	15
No. of Loans/Credits per million population	1.33	1.43	1.53

Current Official Exchange rate:
Escudo 84 = $1.00 (Aug. 1982)

Average Lending Per Capita Per Annum: Current $(Constant FY82 Commitment $)

	FY77-81	FY82-86	FY83-87
IBRD	12.3(14.2)	16.3(14.2)	18.5(15.5)
IDA	-	-	-

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a/ The FY82-86 lending program proposed in this CPP compares with the program for the same period approved after the last Bank-wide lending program review (November 1981) as follows:

	FY82-86 Lending Program		Percentage Change
	Approved	Proposed	Proposed/Approved
No. of Loans	17	14	-18%
Current $ million	799	799	-
Constant FY82 Commitment	764.9	697.3	-1%
Per capita per annum (constant FY82 commitment)	14.2	14.2	-

COUNTRY PROGRAM PAPER

PORTUGAL

REVIEW DRAFT

Table of Contents

PORTUGAL

COUNTRY PROGRAM PAPER

A. Country Background

Political

1. Since constitutional democracy was established in Portugal in 1976, the country has been governed by coalitions and minority governments leading to frequent government changes. The current government of Mr. Pinto Balsemao's was formed in August 1981 and is the eighth government since 1976. Parliamentary majority is held by the Aliança Democratica (AD), which is a coalition of three parties which entered elections as one group: the Social Democrats (PSD), the more conservative Christian Democrats (CDS) and the Monarchists. Of these, the PSD has the largest number of seats in Parliament. The President of the Republic, General Eanes, does not belong to any party, but maintains a strong public position and was comfortably reelected for another five years in the presidential elections of December 1980. The strong differences between the AD coalition partners has impeded its ability to move decisively. However, AD was able to manage the redrafting of the 1976 Constitution in consultation with the Socialist Party. The new Constitution has been approved by Parliament and awaits promulgation by the President. Major changes include abolishing the Revolutionary Council set up in 1974 and reducing the power of the President. In addition to the constitutional reform, the approaching Municipal elections scheduled for December 1982 are contributing to a continued politicization at all levels.

2. The revolution and its immediate aftermath brought about a major redistribution of income and wealth, and a substantial lessening of problems of relative poverty. Some of these gains have been eroded and progress on other developmental issues has been slow and erratic. Successive governments have attempted to introduce development initiatives ranging from the more socialistic to the very conservative, but all had to operate through a highly centralized public administration, which is excessively legalistic and slow to move. These cumbersome administrative procedures on the one hand led to slow implementation, but on the other hand, they are part of an open and consultative governing process which has resulted in a high standard of public accountability. Despite the efforts of the Ministry of Administrative Reform, attempts at decentralization and regionalization of authority have not proved very successful so far, and the cumbersome administrative machinery is likely to remain for some time. A major part of the industrial and financial sectors is in the hands of the central Government. This means that large portions of the Government's resources are tied up in public companies which, for various reasons, are unprofitable. Their operating deficits have accumulated at a time when the Government has tried to encourage more self-financing by industries in order to free public resources for long-term development investments in infrastructure and social services. However, with the new Constitution,

it may now be less difficult to open the nationalized public sector to private initiative as well as to liberalize the labor laws, measures which are necessary in order to enable restructuring of the economy.

3. There are a number of aspects of these administrative weaknesses and of the uncertain political process which have adversely affected development efforts in Portugal, and they are likely to continue to do so. First, many issues which ought to be capable of being addressed at a technical level become highly politicized, and as a result their resolution takes an unnecessarily long period of time. Second, Ministers and Secretaries of State have generally not delegated authority to their civil service (which, in any event, is weak) and even small decisions are escalated to an unnecessarily high level, thus again delaying action. Third, with so much decision-making authority resting in the hands of the more senior officials, there has been a considerable discontinuity of attitude on a number of issues. We have frequently found that a new Minister or Secretary of State is unwilling to carry forward decisions of his predecessor (even if he was from the same party) without a further, and again time-consuming, review of the issues. Finally, since the formation of the present ruling coalition, there have been persistent reports of lack of cohesion between its members and of philosophical differences within the PSD and between the PSD and the CDS. This has led to a good deal of indecision. While we cannot expect any real improvement in this area over the short-term, it should be said that the present Government has shown itself to be capable of reaching sound judgments on economic matters given time, and has recently taken a number of pricing decisions which involved considerable political risks.

4. In the last two years, the politicizing of all government activities has become more intense while Portugal's development performance has deteriorated; at the same time, the period witnessed a series of unsuccessful attempts to reach an agreement with the IMF for an Extended Fund Facility. In spite of the increasing difficulties, the successive governments have been and continue to be interested in working with the Bank. In some ways, the Portuguese are more like some of our most unsophisticated borrowers in their grasp of how the Bank works and how to take full advantage of the relationship. Nonetheless, our working relations are characterized by intense discussions, a creditable respect for obligations and covenants, and honesty.

Economic

5. In 1974, the Portuguese economy was severely disrupted by major external shocks, namely the simultaneous occurence of the first oil price hike, the loss of African colonies and associated important captive export markets and raw materials sources, and a sharp increase in unemployment associated with large net immigration from the former colonies. While the revolution of 1974 resulted in a desirable reduction in economic inequality, its short-term consequences (e.g., land reform, worker take-overs of plants, widespread nationalizations) were extremely disruptive and continue to exert a negative influence. The destabilization of the macroeconomy associated with these events came to a head in 1977 when there was a very large ($1.5 billion)

external payments deficit, exhaustion of foreign currency reserves and heavy borrowing against Portugal's ample gold reserves. However, the macro instability was resolved through a sequence of measures (exchange rate adjustment, interest rate increases, and general restraint in monetary, fiscal and wages policy) supported by a one year IMF stabilization program beginning in May 1978. By 1979, the deficit on the current account had been virtually eliminated, inflation had declined significantly to 24 percent (from 27 percent in 1977) and Portugal's creditworthiness for external borrowing had been firmly reestablished. The measures leading to this result were possible in spite of considerable political flux with many Government changes during the period, and without a severe reduction in growth rates (these averaged over 3.5 percent in 1978 and 1979). Nevertheless, the economic developments of the late 1970s did little to address the seriously deficient state of socio-economic development, and many of the social indicators (e.g., child mortality and adult literacy) remain at levels more common in Third World countries.

6. It was a reasonable expectation that the Government would take advantage of the stable economic position achieved by 1979 to address many of the severe structural problems of the economy, especially in the industrial and agricultural sectors. These problems had been exacerbated both by the revolution and by the stabilization program, and were increasingly in need of attention, given Portugal's decision to join the EEC by 1983 (subsequently changed to 1984). Unfortunately, this did not happen. Structural problems were not addressed with any sense of urgency, largely because of preoccupations with a number of political and socioeconomic issues, and especially the two important elections in 1980. In the event, the stance of economic policy in 1980 became more expansionary. This was conditioned far more by electoral considerations than by economic reality but it did reflect the decline of real wages after 1976 and the perceived need to correct this as well as to produce an improved investment performance. This policy included an ill-designed revaluation of the currency in February 1980, and a suppression of inflationary forces through failure to adjust administered prices. As a consequence, both GDP and real wages rose sharply while inflation fell to 17 percent, but the current account balance of payments recorded a deficit of $1.2 billion (5 percent of GDP) and the budget deficit reached 10 percent of GDP. Even after the election of a four-year Parliament with a sound majority at the end of 1980, the macroeconomic management of the economy remained indecisive and loose. Partly for this reason, partly because of the international recession and the appreciation of the dollar, and also partly because of a severe drought, all the major economic indicators for 1981 suggest a deteriorating position. The current account balance of payments recorded a deficit of over $2.7 billion (11 percent of GDP), inflation was in excess of 20 percent (and reached a month on month rate of 25 percent by year end), agricultural production fell, the overall growth rate was on the order of 2 percent, export volumes fell, and the overall Government budget deficit rose further as a percentage of GDP. The IMF has made several unsuccessful attempts since late 1980 to agree on an Extended Fund Facility (EFF) having a significant structural element, but the Government was not prepared to address some of the medium-term issues involved. It now seems increasingly likely that 1982

or 1983 will see the need for a relatively tough stabilization program. In the meantime the Fund is considering the case for possible use of the Compensatory Finance facility which could provide up to about SDRs 129 million in foreign exchange on an unconditional basis and at a very low rate of interest. The Government has also independently taken some steps in the direction of stabilization. In particular, most interest rates were raised by 2 percentage points in July 1981 and again in April 1982, and the exchange rate was devalued by an average of 9.5 percent on June 15 in response to a series of major currency re-alignments within the EEC. This adjustment has been excessive vis-a-vis the US dollar (in which food and energy imports are denominated) but has not effected much improvement against some European trading partners and notably France. Thus, further adjustments would seem to be called for, in the relative weights of the currencies in the basket and in the rate of the crawling peg to account for differential inflation rates. A number of relatively stiff pricing increases (e.g., for water, electricity, fuels and certain food items) have been announced in recent months in an effort to reduce public sector deficits. In addition, the Government followed its devaluation decision by prompt action to increase the domestic prices of major imported commodities and notably fuels, but in some cases the effects of the devaluation were not fully passed on. The increase in domestic prices should restrict the budgetary consequences of the further strengthening of the dollar relative to the escudo.

B. Country Objectives

General

7. The current Government has defined its main economic objectives in broad terms, but has not presented a coherent economic program showing in detail how it will proceed to address them. Thus, its medium-term objectives are uncertain. The first AD Government was targetting a medium-term aggregate growth rate of 4.5 to 5.0 percent but because of the worsening economic situation since then, this target growth rate will certainly need to be revised downward. This moderation of growth targets will require measures in the very near future designed, among other things, to moderate the Government's own budgetary deficit, slow the growth of private domestic demand through appropriate pricing, wage, monetary and other policies, and restrain the growth of external debt. The probable macroeconomic consequences of such policies are discussed later.

8. The Government's general stance towards economic policy includes a reduced involvement of the public sector in productive activities, but it remains to be seen what this will imply for investments by the large public enterprises, many of which have ambitious plans for expansion. The authorities seem likely to give priority to the completion of projects already initiated and to essential investments in those enterprises where constitutional restrictions will prevent a substantial degree of private involvement. The commitment of public resources to new large-scale public sector projects seems likely to be less than in the recent past. Similarly, although the

Government's philosophical commitment to a more liberalized economy is clear, this has not yet led to a well-defined program of action to end the pervasive distortions arising from continued tight controls on pricing and investment in public enterprises, financial restrictions on interest rates and credit ceilings, continuing non-tariff barriers to trade (mainly import licensing), and general price (including rent) controls. Indeed, there was evidence of an intensification of some of these restrictions in 1981. This contrasts with the situation in relation to tariffs which are already low compared to many countries of a similar per capita income, and will be liberalized even more, at least in the industrial sector, as a result of EEC membership.1/

9. The structural issues which the Government will need to address as part of its objective of bringing living standards closer to average European levels are numerous and complex. They include the need to raise productivity and production in agriculture, both to lessen the very high requirement for imported food 2/ and to take full advantage of new export opportunities in the EEC; the need to restructure the industrial sector to ensure that the EEC trading advantage accruing from relatively low wage rates is not negated by poor productivity; the need to reform the general management and performance of the large public enterprise sector; and the need to reduce the very high dependence on imported oil through appropriate conservation measures and the development of alternatives, including renewable energy resources. In addition, the Government has on many occasions expressed its commitment to reduce regional imbalances.

Exports

10. However, notwithstanding the general uncertainty, two aspects of the Government's stated approach are clear. First, in its public pronouncements, it attaches high importance to investments and other actions which can result in significantly improved export earnings. This priority (which reflects a viewpoint which we have frequently repeated in our economic and project work since 1977) is undoubtedly correct, given Portugal's very low coverage of imports by export earnings (less than 50 percent in 1981). It implies an emphasis on private sector industry, which accounts for the bulk of exporting enterprises. Unfortunately, the specific export incentives to support this effort are not particularly strong at this time, although these were improved by the June 1982 devaluation. Additionally, policy interventions will be necessary which are selective in nature and sectorally specific. Precisely what these will be is being progressively clarified by, among other things, a series of sectoral studies to which the Bank has provided considerable technical and financial assistance.

1/ The rather different situation in agriculture is dealt with in para. 44.

2/ This problem will be intensified by EEC entry because of the significant increases in the import price for major food items which this will cause.

Energy

11. Second, the Government is preparing a comprehensive plan for the energy sector, aimed at significantly reducing the present high burden of imported energy and increasing the utilization of domestic energy resources (mostly hydro). This is being based on a very comprehensive analysis of present and possible future energy needs and supplies, supported by the U.S. Department of Energy. The Government is committed to conservation through general methods, including appropriate pricing of major fuels. 1/ In addition, Portugal has recently obtained a Bank loan for a project designed to save energy in a number of major industrial enterprises (e.g., cement and fertilizers). This includes a selective audit of energy use in other subsectors as a basis for designing a further program of energy-saving investments. Success in the conservation area could reduce the income elasticity of energy consumption from well above to somewhere near 1.0 by the end of the decade. Finally, the Government is undertaking an exploration program to ascertain the prospects for developing indigenous petroleum and coal supplies.

Other

12. Beyond these reasonably well-defined policy objectives, the Government is also developing programs of action in other areas. First, a commission appointed in 1980 is undertaking an in-depth review of the workings of some major public enterprises. The immediate purpose of this review, from which first conclusions are now available, is to assess the extent to which the deteriorating financial position of these enterprises reflects an unacceptably low economic performance, and to propose possible remedies. The Government has demonstrated its commitment to phase out certain subsidies (e.g., fuel, bread and fertilizers) which have impinged unfavorably on the operations of the public enterprises. Second, work is reasonably well advanced in designing specific programs of restructuring for industrial sectors such as textiles, pulp and paper, and engineering, which account for significant shares of Portuguese exports and employment but which are unable to achieve their full potential because of various financial, technical, manpower and organizational problems. The Bank is closely involved in this work, and programs of action are expected for textiles and electro-mechanical engineering in the near future. Third, a number of separate exercises are underway to try to reform Portugal's cumbersome and inefficient tax structures and financial markets. To a degree, these reforms are motivated by the expected EEC entry (e.g., the introduction of a value-

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1/ Portugal already enforces the highest prices for gasoline in Europe and has made several major adjustments to diesel and fuel-oil prices in the past year. Fuel oil and diesel prices are now at the lower end of the European range, having been raised in December 1981 and April 1982 following negotiations of our oil exploration loan signed in September 1981.

added tax on which Portugal is receiving technical help from IMF experts). Together, they contain considerable potential for raising the efficiency of the environment within which both public and private companies operate.

C. Medium-Term Prospects and Policies

13. The 1982-85 period is a time in its history when Portugal should ideally be implementing an extensive reform of its industrial and agricultural structures in order to prepare for entry into the EEC, now planned for 1984. However, preliminary projections prepared for this paper indicate unambiguously that the pursuit of growth rates of 4.5 to 5.0 percent, which were deemed necessary two or three years ago to realize some of the country's ambitious investment programs 1/, would be very hazardous given Portugal's poor starting base namely a current account deficit of over $2.7 billion in 1981. If the Government were to attempt to achieve a 4.5 to 5.0 percent growth rate without major change in the exchange rate, interest rates and other policies, the current account deficit would probably rise to a figure of about $5 billion (13 percent of GDP) by 1985 and medium- and long-term debt would increase from about $6 billion in 1980 to $16 billion in 1985. If this were to continue up to 1990, medium- and long-term debt could exceed $50 billion and the debt service ratio reach 40 percent. Even in the scenario where the exchange rate, the interest rate and other policies were all appropriately adjusted, total external debt could be as high as $33 billion by 1990 and the debt service ratio could equal 23 percent. Given the more likely slower policy and investment response, Portugal will at best be able to attain about a 3 percent growth rate with debt service ratio rising to about 24 percent in the late 1980s, and declining thereafter.

14. Our projections assume that the feasible growth rate would average somewhat less than 3 percent to 1985, rising toward 3.5 percent by 1990. This rate of growth would leave the economy in a reasonably sound financial state by the end of the 1990s, and would allow the recent rapid build up of external debt to be significantly stabilized. At the same time, such a rate of growth would allow a reasonable growth of the investments needed for restructuring and, indeed, since it is brought about in part by a resumption of rapid export growth, it should stimulate investment in export-based industries. In addition it should permit consumption to grow at a rate averaging over 2 percent between 1983 and 1990. It will not, however, be a growth rate which can make much impact on Portugal's unemployment rate, currently estimated at 8.8 percent. Also bearing in mind the serious overmanning of many of its major sectors, such as textiles, and the consequent need for some industrial restructuring to be labor-saving, one has to anticipate a significant conversion of underemployment into open unemployment in the next few years. Furthermore, modernization of agriculture will certainly displace labor to seek jobs in other sectors.

1/ See Portugal: Priorities for Public Investment, Report No. 2883-PO, July 1980.

15. Assuming that the obvious political costs of this development can be accepted, there are certain basic principles which should guide the Government's pursuit of this growth path, as well as the Bank's reaction to it. First, the growth in the medium-term should be orderly and planned, and above all should reflect the priorities of structural change in the economy. The slowdown in growth, as compared to earlier government plans, should not be seen as a reason for aborting or delaying these changes because if it is, a crisis may be averted for the time being only to reemerge in some later year when growth begins to accelerate again. Second, the export performance of the economy is vital to its medium- and long-term stability, and the measures which are enacted in the short-term to restore the serious loss of competitiveness of the past two years should not be seen as a once and for all effort. The package of incentive measures which are available to exporters, including the exchange rate as a central element, needs to be kept under continuing review to ensure that these are adequate relative to competitors. 1/ Third, while the incentive package is important, the ability to respond to incentives is also a serious problem in both the agricultural and industrial sectors, and needs to be addressed through specific supply-based actions (including assistance with certain investments in both these sectors). It is expected that an increase in direct foreign investment will be one of the major positive opportunities offered by EEC accession and therefore needs to be carefully encouraged. If these broad principles can be accepted and acted upon, it should be possible to achieve a reasonable pace of adjustment to Portugal's new trading environment while avoiding a repetition of the jerky growth of the past few years.

16. An unavoidable first step in our scenario will be the adoption of further short-term measures designed to stabilize the balance of payments' current account deficit as well as the budget deficit. Although it is possible that the balance of payments situation may improve slightly in 1982 because external factors may be more favorable and because of the effects of the June measures, 2/ we are obliged to conclude in the light of our projections that improvements will not occur in the medium-term without further changes in macroeconomic policies. The short-term policy package which the Government will have to adopt is difficult to define with any degree of precision, but it is certain to involve tighter monetary, fiscal and, possibly, income policies designed to contain the rate of growth of domestic demand. In addition, further adjustments in the exchange rate policy are necessary to re-establish competitiveness relative to those countries against which it has been lost since 1980 and then to maintain this on a permanent basis. The monetary policy change would need to include further action on interest rates to restore positive real rates, and to try to reestablish an expanding volume of migrant remittances. For the moment, it is reasonable to expect that the Government will take these measures indepen-

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1/ This can be achieved by maintaining an appropriate rate of crawling peg depreciation.

2/ The preliminary results indicate however little overall improvement.

dently. However, they may choose to seek further IMF assistance to help avert a major crisis. One way or another, the necessary short-term measures will probably be taken within the next six months. As noted earlier, the IMF is currently involved in discussion only of a Compensatory Finance Facility.

17. Our medium-term projections also take account of a probable fall in the import price for oil in 1982 for Portugal, the ending of the European recession, and a less restricted position for Portugal's textiles exports to the EEC. Both of these last assumptions are relatively optimistic. These elements together should permit a growth rate of exports on the order of 7 percent per annum to 1985, accelerating slightly thereafter as a result of EEC entry. A detailed assessment of the trade prospects associated with EEC entry suggests only limited additional import penetration of Portuguese markets in the early years of membership, and this is also built into the projections 1/; the development of the terms of trade seems likely to be largely neutral during the period taken as a whole. These factors combined suggest a reduction in the current external deficit to about 7 percent of GDP by 1985 and its elimination by 1990. The growth rates of GDP which seem feasible (2.5 percent, 1980-85 and 3.3 percent thereafter) are consistent with a rising share of both exports and fixed investment to GDP. The latter is a critical element in the program of industrial and agricultural restructuring.

18. The program of medium-term policy actions required by this scenario will need to be consistent with the Government's own emphasis on export earnings and energy economy, as pursued through the strategy defined above. Our recent program of economic and sector work has been mainly concerned with putting some flesh on the bare bones of this strategy, and will be similarly directed in the future.

19. Government action so far in the agricultural sector has not been adequate and a much greater urgency of approach is needed. Emphasis should be placed on productivity improvements to reduce food imports (imports of $1.3 billion in 1981), and also on some redirection of resources in response to the opportunities within the EEC Common Agricultural Policy. Particularly important in both these respects is the need to strengthen the extension services and related research, animal health, and credit services so as to increase the number of farmers capable of producing nearer average European yields. 2/ In addition, a major institutional effort is needed (e.g., to form producers' associations for certain products and to update grading

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1/ The smaller European economies such as Belgium and the Netherlands experienced a sharp increase in import elasticities after EEC entry. This effect is likely in Portugal after a transition period. See, Portugal: The Prospects for External Trade (report in draft).

2/ At present, Portugal manages to attain only about one-fourth of the European average.

systems for wines and fruits). Our analysis suggests that Portugal's present deficit in agricultural trade could be turned into a surplus in particular through substantial increases in exports of forest-based products, fruits and vegetables and tomato concentrate. Our projections build in a degree of progress in these areas sufficient to generate a slightly rising growth rate for agricultural production and a decline in the import elasticity for food.

20. In the industrial sector, the fundamental need is to rationalize traditional sectors such as textiles while, at the same time, creating adequate new jobs in other sectors to absorb some of the unemployment (as well as further job losses in the agricultural sector) which this rationalization process will necessarily create. 1/ This broad strategy requires a general export bias, a structure of incentives favoring investments and exports in non-traditional areas, as well as appropriate productivity-raising investments in the traditional ones. The early liberalization of Portugal's very restricted labor markets, although difficult to implement in practice, is vital to increase labor mobility, a necessary element of effective restructuring, as is better training and effective use of skilled labor. It will also require actions in relation to infrastructure in some regions and, above all, to the financial markets and especially the taxation arrangements which currently distort the allocative functions of these markets. In addition, it would be our judgement that a significant degree of self-restraint in the Government's own expenditures would be a sine qua non for the major structural shift which Portugal needs in the industrial sector. The strong public sector bias in industrial investment of the post-revolution years has not been conducive to either employment creation or export growth. It has contributed to a rapidly rising overall public deficit which has necessitated high marginal tax rates and high interest rates, and has resulted in high inflation. Many of the distortions and policy inadequacies which negatively affect the industrial sector can be linked back to the fact of the large public deficit, and could readily be moderated if this deficit were reduced. 2/

21. Population growth is not a major issue in Portugal. Although the Government does not have an aggressive family planning program, the crude birth rate, which was 24 per thousand in 1960, dropped to 18 in 1980 (compared with 29 in Costa Rica which does have a major program, 14 in France and 9 in Germany). The annual population growth rate is low at about 1 percent. 3/ Some emigration to Brazil and other countries still takes place, but emigration to Europe has virtually stopped. Health indicators are poor with levels of infant morality reaching 35 per thousand (14 in France) and

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1/ See, Portugal: Policies for Industrial Restructuring, Report No. 3804-PO, August 4, 1982.

2/ In the context it should also be noted that the service sector is a large and relatively fast growing sector of the economy.

3/ Official estimates vary between 0.9 percent and 1.3 percent.

the highest death rate in Europe for specific diseases. Regional disparities are large and health services are almost unavailable in the depressed areas of the interior. Malnutrition is widespread despite an average calorie intake of 2900, as about 50 percent of the population, in 1975, had less than the minimal level of consumption for milk, meat, cheese and eggs (70 percent in rural areas). The serious demographic issue is unemployment, 8.8 percent in 1981, contributed to by large-scale immigration from the overseas territories after April 1974, the continuing weak state of the economy, and structural imbalances between the supply and demand for labor.

D. Assessment of External Assistance Requirements

22. The scenario presented above will not be an easy one for the Portuguese Government to deliver. It requires an effort sustained over the next few years as well as a major program of restructuring of key industries, combined with import (and especially energy) saving investments. It is sobering, therefore, to realize that even if the scenario is achieved, Portugal's external debt and financing problems will remain severe.

23. Portugal's end of 1981 external debt outstanding is estimated at over $10 billion; this includes short-term debts of about $3.4 billion. The structure of this debt gives a very high weight (70 percent of MLT debt) to private debts, many of which were built up coincident with Portugal's improving creditworthiness from 1977 onwards. Because these debts typically have a maturity of six or seven years, there will be a rapid build-up of amortization requirements from 1983 onwards. Given this and the fact that the flows of official borrowings are known to be limited, there will be a need for further extremely large private borrowings to 1990 to finance projected balance of payments deficits. Specifically, if it is assumed that new commitments of official debt will rise from $320 million in 1980 to $590 million in 1990, new commitments of private debt will need to rise from $820 million in 1980 to $3.2 billion by 1990 (see Attachment 3c for assumed borrowing costs and terms). The resource transfer (disbursements minus amortizations) coming from private debt will peak at $1.9 billion in 1984 and should decline thereafter to become negative by 1990. In other words, despite a quadrupling of private debt commitments, private net resource transfers will decrease by about $1.8 billion in nominal terms. For official debt, the net resource transfer is estimated to increase steadily through the late 1980s.

24. The potential seriousness of the debt problem should encourage the Government to take the tough general economic measures from which it has so far shied away. The nature of the problem is underscored by the fact that, by 1990, interest on medium- and long-term debt will total $1.7 billion. The magnitude of the overall debt service burden, including amortizations, will depend on how the Government deals with existing levels of short-term debt. On the assumption that this is merely rolled over and that there is no further net accumulation, the debt service ratio will rise from 13.4 1/ percent

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1/ Based on data of the Debt Reporting System (DRS); figures from the Bank of Portugal show a higher debt service ratio.

of exports of goods and services in 1981 to 20.4 percent by 1990 (after a peak of 24.0 percent in 1988). This excludes interest on short-term debts of about $500 million. However, a full repayment of short-term debts would sharply increase the ratio. A full repayment in 1981, for example, would have generated a debt service ratio (including amortization of short-term debts) of 50 percent. A final aspect of this problem is that, until now, Portugal's ample gold reserves have served as the main underpinning of its international credit rating. Efforts in the past to sell gold caused such a serious deterioration in bankers' attitudes toward Portugal, that the Central Bank has stopped any further efforts to use the gold other than for short-term pledges with the Bank of International Settlements. At present, assuming a gold price of $450 ounce, its 22.17 million ounces of gold have a market valuation of about $10 billion. This compares with Portugal's MLT debt of about $7 billion. However, with the scenario we have projected, the total external MLT debt outstanding by 1990, will be equivalent to nearly twice that valuation. This fact is likely to reduce the country's reasonably good international credit standing.

25. In this situation, the funds which are capable of being mobilized from multilateral and bilateral official sources will certainly decline relative to total necessary debt flows and amounts outstanding. By 1990, for example, official debt will represent 16 percent of the outstanding MLT debt shown in our projection, and about 15 percent of disbursements. This compares with a 35 percent share of outstandings in 1980. This relative decline occurs despite the fact that commitments from official sources other than the World Bank are expected to rise from $186 million in 1980 to $400 million in 1990, based on the expected expansion of lending from the European Investment Bank and other European sources. The World Bank share will also decline. The calculations underlying this result assume that new commitments of the World Bank, which have up to now amounted to about $140 million per annum in real terms, will not rise much above this level in real terms through the period of the 1980s. This is based on our calculations that Portugal will not reach the trigger point for graduation until 1986 at the earliest and will therefore continue to be an active borrower from the Bank during the entire period covered by this review.

26. Although they are small relative to the total need, official transfers will exert an increasingly important leverage for the raising of the large amounts of private capital which Portugal will need. There are three main reasons for this. First, many of the necessary private funds will become available as the result of cofinancing arrangements involving official funds, and may not be available in the absence of such arrangements. Second, most private funds bring only minimal assistance to the country in the technical design and implementation of investment projects. Given the serious inadequacies of Portugal in these respects, the presence of official donors who can provide such assistance is vital as a catalyst for generating an adequate availability of projects to serve as the vehicle for private resource transfers. (Portugal's slow use of EEC preaccession aid is a particular, but not unique, example of this problem.) Third, the presence of official donors,

together with the IMF, and of reasonable quantities of their funds, provides an extremely important signal to potential private sources concerning the soundness of both macro- and microeconomic management in the country. Recent examples of this have been the reluctance of commercial banks to provide financing to the state electricity corporation when the processing of a proposed Bank loan was temporarily suspended and the withdrawal of their offers to the steel company when we withdrew from the project (see para. 35). This signal will become increasingly important as the ratio of gold reserves to total external debt falls below unity. In short, a declining relative quantity of official funds is not synonymous with a declining relative importance. Every effort needs to be made to maintain the levels of such funds if the already rather restrained economic scenario which we envisage is to be realized.

E. Bank Group Strategy and Operations

Previous Bank Operations

27. The initial phase of Bank lending to Portugal, 1963-66, was concentrated in the power sector, in line with Government priorities. Five loans were made, three for thermal generation and two for hydroelectric generation, for a total of $57.5 million. All five projects were successfully completed. A hiatus of ten years then intervened due to Portugal's colonial policies, during which Portugal was able to derive only limited benefit from its membership in the Bank. Since the resumption of lending in 1976, sixteen loans have been approved for a total of US$715 million, net of cancellations, averaging 2-3 loans per year. Disbursements now total about $182 million, or about 35 percent of the total commitments (excluding the two loans just approved by the Board). The disbursement experience with loans implemented by public companies, especially in the industrial sector, has been good; that through Government agencies has been quite slow.

28. The first group of loans after the resumption of lending in 1976 covered a wide spectrum of needs and was designed to enable a significant resource transfer over a short period of time. The early projects followed traditional Bank lending lines and supported ongoing programs in existing Government agencies and/or institutions: power, highway rehabilitation, development finance, technical education, and water supply. These projects included institution-building measures, and most of them established a satisfactory basis for repeater operations--second highways, second education, second development finance, and proposed seventh power. The notable exception was the water supply project which suffered from poor management and political pressures, and which only now is beginning to show progress.

29. While repeater operations were utilized to continue the basic influence of the Bank Group in these sectors, the thrust of our economic work and the course of general economic and political events in Portugal turned attention elsewhere. It became clear to the successive governments that the major developmental issues confronting them were those associated with the

structural adjustments necessary to modernize Portugal's industrial and agricultural bases, in the face of both increasing domestic consumption and the prospect of integration into the European economy. While the traditional types of projects were welcomed by Portugal as helping to provide for long-run development, restructuring issues took precedence and the second group of projects were arranged largely through public and private enterprises. The upgrading of the very important small- and medium-scale (SMI) industrial sector was identified early on as a major ingredient of the adjustment process needed to increase exports, reduce imports, and service the growing domestic demand; the first SMI project provided funds for onlending through commercial banks as well as technical assistance for the establishment of a new SMI promotion/assistance agency. Another ingredient of the restructuring process involved the rehabilitation of heavy industrial concerns to improve the efficiency of import-substituting industries; the Fertilizer Modernization and the Mechanical Industries projects supported such efforts. The Agricultural and Fisheries Credit (IFADAP) project assisted with the creation of Portugal's first agricultural credit institution and represents an attempt to upgrade agricultural practices in the Alentejo area, which has very high potential. The better use of major domestic resources was attempted through the First Forestry project (which is partly implemented by a public company and which also offers good export prospects) and the Petroleum Exploration project.

30. This second group of projects is producing uneven results. At the project level _per se_, after some delays, good progress on the whole has been achieved for all but the IFADAP project, and procurement is proceeding more smoothly than that through Government agencies; this is true for the large public companies, where the technical capacity of staff is excellent, as well as for the SMI program where the operating rules are considerably less stringent. The beneficiaries' commitment to the investments has been fully justified and even strengthened by subsequent economic developments. However, reasonable success in the physical implementation of projects has been qualified by disappointing performance in relation to some of the institutional, financial and other more general concerns that the projects sought to address. This is linked to the phenomena mentioned elsewhere in this paper of excessive politicization, a sluggish bureaucracy, as well as to difficulties in the financial relationships between the central Government and public companies. While the Government is aware of the problems encountered and has fairly clearly stated objectives, they lack a clear strategy or a plan for dealing with these broader questions over a specified time frame. The delays and problems in project implementation have been the object of numerous discussions with the Portuguese authorities, including two joint implementation reviews (in March and in November 1981). While these reviews have led to improvements in some areas, it clearly remains difficult for the Government to comply with undertakings to take certain actions or decisions within specified periods, even when the Government itself sets the deadline.

31. The IFADAP project has faced a number of special problems, in addition to the general ones mentioned in para. 30. These relate to the consequences of land reform measures introduced with the revolution and the

multiplicity and inconsistency of credit programs for agriculture. The Government is now putting together a package of proposals to revise the project, including expansion of the project area, changing the role of the project unit, adjusting the repayment schedule, introducing constant interest rates in the project area, allowing IFADAP to lend directly to farmers and imposing limits on competing and cheaper lines of credit to farmers in the project area. Even if all of these changes are agreed upon, a substantial amount of the loan, probably \$30 million out of the \$70 million loan amount, could not be used by the loan closing date of June 30, 1984; if an acceptable package of measures can be agreed upon, we would be prepared to consider an extension of the closing date, especially since the Portuguese have already incurred over \$2 million in commitment charges on this loan. The alternative to agreeing to such extensive changes in the project design would be to cancel the uncommitted portion of the loan, or about 95 percent of the loan amount. We propose to continue working with the Government to salvage this project because of the priority need to develop agricultural production and the desirability of capitalizing on the effort already invested in the project agencies.

Future Bank Strategy and Priorities

32. Bank lending to Portugal in the next few years will need to take account of two main background factors. The first is Portugal's need to restructure its economy, particularly its agricultural and industrial sectors, and will require significant institutional reform and the opening up of new sources of external finance. Portugal's weak institutional base for preparation and implementation of such programs continues to be a major constraint. The second is the severe external payments position and the necessary stabilization of the economy which is likely to severely restrict the availability of complementary financing from the Government and the domestic banking system, and to entail continued high nominal interest rates. The first of these factors argues for an emphasis in Bank lending which can assist the major productive sectors of the economy to adjust as well as is possible to the trading environment of the EEC, and so, to minimize the transitional costs. The second argues for a project emphasis which can contribute significantly to foreign exchange earnings/saving while at the same time limiting its demands on budgetary funds. In addition, the prospect of EEC membership argues for an increasingly close collaboration with the EEC and other associated agencies, especially with regard to the restructuring programs and the development of the Portuguese capacity to develop suitable programs to utilize the assistance and financial facilities which will become available. The current EEC Pre-Accession program provides about 275 million ECU, about half in grants, which is spread quite thinly across a wide range of sectors--SMI lending and technical assistance, agriculture marketing, highways, power, school building, industrial estates, sanitation services and river training.

33. Economic and Sector Work. We therefore propose to consolidate our strategy of assistance to Portugal in order to better address structural problems in an integrated fashion. The groundwork for this strategy is being

laid by our economic and sector work. Despite the political flux and short-term focus, the Portuguese have been receptive to discussions of the results of our economic and sector work and to the attendant policy options. The case for industrial restructuring and the policy options available were elaborated in the recent report "Policies for Industrial Restructuring," which was discussed with the Government in June. The current updating economic report takes a close look at the possible consequences of European integration for the agricultural sector, which will be followed up by a full agricultural sector review by early 1983. Studies of the structural adjustments needed in the textiles industry, mechanical industries, pulp and paper industry, and of technological development in general, have been funded under ongoing lending operations. A major review of the energy sector is scheduled for FY83. Policy options and implementation programs are being developed, out of which a relevant lending program can be identified in the light of experience gained in implementing ongoing projects.

34. Conditionality. Just as the restructuring process needs to be viewed on the Portuguese side as an integrated undertaking, so should we in the Bank also keep in mind the fact that all cannot be put right in a sector within the context of a single lending operation. Once agreement on the overall objectives is reached and satisfactory plans are developed, conditionality under our loans should be programmed to take a step-by-step approach over time, taking into account the Portuguese governmental framework which calls for free discussion of issues at many levels and the evolution of a political consensus. By setting modest institutional goals in our project lending activity, consistent and cumulative with those under other projects and with the policy dialogue provided through our economic work and that of the IMF, the Bank can contribute to a sustained improvement of the general economic environment. The relationship between the IMF and the Bank has been very close and we share a common view of the needed policy reforms.

35. We have found the Portuguese to be willing to work on overall policy questions within the context of our economic work and individual lending operations, even when the volume of lending is relatively small. Thus, we have been able to maintain a SAL type dialogue even without SAL lending operations. We do not think much would be gained by consolidating our lending funds under a general SAL, and we would lose the opportunities which specific projects offer. However, many of the underlying causes of the implementation problems in Portugal's development program are common to most of its projects (e.g., poor Government budgeting and management practices, reluctance to be explicitly accountable for subsidies, etc.). We have exercised some useful pressure on the Government to come to terms with difficult issues of substance and timing, and propose to remain strict. The Portuguese are complaining increasingly that we apply more and tougher conditions to them than to other borrowers. This may appear to be the case to the Portuguese for several reasons. First of all, the Portuguese assign responsibility for several projects to previous governments and are surprisingly unable to formulate specific suggestions for overcoming difficulties which some covenants may present in changed circumstances. Secondly, as our conditionality is

designed to address basic and sometimes difficult issues, it often requires continuing action and adjustments, which are difficult to sustain in the political and administrative environment described in Part A above. Also our prodding about schedules which they set and are unable to maintain, for political and other reasons cause vexation. Such complaints are becoming more prominent in our discussions but are more indicative of the Government's own difficulties in implementing designs than a hardening of our terms. If we were to ease off on agreed schedules, the portfolio and future programs that they desire would suffer. While painful, the withdrawal of Bank support for the proposed Seixal Steel project and the delay in funding for the Power VII project (until basic but politically and financially very difficult changes were made in the financial area) have yielded positive results as was our insistence on price adjustments under the $20 million Petroleum Exploration loan in FY81. As a consequence, the FY82 lending program was cut nearly in half in lending volume from that of previous years. We will be prepared in the future to select and design projects which we support to address major issues and link the proposed lending volume to satisfactory progress on policy questions.

36. Lending Operations. We propose to continue in Portugal with a program of about three operations per year, for a lending volume of about $190 million per year in nominal terms, representing a slight decline in real terms on an annual basis from that reached in the late 1970s. The FY82-86 program is maintained at the same overall level as that approved in November 1981 (which was below norm) and the FY87 program was added at roughly the same level in nominal terms as the FY86 program. This program results in a steady decline in real terms in lending volume over the next five years. With the level of cofinancing which it is hoped will continue to be available especially in the industry and energy sectors (para. 25), the projects supported would be of sufficient scope to provide a suitable vehicle for the restructuring programs. Since the resumption of lending in 1976, the Bank has been able to minimize the share of its lending in total project cost; Bank loans have contributed only about 20 percent of project cost, as compared to a Bankwide average of about 45 percent. Although there has been little formal direct cofinancing, the Portuguese have been able to raise considerable financing on their own, arranging both suppliers' credits and commercial credits on very favorable terms. Other borrowings have contributed about 40 percent of total project cost for projects in which the Bank has been involved.

37. Three major areas of project work need to be given priority for the reasons broadly outlined above. These are the industrial, energy and agriculture sectors. Agriculture has proved to be the most difficult sector to work in, but is the area in which the Bank is best equipped to offer the type of assistance which is not readily available elsewhere. The most serious constraints limiting the sector's absorptive capacity are the lack of project planning and preparation capacity and the weakness of the credit system. Our proposed lending program for agriculture is, therefore, smaller than we would like, and reflects not a lower priority than industry, but rather the weakness

of the Government's own efforts. Should more agricultural project opportunities develop, we would substitute them for other activities within the total proposed lending program.

38. In the industrial sector, we propose to give high priority to the financial issues, particularly those related to public enterprises. As a starting point, we suggest working with the Government to establish a viable financial program for all public investments. We propose to include in our economic work program special studies to assist the Government in consolidating financial information relating to the public sector enterprises and establishing their likely interlocking debt structure, and to assist in the updating and review of the public sector investment program. If a viable overall action program can be developed for improving the operating efficiency and rationalizing the financial structures of the public sector enterprises and for allocating the public sector investment program, we should be prepared to consider a program loan to support these efforts, for example, by financing priority import requirements of economically justified public enterprise investments.

39. As we expect progress on these broader public finance issues to be slow and uneven, we also propose to pursue the dialogue on other more specific topics through our project work. As part of the restructuring programs, we will seek a dialogue with the Government on credit policies, rationalization of tax policy as regards private sector securities and treatment of equity, investment and export incentives, and the development of financial markets. We are preparing an industrial strategy paper to identify specific policy recommendations associated with these issues and develop the appropriate linkages of conditionality to the lending program.

40. A major vehicle for industrial project lending will need to be the domestic financial intermediaries. Activities to raise productivity need to be undertaken for the most part at the enterprise level in the private sector, and these enterprises are often too small for individualized attention by the Bank. These lending operations need to be supported and supplemented by technical assistance programs within the relevant Government agencies, industry groups, and the financial intermediaries themselves. The policy dialogue and technical advice need to be continuously monitored and adjusted to reflect the pace of other developments.

41. We propose supporting restructuring programs in the important textiles sector (16 percent of industrial production, 31 percent of exports, and 26 percent of employment) and electro-mechanical sector (17 percent of industrial production, 20 percent of exports, and 20 percent of employment). Another candidate for restructuring is the pulp and paper sector, which would also include a major component for energy conservation and diversification. In the textiles sector, the restructuring will seek to correct the disequilibria existing between the different process stages, reduce regional imbalances, limit the negative social effects likely to result from the necessary large reduction in labor force, and provide incentives to increase produc-

tivity and exports. Such programs will likely involve improved access to financial resources (through lending, mergers, bond issues, foreign investments, etc.), technical assistance, and manpower training. The electromechanical industry is far less homogeneous than the textiles industry and the restructuring programs are likely to be based on a two-tier approach, with specific management and investment programs for the limited number of medium- and large-scale public and private enterprises, and a strengthening of technical support for the industry in general. We also propose to continue our work with the SMI agencies, which offer finance and useful technical assistance to economically and financially viable SMI enterprises in all sectors. We are now working to define the appropriate scale for eligible enterprises under the textiles and mechanical industries programs, to ensure that the technical assistance activities and credit eligibility standards complement those under the SMI program.

42. The employment and labor issues of restructuring will be extremely important, not only for their political sensitivity, but also because manpower studies have identified a very large shortfall in skilled and semi-skilled labor and a major shift within those currently employed from unskilled to semi-skilled employment under reasonable industrial growth projections. While the Government has been reluctant to enter into a dialogue with the Bank on such issues, we think there is a role for the Bank, once the basic political level decisions are made, through manpower and training programs. Due to the weakness of the central administration in planning and coordinating training activities, project proposals have been slow to develop and we may consider addressing some assistance to develop an appropriate policy and planning mechanism which will be necessary to direct this dynamic process. A technology project is also in the process of being designed to help address the severely deficient technological state of Portugal's industry, which is even far behind that of Spain.

43. The IFC has already become involved in the development of financial markets through its first investment in Portugal in a small investment company, and through its consultations with the Government on the appropriate establishment of leasing. In October, IFC will present to the Board a proposal to make an investment in the first majority privately-owned Portuguese leasing company. Additional areas which IFC is considering are the establishment of financial institutions which would assist in revitalizing the country's security markets which were devastated as a result of the nationalizations of 1973, housing finance and the introduction of private Portuguese companies to international capital markets. Despite the private sector orientation of the Government and the clear commercial advantages of EEC accession for some sectors, IFC has not been able to make much progress in the development of an investment program in Portugal. Identification of suitable projects for IFC financing has been hindered by the low level of investment in private industry in general, and by the small size of projects undertaken which have been able to acquire the needed foreign exchange from local institutions. Projects in various stages of consideration are in the chemicals, fishing, transportation and tourism sectors.

44. Work in the agricultural sector is crucial to the overall adjustment process. Unless the pace of preparation for operations under the Common Agricultural Policy accelerates rapidly (para. 19), the eventual budgetary, foreign exchange, and social costs will be large. The development of the agricultural sector faces the constraints of a poor land base, backward technology and cropping pattern, uncertainties of land tenure, weak institutions, including the Ministry itself which was established only after the 1974 revolution, and a complex system of government intervention. Furthermore, the agricultural extension system is seriously understaffed and isolated from actual farm problems.

45. Priority areas for attention through the extension sevices are improving land use (e.g., shifting from intensive to extensive livestock farming) and revising cropping patterns (one half of land currently is fallow). Two extension approaches are being supported by Bank-financed projects--farm planning teams through the Agricultural and Fisheries Credit project and the training and visit system on a pilot basis in the Tras-os-Montes Rural Development project. Agricultural credit policies are the subject of discussion with the Government at present, as we try to reshape the first Agricultural Credit project and begin implementation of the Rural Development project. Portugal should be able to take advantage of its early spring season to produce fruits and vegetables for the European market; major adjustments are needed in its production of table wines, and large investments are needed in afforestation and related processing industries to help increase the very considerable trade surplus of which this subsector is capable. An agroindustries project is under preparation with FAO/CP assistance, which will focus on the fruits and vegetables, wine and dairy subsectors. Follow-up projects in rural development and agroindustries will be considered after the results of these first attempts are known.

46. The first Forestry project, as well as studies under the SMI I and Industrial Energy Conservation and Diversification project, are developing a specific set of proposals for further afforestation and downstream investments which should lead to further valuable forestry sector projects in the future. Fisheries also play an important part in the restructuring process. Current Portuguese fishing operations are less productive than those of other parts of Europe, and fishermen in Portugal represent one of the poorest segments of society. As is the case in agriculture, the Portuguese fishermen will prove difficult to reach, given the strong hold of traditional practices and the undercapitalized nature of their operations.

47. In energy, a first Industrial Energy Conservation and Diversification project was processed in FY82. It contains components specifically designed to produce further programs of investments. These include energy audits of the major energy-using industries, designed to identify energy-saving practices and investments in industrial processes, as well as a component to examine the Portuguese potential for developing renewable energy resources. One of the goals of the national energy plan is to reduce the country's dependence on petroleum imports through diversification to coal.

A coal exploration engineering loan is proposed to assist the Government in launching a nationwide exploration program. The work in the energy sector is also likely to include further lending for electrical power generation. A seventh power project has been discussed with the Government, which is at last facing up to some of the difficulties brought about by the partial nationalization of the distribution companies. Proposals are being prepared to strengthen the financial health of the sector by clarifying the basis of payments for facilities and services. EDP, the national power company, will need to undertake a major investment program to redress some of its imbalances in supply capacity which are due to heavy dependence on imported petroleum products, and to meet the growing overall domestic demand for electricity.

48. Some related infrastructure investments are also being considered. Investments in the transport system, especially highways, are being considered in order to help in the development of a balanced program of maintenance and investment, as well as to influence the sector investment program towards meeting the needs of the northern industrial part of the country. Another possibility under consideration is the financing of construction of a portion of the national North/South toll road and to establish improved linkages in the industrial corridors. We are considering project proposals for housing finance for lower income groups and municipal infrastructure. We are prepared to consider assisting in these areas for programs designed to serve as a vehicle to improve institutional, financial and technical aspects of such undertakings and if we obtain movement on major policy questions as part of our lending operations. Besides addressing real needs of the people, appropriate structuring of these programs could enhance resource mobilization capacity as well.

Conclusions and Recommendations

49. Portugal's underdevelopment is comparable in many areas to that of poor non-European Bank borrowers, in particular at the institutional level. After some 50 years of autocratic rule and relative isolation, Portugal is just beginning to come to grips with the process of catching up with the rest of the world. The sorting through of the political process over the past eight years has indeed put the development process on a slow, and at times, erratic course. We have been frustrated by their false starts, indecision and delays. Nonetheless, the Portuguese do recognize that they need technical assistance, policy advice, and financial aid from the outside, and do show a genuine interest in continued relations with the Bank Group. Notwithstanding the mixed performance at the project level, our work has touched upon priority areas and has yielded positive results on several important policy issues. The lack of firmness in the proposed program is due in large measure to uncertainties on the part of the Government about where and in what ways they want Bank assistance and how quickly they are prepared to face some of the difficult questions confronting them. We will need to be patient, keeping in mind that, while decisions and actions have been slow in the making, successive Portuguese Governments have shown themselves to be capable of reaching sound judgements, given time. We consider it appropriate to con-

tinue to design loan conditions to address sector issues. Where necessary, we should also be prepared to take a tough stand and exercise remedies when the Government procrastinates in the implementation of agreed solutions to obvious problems.

50. The proposed restructuring will necessarily be a slow process, and even if Portugal succeeds in restructuring its economy along the lines elaborated in Part C, Portugal's external debt and balance of payments problems will remain severe through the end of the decade. Portugal is currently the object of considerable attention by the international community. International borrowings have increased markedly, but foreign investment has not yet made a significant entry. Our calculations include a significant expansion of total foreign borrowings, but the need for official borrowings still remains. This is not only for resource transfer reasons, but also because of the catalytic role which official transfers will play in raising the large amounts of private capital which Portugal will need. Several banks have expressed their desire for expanded lending to Portugal, but preferably in the context of a Bank-financed operation and under the umbrella of the Bank/IMF general seal of good macro and microeconomic management. Furthermore, given the serious inadequacies of project preparation, the Bank can play an important role in generating projects to serve as the vehicle for private resource transfers. Some of the proposed lending operations would therefore be interesting test cases for new co-financing techniques being considered by the Bank.

51. We propose preparing a short updating note and revised Attachment I in about 18 months. This should allow sufficient time for initiation of the restructuring programs and provide us with a clearer view of many of the specific issues and programs curently under discussion regarding Portugal's accession to the EEC.

Population: 9,836 million (mid-1980)
GNP Per Capita: $2,350
Area: 92,100 Km2
Literacy Rate: 71 percent

Attachment 1a

PORTUGAL: ACTUAL AND PROPOSED PROGRAM OF LENDING OPERATIONS THROUGH 1987

Project		Through FY76	FY77	FY78	FY79	FY80	FY81	FY82	Current FY83	FY84	FY85	FY86	FY87	Total Through FY76	Total FY77-81	Total FY82-86	Total FY83-87	Reserve Projects
Agric.& Fish. Credit	IBRD			70.0														
Ag.& Fish Credit II	IBRD																	60.0(86)
Agro-Industries I	IBRD									50.0								
Agro-Industries II	IBRD												60.0					
Forestry I	IBRD					50.0												
Forestry II	IBRD										65.0							
Rural Dev I (Iras)	IBRD							51.0										
Rural Devt. II	IBRD												50.0					
Education I	IBRD			21.0														
Education II	IBRD					40.0												
Manpower Training	IBRD																	40.0(84)
Coal Expl. Eng.	IBRD									15.0								
Heavy Oil Eng./ Oil Explor/Prod.	IBRD																	30.0(85)
Indust.Energy Cons.I	IBRD							30.0										
Ind.Energy Cons. II	IBRD											60.0*						
Petroleum Expl. Eng.	IBRD						20.0											
Banco de Fomento Nacional I	IBRD		50.0															
BFN II	IBRD						100.0											
Industrial Techn.	IBRD										55.0*							
SMI I	IBRD				45.0													
SMI II	IBRD								40.0									
SMI III	IBRD											78.0						
Fertilizer Modern.	IBRD				58.0													
Ind.Restruct.(Text)I	IBRD								50.0									
Ind.Restruct. II	IBRD												80.0*					
Mech. Industries I	IBRD					44.0												
Mech. Industries II	IBRD									65.0								
Pulp and Paper	IBRD										60.0							
Power I-V	IBRD	57.5																
Power VI	IBRD	36.0																
Power VII	IBRD								80.0a/									
Power VIII	IBRD																	90.0(87)
Highways I	IBRD		24.0															
Highways II	IBRD				40.0													
Highways III	IBRD											50.0						
Ports	IBRD																	50.0(86)
Toll Road	IBRD																	30.0(84)
Lisbon Water Supply	IBRD			40.0														
Housing	IBRD									50.0								
Municipal Infra-structure	IBRD																	50.0(84)
Lending Program	IBRD	93.5	74.0	131.0	143.0	134.0	120.0	81.0	170.0	180.0	180.0	188.0	190.0	93.5	602.0	799.0	908.0	
	Number	6	2	3	3	3	2	2	3	3+1	3	3	3	6	13	14+1	15+1	
Lending Program in Constant FY82 $:			99.7	165.8	172.5	153.5	128.5	81.0	159.5	159.0	150.0	147.8	140.8		720.0	697.3	757.1	
Commitment Deflator (FY82 = 100)			74.2	79.0	82.9	87.3	93.4	100.0	106.6	113.2	120.0	127.2	134.9					
Standby Projects	IBRD									55.0	60.0	80.0						
										1	1	1						

* Standby projects

a/ Amount likely to be increased to about $100 million, but will be accommodated within the two-year program by corresponding reductions in other loans.

EM1DB
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9/13/82

Attachment 1b

PORTUGAL - SUMMARY OF BANK GROUP AND OTHER OFFICIAL LENDING

	Through FY76	FY77	FY78	FY79	FY80	FY81	FY82	Current FY83	FY84	FY85	FY86	FY87	Total to FY76	Total FY77-81	Total FY82-86	Total FY83-87
SECTORAL DISTRIBUTION OF BANK GROUP COMMITMENTS (%)																
Agric. & Rural Dev.			53.5		37.3		63.0		27.8	36.1		57.9		20.0	20.8	24.8
Education			16.0		29.9									10.1		
Energy						16.7			8.3		31.9			3.3	13.1	8.2
Industrial Finance		67.6		31.5		83.3		23.5		30.6	41.5			32.4	21.7	19.1
Industry				40.5	32.8		37.0	29.4	36.1	33.3		42.1		16.9	21.9	28.1
Power	100							47.1					100		10.0	8.8
Transportation		32.4		28.0							26.6			10.6	6.3	5.5
Water Supply/Housing			30.5						27.8					6.7	6.3	5.5
Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
BANK GROUP DISBURSEMENTS (US$ m)													FY 72-76	FY 77-81	FY 82-86	FY 83-87
IBRD o/s /a																
incl. undisbursed	83.0/b	155.3/c	286.2/d	427.7/e	554.0/f	638.2/g	688.8h/	821.7	947.5	1061.1	1176.3	1284.2		2061.4	4695.4	5290.8
excl. undisbursed	47.0/b	45.3/c	47.2/d	63.5/e	104.7/f	116.4/g	156.5h/	231.1	330.5	428.7	531.3	642.7		377.1	1678.1	2164.3
IBRD Gross Disbursements	57.5	-	2.0	17.8	49.2	47.5	66.2	111.7	153.6	164.6	175.4	193.5	.2	116.5	671.5	798.8
less: repayments	20.4	3.4	3.7	4.8	8.7	10.6	19.8	37.1	54.2	66.4	72.8	82.1	14.7	31.2	250.3	312.6
equals: net disbursements	37.1	-3.4	-1.7	13.0	40.5	36.9	46.4	74.6	99.4	98.2	102.6	111.4	-14.5	85.3	421.2	486.2
less: interest & charges	28.2	2.9	3.2	4.4	7.2	11.7	13.3	20.8	31.0	42.4	53.0	64.1	15.7	29.4	160.5	211.3
equals: net transfer	8.9	-6.3	-4.9	8.6	33.3	25.2	33.1	53.8	68.4	55.8	49.6	47.3	-30.2	55.9	260.7	274.9

	Actual								Projected			
	CY 1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1990
IBRD EXPOSURE (%)												
IBRD Disbursement/Total Gross Disbursements	0	0	.01	.44	1.04	1.92	2.5	4.7	7.0	6.6	5.6	3.1
IBRD DOD/Total DOD	3.71	2.66	1.48	0.94	1.32	2.15	2.5	3.0	3.9	4.5	4.9	4.8
IBRD Debt Service /Total Debt Service	5.65	4.31	3.10	1.86	1.81	1.97	2.1	3.8	3.8	4.6	4.2	4.3

	Actual										Projected					
	CY 1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
COMMITMENTS FROM OFFICIAL SOURCES (US$m)																
Concessional Loans																
Total Bilateral	14.3	90.3	112.9	70.0	115.6	62.6	-	-	-	-	-	-	-	-	-	
United States	14.3	90.3	79.0	38.0	38.0	40.0	-	-	-	-	-	-	-	-	-	
Germany			30.2	22.4	57.3	22.6	-	-	-	-	-	-	-	-	-	-
United Kingdom				9.6	-	-	-	-	-	-	-	-	-	-	-	-
Other			3.7	-	20.3	-	-	-	-	-	-	-	-	-	-	-
Total Multilateral	.05	.5	.5	.5	.3	1.0	-	-	-	-	-	-	-	-	-	-
Other	.05	.5	.5	.5	.3	1.0	-	-	-	-	-	-	-	-	-	-
Non-concessional Loans																
Total Bilateral	57.0	33.6	203.4	845.2	256.8	58.4	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0
United States	49.0	33.6	135.5	465.0	121.8	28.0)										
Germany			2.7	213.3	85.0	30.0)										
France			3.2	-	50.0	-)	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0
United Kingdom	-	-	-	20.0	-	-)										
Other	8.0	-	62.0	146.9	-	.4)										
Total Multilateral	3.5	158.2	160.9	216.1	211.2	198.5	340.0	360.0	380.0	390.0	430.0	468.0	510.0	510.0	560.0	560.0
IBRD	-	36.0	74.0	131.0	143.0	134.0	120.0	81.0	170.0	180.0	180.0	188.0	190.0	190.0	190.0	190.0
European Investment Bank	-	100.6	68.4	44.7	63.1	59.1)	220.0	279.0	210.0	210.0	250.0	280.0	320.0	320.0	370.0	370.0
Other	3.5	21.6	18.5	40.4	5.1	5.4)										
TOTAL COMMITMENTS	74.85	282.6	477.7	1131.8	583.9	320.5	370.0	390.0	410.0	420.0	460.0	498.0	540.0	540.0	590.0	590.0

/a As of the end of the fiscal year.
/b The exchange adjustment of $9.7 million as of June 30, 1976 has been included in these figures.
/c The exchange adjustment of $11.4 million as of June 30, 1977 has been included in these figures with an increase of $1.7 million since FY76.
/d The exchange adjustment of $15.0 million as of June 30, 1978 has been included in these figures with an increase of $3.6 million since FY77.
/e The exchange adjustment of $18.3 million as of June 30, 1979 has been included in these figures with an increase of $3.3 million since FY78.
/f The exchange adjustment of $19.0 million as of June 30, 1980 has been included in these figures with an increase of $0.7 million since FY79.
/g The exchange adjustment of $-6.2 million as of June 30, 1981 has been included in these figures with a decrease of $25.2 million since FY80.
/h The exchange adjustment of $-12.4million as of June 30, 1982 has been included in these figures with a decrease of $6.2 million since FY81.

Note: All data in this table reflect O/S amounts and transactions of loans sold to Third Parties.

EMIDB
September 23, 1982
(0648G)

Attachment 1c

PORTUGAL

DISBURSEMENTS

	FY78	FY79	FY80	FY81	FY82
Undisbursed balance at July 1 (US$m) 1/	60.00	169.04	324.22	355.01	501.50
Commitments during FY (US$m)	131.00	143.00	134.00	120.00	81.00
Total disbursed during FY (US$m)	1.96	17.82	49.21	47.51	66.21
Disbursement rate (3 : 1)(100)	3.27	10.54	15.18	13.38	13.20
Comparators (%)					
(a) Disbursement rate for total of other loans in the Region 2/	21.26	21.12	21.71	21.42	23.11
(b) Bank-wide IBRD/IDA average disbursement rate 2/, 3/	21.19	21.73	21.31	21.47	23.93
(b) Average disbursement rate for:					
Argentina	9.21	7.20	12.13	13.61	19.20
Malaysia	12.88	18.94	13.50	18.50	19.93
Yugoslavia	22.68	24.10	28.91	20.62	25.32

1/ Undisbursed balance includes signed but not effective loans and credits for all computations.
2/ Excludes IDA 6 credits.
3/ Excludes IFC loans.

Note: Above includes effects of program lending.

Loan Department
Loan Accounts Division
September 13, 1982
(0648G)

TABLE 3A
PORTUGAL - SOCIAL INDICATORS DATA SHEET

AREA (THOUSAND SQ. KM.) TOTAL 92.1 AGRICULTURAL 40.8	PORTUGAL 1960 /b	1970 /b	MOST RECENT ESTIMATE /b	REFERENCE GROUPS (WEIGHTED AVERAGES - MOST RECENT ESTIMATE) /a MIDDLE INCOME EUROPE	INDUSTRIALIZED MARKET ECONOMIES
GNP PER CAPITA (US$)	360.0	970.0	2370.0 *	2323.9	10328.2
ENERGY CONSUMPTION PER CAPITA (KILOGRAMS OF COAL EQUIVALENT)	460.1	921.5	1443.4	2107.4	7277.7
POPULATION AND VITAL STATISTICS					
POPULATION, MID-YEAR (THOUSANDS)	8826.0	8628.0	9836.0	.	.
URBAN POPULATION (PERCENT OF TOTAL)	22.5	26.2	30.6	47.9	78.0
POPULATION PROJECTIONS					
POPULATION IN YEAR 2000 (MILLIONS)			11.5	.	.
STATIONARY POPULATION (MILLIONS)			13.5	.	.
YEAR STATIONARY POPULATION IS REACHED			2070	.	.
POPULATION DENSITY					
PER SQ. KM.	95.9	93.7	106.1	83.3	138.5
PER SQ. KM. AGRICULTURAL LAND	182.4	200.7	239.2	155.4	509.7
POPULATION AGE STRUCTURE (PERCENT)					
0-14 YRS.	29.2	28.4	26.7	31.1	22.7
15-64 YRS.	62.9	61.9	63.2	61.2	65.7
65 YRS. AND ABOVE	8.0	9.7	10.1	7.7	11.6
POPULATION GROWTH RATE (PERCENT)					
TOTAL	0.5/c	-0.2/c	1.3	1.6	0.8
URBAN	2.1	1.3	2.9	3.5	1.4
CRUDE BIRTH RATE (PER THOUSAND)	24.1	19.9	18.2	23.6	14.5
CRUDE DEATH RATE (PER THOUSAND)	7.5	9.9	9.6	9.2	9.3
GROSS REPRODUCTION RATE	1.6	1.5	1.2	1.6	0.9
FAMILY PLANNING					
ACCEPTORS, ANNUAL (THOUSANDS)	..	..	..	.	.
USERS (PERCENT OF MARRIED WOMEN)	..	..	..	..	..
FOOD AND NUTRITION					
INDEX OF FOOD PRODUCTION PER CAPITA (1969-71=100)	92.0	105.0	77.0	116.0	111.1
PER CAPITA SUPPLY OF					
CALORIES (PERCENT OF REQUIREMENTS)	118.4	134.7	127.1/d	125.1	130.8
PROTEINS (GRAMS PER DAY)	80.1	92.8	84.1/d	92.7	97.1
OF WHICH ANIMAL AND PULSE	33.0	40.5	38.6/d	35.9	61.3
CHILD (AGES 1-4) MORTALITY RATE	9.0	4.3	2.3	9.2	0.5
HEALTH					
LIFE EXPECTANCY AT BIRTH (YEARS)	63.3	67.1	70.8	67.6	73.8
INFANT MORTALITY RATE (PER THOUSAND)	81.0	52.7	35.1	65.1	11.3
ACCESS TO SAFE WATER (PERCENT OF POPULATION)					
TOTAL	28.9	34.5	65.0/e	..	..
URBAN	82.1	..	90.0/e	..	..
RURAL	14.4	..	56.0/e	..	..
ACCESS TO EXCRETA DISPOSAL (PERCENT OF POPULATION)					
TOTAL	..	..	..	..	..
URBAN	..	..	..	..	..
RURAL	..	..	..	..	..
POPULATION PER PHYSICIAN	1247.5	1057.9	698.0/d	1105.4	620.7
POPULATION PER NURSING PERSON	1421.8/f	1035.0	466.9/d	634.4	246.9
POPULATION PER HOSPITAL BED					
TOTAL	182.9	..	187.4/d	286.8	122.0
URBAN	70.0/f	70.8	80.9/d	192.0	140.6
RURAL	..	..	..	..	..
ADMISSIONS PER HOSPITAL BED	..	9.8	13.5/d	20.0	17.7
HOUSING					
AVERAGE SIZE OF HOUSEHOLD					
TOTAL	3.9	3.7	..	..	..
URBAN	4.0	..	..	..	..
RURAL	3.9	..	..	..	..
AVERAGE NUMBER OF PERSONS PER ROOM					
TOTAL	1.1	0.8	..	..	..
URBAN	1.0	..	..	..	..
RURAL	1.1	..	..	..	..
ACCESS TO ELECTRICITY (PERCENT OF DWELLINGS)					
TOTAL	40.5	64.2	..	..	..
URBAN	88.5	..	..	..	..
RURAL	27.4	..	..	..	..

TABLE 3A
PORTUGAL - SOCIAL INDICATORS DATA SHEET

	PORTUGAL			REFERENCE GROUPS (WEIGHTED AVERAGES - MOST RECENT ESTIMATE) /a	
	1960 /b	1970 /b	MOST RECENT ESTIMATE /b	MIDDLE INCOME EUROPE	INDUSTRIALIZED MARKET ECONOMIES
EDUCATION					
ADJUSTED ENROLLMENT RATIOS					
PRIMARY: TOTAL	..	98.0	117.0/d	102.9	101.7
MALE	..	99.0	119.0/d	107.1	103.9
FEMALE	..	96.0	115.0/d	99.0	103.6
SECONDARY: TOTAL	..	57.0	55.0/d	60.2	88.4
MALE	..	63.0	54.0/d	66.4	83.4
FEMALE	..	51.0	56.0/d	54.0	84.2
VOCATIONAL ENROL. (% OF SECONDARY)	46.4	33.6	16.5/d	31.6	18.2
PUPIL-TEACHER RATIO					
PRIMARY	34.0	33.6	19.1/d	25.8	20.3
SECONDARY	19.0	16.6	22.9/d	22.2	16.1
ADULT LITERACY RATE (PERCENT)	62.0	71.0	..	75.9	98.9
CONSUMPTION					
PASSENGER CARS PER THOUSAND POPULATION	17.9	63.9	108.3/g	51.0	338.4
RADIO RECEIVERS PER THOUSAND POPULATION	96.1	158.6	161.2	157.2	1021.7
TV RECEIVERS PER THOUSAND POPULATION	5.2	45.1	123.1	123.7	403.6
NEWSPAPER ("DAILY GENERAL INTEREST") CIRCULATION PER THOUSAND POPULATION	63.2	86.1	62.7	112.3	331.2
CINEMA ANNUAL ATTENDANCE PER CAPITA	3.0	3.0	3.5	4.0	3.6
LABOR FORCE					
TOTAL LABOR FORCE (THOUSANDS)	3397.3	3386.7	3789.3	.	.
FEMALE (PERCENT)	17.9	24.8	25.9	36.6	36.0
AGRICULTURE (PERCENT)	44.1	33.3	24.0	38.7	6.2
INDUSTRY (PERCENT)	29.0	33.2	36.2	25.9	37.8
PARTICIPATION RATE (PERCENT)					
TOTAL	38.5	39.3	38.5	44.5	45.4
MALE	66.0	62.3	60.3	56.3	58.9
FEMALE	13.2	18.5	19.0	32.8	32.4
ECONOMIC DEPENDENCY RATIO	1.0	1.0	1.0	0.9	0.8
INCOME DISTRIBUTION					
PERCENT OF PRIVATE INCOME RECEIVED BY					
HIGHEST 5 PERCENT OF HOUSEHOLDS	..	..	..	..	..
HIGHEST 20 PERCENT OF HOUSEHOLDS	..	56.1/h,i	56.3/h,i	..	43.0
LOWEST 20 PERCENT OF HOUSEHOLDS	..	6.2/h,i	7.3/h,i	..	5.5
LOWEST 40 PERCENT OF HOUSEHOLDS	..	20.6/h,i	21.4/h,i	..	16.5
POVERTY TARGET GROUPS					
ESTIMATED ABSOLUTE POVERTY INCOME LEVEL (US$ PER CAPITA)					
URBAN	..	..	..	..	..
RURAL	..	..	..	..	..
ESTIMATED RELATIVE POVERTY INCOME LEVEL (US$ PER CAPITA)					
URBAN	..	..	480.0/d	..	..
RURAL	..	..	480.0/d	406.6	..
ESTIMATED POPULATION BELOW ABSOLUTE POVERTY INCOME LEVEL (PERCENT)					
URBAN	..	..	..	..	..
RURAL	..	..	..	..	..

.. Not available
. Not applicable.

NOTES

/a The group averages for each indicator are population-weighted arithmetic means. Coverage of countries among the indicators depends on availability of data and is not uniform.

/b Unless otherwise noted, data for 1960 refer to any year between 1959 and 1961; for 1970, between 1969 and 1971; and for Most Recent Estimate, between 1978 and 1980.

/c Due to emigration population growth rate is lower than rate of natural increase; /d 1977; /e 1975; /f 1962; /g 1976; /h Highest 25% and lowest 25% and 50% of households; /i 1968; /j 1973-74.

* The 1981 World Bank Atlas shows 1980 GNP per capita of $2350.

August 1982

DEFINITIONS OF SOCIAL INDICATORS

Notes: Although the data are drawn from sources generally judged the most authoritative and reliable, it should also be noted that they may not be internationally comparable because of the lack of standardized definitions and concepts used by different countries in collecting the data. The data are, nonetheless, useful to describe orders of magnitude, indicate trends, and characterize certain major differences between countries.

The reference groups are (1) the same country group of the subject country and (2) a country group with somewhat higher average income than the country group of the subject country (except for "High Income Oil Exporters" group where "Middle Income North Africa and Middle East" is chosen because of stronger socio-cultural affinities). In the reference group data the averages are population weighted arithmetic means for each indicator and shown only when majority of the countries in a group has data for that indicator. Since the coverage of countries among the indicators depends on the availability of data and is not uniform, caution must be exercised in relating averages of one indicator to another. These averages are only useful in comparing the value of one indicator at a time among the country and reference groups.

AREA (thousand sq.km.)
Total - Total surface area comprising land area and inland waters; 1979 data.
Agricultural - Estimate of agricultural area used temporarily or permanently for crops, pastures, market and kitchen gardens or to lie fallow; 1979 data.

GNP PER CAPITA (US$) - GNP per capita estimates at current market prices, calculated by same conversion method as World Bank Atlas (1978-80 basis); 1960, 1970, and 1980 data.

ENERGY CONSUMPTION PER CAPITA - Annual consumption of commercial energy (coal and lignite, petroleum, natural gas and hydro-, nuclear and geothermal electricity) in kilograms of coal equivalent per capita; 1960, 1970, and 1979 data.

POPULATION AND VITAL STATISTICS
Total Population, Mid-Year (thousands) - As of July 1; 1960, 1970, and 1980 data.
Urban Population (percent of total) - Ratio of urban to total population; different definitions of urban areas may affect comparability of data among countries; 1960, 1970, and 1980 data.
Population Projections
Population in year 2000 - Current population projections are based on 1980 total population by age and sex and their mortality and fertility rates. Projection parameters for mortality rates comprise of three levels assuming life expectancy at birth increasing with country's per capita income level, and female life expectancy stabilizing at 77.5 years. The parameters for fertility rate also have three levels assuming decline in fertility according to income level and past family planning performance. Each country is then assigned one of these nine combinations of mortality and fertility trends for projection purposes.
Stationary population - In a stationary population there is no growth since the birth rate is equal to the death rate, and also the age structure remains constant. This is achieved only after fertility rates decline to the replacement level of unit net reproduction rate, when each generation of women replaces itself exactly. The stationary population size was estimated on the basis of the projected characteristics of the population in the year 2000, and the rate of decline of fertility rate to replacement level.
Year stationary population is reached - The year when stationary population size will be reached.
Population Density
Per sq. km. - Mid-year population per square kilometer (100 hectares) of total area; 1960, 1970 and 1979 data.
Per sq. km. agricultural land - Computed as above for agricultural land only; 1960, 1970 and 1979 data.
Population Age Structure (percent) - Children (0-14 years), working-age (15-64 years), and retired (65 years and over) as percentages of mid-year population; 1960, 1970, and 1980 data.
Population Growth Rate (percent) - total - Annual growth rates of total mid-year population for 1950-60, 1960-70, and 1970-80.
Population Growth Rate (percent) - urban - Annual growth rates of urban populations for 1950-60, 1960-70, and 1970-80.
Crude Birth Rate (per thousand) - Annual live births per thousand of mid-year population; 1960, 1970, and 1980 data.
Crude Death Rate (per thousand) - Annual deaths per thousand of mid-year population; 1960, 1970, and 1980 data.
Gross Reproduction Rate - Average number of daughters a woman will bear in her normal reproductive period if she experiences present age-specific fertility rates; usually five-year averages ending in 1960, 1970, and 1980.
Family Planning - Acceptors, Annual (thousands) - Annual number of acceptors of birth-control devices under auspices of national family planning program.
Family Planning - Users (percent of married women) - Percentage of married women of child-bearing age (15-44 years) who use birth-control devices to all married women in same age group.

FOOD AND NUTRITION
Index of Food Production per Capita (1969-71=100) - Index of per capita annual production of all food commodities. Production excludes seed and feed and is on calendar year basis. Commodities cover primary goods (e.g. sugarcane instead of sugar) which are edible and contain nutrients (e.g. coffee and tea are excluded). Aggregate production of each country is based on national average producer price weights; 1961-65, 1970, and 1980 data.
Per capita supply of calories (percent of requirements) - Computed from energy equivalent of net food supplies available in country per capita per day. Available supplies comprise domestic production, imports less exports, and changes in stock. Net supplies exclude animal feed, seeds, quantities used in food processing, and losses in distribution. Requirements were estimated by FAO based on physiological needs for normal activity and health considering environmental temperature, body weights, age and sex distribution of population, and allowing 10 percent for waste at household level; 1961-65, 1970 and 1977 data.
Per capita supply of protein (grams per day) - Protein content of per capita net supply of food per day. Net supply of food is defined as above. Requirements for all countries established by USDA provide for minimum allowances of 60 grams of total protein per day and 20 grams of animal and pulse protein, of which 10 grams should be animal protein. These standards are lower than those of 75 grams of total protein and 23 grams of animal protein as an average for the world, proposed by FAO in the Third World Food Survey; 1961-65, 1970 and 1977 data.
Per capita protein supply from animal and pulse - Protein supply of food derived from animals and pulses in grams per day; 1961-65, 1970 and 1977 data.
Child (ages 1-4) Death Rate (per thousand) - Annual deaths per thousand in age group 1-4 years, to children in this age group; for most developing countries data derived from life tables; 1960, 1970 and 1980 data.

HEALTH
Life Expectancy at Birth (years) - Average number of years of life remaining at birth; 1960, 1970 and 1980 data.
Infant Mortality Rate (per thousand) - Annual deaths of infants under one year of age per thousand live births; 1960, 1970 and 1980 data.
Access to Safe Water (percent of population) - total, urban, and rural - Number of people (total, urban, and rural) with reasonable access to safe water supply (includes treated surface waters or untreated but uncontaminated water such as that from protected boreholes, springs, and sanitary wells) as percentages of their respective populations. In an urban area a public fountain or standpost located not more than 200 meters from a house may be considered as being within reasonable access of that house. In rural areas reasonable access would imply that the housewife or members of the household do not have to spend a disproportionate part of the day in fetching the family's water needs.
Access to Excreta Disposal (percent of population) - total, urban, and rural - Number of people (total, urban, and rural) served by excreta disposal as percentages of their respective populations. Excreta disposal may include the collection and disposal, with or without treatment, of human excreta and waste-water by water-borne systems or the use of pit privies and similar installations.
Population per Physician - Population divided by number of practising physicians qualified from a medical school at university level.
Population per Nursing Person - Population divided by number of practising male and female graduate nurses, assistant nurses, practical nurses and nursing auxiliaries.
Population per Hospital Bed - total, urban, and rural - Population (total, urban, and rural) divided by their respective number of hospital beds available in public and private general and specialized hospital and rehabilitation centers. Hospitals are establishments permanently staffed by at least one physician. Establishments providing principally custodial care are not included. Rural hospitals, however, include health and medical centers not permanently staffed by a physician (but by a medical assistant, nurse, midwife, etc.) which offer in-patient accommodation and provide a limited range of medical facilities. For statistical purposes urban hospitals include WHOs principal/general hospitals, and rural hospitals, local or rural hospitals and medical and maternity centers. Specialized hospitals are included only under total.
Admissions per Hospital Bed - Total number of admissions to or discharges from hospitals divided by the number of beds.

HOUSING
Average Size of Household (persons per household) - total, urban, and rural - A household consists of a group of individuals who share living quarters and their main meals. A boarder or lodger may or may not be included in the household for statistical purposes.
Average number of persons per room - total, urban, and rural - average number of persons per room in all urban, and rural occupied conventional dwellings, respectively. Dwellings exclude non-permanent structures and unoccupied parts.
Access to Electricity (percent of dwellings) - total, urban, and rural - Conventional dwellings with electricity in living quarters as percentage of total, urban, and rural dwellings respectively.

EDUCATION
Adjusted Enrollment Ratios
Primary school - total, male and female - Gross total, male and female enrollment of all ages at the primary level as percentages of respective primary school-age populations; normally includes children aged 6-11 years but adjusted for different lengths of primary education; for countries with universal education enrollment may exceed 100 percent since some pupils are below or above the official school age.
Secondary school - total, male and female - Computed as above; secondary education requires at least four years of approved primary instruction; provides general, vocational, or teacher training instructions for pupils usually of 12 to 17 years of age; correspondence courses are generally excluded.
Vocational enrollment (percent of secondary) - Vocational institutions include technical, industrial, or other programs which operate independently or as departments of secondary institutions.
Pupil-teacher ratio - primary, and secondary - Total students enrolled in primary and secondary levels divided by numbers of teachers in the corresponding levels.
Adult literacy rate (percent) - Literate adults (able to read and write) as a percentage of total adult population aged 15 years and over.

CONSUMPTION
Passenger Cars (per thousand population) - Passenger cars comprise motor cars seating less than eight persons; excludes ambulances, hearses and military vehicles.
Radio Receivers (per thousand population) - All types of receivers for radio broadcasts to general public per thousand of population; excludes unlicensed receivers in countries and in years when registration of radio sets was in effect; data for recent years may not be comparable since most countries abolished licensing.
TV Receivers (per thousand population) - TV receivers for broadcast to general public per thousand population; excludes unlicensed TV receivers in countries and in years when registration of TV sets was in effect.
Newspaper Circulation (per thousand population) - Shows the average circulation of "daily general interest newspaper", defined as a periodical publication devoted primarily to recording general news. It is considered to be "daily" if it appears at least four times a week.
Cinema Annual Attendance per Capita per Year - Based on the number of tickets sold during the year, including admissions to drive-in cinemas and mobile units.

LABOR FORCE
Total Labor Force (thousands) - Economically active persons, including armed forces and unemployed but excluding housewives, students, etc., covering population of all ages. Definitions in various countries are not comparable; 1960, 1970 and 1980 data.
Female (percent) - Female labor force as percentage of total labor force.
Agriculture (percent) - Labor force in farming, forestry, hunting and fishing as percentage of total labor force; 1960, 1970 and 1980 data.
Industry (percent) - Labor force in mining, construction, manufacturing and electricity, water and gas as percentage of total labor force; 1960, 1970 and 1980 data.
Participation Rate (percent) - total, male, and female - Participation or activity rates are computed as total, male, and female labor force as percentages of total, male and female population of all ages respectively; 1960, 1970, and 1980 data. These are based on ILO's participation rates reflecting age-sex structure of the population, and long time trend. A few estimates are from national sources.
Economic Dependency Ratio - Ratio of population under 15 and 65 and over to the total labor force.

INCOME DISTRIBUTION
Percentage of Private Income (both in cash and kind) - Received by richest 5 percent, richest 20 percent, poorest 20 percent, and poorest 40 percent of households.

POVERTY TARGET GROUPS
The following estimates are very approximate measures of poverty levels, and should be interpreted with considerable caution.
Estimated Absolute Poverty Income Level (US$ per capita) - urban and rural - Absolute poverty income level is that income level below which a minimal nutritionally adequate diet plus essential non-food requirements is not affordable.
Estimated Relative Poverty Income Level (US$ per capita) - urban and rural - Rural relative poverty income level is one-third of average per capita personal income of the country. Urban level is derived from the rural level with adjustment for higher cost of living in urban areas.
Estimated Population Below Absolute Poverty Income Level (percent) - urban and rural - Percent of population (urban and rural) who are "absolute poor".

Economic and Social Data Division
Economic Analysis and Projections Department
May 1982

ATTACHMENT 3a

Population: 9,836 million (mid 1980)
GNP per capita: US$2,350 (1980)

PORTUGAL - ECONOMIC INDICATORS

Indicator	Amount (US$ million - current prices -1980)	Annual Growth Rates: ACTUAL 1975	1976	1977	1978	1979	1980	PROJECTED 1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
NATIONAL ACCOUNTS																	
Gross Domestic Product a/	24077	-4.3	6.9	5.6	3.2	4.5	5.5	1.4	3.1	2.1	2.7	3.0	3.3	3.3	3.3	3.3	3.3
Agriculture	2781	-6.5	-1.5	-10.0	4.0	9.0	3.0	-6.0	8.0	2.0	2.0	2.0	3.0	3.0	3.0	3.0	3.0
Industry	8122	-9.5	4.6	9.5	3.2	5.0	6.0	1.5	2.0	2.0	3.0	3.0	3.5	3.5	3.5	3.5	3.5
Services	11033	-0.2	9.8	6.0	2.8	3.3	5.8	4.5	2.0	1.5	2.0	2.5	2.5	2.5	2.5	2.5	2.5
Consumption	21486	0.3	4.1	2.5	1.1	1.8	4.8	3.5	1.9	2.3	2.5	2.4	2.6	2.0	1.8	1.7	1.6
Gross Investment	6043	-45.3	29.7	34.7	-4.7	-2.1	12.1	6.1	-1.1	-3.8	0.4	1.7	1.7	3.3	3.3	3.3	3.3
Exports of GNFS	6768	-15.6	0	5.9	14.6	27.3	8.2	-3.4	9.7	6.6	6.6	6.6	7.4	7.5	7.5	7.5	7.6
Imports of GNFS	10220	-25.3	3.4	12.0	-1.8	7.8	9.6	3.8	2.2	2.0	3.6	3.6	4.0	3.7	3.7	3.6	3.6
Gross National Savings	1984	-61.9	58.3	55.3	17.2	27.5	7.7	-16.7	5.9	1.0	2.4	4.8	5.4	8.8	9.6	10.1	10.6
PRICES																	
Rate of Inflation - GDP deflator		16.1	16.3	26.0	19.3	24.3	15.0	20.0	20.0	16.0	12.0	10.0	6.0	6.0	6.0	6.0	6.0
Exchange Rate ($1 = Esc.)		25.55	30.22	38.28	43.94	48.92	50.06	61.5	78.5	87.4	93.8	97.7	100.4	100.4	100.4	100.4	100.4

	Share of GDP at Market Prices (%) (at current prices b/) 1970	1975	1980	1985	1990	Average Annual Increase (%) (at constant 1963 prices) 1960-1970	1970-1975	1975-1980	(at constant 1980 prices) 1980-85	1985-1990
Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	6.4	2.2	5.1	2.5	3.3
Agriculture	16.2	14.2	11.5	10.5	9.7	1.5	-1.2	0.7	2.1	3.0
Industry	30.4	31.1	33.7	33.9	33.8	8.4	5.2	5.7	2.3	3.5
Services	43.2	45.7	45.8	46.0	45.3	6.6	6.3	5.5	2.3	2.5
Consumption	83.3	96.2	89.2	87.6	84.5	6.0	7.6	2.9	2.4	1.9
Gross Investment	23.5	16.4	25.1	22.5	23.9	9.3	-5.8	10.5	-0.1	3.1
Exports GNFS	23.4	19.7	28.1	32.4	35.8	9.3	-0.7	10.8	5.8	7.5
Imports GNFS	30.2	32.2	42.4	42.5	44.2	9.9	2.5	6.2	2.9	3.7
Gross National Savings	25.5	3.8	8.2	20.4	22.4	8.4	-10.5	31.5	-0.4	8.9

	As percentage of GDP 1975	1976	1977	1978	1979	1980	1981 c/
PUBLIC FINANCE							
Current Revenues	24.8	28.1	27.0	27.2	26.6	30.0	31.2
Current Expenditures	27.2	30.9	29.0	30.6	30.4	33.8	36.4
Surplus (+) or Deficit (-)	-2.5	-2.8	-2.0	-3.4	-3.8	-3.8	-5.2
Capital Expenditure	4.4	4.7	5.4	5.5	4.7	5.9	5.4
Foreign Financing	0	0.2	0.5	2.4	2.3	1.8	n.a.

OTHER INDICATORS	1970-75	1975-80	1980-85	1985-90
GNP Growth Rate	4.0	4.6	2.6	3.2
GNP per Capita Growth Rate	2.6	3.2	1.4	2.0
Energy Consumption per Capita Growth Rate	7.9	6.5	4.8	3.5
ICOR	5.6	3.7	10.0	6.8
Marginal Savings Rate	neg.	0.11	0.28	0.56
Import Elasticity	1.14	1.22	1.16	1.12

a/ At market prices; some components are expressed at factor cost and so do not add up due to exclusion of net indirect taxes.
b/ Projected years at constant prices.
c/ Estimate only.

July 22, 1982
(0903G)

ATTACHMENT 3b

Population: 9,836 million (m
GNP per capita: US$2,350 (1980)

PORTUGAL - EXTERNAL TRADE

Indicator	Amount (US$ million-current prices -1980)	Annual Growth Rates (at constant 1970 prices) ACTUAL 1975	1976	1977	1978	1979	1980	(at constant 1980 prices) PROJECTED 1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
EXTERNAL TRADE																	
Merchandise Exports	4586	-16.0	4.3	4.1	11.1	29.3	7.1	-3.9	7.3	7.3	7.3	7.3	8.6	8.6	8.6	8.6	8.6
Agriculture and Food	553	-0.3	17.8	1.3	3.5	15.3	-1.0	-10.0	5.0	5.0	5.0	5.0	8.0	8.0	8.0	8.0	8.0
Wood, Cork, Paper and Pulp	813	-17.8	28.0	-3.8	3.3	28.2	17.3	-10.0	7.0	8.5	8.5	8.5	8.5	8.5	8.5	8.5	8.5
Textiles and Clothing	1154	-18.4	-6.7	-0.5	22.1	26.2	-8.0	0.0	7.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Petroleum Products	288	-17.1	0.5	11.0	9.6	33.6	50.0	-8.0	9.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0
Other Manufactures	1778						13.0	-1.0	8.0	8.0	8.0	8.0	10.0	10.0	10.0	10.0	10.0
Merchandise Imports	8786	-23.1	18.0	12.8	-2.1	6.7	9.0	3.1	2.0	2.0	3.8	3.7	4.1	3.8	3.7	3.7	3.7
Food	817	-20.9	19.7	-7.5	-3.1	16.9	8.7	4.6	-4.2	3.6	3.7	3.2	3.5	2.5	2.2	1.7	1.4
Other Consumer Goods	534	-26.5	10.9	-23.9	-9.7	4.1	10.9	5.2	2.3	2.9	3.2	2.9	3.2	2.3	1.8	1.6	1.3
Petroleum Products	2189	-7.5	6.7	-1.5	10.6	15.3	2.5	1.6	3.1	2.4	3.2	3.4	3.8	3.8	3.8	3.8	3.8
Intermediate Goods	3292	-23.9	28.8	19.4	-3.5	3.3	10.9	1.8	2.4	2.4	3.6	3.6	3.6	4.2	4.2	4.2	4.2
Capital Goods	2004	-27.5	18.4	26.7	-5.8	3.6	11.0	5.9	2.5	-0.1	5.0	4.3	4.8	4.0	4.0	4.0	4.0
PRICES		(1970 = 100)							(1980 = 100)								
Export Price Index		100.0	107.1	145.1	179.0	229.1	315.7	95.9	105.2	113.7	122.6	131.9	140.6	149.9	159.7	170.3	181.6
Import Price Index		100.0	111.4	143.9	177.5	240.0	381.0	102.5	105.5	114.3	123.3	132.5	140.5	149.3	158.6	168.1	178.2
Terms of Trade Index		100.0	96.1	100.8	100.8	95.5	82.9	93.6	99.7	99.5	99.4	99.5	100.1	100.4	100.7	101.3	101.9

	Composition of Merchandise Trade (%) (at current prices) 1970	1975	1980	1985	1990	1985	1990
EXPORTS							
Agriculture and Food	20.9	16.8	12.1	10.4	9.7	10.7	10.7
Wood, Cork, Paper and Pulp	16.1	15.9	17.7	18.7	18.8	17.9	17.9
Textiles and Clothing	26.4	27.3	25.2	25.4	23.5	23.4	20.1
Petroleum Products	..	..	6.3	6.3	8.6	8.3	10.1
Other Manufactures	36.7	40.0	38.8	39.1	39.3	39.7	41.2
IMPORTS							
Food	11.0	16.6	9.3	8.2	8.6	9.8	9.3
Other Consumer Goods	9.3	8.3	6.1	6.1	5.6	5.8	5.3
Petroleum Products	9.5	16.4	24.3	24.1	23.8	25.7	25.7
Intermediate Goods	41.5	36.8	37.5	36.9	36.9	36.0	36.6
Capital Goods	28.6	21.9	22.8	23.8	25.0	22.7	23.1

	Share of Trade With Industrial Countries (%) 1970	1975	1980	Share of Trade with Developing Countries (%) 1970	1975	1980	Share of Trade with Capital Surplus Oil Exporters (%) 1970	1975	1980
DIRECTION OF TRADE									
Exports	66.1	78.5	81.7	33.0	19.6	16.3	0.9	1.9	1.9
Imports	72.1	70.9	73.6	22.9	17.4	12.0	4.9	11.6	14.4

EM1DB
July 22, 1982
(0903G)

ATTACHMENT 3c

Population: 9,836 million (mid 1980)
GNP per capita: US$2,350 (1980)

PORTUGAL - BALANCE OF PAYMENT, EXTERNAL CAPITAL AND DEBT

(million US$ at current prices)

Indicator	ACTUAL						PROJECTED									
	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
BALANCE OF PAYMENTS																
Exports of Goods and Services	2876	2579	2871	3492	5234	6797	6275	7469	8590	9864	11303	12920	14774	16903	19349	22160
of which Merchandise f.o.b.	1936	1790	2001	2379	3550	4575	4227	4977	5771	6682	7724	8934	10337	11965	13854	16047
Imports of Good and Services	4730	4833	5500	5953	7762	11052	11870	12537	13958	15600	17345	19114	20987	22989	25138	27422
of which Merchandise f.o.b.	3606	3965	4533	4787	6182	8781	9285	9738	10760	12051	13422	14817	16304	17930	19708	21657
Net Transfers	1037	964	1134	1635	2476	2997	2824	3000	3355	3640	3932	4207	4501	4816	5154	5515
of which Remittances	913	907	1174	1671	2455	2928	2824	3000	3355	3640	3932	4207	4501	4816	5154	5515
Current Account Balance	-817	-1290	-1495	-826	-52	-1258	-2771	-2128	-2013	-2096	-2110	-1987	-1712	-1270	-635	253
Private Direct Investment	122	51	52	56	59	100	200	250	300	350	400	440	485	530	585	645
MLT Loans (net)																
Official	14	97	265	840	227	40	-6	51	74	89	111	101	114	179	205	178
Private	244	214	482	656	614	427	1111	1949	1866	1931	1890	1741	1426	895	204	-695
Other Capital	-251	800	337	-623	-780	633	1236	-	-	-	-	-	-	-	-	-
Change in Reserves (- = increase)	688	128	359	-103	-68	58	230	-122	-227	-274	-291	-295	-313	-334	-359	-381
International Reserves	1534	1301	1391	1880	1951	1815	1585	1706	1934	2208	2499	2795	3107	3442	3801	4182
of which Gold	1136	1125	1025	1009	1020	1020a/	1020	1020	1020	1020	1020	1020	1020	1020	1020	1020
Reserves as months imports	5.0	3.7	3.4	4.4	3.5	2.5b/	1.6	1.6	1.6	1.7	1.7	1.8	1.8	1.8	1.8	1.8
EXTERNAL CAPITAL AND DEBT																
Gross Disbursements	340	411	899	1574	1630	1328	1759	2658	2759	3236	4039	4304	4552	4695	4211	3434
Official Grants	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Concessional Loans	9	33	71	51	83	61	80	60	59	68	56	60	66	76	86	101
DAC	9	33	71	51	83	61	80	60	59	68	56	60	66	76	86	101
Non-concessional Loans	331	378	828	1523	1547	1267	1679	2598	2700	3168	3973	4244	4486	4619	4125	3333
Official Export Credits	71	49	42	65	46	158	12	11	20	26	28	29	28	35	33	31
IBRD	-	-	.1	7.7	34	56	64	116	186	216	231	231	220	212	202	192
Other Multilateral	3	58	53.9	70.3	64	98	79	106	60	61	82	101	129	157	183	197
Private	257	271	732	1380	1403	956	1524	2365	2434	2865	3632	3883	4109	4215	3707	2913
External Debt																
Debt Outstanding and Disbursed	1060	1343	2185	3699	4998	5625	6584	8583	10523	12543	14544	16387	17926	19001	19410	18893
Official	316	420	707	1584	1900	1973	1832	1882	1956	2045	2156	2257	2371	2550	2755	2933
Private	744	923	1478	2115	3098	3652	4752	6700	8567	10498	12388	14130	15555	16471	16655	15960
Undisbursed Debt	253	526	605	1020	911	800	1590	2281	2904	3383	3636	3677	3584	3477	3551	3867
Debt Service c/																
Total Service Payments	112	143	218	406	728	988	1223	1324	1651	2207	3182	3775	4478	5205	5475	5651
Interest	37	41	78	149	311	450	570	666	832	990	1155	1313	1466	1584	1672	1701
Payment as % of Exports	3.0	4.1	5.4	7.9	9.5	10.2	13.4	12.6	13.8	16.3	20.9	22.0	23.2	24.0	22.3	20.4
Average Interest Rate on New Loans	7.9	7.6	7.4	8.9	10.8	10.3	10.6	9.8	10.0	9.9	9.4	9.4	9.3	9.4	9.1	9.4
Official	7.6	6.3	6.8	7.6	7.5	8.1										
Private	8.0	8.4	8.0	10.8	12.9	11.2										
Average Maturity of New Loans (years)	10.7	10.4	11.1	8.6	10.4	9.2	9.8	9.4	9.4	9.3	9.2	9.3	9.5	9.4	10.0	10.3
Official	17.3	13.7	14.1	10.0	12.9	13.8										
Private	7.3	8.2	7.9	6.8	8.7	7.3										

a/ At national valuation. This valuation was revised upwards in 1980 but the figures shown here do not include the effect of the revaluation.
b/ Equivalent to 11.7 months if gold is valued at $350 per ounce.
c/ Based on DRS figures. They differ from the ones of the Bank of Portugal.

September 21, 1982
(0903G)

Attachment 4
Page 1 of 4

PORTUGAL

ECONOMIC AND SECTOR WORK PROGRAM, 1982-1986

Subject	Type of Work	Remarks	Reponsible Department	Total Man-weeks Required FY82	FY83	FY84	FY85	FY86
I. Economic - Macro								
1. Monitoring 2. Assessment of Medium-Term Prospects	CEM about once every two years normally linked to study of some narrowly defined special issue. Additional brief visits and BTO if country developments require it.	Main audience is Bank Management and, in some cases, the Board. However, following earlier practices, dialogue with Government will be sought on all substantive issues.	EM1	42	4	20	20	20
II. Economic - Special Topics								
1. Income Distribution and Food Subsidies	Analysis of income distribution trends, special attention to consequences and policies needed in light of adapting to EEC levels of food prices.	This report seen as a technical study to support broader work on agricultural sector issues. Audience Government and Bank management.	EM1		20			
2. Public Enterprises	Technical Assistance to Government's own efforts to assess and improve public enterprise performance.	Government exercise already begun on pilot basis. Potentially large role for Bank in supporting this with technical analysis. Audience, mainly Government.	EM1			25		
3. Public Investment Review	Update of major exercise undertaken in FY1980.	Timing uncertain since it depends on Government assembling a medium-term program which has so far been delayed. Audience, Government and Bank management.					30	
4. Employment Prospects	Assessment of major issues in this area and effects of both EEC entry and reform in labor legislation.							40
Other Economic and Sector Work	Support to operations, President's reports, various briefs, etc.	Will include various analysis of graduation-related questions (e.g. borrowing needs) in the later years.		20	20	20	30	30
III. Country Program Paper			EM1	10	12	-	12	12
IV. Sector Work								
1. Agriculture	Update of 1976 SM. Focus on implications of Portugal's entry into EEC.	Audience, Government and Bank Management.			57			
2. Energy	Assessment of energy demand management and conservation as well as progress in developing domestic energy resources.	Audience, Government, Bank Management and Other donors. Will be partly financed by UNDP.			17	40		
3. Transport	Update 1979 SM and review Government progress on transport master plan.			4				
4. Industrial Policy	Major review of industrial restructuring needs and policies in light of EEC entry.	Audience, Government and Bank Management and other donors.	EM1	36				
5. Industrial Sector - Other	Various follow-up exercises of FY81-82 industrial sector review (e.g., pulp and paper, technology, engineering, and financial sector questions).	Will be partly undertaken in context of specific operations.	EMP	__	15	15	15	15
TOTAL				112	135	120	107	117

EM1DB
September 13, 1982
(0903G)

COUNTRY ECONOMIC AND SECTOR WORK PROGRAM, 1982-87

1. When Portugal approached the Bank in 1974/75 to seek a resumption of lending, the first priority of the ESWP was to undertake a number of relatively basic exercises to define the situation in, and the needs of, the economy in the new circumstances after the revolution. A CEM was written in July 1975 (730a-PO) and was followed by an in-depth review of the agricultural sector in late 1976. This work enabled us to launch our program of assistance to the agricultural sector. It was followed by a mission in April 1977 on Manufacturing Export Industries (Report No. 1695a-PO), which had a significant influence on the subsequent radical adjustments in exchange rate, interest rate and other policies undertaken in 1978. It also served to identify the first SMI loan (signed in 1979) and the loan for mechanical industries (signed in 1980). Reviews were also undertaken of the education and the water and sewerage sectors, and both were followed by lending operations. With these, as with the second CEM which was undertaken shortly afterwards, the Government showed itself to be seriously interested in a dialogue with the Bank on economic and sector issues and to be prepared to adjust its own policies in response to Bank ideas.

2. In the past three years, it has proved increasingly possible to define an ESWP which has been more focused on specific areas of difficulty or subsectors from which particular projects may arise. An in-depth analysis of Priorities for Public Sector Investment (Report No. 1883-PO undertaken in 1979/80) was particularly useful in that it encouraged the Government, for the first time, to see the investments of its large public enterprise sector as something to be programmed to take account of macroeconomic constraints, subsectoral priorities and the dictates of economic efficiency. A subsequent CEM had special focus on domestic resource mobilization (Report No. 3365-PO). A recently finalized report on Policies for Industrial Restructuring provides a thorough analysis of Portugal's industrial restructuring needs in the light of her EEC entry. This report will serve as the basis for writing the Industrial Sector Strategy Paper for Portugal, for opening up a number of specific dialogues with the Government (e.g. on financial sector reforms) and for establishing areas of priority for project work in the coming years. A similar process of economic intelligence has now begun in relation to the agricultural sector with an economic mission of March 1982. The green cover version of the report of this mission (The Prospects for External Trade with Special Reference to Agriculture) has identified a number of key policy and project questions to be analysed more fully in the full-scale Agricultural Sector Mission scheduled for later in FY83. A green cover memorandum providing a comprehensive analysis of the situation in the Transport Sector has recently been finalized. This will provide the underpinning for our project and other work in that sector for some time to come.

A. Macro-economic Issues

3. (i) Monitoring. Given the currently serious state of the macroeconomic indicators, a regular general monitoring needs to be undertaken frequently during the next one or two years.

4. (ii) Public Investment. The review of public investment priorities referred to earlier is now somewhat dated and can no longer serve as a basis for our project selection in the public sector. It is, therefore, proposed that we undertake a limited update of this work in FY84.

5. (iii) Problems of employment and unemployment were last assessed in the context of the 1978 CEM. Given the disturbances to labor markets which are likely to arise because of EEC membership, and not least because of a liberalization to existing labor laws, a further enquiry into this set of issues is justified. This is especially true in the light of the seriously negative impact which present labor legislation could impose on some of the possible future projects for industrial restructuring.

B. Sectors

6. (i) Agriculture. The recent mission on agricultural trade prospects has identified a number of critical policy questions which will be analysed more fully by the sector mission planned for FY83. These include problems of agricultural extension, credit policy and institutional reform associated with EEC entry (e.g. revamping of marketing arrangements for cereals and grading standards for fruits and for wines). In addition, a seperate special study on food subsidies is proposed. The revision of policy in this area, as necessitated by EEC entry, will have a potentially serious impact on those in most serious poverty.

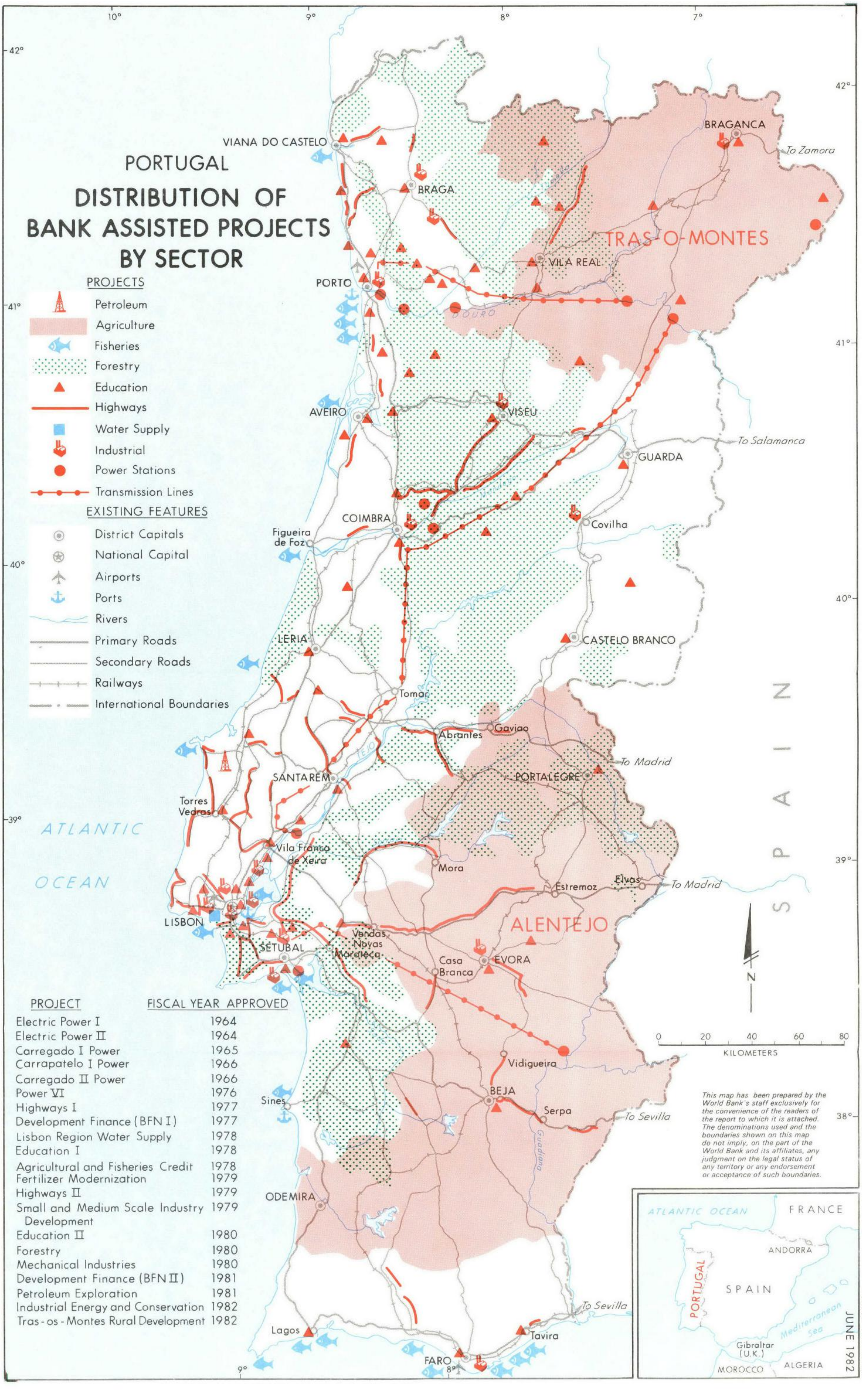
7. (ii) Industry. Subsectoral studies linked to projects (e.g. mechanical engineering, pulp and paper and technology) will help to fill out the broad framework of an industrial strategy already identified in the recent report on Policies for Industrial Restructuring. Because of its probable importance in our future lending program, resources have been allocated for an in-depth examination of the strategy for the engineering sector as indicated by the on-going subsectoral study. In addition, it is proposed that we undertake one or more special excercises to look at the special problem of Portugal's public enterprises. Although the precise form of this exercise has not yet been defined, its central purpose would be to help the Government define a set of actions to remedy the inadequate performance of these enterprises both in financial terms and in other respects (e.g. most aspects of management performance).

8. (iii) Energy. A full scale review of energy demands, development of indigenous energy resources and policies for conservation is planned for FY83/84. This review is justified by reference to our considerable present, and expected future, involvement in many aspects of Portugal's energy program and policies.

9. (iv) Transport. A comprehensive green cover review has recently been completed. No further sector work is planned at present.

10. (v) Education. A small amount of work is planned to keep us abreast of the policies and needs of the sector.

(0981G)



PORTUGAL
DISTRIBUTION OF BANK ASSISTED PROJECTS BY SECTOR
PROJECTS
Petroleum
Agriculture
Fisheries
Forestry
Education
Highways
Water Supply
Industrial
Power Stations
Transmission Lines
EXISTING FEATURES
District Capitals
National Capital
Airports
Ports
Rivers
Primary Roads
Secondary Roads
Railways
International Boundaries
PROJECT
FISCAL YEAR APPROVED
Electric Power I 1964
Electric Power II 1964
Carregado I Power 1965
Carrapatelo I Power 1966
Carregado II Power 1966
Power VI 1976
Highways I 1977
Development Finance (BFN I) 1977
Lisbon Region Water Supply 1978
Education I 1978
Agricultural and Fisheries Credit 1978
Fertilizer Modernization 1979
Highways II 1979
Small and Medium Scale Industry Development 1979
Education II 1980
Forestry 1980
Mechanical Industries 1980
Development Finance (BFN II) 1981
Petroleum Exploration 1981
Industrial Energy and Conservation 1982
Tras-os-Montes Rural Development 1982
ATLANTIC OCEAN
VIANA DO CASTELO
BRAGA
BRAGANCA
To Zamora
TRAS-O-MONTES
VILA REAL
PORTO
DOURO
AVEIRO
VISEU
To Salamanca
GUARDA
COIMBRA
Figueira de Foz
Covilha
LERIA
CASTELO BRANCO
Tomar
Abrantes
Gaviao
To Madrid
SANTAREM
PORTALEGRE
TEJO
Torres Vedras
Vila Franca de Xeira
Mora
Estremoz
Elvas
To Madrid
LISBON
ALENTEJO
SETUBAL
Vendas Novas
Morateca
Casa Branca
EVORA
Vidigueira
BEJA
Serpa
Guadiana
To Sevilla
Sines
ODEMIRA
Lagos
FARO
Tavira
To Sevilla
SPAIN
N
0 20 40 60 80
KILOMETERS
This map has been prepared by the World Bank's staff exclusively for the convenience of the readers of the report to which it is attached. The denominations used and the boundaries shown on this map do not imply, on the part of the World Bank and its affiliates, any judgment on the legal status of any territory or any endorsement or acceptance of such boundaries.
ATLANTIC OCEAN
FRANCE
ANDORRA
PORTUGAL
SPAIN
Mediterranean Sea
Gibraltar (U.K.)
MOROCCO
ALGERIA
10° 9° 8° 7°
42° 41° 40° 39° 38°
IBRD 14942R1
JUNE 1982

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

OPS/MC82-30

TO: Members of the Managing Committee

DATE: September 22, 1982

FROM: Ernest Stern, SVP, Operations ES.

SUBJECT: Sub-Saharan Africa Report

We are planning to review the status of the implementation of the Sub-Saharan Africa Report for internal discussion towards the end of this fiscal year, and subsequent distribution to the Board for information. The work will be undertaken by staff of the two African Regions and the Country Policy Department of OPS.

cc: Mr. Humphrey
Mr. Southworth

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

OPS/MC82-28

TO: Members of the Managing Committee

DATE: September 17, 1982

FROM: Ernest Stern, SVPOP ES

SUBJECT: TANZANIA - Overdue Service Payments

Attached is a paper from Mr. Wapenhans on Tanzanian debt.

OFFICE MEMORANDUM

TO: Mr. Ernest Stern, SVPOP

DATE: September 17, 1982

FROM: Mr. Willi A. Wapenhans, RVP, EAN

SUBJECT: TANZANIA - Overdue Service Payments

1. The purpose of this memorandum is to brief you on the status of overdue service payments from Tanzania.

2. As you know, we suspended disbursements on all loans and credits to Tanzania (with the exception of the Songo Songo Petroleum Exploration Project and expenditures for technical assistance and training) on June 14, 1982. Since then, we have received no payments from the Government, despite persistent efforts by our Resident Mission to remind the Ministry of Finance and the Bank of Tanzania of the damaging effects of the suspension. At the Annual Meetings in Toronto, the Minister of Finance (Mr. Jamal) said that the Government was still hoping to make the necessary payments soon, but that the problem remained one of limited foreign exchange resources rather than administrative will within Tanzania.

3. The Tanzanian overdues to the Bank Group now amount to US$14.7 million, of which US$13.3 million is owed to the Bank. Neither the suspension of disbursements nor the prospects of sizeable net transfers to the Government (once the suspension is lifted) have been enough to persuade the Tanzanian authorities to allocate the necessary foreign exchange to meet the payments. (Debt service to the Bank Group in FY82 was approximately US$35 million, compared with disbursements of US$114 million.)

4. By Regional standards, Tanzania's total external debt is not very large. Debt service in 1982 was expected to absorb about 15% of export earnings, compared with 100% in the Sudan. Tanzania's obligations increased sharply during 1979 and 1980 as a result of commercial borrowing and suppliers' credits, made necessary by the Uganda War, and have not been growing significantly since then, mainly because Tanzania is no longer creditworthy even for export insurance cover in Europe. The Bank holds 14% of Tanzania's external debt outstanding and disbursed (for the Bank Group it is 28%) and accounts for 25% of Tanzania's debt service (27% for the Bank Group). This relatively high level of Bank exposure reflects the large amount of grant assistance provided by bilateral sources during the 1970s and the write-off of US$277 million in earlier loans by bilateral agencies in 1978 and 1979. The Bank Group's share of Tanzania's debt service is projected to fall during the 1980s, following the ending of IBRD lending in FY79 and the continued need for the country to borrow funds from non concessional sources (e.g. suppliers' credits).

As of June 30, 1982, the status of Bank loans and IDA credits was as follows:

	US$ million
Bank Loans Outstanding	295.04
Bank Loans Outstanding and Disbursed	212.91
IDA Credits Outstanding	695.91
IDA Credits Outstanding and Disbursed	377.48

(These figures do not include Tanzania's share of loans to the former East African Community, which account for US$2.4 million of the total US$14.7 million currently owed to the Bank Group.) Service payments to the Bank Group have been problematical since January 1980 and consistently late during the last eighteen months; however, once accumulated, arrears were usually settled entirely and within a short period of time. There has been only one previous suspension (in September 1981) and this lasted barely a month.

5. The economic situation in Tanzania remains extremely difficult and it is certain that settlement of the overdue service payments will entail unfortunate domestic costs, such as a further reduction of resources available for food imports and productive inputs. In 1981, it was estimated that only US$85 million would be available for the foreign exchange needs of the entire economy, once adequate provision was made for oil, food imports and debt service to the Bank Group only. Since then, Tanzania's circumstances have deteriorated further and it is more difficult for the Government to maintain the priority for repayment to the Bank. The prospects for an early settlement with the IMF are still not bright, although a Fund mission will be going to Dar es Salaam for formal negotiations of a Standby Arrangement in mid-October 1982. No other lending institution (except the IMF) is apparently being paid and Bank Group repayments have been the last to be discontinued. Other agencies - including IFAD, the Commonwealth Development Corporation and the Kuwait Fund - have suspended their own disbursements, at least temporarily, during the last year.

6. Despite the duration of the present suspension, the Government has yet to feel major consequences in project implementation, although during the Annual Meeting the Tanzanians were concerned about the contract for the Morogoro Water Supply project, for which the Board approved a supplemental credit in June which we have not signed. No major contracts have been cancelled, and the first formal notice of a possible cancellation that we are aware of (on the Morogoro Textile Project) will not be given to the Government until October 1, 1982. It is now likely that the costs of the suspension will mount rapidly. In an effort to minimize the disruptive effects of the suspension, we had been advising suppliers and contractors who contacted us that we hoped the matter would be resolved prior to, or during, the Annual Meetings. They are now not likely to accept further assurances that the suspension will be temporary.

7. While cancellations of some contracts may soon occur and dramatize the importance to the Government of settling the overdue payments quickly, we believe that additional steps need to be taken now. In the hope that the suspension would prove relatively brief, we have attempted as far as possible to maintain normal operations in the country. While approved credits have not been declared effective and Closing Dates have not been formally postponed, we have continued to process new projects and made certain special allowances, e.g. we have kept some project accounts open longer than normal to allow for processing of disbursement applications already received.

8. To encourage an almost immediate resolution of the payments problem, I now propose that we inform the Government that we will suspend the processing of the Dar es Salaam Sewerage and Sanitation Project (due for Board Presentation on October 19) and defer the appraisal of a Coal Engineering Credit (which was scheduled for October 10), as well as all other appraisals. We will also inform the Government that unless all arrears are paid by October 31, 1982, we will (a) defer negotiations of the Mtera Hydroelectric Project; (b) close those project accounts which have been unilaterally kept open for projects under implementation; and (c) approve no new contracts for technical assistance and training under existing credits. Economic work, including the mission which is due to review the Government's Structural Adjustment Program later this month would, however, go forward.

9. While these actions will have damaging consequences for our Tanzanian operations, we believe that they would communicate further to the Government the importance of making the overdue service payments to the Bank Group. In current circumstances, they would also be more persuasive than the ultimate remedies at our disposal, such as cancellation of loans and credits, which should be considered as a last resort.

10. Mr. Kraske and Mr. Dunn will be visiting Tanzania later this month and will take up this matter again with Ministers and senior officials. I shall report to you on future developments, as promptly as possible. In the meantime, I would be grateful for any additional suggestions which you would wish to make on this subject.

Cleared with and cc. Mr. Dunn

cc. Messrs. Rotberg, Hittmair, Hattori, Scott, Ducker, Takahashi, Wyss, Greene, Thomas, van Opstal, Moussu-Rizan

RCalderisi:dsl

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

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OFFICE MEMORANDUM

TO: Members of the Operations Policy Subcommittee

DATE: September 13, 1982

FROM: Sidney E. Chernick, CPD

SUBJECT: Prefinancing of Project Expenditures

The attached draft memorandum will be considered by a meeting of the OPSC in mid-October. It is intended that eventually this paper would be incorporated as an annex to a new OMS on disbursements. Comments and questions should be addressed to Mr. Norman Horsley (SVPOP).

Attachment

cc: Messrs. Hattori
Hittmair
Perch
van der Tak
Rajagopalan
Waide
Raizen
Mould
Mayer
Ms. Pratt
Messrs. Humphrey
Horsley
Kopp

PREFINANCING OF PROJECT EXPENDITURES

SUMMARY

(a) Some borrowers are unable to sustain timely project cash flows due to system deficiencies and/or lack of financial resources (para. 1.04);

(b) A revolving fund is not intended to remove the causes of borrowers' problems in (a) above (para. 2.02);

(c) The making of advances for revolving funds does not necessarily place borrowers or the Bank in the best management position, which should be an important consideration in project implementation (paras. 2.05, 2.06);

(d) If a borrower is unable to meet project financial commitments, there is a strong possibility that it will be unable to sustain the subsequent recurrent expenditure commitments (para. 2.10);

(e) All possible steps should be taken to ensure that project design and implementation incorporate all systems necessary to minimize disbursement delays (para. 2.14);

(f) The following systems could improve project prefinancing: (i) commercial bank overdrafts or lines of credit; (ii) revolving funds; and (iii) a Bank loan for country financing of a multiple projects revolving fund (para. 3.01);

(g) The optimum facility for prefinancing would be the one which provides resources only when immediately required, e.g. an overdraft (para. 4.01);

(h) The Bank should consider issuing Special Commitments to borrowers to support overdraft facilities and use the "tested telex" procedure to expedite reimbursement of disbursements made by commercial bankers from overdrafts (paras. 4.09, 4.10); and

(i) It is generally to be preferred that the Bank should be only a contributor of last resort to a revolving fund (para. 5.02).

DRAFT

PREFINANCING OF PROJECT EXPENDITURES

(REVOLVING FUNDS, SPECIAL FUNDS, LINES OF CREDIT, ETC.)

I. INTRODUCTION

1.01 Projects in which the Bank participates are financed by borrowers, using local and foreign currency funds, including funds denominated in foreign exchange provided by the Bank and, in some cases, by co-financiers.1/ The extent of local currency financing by the Bank is mostly determined on country and project grounds, and is usually authorized in management-approved recommendations of Country Program Papers (CPPs).2/

1.02 The Bank has generally maintained a policy of requiring borrowers to pre-finance all project expenditures, and to claim as disbursements from a loan the agreed proportions of expenditures specified in disbursement categories in loan agreements. Exceptions, which can apply to foreign and

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1/ Throughout this Paper, reference to the financing of projects and disbursement of loans by the Bank should be interpreted as applying to IDA credits, unless the context otherwise provides.

2/ OMS 1.22 Local Cost Financing and Cost Sharing, para. 5.

local expenditures, are cases where either payment is made to a contractor, supplier, etc., directly by the Bank on a borrower's instructions (a Procedure III Withdrawal Application) or by reimbursements to a commercial bank which negotiates a draft for funds drawn under a letter of credit issued by the borrower's bankers (which the Bank guarantees to reimburse) (a Procedure V or VI Application)3/.

1.03 Pending Bank disbursement from the loan proceeds, the provision by a borrower of an adequate and timely cash flow to finance the proportions of project expenditures, by categories, which are borne by the borrower is essential for expeditious implementation. While the Bank is concerned that project entities have sufficient funds to finance all project expenditures, this paper is primarily concerned with the timely prefinancing by borrowers of expenditures related to those categories of loan disbursement which specify local expenditures, or what are usually small amounts of foreign expenditures.

1.04 Some borrowers (mostly government departments or agencies) are unable to sustain timely project cash flows. One or more reasons may contribute to this situation. These include:

(a) systems deficiencies:

(i) inadequate budget formulation and approval practices;

3/ See Guidelines for Withdrawal of Proceeds of Bank Loans.

(ii) failure to allocate and distribute government funds to projects in a timely manner;

(b) lack of financial resources for project implementation; and

(c) an inadequate process for claiming withdrawal of proceeds Bank loans, in order to replenish local sources of funds.

1.05 Efforts by borrowers and Bank staff to resolve these problems have included the formation of <u>revolving or special funds</u>, particularly from the mid-1970s. This paper examined these practices, and makes recommendations concerning future Bank participation in the establishment and operation of such mechanisms, together with suggestions for alternative means of achieving efficient financing of projects including disbursement of loan proceeds to borrowers.

II. CURRENT APPLICATIONS OF REVOLVING FUNDS FOR PREFINANCING OF PROJECT EXPENDITURES

2.01 A revolving fund is sometimes referred to as a working fund, a special fund or an imprest account. It is a temporary advance of funds from one or more contributors which is usually deposited in one bank account, and may be used to finance designated project expenditures. The level of a fund is sustained by the contributor(s) e.g. the Bank making periodic payments into the bank account, usually disbursements of loan proceeds equivalent to amounts drawn down from the fund, until its winding-up at a specified time. Attachment 1 contains a listing of 94 revolving funds to which the Bank has made, or proposes to contribute, advances of loan funds through a specific disbursement category in loan agreements.

2.02 The use of revolving funds is an expedient which does not remove, and rarely diminishes the borrower's problems which prevent the provision of adequate and timely funds for project implementation. Thus, by advancing loan funds to establish a revolving fund, the Bank does not seek to encourage the correction of deficiencies or anomalies in the Borrower's systems which affect Bank-financed projects, and the country's development process generally.

- Systems Deficiencies

2.03 Examination of the background to the introduction of revolving funds for projects' financing indicates that this growth is concentrated in the agriculture, education, health, and highways sectors, particularly for projects to be executed at dispersed or rural sites, often with poor communications. Many member governments inherited an overly centralized system of financial administration, and few have developed the necessary decentralization to support development projects.4/

4/ The Mexican Government faced these problems with the PIDER rural development programs, and with Bank encouragement, took early steps to decentralize the decision-making and project financing process in order to meet just such problems. Their experiment is so successful that it appears likely to become a model for all regional/district governmental operations.

2.04 Prior to establishing a revolving fund as a solution it might well be desirable to first make a detailed examination of the problems and explore potential solutions. The problem is normally country specific, and sector specific project appraisals do not always examine the efficacy of overall national budgeting, funds flows and related systems. Appraisals often correctly diagnose those parts of the system which do not work efficiently, and so have an adverse impact on the project, but localized, rather than country, solutions have been sought.

2.05 The making of advances to project entities by borrowers and/or the Bank by placing proceeds of budget allocations and/or loans in a bank account in anticipation of meeting expenditures (usually up to three months in advance) does not necessarily place either the Bank or the borrower in the best cash management position, because the estimated initial requirements tend to be fixed at a maximum, despite evidence that in any three month period the average amount drawn down is likely to represent about 50%-60% of a fund.

2.06 Efficient cash management should be an important consideration in project implementation. Traditional revolving funds, or imprests, require the deposit of funds (normally with a banker) to await their use by a project entity. Unless specific rules are established for interim use by the banker who holds the funds, e.g. to pay interest on unused balances, the funds so deposited are not put to best use. In most projects where IDA credits have been used, evidence of requiring interest payments by bankers is not apparent.

2.07 An important example is the series of project-specific special accounts which are currently set up in the Brazil Central Bank, with a current commitment on the Bank to transfer about US$50 million through several different loan agreements to provide for immediate disbursements to borrowers by the Central Bank. If such an account is to be funded by the Bank, consideration might be given to relating it to the forecast turnover of funds for all disbursement activities rather than establishing it on a project-by-project basis. An alternative method would be for the Brazil Government to set up the fund and agree with the Bank on a formula for reimbursement dates for calculation of foreign exchange transfers; an arrangement for such transfers by tested telexes; and arrangements for post-transfer review of withdrawal applications (similar to that currently in force for the Special Acounts).

- Borrowers' Inability to Provide Funds

2.08 Para. 1.04 (b) suggests borrowers' potential lack of funds to finance projects. It is useful to examine the implications of pre-financing for a government and simultaneously to estimate the recurrent expenditures to which a government would be committed following project completion. The extreme case is likely to lie in countries where the Bank finances 90% of project costs. However, in all cases, a borrower's commitment to pre-financing will depend on the extent of direct foreign cost financing by the Bank. For this reason, and because of the wide range of annual investment performance on projects, no absolute rule can be established. Attachment 2 provides four examples to demonstrate borrwer's annual commitments under 90% and 70% Bank/IDA financing, and the potential commitment required to pre-finance Bank financed expenditures over three-monthly periods.

2.09 From the examples in Attachment 2, a borrower would incur in the first and second years of project implementation a total commitment (i.e., pre-financing of the Bank's and borrower's shares) not exceeding about 2.5% of project costs in a case involving 90% Bank financing, and not exceeding about 5% where 70% financing is proposed. The maximum commitments are about 4.5% and 9% respectively during the peak investment year (which is usually about the fourth year). Commitments at this level, particularly in sectors where revolving funds are currently employed, are below the probable annual recurrent cost levels which a borrower will have to commit in order to sustain the project benefits post-completion. Column (7) of the tables in Attachment 2 demonstrates that possible annual incremental commitments for pre-financing of Bank-financed expenditures at no time exceed about 2% of project costs and average under 1%.

2.10 If a borrower is unable to meet financial commitments of this modest order from the outset, the use of a Bank-financed revolving fund may obscure the issue of a borrower's inability to support a project in the long term. Adequate funding commitments should be ensured from the start of implementation and well into the operational phase of a project.

- Withdrawals of Loan Proceeds

2.11 An inadequate process for withdrawal (para. 1.04 (c)) may be caused by: the local system(s) for compiling and dispatching disbursement claims; international postal delays in transmission to the Bank; delays in subsequent Bank processing and transmission of disbursed proceeds of a loan to the authorized recipient (e.g. a Central Bank); or slow transfer by the authorized recipient to the final destination (e.g. the project entity, treasury, etc.). Any of the foregoing may substantially, albeit temporarily, deplete a project's cash flow, particularly in those cases where the project entity relies on Bank disbursements as a source of funds either as part of its budgeted cash flow, or where further tranches of government-supplied funds are calculated by reference to the government's receipt of a specified level of disbursements of a Bank loan. (This may apply particularly to IDA Credits which are normally disbursed direct to governments).

2.12 Under conditions of severe inflation and/or unstable currency exchange rates, disbursements delays could result in a marked slow-down in the receipt of funds by a borrower e.g. as in Brazil in the period 1970-1980. As an example, at the date a borrower pays a local contractor in local currency the dollar/local currency exchange rate was 1:100. A delay in claiming withdrawals and actual transfer of loan proceeds in foreign currency to the Central Bank may take 30 days, by which time the rate of exchange is 1:105. Thus a payment out of 1 million, instead of earning US$10,000 equivalent will draw down only about $9,525 equivalent. This example can give rise to two effects on project's lending: (a) the Bank's disbursements will be slowed; and (b) borrowers will have to fund a higher proportion of the local expenditures in the categories concerned, unless adequate provision was made for the currency exchange effects of inflation in the price contingencies for the related components.

2.13 The Bank's practice of only disbursing loan proceeds following actual payments by borrowers places a responsibility on the Bank to disburse as expeditiously as possible once it has received a satisfactory form of withdrawal request from a borrower. This responsibility rests primarily with Loan and Treasurer's Departments, but Projects Departments have a responsibility to ensure the Loan Department is provided with all information necessary, e.g. contract documents, to allow expeditious review and approval of withdrawal applications.

2.14 To these problems of borrowers of maintaining adequate cash flows for projects must be added the Bank's concern for expeditious project implementation and a high rate of disbursements. It is therefore essential that all possible steps be taken to ensure that, inter alia, project design and implementation incorporate all systems necessary to minimize disbursement delays and that the Bank's systems are similarly kept under review.

III. POSSIBLE SYSTEMS OF PREFINANCING

3.01 There are three systems which could improve project prefinancing. These are:

(a) Use of lines of credit or overdrafts provided by central or commercial banks, linked with a revised withdrawal procedure;

(b) Use of revolving funds by borrowers, with Bank participation; and

(c) Provision of a Bank loan for pre-financing the Bank's share of expenditures for multiple projects in a country.

3.02 The use of any of the systems in para. 3.01 does not, in any way, eliminate the need to ensure that each borrower's systems for documenting expenditures and preparing and submitting withdrawal applications is achieved in a timely manner. This part of the withdrawal and disbursement process is likely to remain the weakest, and consequently the major cause of delays, unless special efforts are made during project preparation to ensure its efficient operation from the start of project implementation. However, if a borrower's system of applying for loan withdrawals is satisfactory, and the Bank's disbursement performance for the country concerned is within the average for all borrowers, the problem is the inability of a government to provide adequate and timely funds.

3.03 Borrowers, particularly governments, should plan sufficiently far ahead, usually not less than one fiscal year, to provide adequate and timely funds to project entities to avoid project implementation delays due to lack of finance, and to install speedy withdrawal applications.

- Determination of Credit Facilities Required

3.04 A credit facility may be a commercial bank overdraft or a line of credit, a revolving fund without or with Bank participation, or a normal periodic cash allocation derived from an annual budget allocation for project expenditures. The amount of any credit facility which may be established to finance or pre-finance project expenditures must be accurately forecast. Prudent cash management requires that the fund ceiling should be variable to meet the variations in disbursements rates of categories during the period of project implementation in which it remains in force. The maximum ceiling of a credit facility may be prescribed in the SAR and loan agreements, but the initial tranche or facility may need only to be a small proportion thereof, thus recognizing either normally low implementation rates at the start of a project, or that items in some categories may not be substantially drawn upon until later in the implementation period.

3.05 A key factor in forecasting limits of a credit facility will be the period(s) of time for which it will be required. For those parts of a credit facility designed to pre-finance items to be the subjects of Bank disbursements, two possible time delay factors should be exmained, viz., (i) the time period between drawings on the facility and dispatch of related Withdrawal Applications to Washington (the Application Period); and (ii) the time interval between the dispatch in (i) and the receipt of funds by the provider of the credit facility to replace the drawings (the Disbursement Period).

3.06 If the drawing from the credit facility and dispatch of the Withdrawal Application are simultaneous, or within two or three days, the Application Period should be assumed to be not exceeding one week. An Application Period should be measured in this manner in periods of weeks. The Withdrawal Period should be similarly measured; as an example, if a facility is evolved for use of tested telexes (para. 4.10) between bankers and the Bank, the Period may be three days maximum. Otherwise it will be in the current period for disbursements using the Loan and Treasurer's Departments normal system. Thus Application and Withdrawal Periods of two weeks each would require a credit facility of (a) four weeks expenditures; and (b) the amount of any additional drawings during that period. This example is likely to be the lowest achievable and should be the target objective.

3.07 It is not desirable to forecast a credit facility requirement by using (say) the three months of highest expenditures in the categories concerned and using this as the amount of the facility. If the Withdrawal and Disbursement Periods should total 13 weeks, then this calculation could be used to determine the ceiling on the facility, but initial and subsequent tranches should be calculated and timed, with reductions from the ceilings similarly calculated.

IV. LINES OF CREDIT OR OVERDRAFTS PROVIDED BY COMMERCIAL BANKS

4.01 The optimum type of credit facility would be that which provides resources only when immediately required. Such a facility approximates to the line of credit, or overdraft facility. A Commercial Bank is the usual facility available to supply short term funds for commercial and business operations. These banks should be able to meet the short-term (typically up to three-months) needs of a project entity, for the categories of local and foreign expenditures concerned (para. 1.04). They would normally work on the overdraft basis, i.e. by charging interest on overdrawn balances, with the possiblity of a commitment fee based on the maximum facility to be provided.

4.02 The overdraft rate would be negotiable, but would be likely to reflect the country's normal short-term money rate, and would be borne by the borrower or project entity as part of project costs. Rigorous control over Withdrawal and Disbursement Periods (para. 2.04) would minimize interest on overdrawn balances.

4.03 The central bank or a commercial bank (the respondent bank) of the country concerned should be requested by the borrower to pre-finance the equivalent of the Bank's share of the costs of the appropriate categories of works, goods and services involved, pending Bank disbursement. If a commercial bank is used it is preferable that it is authorized to deal in foreign exchange, so facilitating both receipt of Bank disbursements, and making small foreign exchange payments on behalf of a borrower. The use of commercial banks may provide a wider spread of services through branch banks than a central bank; an essential feature in projects with widespread implementation centers.

4.04 A Central Bank could operate in a similar manner to the commercial bank, but may have these advantages: (a) because it can deal in foreign exchange, the transfer of Bank funds would be easier and small foreign payments could also be effected; (b) it may be possible to operate a very large fund to service multiple projects; and (c) it may be able to operate a fund in co-operation with commercial banks by using their funds.

4.05 The Central Bank should be considered particularly in countries where a number of projects are likely to be involved, and/or where currency exchange problems are acute, e.g. Brazil, because the Central Bank's internal systems, and its communication systems with the World Bank and with the country's banks are likely to be satisfactory.

4.06 Normally, it should be necessary only to maintain one account for a project (or one account for each sub-project or district office, etc.) in the respondent bank. This account should be established and sustained by the borrower's proportionate contributions to the expenditures in the disbursement categories concerned, and, if appropriate, 100% of the expenditures for non-Bank financed items. A satisfactorily controlled system of check-drawing for 100% of all expenditures concerned by the project entity(ies) should be instituted, with a related expeditious Withdrawal Application process for those proportions of total expenditures due to be disbursed by the Bank.

4.07 An adequate mechanism to ensure borrower participation would be necessary. Such a system should be established by making a condition of effectiveness the borrower's initial deposit at the respondent bank of an amount necessary to provide for continuous financing of the borrower's proportion for a reasonable period (say, three months) together with completion of a lending agreement between the banker and the borrower, for the terms of fund operation. Pressure to provide the borrowers' contributions to sustain the fund, following withdrawal of funds by the borrower, or a related project entity to meet expenditures, should be achieved by establishing a minimum amount of borrower's funds below which the Bank will not agree to reimburse the respondent bank, resulting in this latter bank ceasing to honor withdrawals (checks) drawn on the overdraft or line of credit. This service would be reinstated by the respondent bank on receipt of the borrower's required payment into the bank account.

4.08 In some countries, whose governments fail to distribute funds to projects in a timely manner, it may be necessary for the borrower's share to be financed temporarily by a respondent bank, e.g. Colombia: Rural Roads projects. In such cases, the respondent bank should be asked to provide funds up to a specified limit on behalf of the borrower, and be informed that until the borrower has cleared that overdraft amount and, if appropriate, provided a specified amount of additional funds, the Bank would not agree to reimburse the respondent bank. This system would require the respondent bank to inform the Bank of the status of the account at time of submission of Withdrawal Applications.

4.09 To expedite disbursements, when line of credit or overdraft procedure acceptable to the Bank is used, the Loan Department should consider the issue of a form of Special Commitment pursuant to Section 5.02 of the General Conditions Applicable to Loan and Guarantee Agreements; these Special Commitments to be available at the request of a borrower for provision to a respondent bank acceptable to the Bank. The procedure would require a new type of Withdrawal Application form (similar to Procedures V and VI). A draft form of a Special Commitment to be provided by the Bank to a respondent Bank is in Attachment 3.

4.10 This system in para. 4.09 desirably should be based on expediting the Bank's payment to the respondent bank by use of the "tested telex or cable" procedure, whereby banks can claim reimbursements from the Bank for payments made by them e.g. as under letters of credit, etc.5/ By this procedure, on receipt of an adequately signed Withdrawal Application, with confirmation of borrower's payments, a commercial bank could obtain payment by return (unless routing through a Central Bank was necessary) and forward the Withdrawal Application for subsequent Bank examination. Any adjustments could be made by reducing future disbursements; notifying the borrower of a need to reimburse the respondent bank, and asking the banker to confirm receipt.

V. REVOLVING FUNDS AS CREDIT FACILITIES

5.01 A revolving fund established in a banking facility is similar to a line of credit or an overdraft facility, whereby a check-drawing facility up to a specified limit is continuously available to designated drawers on a bank account. Bank participation is not a prerequisite for the establishment of such a facility.

5.02 It is broadly to be preferred that the Bank should be a contributor to revolving funds only when a borrower is unable to pre-finance the Bank's share of project expenditures in specific categories in a loan agreement and when neither the Central Bank, nor a commercial bank in the country is able to make a line of credit available to the borrower against an agreement by the Bank to reimburse authorized expenditures.

5/ Attachment 4 is an example of the letter used by the Loan Department to authorize the use of tested telexes.

The grounds for an inability to raise a line of credit are most likely to be country specific e.g., inability to exceed debt-ceilings. Laws or regulations in some countries may prohibit overdrafts by government agencies. Country specific prohibitions would probably affect all projects to be implemented by government agencies, and may require a revolving fund to service multiple projects instead of separate funds for each project (See Section VI below).

5.03 A revolving fund can be established by a borrower only (possibly at the Bank's request to ensure funds availability). This may involve an intermediary bank in addition to the borrower, particularly in the loan withdrawal and disbursement process. If the Bank is to participate funds obtained as a withdrawal from a specific category of the loan proceeds should be passed, through the borrower to an intermediary (usually a bank). Revolving funds are the property of the borrower, but when the Bank is involved, it still has a responsibility to ensure the proceeds of any Bank funds deposited by a borrower in a revolving fund are used for the purposes for which the loan was granted[6/]. Adequate mechanisms, including audit, must be established for the Bank to monitor the use of that part of a revolving fund for which it has a responsibility.

5.04 There are two basic types of revolving fund which the Bank supports by making advance disbursements. Several variations on these two basic types are in use e.g. to provide funds for foreign expenditures in

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6/ Section 5 (b) of Article III of the Bank's Articles.

addition to local expenditures, or to service multiple projects. Attachment 5 summarizes the principal characteristics of these two funds, which are described as Class A and Class B funds.

5.05 The first type of fund is similar to a bank current or checking account, which is funded by the Bank and the borrower jointly with estimated expenditure requirements over a brief time period e.g. one to three months. The project entity draws on the fund, using checks, to meet small local expenditures. Replenishment is by Bank disbursements on the basis of Withdrawal Applications and corresponding borrower inputs in the agreed financing ratios according to disbursement categories (e.g. 60:40). This type of fund was used for the Saharan drought projects, but was subjected to abuse in some countries. Its primary objective is to relieve short-term liquidity problems of governments.

5.06 The second type of fund maintains the Bank's contribution separately in a respondent bank. Funds are transferred to project entity's operating account on receipt by the banker of Withdrawal Applications, who then claims disbursements from the Bank. The Bank's and borrower's funds are not merged until transfer to the operating account. This fund is primarily designed to expedite disbursements, rather than to address liquidity problems of borrowers.

VI. PROVISION OF WORLD BANK LOAN FOR PREFINANCING

6.01 It may be appropriate for the Bank to make a loan available to a government to prefinance the Bank's share of expenditures of multiple projects over several years. Such a loan should be admissible under Article III on the grounds of use of (the Bank's) resources for development projects (Section 1 (a)), and that the purposes of granting the loan is to provide a revolving fund for development projects (Section 5 (b)). The project for purposes of Section 5 (c) is a revolving fund established for the purpose of expediting and facilitating implementation of projects in a country.

6.02 A loan established under these conditions should be subject to terms and conditions appropriate to installing and maintaining a revolving fund. The Class C fund in Attachment ~~3~~ 5 is an example of such a fund, with its operational requirements detailed. As the capital value of the fund should be maintained throughout its life by use of disbursements from project loans, repayment could be effected by the borrower at any appropriate time. The loan should be advanced in tranches, based on a forecast of the program of projects over (say) three to five years. If necessary, the Special Commitment Procedure (para. 4.09) may be used to expedite disbursements to the fund from the Bank.

VII. OTHER MATTERS

- Country Credit (or Debt) Ceilings

7.01 Informal discussions with the IMF indicate that they would not be concerned if the Bank encouraged governments to seek overdraft facilities for projects, against a Bank guarantee of reimbursement, particularly for the typical overdrawings necessary for the majority of projects to date. If the amount involved was very large relative to the size of the project and a country's agreements on debt management with the IMF, the latter would wish to be consulted.

- Establishment of Date of Reimbursement by the Bank for Currency Exchange Purposes

7.02 The Brazil case (para. 4.02) has raised the question of the fixing of the date when the Bank should determine the currency exchange rate applicable for withdrawals of loan proceeds.

7.03 The date most readily determined would be the date on which a commercial bank or Central Bank makes a payment from a credit or overdraft facility. In Brazil, if the Central Bank should reimburse cruzeiros to a borrower (e.g. BNH) the effective date should be the date of that transaction. This should encourage early and prompt borrower action to obtain disbursements. An acceptable alternative would be the mid-point date of each month, i.e. all transactions by borrowers in August 1982 would be reimbursed by the Bank at the currency exchange rate ruling on August

16, 1982. If other dates, e.g. date of check drawing were used, there is unlikely to be firm evidence that payment actually took place on such date.

- Documentation Processing by Banks

7.04 To minimize charges by bankers, they should not be asked to participate in detailed processing of documentation by borrowers or the Bank. The following should probably be required of a banker:

(a) satisfaction with withdrawal procedures by the borrower from the line of credit, e.g., authorized signature(s) on checks;

(b) satisfaction with borrower's Withdrawal Applications from Proceeds of Bank Loans which the banker is required to forward to the Bank to support tested telexes or cables. This satisfaction should normally include authorized signatures, banker's evidence of borrower's withdrawal from line of credit, appropriate supporting documents, and certificate of payment of the borrower's contribution. This latter requirement may be waived if the borrower has made an advance to the banker; when, and if, the advance was drawn down, the banker could no longer send a tested telex for reimbursement. The banker should not be required to be satisfied as to the legality or bona-fide nature of payments other than authorized signatures;

(c) Preparation and dispatch of tested telex or cable for amount of Withdrawal Applications;

(d) Forwarding to Bank of Withdrawal Applications following issue of tested telex; and

(e) Informing borrower and the Bank regularly of transactions and costs of line of credit.

- <u>Use of Commercial Banks not authorized to deal in Foreign Exchange</u>

7.05 Some commercial banks which are most convenient for borrowers to obtain lines of credit may not be authorized to deal in foreign exchange i.e. to receive the Bank's disbursement. In such cases, the Central Bank (or other suitable bank) should be included in the process, either

(a) as the bank which actually makes the disbursement in local currency to the banker providing the line of credit, and immediately claims by tested telex to the Bank, and who receives the Bank's disbursement; or

(b) as the recipient of foreign currency from the Bank's disbursements, for immediate payment of the local currency equivalent to the commerical banker who claimed by tested telex.

- Costs of a Line of Credit or Overdraft

7.06 Commercial bankers may require a commitment fee for making funds available on call. If the funds are for a government department or agency, the government may be able to encourage the banker to waive such a charge. When a charge is proposed it will probably be based on the maximum call amount and the time required (corresponding to similar characteristics of a revolving fund). A line of credit for US$500,000 equivalent for one year, with option to renew could cost about one half of one percent or US$2,500.

7.07 Interest charges on any funds used would be on a daily basis and relate to local money market rates, unless a government was able to negotiate a fixed rate for a term. Rates vary widely at the present time and it is not feasible to present any meaningful forecast. However, the following is given as a guide:

> Assuming a borrower draws down $200,000 equivalent per month in tranches of US$50,000 equivalent on the 7th, 15th, 22nd and last day of each month, and a withdrawal documentation is prepared to enable the banker to prepare a telex by the 7th of the following month, the approximate interest charge using a 15% per annum interest rate would be $2,000 pending receipt of the Bank's

disbursement. (A three month expenditures tranche to form a revolving fund using a Bank loan would cost about US$5,700 per month, or using IDA Credit funds, US$375 per month.

REVOLVING FUNDS AND ADVANCES FINANCED BY BANK LOANS OR IDA CREDITS

Loan Number	Project	Loan Amount (US$ million)	Advance Amount
68 CO	R.R. Const. & Rehab.	25.0	
119 CO	R.R. Extension	15.9	
176 EC	Highway Maint. & Const.	14.5	$ 40,000
267 CO	Atlantic R.R. Equipment	5.4	$ 10,000
343 CO	R.R. Rehabilitation	30.0	
551 CO	Fifth R.R.	18.3	$ 10,000
668 CH	Third Education	7.0	Esc 600,000
755 BR	Education	8.4	$ 420,000
949 PE	Education	24.0	$ 750,000
1050 ES	Sites & Services	2.5	(See Credit)
1100 IND	Sixth Irrigation	65.0	$ 15,000
1291-T-GH	Upper Regiuon Agric. Dev.	21.0	$ 30,000
1465 ES	Second Urban Dev.	6.7	(See Credit)
1737 CO	Third Agric. Dev. - Incorp.	20.0	$ 920,000
1244 NI	Education II	11.0	$ 600,000
1402 NI	Power IX	22.0	$ 1,000,000
1495 NI	Rural Sanitation	3.0	$ 250,000
1496 NI	Maragray Water Supply III	10.1	$ 1,900,000
1785 NI	Agric. & Ind. Rehab.	20.0	$ 3,000,000
1783 DO	Emergency Road Reconst.	25.0	$ 2,200,000
Nicaragua	Education III	38.0	$ 750,000
Nicaragua	Industrial Rehabilitation	Undecided	$ 2,000,000
Nicaragua	Agricultural Rehabilitation	Undecided	$ 3,000,000
Colombia	Rural Roads	33.0	$ 1,350,000
Colombia	Irrigation Rehabilitation	30.0	$ 2,000,000
1067 BR	Education	23.5	Undecided
1142 DO	Education	8.0	Undecided
BR	Multi-State Water Supply	180.0	$12,000,000
NI	Municipal Development	16.0	$ 1,200,000
BR	NW-Health	13.0	$ 1,000,000
BR	NW-Highways	230.0	$15,000,000
BR	Agricultural Development	67.0	$ 4,000,000
BR	Embrapa II - Agric. Research II	60.0	$ 3,000,000
BR	Piaui Rural Development	29.0	$ 2,000,000

/continued/

Credit Number	Project	Credit Amount (US$ million)	Advance Amount	
220 IND	Third Irrigation Rehab.	14.5	$	15,000
309 CD	Livestock Dev.	2.2	$	50,000
441 NIR	Drought Relief	2.0	$	200,000
442 UV	Drought Relief	2.0	$	200,000
443 MLI	Drought Relief	2.5	$	200,000
444 MAU	Drought Relief	2.5	$	200,000
445 CO	Drought Relief	2.0	$	200,000
446 SE	Drought Relief	3.0	$	200,000
485 ET	Drought Area Rehab.	10.0	$	500,000
489 CD	Sategui - Deressia Irrigation	7.5	$	100,000
491 MLI	Integ. Rural Development	8.0	$	200,000
517 ES	Sites & Services	6.0	$	300,000
538 MLI	Livestock	13.3	$	200,000
592 CD	Lake Chad Polders	5.0	$	400,000
599 MLI	Third Highway	10.0	$	500,000
664 CD	Rural Fund	6.0	$	500,000
665 MAU	Technical Assistance	2.7	$	100,000
668 RW	Mixed Farm & Rural Dev.	14.0	$	400,000
669 MLI	Mali-Sud Agriculture	15.5	$	1,225,000
706 UV	West Volta Cotton	3.6	$	400,000
717 BEN	Feeder Roads	5.5	$	300,000
726 ES	Second Urban Dev.	6.0	$	300,000
733 MLI	Second Education	10.0	$	200,000
746 BEN	Third Highway	10.0	$	250,000
753 MLI	Mopti II (Rice)	15.0	$	600,000
760 LA	Agric. Rehab. & Dev.	8.2	$	100,000
766 UV	Urban Dev.	8.2	$	400,000
800 NIR	Forestry	4.5	$	200,000
810 TO	Feeder Roads	5.6	$	300,000
849 GUI	Education	8.0	$	50,000
S 22 GUI	Power Eng. & Repair	1.13	$	100,000
870 GUI	First Water Sup. & Sanitation	12.5	$	600,000
904 SU	South Region Agric.	15.0	$	1,000,000
956 UV	Second Education	14.0	$	400,000
982 UV	Forestry	14.5	$	500,000
MLI	Fourth Highway		$	500,000
952 GUI	Rice	10.4	$	100,000
955 BD	Drainage & Flood Control		$	500,000
965 NI	Urban Reconstruction	22.0	$	800,000
966 NI	Agric. & Ind. Rehab.	10.0	$	3,000,000
Sierra Leone	N. Integrated Agric. Dev. II	8.5	SDR	50,000
Sierra Leone	E. Integrated Agric. Dev. III	SDR 9.2	SDR	230,000
Rwanda	Coffee	15.0	SDR	250,000
Haiti	Agricultural Rehab.	SDR 2.6	$	500,000
Pakistan	OnFarm Water Management	43.5	$	2,400,000
Guinea 1063	Livestock Project	SDR 13.3	$	100,000
Mauritania 1068	Gorgol Irrigation Project	SDR 4.4	$	21,000 up to 300,000

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1035 COM	Coconut Rehabilitation	5.2	$ 300,000
1142 BEN	Highway IV	SDR 9.3	SDR 328,000
1164 UV	Highway IV	37.7	$ 500,000
1174 MLI	ODIPA Tech. Asst.	5.5	$ 260,000
BD	Drainage & Flood Control II	26.7	$ 1,000,000
COM	Highways II	5.6	SDR 180,000
LIB	Monrovia Urban Dev.	8.9	$ 300,000
675 HA	Rural Development	10.0	$ 500,000
HA	Third Education		$ 1,250,000

Proposed:

CO	Highway Sector	$ 4,800,000
PE	Highways VIII	
CR	Highways and Urban Transport Loans	

PROJECT FINANCING
EXAMPLES OF ANNUAL GOVERNMENT CASH OUTLAYS REQUIRES

Example 1 - 90% Bank financing and assuming no direct foreign payments by the Bank

(i) Project cost $20 million

(ii) Project period 6 years

(iii) Financial contributions
- Borrower 10% $ 2 million
- Bank/IDA 90% $18 million

(iv) Forecast of Funding Required:

Year (1)	Annual Total (2)	Bank/IDA (3)	Borrower (4)	3 months Average pre-financing (5)	Total Government funding Requirement (6)	Col. (5) increments as % of Total Project Cost (7)	Col. (6) as % of Total Project Cost (8)	Col. (6) as % of Col. (2) (9)
	$ million							
1	1.5	1.35	0.15	0.35	0.50	1.7	2.5	33
2	2.5	2.25	0.25	0.55	0.45	1.0	2.3	18
3	3.5	3.15	0.35	0.75	0.55	1.0	2.7	16
4	5.0	4.50	0.50	1.15	0.90	2.0	4.5	18
5	4.0	3.60	0.40	0.90	0.15	(1.2)	0.7	4
6	3.5	3.15	0.35	0.75	CR 0.55	(4.5)	-	-
	20.0	18.00	2.00		2.00		10	

Example 1B - as above, but assuming 35% of total project costs are direct foreign payments by the Bank

Year (1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1			0.15	0.22	0.37	1.1	1.8	25
2			0.25	0.37	0.40	0.7	2.0	16
3			0.35	0.51	0.49	0.7	2.5	14
4			0.50	0.73	0.72	1.1	3.6	14
5			0.40	0.59	0.26	(0.7)	1.3	7
6			0.35	0.51	CR (0.24)	(2.9)	-	-
			2.00		2.00		10	

Example 2A - 70% Bank financing and assuming no direct foreign payments by the Bank

(i) Project cost $20 million

(ii) Project period 6 years

(iii) Financial contributions
- Borrower 30% $ 6 million
- Bank/IDA 70% $14 million

(iv) Forecast of Funding Required:

Year (1)	Annual Total (2)	Bank/IDA (3)	Borrower (4)	3 months Average pre-financing (5)	Total Government funding Requirement (6)	Col. (5) increments as % of Total Project Cost (7)	Col. (6) as % of Total Project Cost (8)	Col. (6) as % of Col. (2) (9)
	$ million							
1	1.50	1.05	0.45	0.25	0.70	1.2	3.5	47
2	2.50	1.75	0.75	0.45	0.95	1.0	4.8	38
3	3.50	2.45	1.05	0.60	1.20	0.7	6.0	34
4	5.00	3.50	1.50	0.85	1.75	1.3	8.7	35
5	4.00	2.80	1.20	0.70	1.05	(0.7)	5.3	26
6	3.50	2.45	1.05	0.60	0.35	(3.5)	1.8	10
	20.00	14.00	6.00		6.00		30	

Example 2B - as above, but asuming 35% of total project costs as direct foreign payments by the Bank

Year (1)	Annual Total (2)	Bank/IDA (3)	Borrower (4)	3 months Average pre-financing (5)	Total Government funding Requirement (6)	Col. (5) increments as % of Total Project Cost (7)	Col. (6) as % of Total Project Cost (8)	Col. (6) as % of Col. (2) (9)
1			0.45	0.17	0.62	0.8	3.1	41
2			0.75	0.28	0.86	0.5	4.3	34
3			1.05	0.40	1.17	0.6	5.9	33
4			1.50	0.57	1.67	0.8	8.3	33
5			1.20	0.46	1.09	(0.5)	5.5	27
6			1.05	0.40	0.59	(2.3)	3.0	17
			6.00		6.00		30	

THE WORLD BANK
1818 H Street, N.W. Washington, D.C. 20433, U.S.A.
Telephone (202) 477-1234. Cable Addresses: INTBAFRAD & INDEVAS
Telex Nos. ITT 440098, RCA 248423, WUI 64145

SPECIAL COMMITMENT No. S ______________

______ Date ______________________

Application No. ___________

______

Gentlemen:

We refer to the attached copies of an Application for Special Commitment and our Loan Agreement/Development Credit Agreement No. _______

Titled ____

Dated ____

Borrower ____

under which the following local (and foreign) expenditures expressed in US dollars are eligible for financing:

Category of expenditure	Total local (and foreign) expenditures in category in US$	% of expenditures to be financed by us	Equivalent amount eligible for reimbursement by us	Ceiling limit on any item of foreign expenditure (US$)

We understand that you are prepared to receive and review Applications for Reimbursement and/or Payment to be Made from the Borrower and will disburse the amounts requested to the extent that they cover our share of the expenditures eligible for withdrawal from our Loan/Credit Account.

In consideration of your acceptance hereof as provided below, we hereby irrevocable agree to reimburse you for any payment which will have been made by you under and in accordance with the terms of this Special

Commitment and the above-mentioned Loan/Credit as the same shall be amended or extended from time to time.

Reimbursement shall be made by us promptly on receipt by us of a tested telex or cable from you. This Special Commitment, as a qualified agreement to reimburse, is subject to the following terms and conditions:

1. Only payments made in local currency or up to the limits of US$ amounts of foreign currency in the categories specified are eligible for reimbursement.
2. Contracts or purchase orders for local currency expenditures valued at more that the equivalent of US$ ______________ are subject to our prior review before withdrawals may be made. Therefore, unless specifically authorized in writing by us, you agree to make no payments in respect of expenditures under such contracts or purchase orders.
3. We shall furnish you with evidence of the authority of the borrower and the person or persons authorized to sign applications for withdrawal and a copy of the authenticated specimen signature of any such person. You agree to make payments only against applications for withdrawal signed by persons so authorized.
4. We shall not be obligated to reimburse you for any payment unless a written request substantially in accordance with the form entitled "Bank's Report of Payment and Request for Reimbursement" printed on the back hereof, and accompanied by a copy of [the borrower's] application(s) and summary sheet(s) shall have been mailed to us at our above stated address promptly after payment is made.

5. In the event that the right to make withdrawals under our Loan Agreement Development Credit Agreement (Project), dated , with would have been suspended with respect to the amount of our financing allocated to the items covered by this Special Commitment or such amount would have been cancelled, in whole or in part, we shall not be obligated to reimburse you for any payment made by you subsequent to the date of such suspension or cancellation.

6. World Bank financing is limited to an amount demoninated either in U.S. dollars or Special Drawing Rights of the International Monetary Fund (SDRs). We have committed a total amount equivalent to US$/SDRs ___________ to reimburse you for your payments made after the date of this Special commitment and before ___________ which is the initial expiration date of this Special Commitment. We will notify you in writing of any extensions to this expiration date or increases in the total amount eligible for reimbursement. The equivalent amounts eligible for reimbursement for each category shown above may not be exceeded without our prior written approval.

7. We reserve the right of the Bank's accredited representatives to inspect the applications for withdrawal submitted by the borrower and any of the documentation submitted in support of such applications. You agree to retain all supporting documentation with a copy of the related application for withdrawal for a period of three years after the date of your payment. In the event that we determine that any application or amount paid by you is not eligible for withdrawal, our reimbursement will be reduced accordingly and our borrower has agreed to promptly reimburse you the amount not paid by us.

8. We shall not be obligated to you in respect of interest, commission, other charges or expenses in connection with your payments.

Please confirm your acceptance of this agreement on the foregoing terms and conditions by signing the Form of Acceptance on the enclosed copy of this letter and returning it to us. If the copy of this agreement signed by you is not received by us by the time of your first request for an advance or reimbursement, such request shall constitute your acceptance of this Special Commitment including all the terms and conditions herein set forth as evidenced by the copy of this agreement on our files.

Very truly yours,

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

By: ______________________
Authorized Signature

FORM OF ACCEPTANCE

We confirm our acceptance of this agreement on the terms and conditions above stated.

____
Bank

By: ______________________
Authorized Signature

Please return a copy of this agreement after form of acceptance is signed to:

The World Bank
Disbursements Division,
Controller's Department
1818 H Street, N.W.
Washington, D.C. 20433

ATTACHMENT 4

Date:

____

____

Re: Your Ref.: ____________________
Your Correspondence: ________________
Your Correspondent's L/C No.: __________
IBRD Loan/IDA Credit No.: ____________
IBRD/IDA Agreement to Reimburse No.: ______

Gentlemen:

We have issued our Agreement to Reimburse covering this letter of credit.

In order to reduce the time between the date of your payment to the beneficiary and the date of reimbursement by us, we will accept requests for reimbursement by tested cable or telex. Teles or cable requests for reimbursement should indicate our Loan/Credit Number, the currency and amount paid to the beneficiary, our Agreement to Reimburse Number and the Letter of Credit Number in the following form:

"INTBAFRAD OR INDEVAS YPFOI LOAN OR CREDIT NUMBER CURRENCY AMOUNT

AGREEMENT/REIMBURSE NUMBER LETTER OF CREDIT NUMBER TEST NUMBER"

We would appreciate your agreement by signing and returning the enclosed copy of this letter, that any message in the form above will constitute first, a request by your bank for reimbursement of the payment made to the beneficiary under the Agreement to Reimburse and Letter of Credit mentioned in the message; and, second, a statement that such payment has been made under and in accordance with the terms of such Letter of Credit. Following the transmission of such a message, a copy of the Bank's Report of Payment and Request for Reimbursement marked cable/telex confirmation should be promptly sent to us with a copy of the supplier's invoice.

We are sending you under separate and registered cover, the Bank's private telegraphic key and our certified signatures.

Very truly yours,

Chief
Disbursements Division

Enclosure

cc: Treasurer's Department

TABLE OF REVOLVING FUNDS

CLASS A

1. Characteristics of fund	To provide an operational checking account for local expenditures for a project entity in circumstances where a borrower is unable to provide either the WB's proportion of expenditures, or the borrower's proportion on a timely basis.
- Advantages	(i) Prevents delays in project implementation by providing source of operating funds from date of effectiveness; and (ii) simplicity of operation by project entity.
- Disadvantages	(i) Does not provide access by project entity to foreign exchange; (ii) Extensive local controls may be needed to ensure accountability for large numbers of transactions; and (iii) difficulties in identifying.
2. Title of fund	WB Loan or project description.
3. Owner of fund	Borrower.
4. Location of fund	Central Bank, or commercial bank authorized to deal in foreign exchange and acceptable to the borrower and WB.
5. Operational responsibility	(i) Banker in 4 above; (ii) borrower or authorized agency; and (iii) WB monitoring acceptability of withdrawals.
6. Contributor(s) to fund (excluding 14 below)	WB and Borrowers in agreed proportions.
7. Establishment of fund	(i) Agreement between borrower and bankers in 4 above on conditions of fund operation, including escrow rules; (ii) Definition of disbursement categories which can be reimbursed from the fund; (iii) Post effective date of project; and <u>either</u> advance of total amount of agreed initial tranches by WB and Borrower (initial tranche may be total agreed contribution by either party) <u>or</u> advance of total amount of WB funds, or WB initial tranche, with Borrower's share to follow at agreed date - fund formally operational and receipt of WB tranche.

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8. Maximum amount of fund.	Average of not exceeding 3-4 months projected WB disbursements of those disbursement categories to which fund applies - See 7 (ii) above. Fund ceiling to be variable according to projected levels of related expenditures.
9. Currency denomination and date of conversion of Bank funds to local currency	(i) Local currency; (ii) Conversion to local currency at exchange rate applicable to foreign currencies used by WB to make initial tranche or further advances (including disbursement) on date of transaction. Disbursements by the Bank to be converted at date of transfer by Bank (normal procedure).
10. Banker's responsibility	(i) "At arm's length" with borrower; (ii) Monthly reporting to borrower and WB; and (iii) observing escrow rules.
11. Eligible expenditures for withdrawal of funds	(i) Local currency by disbursement category - See 7 (ii) above.
12. Withdrawal procedures	Fund used as conventional checking account by project entity.
13. Replenishment by WB and borrower of advances from fund	(i) Borrower forwards to WB Procedure I applications. WB transfers appropriate amount of disbursed loan funds to banker in 4 above; and (ii) borrower to make repayment of specified amounts (e.g. expenditures financed by borrower in past 3 months) at periodic intervals (e.g. every three months) by specific dates in each year.
14. Disallowed payments from fund or non-payment into fund of amounts due from borrower	WB to notify banker and borrower of amount of any disallowed Procedure I application. Banker to place "stop" on further withdrawals after 60 days unless or until borrower pays to fund equivalent of disallowed expenditure in US dollars; and (ii) failure to maintain the borrower's agreed share of the fund would result in the banker placing "stop" on payments after 60 days (or other agreed period) under specific escrow rule agreed between WB, borrower and banker.
15. Costs of fund operation	(i) Interest on amount advanced by WB to establish fund payable by borrower as loan withdrawal at loan interest rate. WB can either add interest due as capitalized interest to loan withdrawals semi-annually, or borrower make semi-annual payment; and (ii) Operating expenses to be borne as agreed between borrower and banker in 4 above.
16. Winding-up, or reduction in total amount of fund	(i) Winding-up - either payments by WB as disbursements against Procedure I Applications to cease when total amount undisbursed, (or total amount that can, likely be disbursed) in related disbursement categories — See 7 (ii) above — is equivalent to 150% of fund maximum. Early winding up to be sought by WB if misuse of fund occures; or return of any fund balance to WB by borrower; (ii) Fund reduction achieved by WB not disbursing against Withdrawal Applications equivalent to amount of reduction agreed with borrower and notified to banker; (iii) Foreign currency expenditure categories - when the total amount of outstanding commitments on Procedure V and VI Withdrawals and 200% of foreign expenditure categories included in the fund — See 7 (iii) and 11 (ii) above — are equivalent to the undisbursed balance of loan related to foreign expenditures categories; and (iv) fund reduction by borrower to be by procedures agreed with WB at negotiation for loan.
17. Monitoring of fund performance	(i) By Controller's Department through Withdrawal Applications review and reconciliation of fund balance with monthly statements from banker; and (ii) By Projects staff examination of disbursements procedures, annual financial statements and auditors' reports.

TABLE OF REVOLVING FUNDS

CLASS B

1. Characteristics of fund	(i) To minimize delays in transmission of Procedure I Withdrawal Applications for disbursements of proceeds by World Bank (WB) to designated recipient banker in country; and (ii) To meet small expenditures in foreign currency (up to about US$20,000 equivalent) to eliminate need by borrower to use Withdrawal Procedures III, V and VI.
- Advantages	(i) Facility to disburse against small expenditures promptly; (ii) When substantial exchange rate fluctuations occur against local currency, fund minimizes losses by borrower, and maximizes US$ amount of loan funds available; (iii) Can provide 100% financing in advance for small foreign exchange expenditures; and (iv) Fund only deals in Bank's share of expenditures and all transactions should be identifiable with disbursement categories.
- Disadvantages	(i) Provides only WB share of expenditures after financing of 100% expense by project entity (except when 100% foreign exchange is required); (ii) Likelihood of large numbers of transactions making verification and reconciliation difficult; and (iii) complexity of operation by banker and project entity concerned.
2. Title of fund	WB Loan or project description.
3. Owner of fund	Borrower.
4. Location of fund	Central Bank, or commercial bank authorized to deal in foreign exchange and acceptable to the borrower and WB.
5. Operational responsibility	(i) Banker in 4 above; (ii) borrower or authorized agency; and (iii) WB monitoring acceptability of withdrawals.
6. Contributor(s) to fund (excluding 14 below)	WB only.
7. Establishment of fund	(i) Agreement between borrower and bankers in 5 above on conditions of fund operation, including escrow rules; (ii) Definition of disbursement categories which can be reimbursed from the fund; (iii) Post effective date of project; and (iv) Advance of agreed first tranche or total amount of funds by WB on basis of Withdrawal Application by borrower.
8. Maximum amount of fund	Average of not exceeding 3-4 months projected WB disbursements of those disbursement categories to which fund applies - See 7 (ii) above. Fund ceiling to be variable according to projected levels of related expenditures.

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9. Currency denomination and date of conversion of Bank funds to local currency	(i) US dollars, but with WB option to provide any appropriate currency for conversion thereto; and (ii) Conversion at US$ rate ruling at time of withdrawal from fund.
10. Banker's responsibility	(i) "At arm's length" with borrower; (ii) Monthly reporting to borrower and WB; and (iii) observing escrow rules.
11. Eligible expenditures for withdrawal of funds	(i) Local currency by disbursement category - See 7 (ii) above.
12. Withdrawal procedures	(i) Funds for local expenditures transferred by banker to an account specified by borrower (and agreed by WB) against authorized signatures on (a) withdrawal form and (b) Procedure I Withdrawal Application to WB; and (ii) Foreign currency expenditures transferred to account(s) agreed between Borrower and WB to pay foreign creditors e.g. to special account in Central Bank for transfer of funds to another country. Likely to be dependent on local exchange control regulations.
13. Replenishment by WB and borrower of advances from fund	(i) Procedure I Withdrawal Application to WB and deposits of proceeds of disbursement through WB disbursement process. For foreign exchange transactions, additional evidence of a bank transfer of funds to banks of creditors in foreign countries; and (ii) Borrower - not applicable.
14. Disallowed payments from fund or non-payment into fund of amounts due from borrower	WB to notify banker and borrower of amount of any disallowed Procedure I application. Banker to place "stop" on further withdrawals after 60 days unless or until borrower pays to fund equivalent of disallowed expenditure in US dollars.
15. Costs of fund operation	(i) Interest on amount advanced by WB to establish fund payable by borrower as loan withdrawal at loan interest rate. WB can either add interest due as capitalized interest to loan withdrawals semi-annually, or borrower make semi-annual payment; and (ii) Operating expenses to be borne as agreed between borrower and banker in 4 above.
16. Winding-up, or reduction in total amount of fund	(i) Winding-up - either payments by WB as disbursements against Procedure I Applications to cease when total amount undisbursed, (or total amount that can likely be disbursed) in related disbursement categories — See 7 (ii) above — is equivalent to 150% of fund maximum. Early winding up to be sought by WB if misuse of fund occurs; or return of any fund balance to WB by borrower; (ii) Fund reduction achieved by WB not disbursing against Withdrawal Applications equivalent to amount of reduction agreed with borrower and notified to banker; and (iii) Foreign currency expenditure categories - when the total amount of outstanding commitments on Procedure V and VI Withdrawals and 200% of foreign expenditure categories included in the fund — See 7 (iii) and 11 (ii) above — are equivalent to the undisbursed balance of loan related to foreign expenditures categories.
17. Monitoring of fund performance	(i) By Controller's Department through Withdrawal Applications review and reconciliation of fund balance with monthly statements from banker; and (ii) By Projects staff examination of disbursements procedures, annual financial statements and auditors' reports.
18. Variants in design	(i) To operate in parallel with working fund of borrower; fund withdrawals transferred to borrower's working fund (preferably maintained at the same bank) after each payment by project entity of 100% of local expenditure items from working fund. Foreign exchange payments permissible on presentation of payment authority, followed by satisfactory payment transfer confirmation arrangements; and (ii) One country fund having an unlimited number of sub-accounts (one for each project). Possible control problems with multi-project/category documentation. Fund level increased automatically as agreed first tranche for each project becomes payable on loan effectiveness.

TABLE OF REVOLVING FUNDS

CLASS C

1. Characteristics of fund	(1) A fund operated by a Central Bank (CB), to finance the WB's share of local and foreign expenditures by a country's project entities (or borrowers), each of whom may use either CB or commercial bank(s) for current checking account facilities; and (ii) Fund established by <u>either</u> (a) special loan from WB (in tranches, if appropriate) with special repayment conditions; <u>or</u> (b) loan in foreign and local currency by CB or commercial bank(s).
- Advantages	(1) Unlimited number of projects may be authorized to participate by borrower; and (ii) facility to disburse local and foreign currency up to any determined limits on each project.
- Disadvantages	(1) Needs well-organized and controlled system.
2. Title of fund	WB Disbursement Fund (———— name of country).
3. Owner of fund	Borrower.
4. Location of fund	CB.
5. Operational responsibility	CB.
6. Contributor(s) to fund (excluding 14 below)	Borrower, using WB loan.
7. Establishment of fund	(1) Borrower determines escrow rules for fund account; (ii) post-effective date of first loan/project (subsequent loans/projects do not participate until declared effective); and, if applicable, (iii) first transfer of loan funds into fund by WB.
8. Maximum amount of fund.	Fund maximum would depend on number of participating projects. However, maximum would be prescribed for each project's facility to use fund - See 12 below.

/continued/

9. Currency denomination and date of conversion of Bank funds to local currency	(i) Foreign currency; and (ii) conversion into local currency at rate ruling at time of payment by banker of project entity - See 12 below.
10. Banker's responsibility	(i) CB for fund operation; (ii) monthly reporting to WB by CB on all transactions (bank statement adequately detailed); and (iii) observing escrow rules.
11. Eligible expenditures for withdrawal of funds	Local and foreign currency expenditures in respect of payments made for items in disbursement categories of loans to borrowers or project entities who are entitled to participate in the fund operations.
12. Withdrawal procedures	(i) WB, CB and borrower to agree on maximum withdrawal facility by a project to prevent overdrawing and to cause borrower to promptly document Procedure I Withdrawals; (ii) Each project entity to transact all related business through either the CB, or one commercial banker but through various branches, if necessary; (iii) CB to guarantee bankers payments from project bank account up to maximum of facility. CB to regularly inform banker and WB of balance of facility for each project. Banker to also maintain running total of balance available in CB; (iv) Borrower's local currency payments made by check following standard local procedures, plus informing banker of check-drawing by providing banker with transfer slip drawn on CB for WB proportion of expenditures. (Thus, if only borrower's share in bank account, banker knows CB will guarantee balance. If borrower's share not available, banker to place "stop" on check.) On payment of payee's check, banker completes transfer slip to CB with date of payment, and CB remits to banker local currency equivalent at date of payment shown on transfer slip. Copy transfer slip returned to borrower with date of transfer and exchange rate applied; and (v) Foreign currency payments by borrower through banker to be effected by transfer slip drawn on CB. CB to transfer foreign funds to payee using standard local procedures. CB to collect local currency from banker, who charges borrower. Copy transfer slip returned to borrower with date of transfer and currency exchange data.
13. Replenishment by WB and borrower of advances from fund	Procedure I Withdrawal forms and forward direct to WB, attaching copy transfer slips and paid checks. WB to pay withdrawals into fund at foreign currency equivalent of exchange rate ruling at dates of CB/banker transactions. Special Commitment procedure available (Attachment 1).
14. Disallowed payments from fund or non-payment into fund of amounts due from borrower	WB to notify CB and borrower of any dissallowed Procedure I application. CB to inform banker of stop on fund withdrawals after 60 days unless or until banker pays to CB equivalent of disallowed expenditure in US dollars.
15. Costs of fund operation	(i) Interest on daily fund balance to be paid by CB to borrower of loan which established fund at rates to be agreed on establishment of fund and reviewed periodically; (ii) CB may charge banker for services; and (iii) Banker may charge borrower for services, including short-term coverage for WB share pending payment by CB, if overdraft facility used by borrower.
16. Winding-up, or reduction in total amount of fund	To be afreed bewteen WB and CB, probably incorporating a facility for WB to collect any outstanding balances from withdrawal applications and receive repayment by CB of remaining balances in fund at agreed time.
17. Monitoring of fund performance	(i) By Controller's Department and Treasurer's Department by quarterly reconcilliation of fund balances, and use of audited annual financial statements of the fund, and borrower's accounts at the commercial banks; and (ii) By Projects staff examination of disbursements procedures, annual financial statements and auditors' reports.

FORM NO. 75 (9-78)

THE WORLD BANK

ROUTING SLIP	DATE: August 26, 1982

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REMARKS:

The attached Country Program Paper on PAPUA NEW GUINEA is scheduled to be discussed at the OPSC meeting on Thursday, September 16, 1982 at 3:00 p.m. in Room E-1208. The meeting will be chaired by Mr. Stern.

FROM:	ROOM NO.:	EXTENSION:
C. L. Robless	D-1348	75533

REVIEW DRAFT
FOR OPERATIONS POLICY SUB-COMMITTEE
CONFIDENTIAL

Country Program Paper

PAPUA NEW GUINEA

August 19, 1982

East Asia & Pacific Regional Office

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REVIEW DRAFT
August 19, 1982

COUNTRY PROGRAM PAPER
PAPUA NEW GUINEA

			FY77-81	FY82-86	FY83-87
1980 Population:	3.0 million /a	IBRD	38.5	232.0 /b	293.0
1980 Per capita GNP:	$780 /a	IDA	87.0	5.0	3.0
Current population growth rate: 2.3%		Total	125.5	237.0	296.0
	No. of loans/credits		8	10	11
	No. of loans/credits per million population		2.67	3.33	3.67

Current exchange rate: K$0.67 = US$1.00

Average lending per capita per annum: Current $ (const. FY82 Commitment $)			
IBRD/IDA	8.4(10.1)	15.8(13.6)	19.7(16.4)
IDA	5.8 (7.0)	0.3 (0.3)	0.2 (0.2)

/a World Bank Atlas, 1981.

/b The FY82-86 lending program proposed in this CPP compares with the program for the same period approved at the last Bank-wide lending program review (September 1981) as follows:

	FY82-86 Lending Program		Percentage Change
	Approved	Proposed	Proposed/Approved
No. of loans and credits	11	10	-9%
Current $ million	240.0	237.0	-1%
Constant FY82 commitment $	203.0	203.7	0
Per capita per annum (Constant FY82 commitment $)	13.5	13.5	0

I. Introduction

1. The last Country Program paper on Papua New Guinea was reviewed by Mr. Stern on April 20, 1979. At the time of the review, Papua New Guinea's economic climate was basically a good one; commodity exports were performing well, and with the recently instituted economic planning and commodity stabilization mechanisms, the outlook was favorable for continuing a development strategy emphasizing economic stability and equity and deliberately modest growth. Areas of risk were identified but seemed to be manageable; among these were the questions of decentralization and localization coupled with the shortage of necessary staff to carry out these initiatives effectively. Exchange rate management, particularly the policy of revaluing the kina to hold down inflationary pressures, was mildly questioned with respect to its effect on development, and high minimum wages (and wage formation policy) was identified as a potential problem area.

2. Since the last CPP, perceptions in PNG regarding its development strategy have changed and trends toward declining productivity and disinvestment in tree crop agriculture, already in the making by the time of the President's review, have grown more pronounced./1 The Government is becoming increasingly aware that PNG's relatively modest growth rate (which has been slightly less than the population growth over the past decade) has not been sufficient to accomplish the Government's basically enlightened development strategy emphasizing basic needs and the welfare of the rural population. In effect, economic management in Papua New Guinea has been conservative and although an important feature in the smooth development of its substantial mineral resources, a consensus seems to be forming both in PNG and in the Bank that more growth on a per capita basis is required and that the mechanisms for initiating this are either absent or ineffective.

3. Because political and economic circumstances now seem to justify it, this CPP will argue for a more activist role by the Bank regarding the institutional structure within which economic decisions are framed and taken. In addition it will reintroduce lending for energy projects and will place less emphasis on integrated rural development projects at the provincial level as suitable vehicles for Bank lending. In other respects, particularly a continuation of the emphasis on lending in agriculture, transport and education, it does not depart substantially from previous Bank strategy. What follows then is an updating of the political and economic scene in PNG followed by a discussion of the major development issues as currently perceived. This sets the scene for developing the proposed Bank strategy for lending as well as economic and sector work. The economic discussion is based largely on the Country Economic Memorandum issued in grey cover in December 1981, and on a Review of Agriculture Services completed in January 1981. A joint Bank/UNDP

/1 Deterioration of existing plantations was specifically mentioned in the postscript to the previous CPP as an area that needed to be investigated.

energy assessment review completed in June 1982 takes a critical and comprehensive look at the energy sector. In addition, six projects will have gone to the Board since the last CPP and several project completion reports are now available to enlarge our knowledge of what in fact does seem to work at the project level. Thus, this CPP, which will be the second since independence in 1975, reflects less Bank perceptions of early post-independence intentions of a new government and more the actual performance of the economy, past, present and future.

II. The Political Background

4. Papua New Guinea has been self-governing since 1973 and gained its independence in 1975 under Michael Somare, who remained Prime Minister until 1980, when he lost a vote of confidence and his position to Sir Julius Chan. Until the July 1982 elections PNG had been a five-party democracy, of striking nonideological cast, and governments have tended to be weak because of the frequent shifts in coalitions based upon personalities and regional or tribal interests rather than national issues. In the July elections, Mr. Michael Somare's Pangu Party won a near majority of the seats allowing Mr. Somare, as the New Prime Minister, to form an apparently strong coalition. The pre-election emphasis of Mr. Somare on planning and growth also heralds a welcome change in focus: the deputy Prime Minister, P. Wingti, was named as Minister of both Primary Industry and Planning, two key ministeries in the growth process.

5. Because of the multiplicity of clans and languages, and given its extremely rugged island topography and poor communications, PNG has been politically and geographically a highly fragmented country with little or no sense of national unity. Thus the national government is probably regarded by many if not most Papua New Guineans as of little relevance to their perceived needs. In large part this underlies the increasing push toward decentralization, dividing the country with a population of three million into 19 provinces, each with its own Parliament and separate administrative apparatus. While the devolution process, begun in 1976, has generally been well managed up until now, there is some danger that it may lead to increasing political instability at high economic cost./1

6. The large number of clans and linguistic groups does insure that no single group can dominate the politics or economy of the country. However, there are clear regional disparities in wealth that are exacerbated by the development of large enclave mineral projects such as that existing on Bougainville Island and that planned on the main island at Ok Tedi. Areas such as East New Britain, which were favored by early colonial and missionary activity, are far ahead of the recently opened up highlands of the main island in virtually every measurable economic and social index. The same can be said for the Motu and Koita people around the capital Port Moresby, who have

/1 A notable "problem province" has been Chimbu in the highlands where frequent direct intervention by the National Government has been required in both administrative and financial affairs.

benefited greatly from rising urban land prices and access to services. Recent attempts by the provincial government to obtain a larger share of the Bougainville copper profits support the view that much of the initiative for decentralization has arisen from the desire of those populations residing in favored areas to insulate their current income and future growth prospects from attempts at regional income redistribution by the national government. Increasingly this has led to tensions which, together with that developing between national and provincial politicians, have become a permanent element of the political environment.

7. If there is a national political consensus on an issue it is the desire to be self-sufficient and truly independent. The unavoidable dependence of the country on a large budgetary grant from Australia and an expatriate dominated civil service is a constant reminder that there are degrees of national independence. Concomitant with the decentralization factor, therefore, is the desire to localize the civil service and the private sector as rapidly as possible while at the same time generating enough economic growth and government revenue to reduce and eventually eliminate Australian budgetary support. These political objectives have clear economic implications which will be increasingly difficult to support under a low growth scenario.

III. The Economic Background

8. The Papua New Guinean economy, whose per capita GDP in 1980 was US$780, has performed relatively poorly since Independence in 1975, with economic growth in the latter half of the decade only averaging 1.8% per annum, a 0.5% yearly regression in per capita growth rates. This contrasts with a 1.9% per capita growth rate for the first half of the decade, and an average -0.2% per capita growth rate for the decade as a whole. This unimpressive growth performance was registered despite the strong growth of copper exports from the Bougainville Mine (BCL) over the period and despite continued substantial budget support from the Australians. The latter amounted to 10% of GDP in 1980, having declined by one-third in real terms since 1970. The growth in minerals production was largely offset by a decline in agriculture, particularly plantation agriculture. In effect, mineral rents derived from Bougainville (and in the future from Ok Tedi) have offset reduced agricultural output whereas the relationship should have been an additive one./1 Reasons for the generally poor performance in agriculture are many and complex, but they largely reflect the failure of the government to address agriculture sector development issues in a coherent and focussed fashion, based upon overall planning and developmental priorities, given the actual resource constraints facing the sector.

/1 Similarly, investments in the mining sector in part simply compensated for disinvestments in tree crop agriculture.

9. The concern of government authorities for maintaining a stable economic environment probably contributed to the smooth development of the country's mineral resources. However, the appreciation of the kina (allowed by the sharp growth in copper exports on top of substantial transfer payments from the Australians) in the mid-1970s in order to dampen imported inflation probably discouraged agricultural exports. One of the reasons for the so called "hard kina" policy, begun in 1977 with successive appreciations of the kina amounting to 27% vis-a-vis the Australian dollar between 1976 and 1979, was to insulate PNG from the growing world inflation and, a fortiori, to limit increases in domestic wages./1 The latter had doubled in real terms as a result of the establishment of the Minimum Wage Boards before Independence between 1972 and 1975. Notwithstanding a number of efforts by the Government to reduce real wages thereafter, it had become clear since 1975 that it would be difficult to accomplish much more than keeping them constant in real terms through indexation to the CPI. (After considerable effort on the part of the Government, this link was finally broken in 1980, but only after relatively high rates of inflation have been reached). The appreciation of the kina was seen by decision-makers as one way of limiting wage demands and dampening domestic price increases which were, via a structurally high marginal propensity to import, strongly linked to international inflation rates.

10. While increases in the CPI, and consequently money wage demands, were probably contained by this measure, real wages remained at their high existing levels, and in retrospect the hard kina policy was probably a mistake from a developmental point of view. In the absence of this policy, money wages would probably have risen more (protecting existing real wage levels) but the direct disincentive to investments in tradeables - exports and import competing goods - would have been much less with higher money wages alone (i.e., with no appreciation) than with the direct squeeze on profits and land rents which the appreciation implied through its immediate impact on kina-denominated earnings. Moreover, while the appreciation may have encouraged a shift to nontradeables, mainly services and construction, services offered little scope for investments and expenditures for construction are largely undertaken by the Government.

11. Employment and manpower. Of the 1.1 million economically active population of Papua New Guinea, only about 15% are formally employed, with the public sector being the largest formal employer, and plantation agriculture running a close second. However, the level of formal employment has remained almost unchanged since 1971, reflecting the drop in plantation agriculture together with some probable increased substitution of capital for labor in the formal sector as a result of high minimum wages a shift which has been verified in the plantation agricultural sector. Should the indexed minimum wage situation remain as it is, together with regulatory and foreign investment constraints as they are, only about 20% of the additions to the labor force in the 1980s is likely to find formal employment in PNG,

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/1 On a trade-weighted basis the kina appreciated a further 15% during the two-year period 1980-81.

assuming (optimistically) that investments in plantation agriculture increase to reverse recent trends and fully compensate for the relative stagnation of employment in the nonplantation formal sector.

12. Papua New Guinea's public finances are generally very well managed, although this issue is likely to become increasingly complicated and problematic as the decentralization process continues. It should be noted that one-third of total budgetary resources for current and capital expenditures available to PNG comes from Australia in the form of an untied grant, although this proportion has sharply decreased since 1968, when it was 65%. It is scheduled to be continued over the next five years, but to be reduced by 5% annually in real terms. The current budget (including the Australian grant) has been in surplus every year but two since 1970, and flows from domestic revenues from BCL are channelled through the Mineral Resources Stabilization Fund to reduce the impact of fluctuations in copper export earnings on government budget revenues. The government was recently able to reverse the course of expenditures and is expected to reduce them by 3% in 1982 when public revenues are expected to drop as a result of a decline in export earnings. The budget process is increasingly being channelled through the National Public Expenditure Plan (NPEP). This planning apparatus, begun in 1976, now encompasses one-quarter of the budget under a four-year "rolling plan" basis which is designed to program public investments, including their recurrent costs, according to a list of strategic objectives (in effect corresponding to the Eight Aims of the National Development Strategy)./1 The NPEP does not, however, plan for capital allocations for years beyond the first budgetary year, and thus is not, strictly speaking, developed on a programmatic basis. The process thus gives little emphasis to development planning, which is generally weak, although it is effective in ensuring that the recurrent costs of investments can be borne by future budgets.

/1 Briefly stated the eight aims are: (a) localization of economy; (b) distribution of economic benefits; (c) decentralization; (d) emphasis on small-scale economic activity; (e) self-reliance in production; (f) self-reliance in public revenue; (g) increasing participation of women in economy; and (h) government control in economy where necessary.

IV. Economic Prospects and Creditworthiness

13. Assuming that present macro-economic and investment strategies remain unchanged, the Papua New Guinea economy will continue to grow at a rate well below its potential. Growth for the first half of the decade is expected to average 2.1%, a slight improvement over the 1.8% rate achieved in 1975-80; between 1985 and 1990 performance is expected to improve to an annual average growth rate of 4.9%. Total growth for the decade will average 3.6%. Performance in 1980-85 is expected to be characterized by (a) a gradually improving agricultural performance over the low levels of the early eighties; (b) a fall in copper exports as BCL recovery rates decline; and (c) an increase in construction activities, associated for the most part with Ok Tedi. The impact of these largely predictable changes in investment and output in the mining and associated construction sector is lumpy, in that ICORs (annual) and import elasticities show considerable year-to-year variation.

14. Improved growth rates over the second half of the decade reflect a somewhat improved situation in agriculture as already planned or implemented measures take effect (with, however, growth rates still relatively low at 3.5% per annum), growth in agricultural export volumes should average about 4.0% a year while subsistence agriculture might grow at about the rate of population growth as farmers move to export-oriented agriculture or to urban areas./1 For the most part, however, overall growth performance in the latter half of the decade will be the result of a marked improvement in the performance of the mining sector as gold production from the OK Tedi mine comes on stream in 1984, with copper following in 1987.

15. With import elasticities calculated on an historical basis ranging from 1.4 for food to 0.85 for intermediate goods (generally most easily supplied from domestic production) and averaging about 1.1, imports of goods and nonfactor services are expected to grow about 9% annually over the decade while export earnings, given a substantial boost from exports of copper concentrates from Ok Tedi, are expected to grow 12.5% per annum in nominal terms to a point where the trade gap is reduced to near zero in 1990. Terms of trade are expected to remain under their 1979 level but to improve somewhat to 95% of that level by 1990.

16. Investments will remain relatively high at about 24% of GDP in the earlier part of the decade but will fall to nearly 17% of GDP at the end of the decade, largely because of the drop in investments associated with the Ok Tedi mine. Gross domestic savings will average 15% of GDP between 1982 and 1985 and 18% of GDP after 1985, when the resource balance turns positive.

/1 At this point it cannot be predicted to what extent this shift of labor out of subsistence agriculture will be toward new jobs in the formal (e.g. plantation) sector or toward the miniscule informal sector, or ultimate unemployment.

17. Largely because of the heavy import requirements associated with Ok Tedi, the current account is expected to be in deficit through 1987, rising to US$400 million in 1982 (12.4% of GDP), and remaining at that approximate level through 1984 (11.3% of GDP). If the Australian grant is considered as a financing item (below the line) the current account deficit in 1984 would be US$730 million, 19.3% of GDP. However, capital inflows associated with Ok Tedi should reduce the overall deficit (i.e., the projected financing gap) to US$230 million in that year.

18. The years 1982-85 are the only years of the decade for which financing gaps are projected; these deficits are assumed to be financed by commercial borrowings at real interest rates of 4% per annum. Surpluses from 1986 onwards will result in the addition of roughly US$1 billion to reserves, about 4% of GDP, and domestic savings will outstrip domestic investments. Debt-service ratios are expected to peak at 9.3% in 1985 (rising from 6.5% in 1981) before falling to 4.8% in 1990. This assumes that none of the projected increase in reserves is used to pre-pay commercial or other debt.

19. The debt-service ratios in question do not include interest and amortization payments on non-guaranteed private debt. If debt service payments of this nature associated with Ok Tedi and Bougainville - doubtlessly the overwhelming bulk of such obligations - were included in the calculations, the recalculated debt-service ratio would rise to 12.3% in 1985 before falling back to 6.4% in 1990. Payments of this level should, however, be easily sustainable, particularly given their expected decline toward the end of the decade and the "reserve cushion" which should be available. One potentially important factor in PNG's creditworthiness picture is the Australian grant, which amounted to US$263 million in 1980. It is clear that an abrupt withdrawal of this grant could bring about acute difficulties, both internal and external, and make it exceedingly difficult for the government to meet its debt service obligations. Yet this problem is more theoretical than real, since Australia's commitment to PNG is strongly based on self-interest in the regional geo-political situation which is unlikely to change.

20. Going behind the details of the projected balance of payments and debt-service figures, one phenomenon stands out. As the economic rents from Bougainville decline, having for the most part been used to support domestic consumption rather than being invested, weaknesses in agricultural and industrial production (in this circumstance aggravated by falling commodity prices) begin to lead to balance of payments difficulties as consumption levels are basically maintained. Growth levels stagnate. But as a new enclave sector - in this case Ok Tedi - comes onstream, the cycle begins to repeat itself. Assuming no immediate changes in investment or consumption patterns take place to respond to the new flows, reserves in excess of those needed to guarantee adequate import cover will accumulate to US$900 million by the end of the decade - almost exactly the net incremental balance of payments earnings of

the Ok Tedi project over the period! Production associated with the project will boost growth rates, and while it is evident that the authorities will not allow any unnecessary accumulation of reserves, it is probable that the cycle - simplified here for presentation, but essentially reflective of the circumstances - may begin again as the economic rents of the project are converted into higher consumption (e.g., through exchange rate appreciation and/or real increases in minimum wages) absorbing the (investible) resources in question. This would be followed by a lower growth rate as the resources are exhausted. Average growth rates would be little above population growth rates with growth in other sectors limited by currency over-valuation, high minimum wages and conservative monetary and fiscal policies. A main feature of the Bank's macro-economic policy dialogue with Papua New Guinea will be to seek ways in which to break this self-defeating cycle through encouraging a more dynamic domestic investment policy, an exchange rate regime more appropriate to a developing country and some relaxation of domestic wage indexation.

V. Major Development Issues

21. Underlying almost any discussion of economic development in PNG is an unspoken assumption about the benefits and costs of conventional economic growth for the society as a whole. As a relative newcomer to the development scene, PNG was virtually a tabula rasa in terms of class structure, industrialization, urbanization and monetization as recently as the 1950s. Virtually every national politician and urban dweller in PNG today was born in a very small village, maintains his or her contacts there, and has a right to the use of traditional lands. Most members of this generation have the alternative of returning to a traditional subsistance life in the rural areas should urban or wage employment decline or become otherwise unsatisfactory. For many contemporary observers of the development scene this is an attractive set of circumstances and one likely to disappear rapidly if industrialization, urbanization, and commercial export-oriented agriculture are promoted. This underlies partially the use of the Eight Aims as development goals, underlying PNG's "National Development Strategy," the absence of emphasis on economic growth, the willingness to allow the expatriate-owned plantations to revert to a lower productivity small-scale cash cropping mode, and the appeal of large-scale enclave mining operations that do little more than generate revenues for the government. It also explains partially the unwillingness of planners even to consider the possibility of large-scale urbanization and internal migration. The following discussion of major development issues assumes that because of demographic pressures and mass education, together with decentralization and the need to improve income distribution and access to social services, a better articulated, growth-oriented strategy is called for. Because the current situation in agriculture may in fact contain the seeds of decline, and because it will remain PNG's leading sector for some time to come in any event, this sector is addressed first, followed by industry, whose current role (except for mining) although small, represents an important collateral element of economic growth as well as a source of urban

(and eventually even rural) employment./1 This is followed by a discussion of the localization issue in the context of education, manpower and training. Finally, the need for a more growth-oriented national planning and public administration machinery is addressed.

22. Agriculture, which employs 85% of the population and contributes a third of GDP and 50% of total exports is clearly a key sector in PNG. An analysis of problems and potentials in this sector requires a recognition of three distinct modes of production: the plantation subsector, small-scale cash cropping, and subsistence food production (the latter two are usually combined in a mixed mode). The plantation subsector has been producing for export copra, coffee, cocoa, palm oil, and small amounts of rubber and tea. Plantations established pre-independence by expatriate interests have deteriorated, especially where reversion to traditional owners took place through the Plantation Redistribution Scheme (PRS). The new owners lack the expertise, management skills, and finance to run efficient operations, and replanting with improved species is not taking place. The expatriate-owned plantations that have not reverted to traditional owners are also running down because of uncertainty about the adequacy of government compensation as well as because of the prohibition against transfer of properties established before 1974 to noncitizens. This had the effect of sharply reducing the market value of these properties and reducing the incentive for investment. The recent attempt by the Prime Minister effectively to annul the PRS may well not change the situation, unless collateral measures encouraging new investments in the sector are adopted, as popular sentiment for localization, whatever the cost, is strong. It is difficult to see any change in this tendency given the politics involved, the low price outlook due partly to the overvalued kina, and the rural minimum wage constraint. Only an active acceptance of foreign ownership and management with a favorable price and cost picture such as that in post-independence Malaysia would change the situation for expatriate-owned plantations and even then considerable time would pass before the trend to deterioration could be halted and reversed.

23. The concept of the nucleus estate with outlying smallholders has worked well in PNG for palm oil and should be applicable for other crops such as rubber, tea and cocoa. The smallholders retain control over their land, benefit from the processing facilities and husbandry skills of the central unit, and have an outlet for their production. Moreover, the problem of the minimum rural wage is circumvented except in the case of the nucleus estate

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/1 The mining sector, an important source of government revenues to PNG, is not treated in this CPP largely because the sector is well-managed, not an important source of economic dualism and in no way can be considered a problem sector. The various flows associated with the sector are taken into account in balance of payments, growth and revenue projections.

workers. However, the organization, financing and management of such estates requires considerable project preparation ability on the part of the Department of Primary Industry (DPI), which is now lacking. Moreover, the inability of the Government to gain access to land which can serve as the nucleus estate is a continuing problem.

24. Small-scale cash cropping is most common for coconuts and coffee where processing is relatively simple and some production takes place even with poor species and inadequate husbandry. The great advantage of this mode of production is its widespread potential for all farmers, its compatibility with a subsistence farming culture, and its flexibility in response to market prices. Its disadvantage lies in the difficulty of providing extension services to help such farmers maintain quality and improve yields. More generally, the deterioration of PNG research and extension services, due partly to rapid localization after independence and partly to the provincialization of this service, raises serious questions as to whether much can be done in this subsector.

25. Without a major change in attitudes towards foreign ownership and management, it is difficult to see how the conventional mode of plantation production can be resuscitated on any meaningful scale. Thus, it is reasonably clear that large-scale crop production will have to be ordered along nucleus estate lines or in clan blocks which could involve separate management contracts with built-in incentives for the (usually expatriate) manager. This is being attempted by DPI and the PNG Development Bank (PNGDB). However, the dearth of agriculture support services and trained technicians able to identify and prepare productive investment projects in agriculture will make such schemes difficult. The payment to producers of world parity prices together with appropriate stabilization mechanisms were felt to provide sufficient stimulus to ensure adequate growth in the sector without large-scale government intervention. At the same time, government exchange rate and minimum wage policies keyed largely to inflation control and urban wage rates have produced, together with low world market prices, a profit picture for much of commercial agriculture wherein it is not clear that any incentive for risk taking or innovation remains.

26. At a 14% share of GDP, the relative importance of <u>industrial</u> activity in PNG about matches that of Indonesia and Burma. The major growth poles are the capital, Port Moresby, and the port city of Lae, each on opposite sides of the main island with no land transport links between them. Growth in this sector, starting at such a low base, has generally exceeded the GDP growth rate. Most of the manufacturing activity is associated with the production of beverages and the processing of tea, coffee, and cocoa.

27. The main natural disadvantages the country faces with respect to growth in industry are: (a) the limited and dispersed internal market; (b) poor internal transport links; and (c) a generally low-skilled and poorly disciplined labor force. It is the self-inflicted disadvantages however that

predominate. These are (a) the wholesale adoption of Australian labor union attitudes that are conflict-oriented and provide for minimum wages several times those in other nearby Asian countries, (b) restrictions on foreign direct investment by new firms, which contributes to domestic concentration; (c) excessive regulation that increases the cost of doing business and the need to deal with multiple layers of government and bureaucracy when starting a new business, (d) difficulty with establishing title to land on which to locate a business enterprise and (e) a foreign exchange regime that discourages import substitution or exports.

28. Given the relative unimportance of industrial activity compared to agriculture, it is difficult to understand why two of the most important economic policy decisions in the country are so strongly influenced by urban labor. Thus, the minimum wage legislation has influenced the profitability of large-scale agriculture, and the concern of economic managers over the impact of domestic inflation on the CPI and hence urban wages has promoted a foreign exchange regime inimical to agriculture exports as well as to import substitution.

29. Part of the explanation lies in the fact that many of the current attitudes and policies were developed and put in place under the colonial regime and have remained unchanged. Virtually all of the legislation set up to protect the young country from the potentially deleterious effects of foreign investments was drafted by expatriate advisors and civil servants. Beyond the protective nature of such legislation and regulations lies the earlier mentioned philosophical point that rapid urbanization and industrialization would be bad for the society as a whole. In this sense, the self-imposed restrictions on industrial development have been effective. However, with large numbers of unskilled youths projected by the government to come into the labor market over the next ten years even if plantation agriculture and employment receive a renewed impulsion, and given a probable and continuing trend of substitution of capital for labor, job creation in the formal sector may at best only absorb about 20% of the increase of the labor force during the next decade./1 Given the fact that relatively little "informal" activity in the industrial sector exists in PNG (whether because of tradition, topography, strict minimum wage legislation, or government regulation) some serious social problems could arise, particularly in the urban areas if the traditional support systems are unable to support the projected numbers of unemployed which the formal sector cannot absorb. From a more developmental point of view, if an acceptable rate of growth in the economy is to be sustained, this will have to be accompanied by a growing industrial sector as well, particularly of small-scale industry.

/1 It is important to note that this estimate assumes a "natural" growth rate of urban employment of about 5% per annum.

30. Without proposing the wholesale abandonment of minimum wage laws and protective foreign investment regulation, there does appear to be a case for encouraging domestic industrial production not only for employment purposes but also to pursue the objectives of self-sufficiency in some of the most obvious areas of import substitution. To do this, some policy changes should be sought whose effect would be to reduce real wages, either through such measures as using an apprenticeship or age-based system (where minimum wages would not apply), not applying them to establishments of less than, say, five persons (which could increase subcontracting) or not requiring formal registration of certain types of new activities, which could help in the establishment of an "informal" sector even if taxes were thereby foregone.

31. Despite its impact on the CPI, changes in the current exchange rate regime should be examined in this context as well, since its overall effect would still be to encourage import substitution or exports. In addition, the government should weigh relaxing localization constraints to foreign investments, particularly in relatively labor-intensive industries, perhaps even to the extent of supplying them with local credit. Finally (as has been urged before), industrial estate schemes circumventing land use constraints coupled with economically justifiable investment incentives should be studied. The attenuation of land use constraints, themselves a major stumbling block to future investment and development, should be more aggressively sought, for existing customs in part reflecting the need to ensure the maintenance of tribal patrimonies, are more than necessarily restrictive.

32. The first of the Eight Aims calls for a rapid increase in the proportion of the economy under the control of Papua New Guineans. It is widely accepted that only through a long-term effort of education and training can PNG's citizens hope to control and benefit from their considerable natural resource base. Beyond this national consensus lies the perception of individuals that access to education, particularly secondary education is the route to a higher personal standard of living. The impact of the group consensus has assured a national emphasis on formal education. The impact of individual perception of the relationship between education and income has led to considerable conflict over the regional distribution of educational opportunities. Given the widely scattered population and the nineteen provincial governments this had led to a proliferation of high cost, low quality secondary and vocational schools and a stagnant enrollment ratio for primary schools.

33. With public sector employment stagnant, the tiny industrial sector unable to expand rapidly enough, commercial agriculture stagnant, a near nonexistent informal sector and the localization of virtually all low and mid-level positions in the modern sector already complete, the relationship between secondary school certificates and income levels may not hold for all future graduates. The National Manpower Assessment predicts a surplus of secondary school graduates by the early 1990s. The Assessment is, however, a

somewhat mechanistic attempt to match secondary graduates with predicted job requirements and is likely to be appropriate for a near stagnant economy whose public sector is the largest employer. However, if some growth is desired and an informal sector is encouraged, restraints on secondary school enrollment could become a future constraint on growth and support pressure for even higher wages. In terms of competence there is likely to be a very large shortage of graduates and the private sector is likely to take the better performers. It is the public sector, including importantly the primary and secondary school faculties, who will be forced to accept certificates of frequently unqualified graduates as proof of competence. The unavoidable and ongoing tension between the implication of quality versus quantity will dominate the education and training scene for years to come.

34. National planning and public administration in PNG reflect both the colonial view of what was feasible and desirable and the early post-independence desire for emphasis on stability and equity. This has been greatly complicated by the more recent desire for economic growth and the partial decentralization of planning and administration to the provinces. It should not be surprising therefore that the planning and administration machinery is frequently ineffective.

35. With the exception of the localization issue, clearly a country concern, public management in PNG seems to reflect strongly that of a developed country (and in particular, that of Australia, which introduced the basic elements of the system). That is to say, the economy is expected to operate by its own inherent dynamic, with the State supplying a stable macro-economic environment within the framework of a socially-oriented regulatory policy. While laudable, it is not evident that this model is appropriate for Papua New Guinea or, to the extent that it may be, that it has been applied without regard to the fact that cost benefit ratios of socially oriented regulations may be different from those in well-off developed countries.

36. As a consequence, economic management in PNG is relatively less oriented toward planning in the sense of setting out long-term objectives to be achieved through various forms of public intervention in sectors whose potential has been identified. To change this emphasis would imply direct intervention in the form of investments, support for research and development, and active concentration on project identification and implementation in the various departments associated with the sectors in question. It would also involve focussing on constraints reflecting the lack of skilled manpower (and instituting training programs targeted on these constraints), as well as the identification and modification of administrative or regulatory constraints which impede progress in the sectors in question. Finally, it would involve a possible reexamination of macroeconomic policies, including the exchange rate regime.

37. A number of these functions are in fact carried out either by the technical departments concerned or by the National Planning Office. However, these are done in an ad hoc way, independent of any coherent or long-term development plan which specifies basic objectives and how these are to be achieved over time. Moreover, there are virtually no mechanisms of coordination save at cabinet level, so that there is no way of guaranteeing the physical coherence of individual investment projects or coordinating the development effort in general. To some extent the project selection process under the NPEP undertaken by the National Planning Office could exercise this function, but in actuality it does not. In effect, the application of the "National Development Strategy" based upon the Eight Aims criteria, together with a year-by-year selection of projects, simply does not lend itself to a dynamic approach to development.

38. To a considerable extent these problems are recognized by Papua New Guinea's leaders, who are becoming increasingly frustrated with the relatively poor performance of the economy and concerned with the difficulties of handling the pace of decentralization (among other issues) in a slow-growing economy. It appears, however, that the expatriate-dominated bureaucracy, perhaps like many others, is not able to initiate change from within, and the power of Papua New Guinea leaders, political or administrative, is too fragmented to permit its imposition from without.

39. It will be extremely difficult to address the above development issues without a political consensus that some explicit changes need to be made. The recent elections in which Mr. Somare returned to power with a near majority in Parliament is a hopeful sign that this consensus is developing. A commonly held fear at independence was that the forces for decentralization, based on the desire of the more affluent regions to have complete autonomy, would render the concept of the nation state not feasible. This has not proved to be the case to date though the tensions are very real. In retrospect the decision at the time of independence to emphasize stability and budgetary control was probably a sensible one given all the uncertainty surrounding the establishment of the new nation. As the uncertainty about the viability of the country abates, it is more and more being taken for granted, though a price is clearly being paid for the decentralization that has served as the solvent for interregional tensions. As time passes and the economic and physical integration of the country proceeds, the basis for stronger national unity will hopefully develop and the issues set forth above can be faced with more confidence. Indeed some of the pressures for such movement are being felt now.

VI. Country Performance Profile

40. Planning and economic management have generally been good, if budgetary control and economic stability are taken to be the prime objective. The case has been made above that for growth orientation, particularly in

agriculture, a great deal is lacking. The Agriculture Services Review /1 makes the case that use of the National Development Strategy and associated strategic objectives are a poor means for allocating planned public expenditures for national departments and that more conventional sectoral allocations are required. In addition, it is recommended that a conventional five-year development plan for agriculture be developed, and that the project preparation ability of the National Planning Office and the sectoral departments be strengthened. In short, a fairly massive intervention by government is required if the key agriculture sector is to grow at a reasonable rate.

41. In the five year period FY77-81, the Bank group made eight loans and credits. Despite efforts in recent years to program two operations a year, it has not been possible to achieve this target due partly to the complexity of the rural development projects attempted and partly to the impact of localization and decentralization on project preparation. The lack of project preparation capacity in agriculture has been particularly disappointing, since it is the sector for which approximately half the lending operations have been programmed.

42. In terms of annual lending volume, commitments between FY77 and FY81 have fluctuated between $3.5 million and $35 million (see commitment line Table 1) with an average of around $30 million per year in constant FY81 dollars. This has led to an average size loan of $19 million. With a population of 3.0 million it also yields an annual per capita lending volume of about $10. This illustrates two dimensions of the absorptive constraint: the average size project is small, and the average number of operations per year is less than two. We have found that the low level of economic activity in PNG constrains project size, and the lack of project preparation capacity determines the number that can be prepared each year. From the Bank's point of view programming is difficult due to the limited number of standby operations that can be put in such a small pipeline. The decision to expand lending into the energy sector was partly based on the need for more lending alternatives and a firmer pipeline of projects that would allow for possibilities of slippage in some of the more complicated agriculture projects.

43. In terms of project implementation (see Table 1), the record has been extremely varied, with the disbursement rate ranging between 68% and 20% with an average for the period 1977-81 at 39%, almost double the regional average of 22%. Such fluctuations are a characteristic of small lending program (see that of Benin in line 5(c) of Table 1) and reflect the impact of relatively large disbursement requests for projects outstanding in a particular time period. In the case of PNG disbursements for the relatively large highway projects have this effect.

/1 January 30, 1981, Report No. 3161-PNG.

VII. World Bank Strategy

44. The basic Bank objectives in PNG are: (a) support for more growth-oriented policies and institutions; (b) the development of large-scale opportunities for permanent cash economy employment based on the substantial agriculture resources of the country; and (c) promotion of human resource development.

45. The case has already been made for a more growth oriented posture on the part of the Government, and this is largely shared by local politicians and civil servants and to some extent by expatriate civil servants. However, the current bureaucracy and policy making machinery is not organized or oriented for such an objective and making the necessary changes will not be easy or rapid. Bank support in this area will probably take the form of sector work in public administration and economic management and specific institutional changes associated with lending in agriculture, transportation and energy.

46. Growth in employment and income based on agriculture should be the basis of long-term development in the country. The mineral based enclave developments such as Bougainville and Ok Tedi are limited and highly localized and can provide the revenues to make the effort in agriculture. The danger is that these nonrenewable opportunities will be dissipated in the form of civil servants' salaries and excessive increases in real wages, again reducing investable surpluses and encouraging labor-saving investments. Bank support in this area will take the form of heavy emphasis on agriculture lending in a variety of forms with complementary investments in transport. The two most successful forms of agricultural lending in the past have been the support of the PNGDB and nucleus estates projects prepared by DPI. The most troublesome initiatives have been the comprehensive rural development projects prepared by NPO and DPI and smallholder livestock projects under the aegis of DPI. PNGDB is emerging as the most effective institution in the agriculture sector and a third line of credit is anticipated that would not only support smallholder investment and clan block development but rehabilitation of some plantations. What makes PNGDB particularly attractive as an institution is the consolidation under one roof of the capacity for project analysis, agriculture credit and, with the recent incorporation of the Plantation Management Agency (PMA), management services. The decline of research and extension services is to be addressed through a support services project now under preparation. The Bank will also support technical assistance to DPI for sectoral planning and project preparation beyond the normal scope of PNGDB, such as nucleus estates. Thus, agriculture credit, support services, technical assistance for planning, and nucleus estates form the core of the proposed agriculture lending.

Table 1: IBRD/IDA DISBURSEMENTS
(Expressed in millions of U.S. dollars)

	Fiscal Year				
	1977	1978	1979	1980	1981
1. Undisbursed balance at July 1/a	13.15	39.23	32.83	43.41	34.63
2. Commitments during FY	35.00	3.50	20.00	30.00	6.00
3. Total disbursed during FY	8.92	9.90	9.42	8.78	17.42
4. Disbursement rate 3 ÷ 1 = %	67.81	25.24	28.70	20.23	50.32
5. Comparators (%)					
(a) Disbursement rate for total of other loans in the Region/b	26.90	21.22	22.26	19.81	20.92
(b) Bankwide IBRD/IDA average disbursement rate/b /c	24.53	21.19	21.73	21.31	21.47
(c) Selected comparators					
Colombia	24.17	22.03	21.39	22.36	26.78
Philippines	19.53	18.07	18.66	15.45	24.69
Morrocco	20.96	22.56	27.62	17.66	11.74
Benin	40.77	18.32	14.58	32.28	44.15

/a Undisbursed balance includes signed but not effective loans and credits for all computations.
/b Excludes IDA 6 credits.
/c Excludes IFC loans.
/d Excludes jointly guaranteed loans.

Note: Above includes effects of program lending.

47. The recent Bank guidelines for lending for beverage crops has weakened considerably the possibility for comprehensive Bank support for PNGDB since coffee and cocoa comprise the bulk of PNGDB lending. PNG does not accept the world-wide view of the Bank on beverage crops and will continue to support expansion of coffee production in the highlands on the grounds of absolute advantage, lack of alternative cash crops, and the lower than national average incomes of the highlanders. For cocoa in the lowlands the main argument for continuing to support production increases will be the need for rehabilitation of existing plantations just to get production back to 1974 levels and the sheer momentum of the rehabilitation program and the specialized support services behind it. An exception to the guidelines is being sought in the context of the preparation of the FY84 agriculture credit project. In order to maintain significant contact with the most effective institution in the agriculture sector, some support for coffee and cocoa would be programmed and an orderly transition to diversification considered.

48. Smallholder livestock (non-PNGDB) and provincial rural development projects will receive little emphasis, the former because of the generally unsatisfactory experience with such projects and the latter because of the high cost of preparation and supervision, the small size of loans and of population affected, and the mixed experience with the Southern Highlands Project. Depending on the experience with the recently signed Enga Rural Development Project, this type of operation may be reconsidered in the next two or three years.

49. Beyond the agriculture support services project, which will be a first time effort in PNG, it is possible that lending for forestry will become part of the agriculture lending program. The forestry subsector has enormous potential in PNG in terms of export earnings and rural cash employment. This project will be approached through an initiating brief in FY83 based on an exploration visit by a mission in FY82.

50. Lending for <u>transport</u> is basically supportive of agriculture development opportunities. The physical integration of the country is essential for that purpose. It also supports whatever industrial development is feasible in the sense that national markets become more integrated. We intend to continue to lend for transport (one project every three years) with heavy emphasis on road maintenance, development of local contractors, and training of PNG civil engineers. If substantial progress towards these objectives is not made under the next lending operation, in FY83 (little progress has been made under the most recent loan), we should consider dropping support of this sector.

51. Human resource development will be supported by a continuation of the series of lending operations in education and training that commenced in 1977. As with transport, education loans will be made at two or three year intervals. Emphasis will continue to be on the expansion of primary education, through support of the sectoral program, and quality improvement in secondary education. Specific technical training components will be attached to such loans unless a comprehensive technical training project can be defined. Project supervision and preparation will continue to provide the opportunity to discuss with government the quantity/quality issues mentioned previously as well as the manpower planning implications of current educational policies.

52. Lending for energy is basically supportive of the commercial development of the country. The Bank made two loans for hydropower projects early in its relationship with PNG. The decision was then made to drop support of this sector on the grounds that bilateral funds were available and that ELCOM, the state-owned electricity producer, was a reasonably mature institution. The recently completed Bank/UNDP Energy Assessment Report has uncovered a number of serious problems and needs for new initiatives in the energy sector. Only the Bank is suitably staffed to support the wide range of initiatives that reach far beyond the competence and authority of the Electricity Commission. By serving as a catalytic agent, as in the case of the recently approved Petroleum Exploration Technical Assistance Project, the Bank can promote private investments, obtain cofinancing, and support the kinds of institutional changes required to reduce the current dependence on oil imports (24% of export earnings in 1981) and reduce electric power costs to levels more consistent with a country rich in energy resources. Thus re-entry into the energy sector is not a return to the previous lending for hydropower alone. It will extend to thermal power options based on natural gas and coal deposits, as well as wood waste from sawmills. Beyond reform of ELCOM as an efficient producer of electricity, Bank support would also be aimed at strengthening the national energy planning group in the Department of Minerals and Energy, an organization that was not affected at all by the earlier lending for hydropower.

VIII. World Bank Lending, Economic and Sector Work Program

53. In terms of absorptive capacity, the best we can hope for in PNG is to raise the number of operations per year to two. Similarly, it is unlikely that the scale of these operations can exceed an average of $25.0 million per operation from FY84 on. Such a lending program for the next five years is set forth in Table 2 and Attachment 1a. Approximately 44% of the lending would be for agriculture and forestry with 21% and 24% respectively for education and transport. Eleven percent is programmed for energy lending. Per capita lending would be $16.4 in constant FY82 commitment dollars. This reflects a 30% increase in the number of projects over a five-year period, and a 25% increase in the average loan size. Given PNG's recent graduation from IDA, it is possible that the assumption about increasing average loan sizes may be optimistic in that increasing cofinancing with groups such as the OPEC and

Table 2: SUMMARY OF PROPOSED LENDING PROGRAM (FY83-87)
(constant 1982 $)

Sector	Operation	Amount ($ million)	% of total lending
Agriculture	5	109	44
Education	2	51	21
Transport	2	58	24
Energy	2	28	11
Total	11	246	100

Kuwait funds and IFAD may be much more likely in an attempt to replace the former Bank-IDA blend with something equivalent. This has, in fact, been the case with the recent Petroleum Exploration Technical Assistance Project that was cofinanced by the OPEC Fund and the proposed transport project for FY83 in which the Kuwait Fund has shown interest.

Aid Coordination

54. Regular reviews with ADB of operational and economic issues have been held at least twice a year to promote consistency in our operations and eliminate unnecessary competition in the identification of projects, such as that we have experienced in health, energy and training. In the absence of economic and sector work, ADB has had difficulties identifying projects and its lending to PNG (US$13.0 million in 1980, US$9.0 million in 1981) remains below target levels. As ADB financing for PNG continues to be a blend of soft and hard funds and as that organization is interested in cofinancing some projects with the Bank in the lead, especially in the agriculture sector, we are exploring the possibility of using this vehicle as a means of making the lending terms for some of our operations more palatable to the PNG government. No formal aid coordination takes place with the Australian Government since their aid is in the form of an untied grant which is renegotiated from time to time and made public. Informal discussions are occasionally held in Canberra when our country economist exchanges views on the performance of the PNG economy.

Local Cost Financing

55. In terms of their local/foreign exchange requirements, projects in Papua New Guinea can be divided into two categories. In those projects where large amounts of civil works or expatriate services are required, the foreign exchange component is frequently as large as 70% of total costs. In a few

projects, mainly in agriculture and education, large amounts of local labor and services are required and the foreign exchange component can be as low as 15 to 25%. We propose to examine projects on a case-by-case basis to determine whether they merit local cost financing by the Bank. We would be prepared to finance up to 60% of the total project cost or the foreign exchange component, whichever is greater. An example is the proposed forestry project for FY85. The recently completed Initiating Project Brief indicates that the best entry into the forestry subsector for the Bank would be support of the modest but enlightened reforestation program of the government. This program is also labor intensive; an expanded program would provide thousands of jobs to unskilled rural labor. Thus, Bank support of an expanded reforestation program would be in direct support of the basic strategy objective of cash employment in the agricultural sector, of which forestry is a subsector. This project could also lead to a substantial movement out of beverage crops and into an export crop that has a better medium and long-term future as well as the ability to attract private capital. In order to promote the development of the forest industries, the Bank would need an entry point, which in this case has a low foreign exchange component because of the desirable input of local labor. In order to allow such a project to compete favorably with civil works and expatriate-intensive projects, the Bank will finance a portion of the local costs, up to 60% of the total project cost.

IX. Economic and Sector Work Program

56. With the completion of the Country Economic Memorandum in December 1981 - supplemented by the Agricultural Services Review of January 1981 - knowledge of the major economic variables of PNG, as well as of several major sectors (agriculture, industry, manpower and employment) has been brought up to date./1 This means that country economic work can be focussed on identifying the major internal bottlenecks to satisfactory economic growth in PNG and the ways in which these constraints can be removed or at least mitigated. The proposed work on public administration and the management of economic development is conceived with this goal in mind and is aimed at orienting the government and the bureaucracy toward institutionalizing decision-making procedures focussing on the identification of major growth sectors, strategies for exploiting them consistent with available resources, and the mitigation of regulatory constraints to growth. This effort will be carried out gradually and cautiously, exploiting various "entry points" where it is widely realized that changes are required. This may be in the area of broad civil service training and structural reform, or in the improvement of project identification and preparation capacities in the Department of Primary Industries (as well as other Departments) or in strengthening the forward planning capacity of the NPO. Details of the proposed economic and sector work are set forth in Attachment 4.

/1 The next major analytical work on the economy should be undertaken in FY84.

57. As for sector work, the Agricultural Services Review provided major background work in this sector and will give rise to work related to the general effort on public administration as it relates to long-range planning and project identification and preparation in this major sector. An obvious need for new initiatives is in forestry, where the exploitation of this important renewable resource is constrained more by problems of land tenure, regulation, and institutional jurisdiction disputes than by technical problems. Energy presents another sector for Bank initiative, and a joint Bank/UNDP sector survey has recently been completed. This and further sector work might support the initiation of a comprehensive energy sector loan. Good sectoral information in transport and education has been generated through sector work done over the past few years together with the continuous updating accompanying the process of supervision and preparation. Additional sector work is planned in the areas of manpower and training needs, and some may be required in the area of regulatory restrictions on inland transport.

Cost of Program

58. A rough estimate of the manpower required to deliver FY83-85 lending and economic and sector work program is shown in Table 3 below and is compared with the FY80-82 program which has just been completed. For a 34% increase in manpower, the real volume of lending is to be approximately doubled. This reflects the larger and more frequent lending operations planned and the less than proportionate manpower inputs required to do so. The large percentage increase in CESW merely reflects the low base from which a modest absolute increase in planned, largely in response to the public administration-economic management initiative.

Table 3: MANPOWER IMPLICATIONS FY83-85 PROGRAM
(man-years)

Item	FY80-82	FY83-85	% Change
Projects Dept. lending	14.4	19.4	+ 35
Program CESW	2.1	4.6	+119
Program other	5.1	5.2	+ 2
OPS	0.8	0.9	+ 13
Total Program	22.4	30.1	+34
Lending in constant FY82 commitments $	71.0	145.0	+104%
No. of projects	4	7	+ 75%

X. Recommendations

59. We seek management approval of:

a) the proposed Bank strategy in PNG (para. 44 through 52),

b) the proposed Bank lending program for FY83-87 of ($246 million) (para. 53),

c) local cost financing on a project-by-project basis (para. 55),

d) the proposed economic and sector work program with emphasis on public administration and economic management (para. 56), and

e) the manpower requirement (30.1 manyears for FY83-85) to carry out the lending and economic work proposed (para. 58).

C81098/J99726/D2931/57-60

Attachment 1a

PAPUA NEW GUINEA

Actual and Proposed Program of Lending Operations Through FY87
(US$ million)

Population: 3.0 million (1980)
GNP per capita: $780 (1980)
Area: 461,700 sq km
Literacy: 32% (1970)

		Through FY76	Actual FY77	FY78	FY79	FY80	FY81	Current FY82	Proposed program FY83	FY84	FY85	FY86	FY87	Total FY72-76	Total FY77-81	Total FY82-86	Total FY83-87
Agric. Dev. I	IDA	1.5															
Agric. Dev. II	IDA	5.0															
Agric. Dev. III	IDA	5.0															
Agric. Dev. IV (Popondetta)	IBRD		12.0														
Rural Dev. I (So. Highlands)	IDA				30.0												
Agric. Dev. V	IDA						15.0										
Rural Dev. II (Enga)	IBRD/IDA							6/2									
Agric. Support Services	IBRD								15.0								
Agric. Dev. VI	IBRD									28.0							
Forestry I	IBRD										30.0						
Agric. Support Services II	IBRD											26.0					
Agric. Dev. VII	IBRD												33.0				
Telecom. I	IBRD	7.0															
Telecom. II	IBRD	10.0															
Education I	IDA		4.0														
Education II	IBRD/IDA						6/6										
Education III	IBRD									29.0							
Education IV	IBRD												34.0				
Highways I	IBRD/IDA	4.5/4.5															
Road Impr. II (Highlands Rd.)	IDA		19.0														
Road Impr. III	IBRD/IDA					17/13											
Ports I	IDA	9.2															
Ports II	IBRD			3.5													
Trans. Dev. I	IBRD								30.0								
Trans. Dev. II	IBRD											38.0					
Power I	IBRD	23.2															
Power II	IBRD	10.8															
Petroleum Tech. Assistance	IDA								3.0								
Energy I	IBRD										30.0						
Lending Program	IBRD	55.5	12.0	3.5	-	17.0	6.0	6.0	45.0	57.0	60.0	64.0	67.0	20.8	38.5	232.0	293.0
	IDA	25.2	23.0	-	30.0	13.0	21.0	2.0	3.0	-	-	-	-	14.2	87.0	5.0	3.0
	Total	80.7	35.0	3.5	30.0	30.0	27.0	8.0	48.0	57.0	60.0	64.0	67.0	35.0	125.5	237.0	296.0
	Number	9	3	1	1	1	2	1	3	2	2	2	2	4	8	10	11
	(of which IDA)	(4.5)	(2)	(-)	(-)	(0.5)	(1.5)	(0.5)	(1)	(-)	(-)	(-)	(-)	(2)	(5)	(1.5)	(1)
Lending program in constant FY82 commitment $			47.2	4.4	36.2	34.4	28.9	8.0	45.0	50.4	50.0	50.3	49.7	71.6	151.1	203.7	245.4
Commitment deflator (FY82 = 100)			74.2	79.0	82.9	87.3	93.4	100.0	106.6	113.2	120.0	127.2	134.9				

PAPUA NEW GUINEA - SUMMARY OF BANK GROUP AND OTHER OFFICIAL LENDING

	Through FY76	Actual FY77	FY78	FY79	FY80	FY81	Current FY82	Proposed program FY83	FY84	FY85	FY86	FY87	Total FY72-76	Total FY77-81	Total FY82-86	Total FY83-87
SECTORAL DISTRIBUTION OF BANK GROUP COMMITMENTS (%)																
Agricultural and rural development	14.2	34.3	-	100.0	-	55.6	100.0	34.5	49.1	50.0	40.6	49.3	14.0	45.4	46.8	45.9
Energy	-	-	-	-	-	-	-	10.3	-	50.0	-	-	-	-	15.1	11.9
Education	-	11.4	-	-	-	44.4	-	-	50.9	-	-	50.7	-	12.8	13.3	22.7
Industry	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Power	34.0	-	-	-	-	-	-	-	-	-	-	-	34.0	-	-	-
Population, health and nutrition	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Telecommunications	21.1	-	-	-	-	-	-	-	-	-	-	-	21.1	-	-	-
Transportation	22.6	54.3	100.0	-	100.0	-	-	55.2	-	-	59.4	-	22.6	41.8	24.8	19.5
Urban development	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Water supply	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
BANK GROUP DISBURSEMENTS (US$ million)																
IBRD																
Outstanding /a																
Including undisbursed	53.4/b	63.5/c	70.0/d	68.6/e	84.6/f	83.1/g	86.1	108.9	162.4	218.6	277.6	337.2				
Excluding undisbursed	45.4/b	49.8/c	53.7/d	55.6/e	58.2/f	53.1/g	53.3	56.2	62.8	74.2	94.7	124.8				
IBRD																
Gross disbursements	47.0	6.3	1.4	3.3	3.6	2.4	3.2	6.1	10.1	15.2	25.4	37.6	45.4	17.0	60.0	94.4
Repayments	1.1	1.4	1.4	1.5	1.9	2.2	3.0	3.2	3.5	3.8	5.0	7.4	1.1	8.4	18.5	22.9
Net disbursements	45.9	4.9	-	1.8	1.7	0.2	0.2	2.9	6.6	11.4	20.4	30.2	44.3	8.6	41.5	71.5
Interest & charges	8.1	3.4	3.3	4.1	4.1	4.3	3.8	4.4	5.5	7.1	9.0	12.0	7.8	19.2	29.8	38.0
Net transfer	37.8	1.5	-3.3	-2.3	-2.4	-4.1	-3.6	-1.5	1.1	4.3	11.4	18.2	36.5	-10.6	11.7	33.5
IBRD/IDA																
Gross disbursements	67.5	8.9	9.9	9.4	8.8	17.4	12.2	14.5	20.2	24.1	33.1	43.1	62.9	54.4	104.1	135.0
Repayments	1.1	1.4	1.4	1.5	1.9	2.3	3.1	3.4	3.7	4.0	5.2	7.8	1.1	8.5	19.4	24.1
Net disbursements	66.4	7.5	8.5	7.9	6.9	15.1	9.1	11.1	16.5	20.1	27.9	35.3	61.8	45.9	84.7	110.9
Interest & charges	8.6	3.6	3.5	4.4	4.4	4.7	4.1	4.9	6.1	7.7	9.7	12.7	8.4	20.6	32.5	41.1
Net transfer	57.8	3.9	5.0	3.5	2.5	10.4	5.0	6.2	10.4	12.4	18.2	22.6	53.4	25.3	52.2	69.8

IBRD EXPOSURE (%)	Actual (CY) 1977	1978	1979	1980	1981	Projected (CY) 1982	1983	1984	1985	1986	1987	1990
IBRD disbursement/total gross disbursements	9.6	4.9	10.3	1.4	1.4	2.2	2.2	2.5	4.1	6.9	10.7	49.0
IBRD DOD/total DOD	14.9	13.4	13.5	10.2	7.9	6.2	4.9	4.2	4.4	5.1	6.3	13.9
IBRD debt service/total debt service	17.0	18.0	11.8	9.8	7.8	6.4	5.2	3.5	2.7	3.0	3.3	6.8

COMMITMENTS FROM OFFICIAL SOURCES (US$ m)	Actual (CY) 1976	1977	1978	1979	1980	1981	Projected (CY) 1982	1983	1984	1985	1990
Grants	187.5	212.9	249.6	261.5	269.0	282.6	293.3	301.2	309.7	313.0	331.5
Of which: Australia	182.7	205.8	242.3	253.9	262.5	276.0	286.1	293.4	301.0	304.0	319.5
Concessional Loans											
Total Bilateral	9.8	-	9.8	14.9	15.5	11.0	11.0	11.0	11.0	11.0	11.0
Total Multilateral	17.5	44.4	43.8	-	43.4	23.6	18.6	27.1	25.1	27.6	-
Of which: IDA	4.0	19.0	20.0	-	13.0	9.0	2.5	1.5	-	-	-
ADB	13.5	25.4	12.4	-	12.3	11.0	12.5	10.0	12.5	15.0	-
Total Nonconcessional Loans	16.7	25.0	3.5	35.0	92.0	106.0	19.0	41.0	59.0	62.0	121.6
Of which: IBRD	12.0	-	3.5	-	17.0	6.0	19.0	41.0	59.0	62.0	106.0
TOTAL COMMITMENTS	231.5	282.3	306.7	311.4	432.9	423.2	341.9	377.3	404.8	413.6	464.1

/a As of the end of the fiscal year.
/b The exchange adjustment of $-0.8 million as of June 30, 1976, are included in these figures.
/c The exchange adjustment of $-1.3 million as of June 30, 1977, are included in these figures with a decrease of $0.5 million since FY76.
/d The exchange adjustment of $2.6 million as of June 30, 1978, are included in these figures with a decrease of $3.9 million since FY77.
/e The exchange adjustment of $2.7 million as of June 30, 1979, are included in these figures with a decrease of $0.1 million since FY78.
/f The exchange adjustment of $3.6 million as of June 30, 1980, are included in these figures with a decrease of $0.9 million since FY79.
/g The exchange adjustment of $-1.7 million as of June 30, 1981, are included in these figures with a decrease of $5.3 million since FY80.

Note: All data in this table reflect o/s amounts and transactions of loans sold to third parties.
IBRD: From FY82-87, 1.5% "Front-end" fee has been included in interest and charges.

East Asia and Pacific Region
August 19, 1982

TABLE 3A
PAPUA NEW GUINEA - SOCIAL INDICATORS DATA SHEET

LAND AREA (THOUSAND SQ. KM.) TOTAL 461.7 AGRICULTURAL 4.7	PAPUA NEW GUINEA 1960 /b	1970 /b	MOST RECENT ESTIMATE /b	REFERENCE GROUPS (WEIGHTED AVERAGES - MOST RECENT ESTIMATE) /a MIDDLE INCOME ASIA & PACIFIC	MIDDLE INCOME LATIN AMERICA & CARIBBEAN
GNP PER CAPITA (US$)	180.0	360.0	780.0	1136.1	1616.2
ENERGY CONSUMPTION PER CAPITA (KILOGRAMS OF COAL EQUIVALENT)	51.0	146.0	299.0	1150.6	1324.1
POPULATION AND VITAL STATISTICS					
POPULATION, MID-YEAR (THOUSANDS)	1932.0	2394.0	2939.0 *	..	
URBAN POPULATION (PERCENT OF TOTAL)	2.7	9.8	17.0	40.8	64.2
POPULATION PROJECTIONS					
POPULATION IN YEAR 2000 (MILLIONS)			4.0	.	.
STATIONARY POPULATION (MILLIONS)			9.0	.	.
YEAR STATIONARY POPULATION IS REACHED			2125	.	.
POPULATION DENSITY					
PER SQ. KM.	4.2	5.2	6.4	373.1	34.3
PER SQ. KM. AGRICULTURAL LAND	508.4	544.1	617.6	2382.8	94.5
POPULATION AGE STRUCTURE (PERCENT)					
0-14 YRS.	40.5	42.0	42.0	39.8	40.7
15-64 YRS.	56.6	55.0	54.8	56.7	55.3
65 YRS. AND ABOVE	2.9	3.0	3.2	3.5	4.0
POPULATION GROWTH RATE (PERCENT)					
TOTAL	1.8	2.2	2.3/c	2.3	2.4
URBAN	15.3	15.2	8.7	3.8	3.7
CRUDE BIRTH RATE (PER THOUSAND)	44.0	41.3	37.2	29.7	31.4
CRUDE DEATH RATE (PER THOUSAND)	22.8	17.9	15.4	7.5	8.4
GROSS REPRODUCTION RATE	..	2.9	2.6	1.9	2.3
FAMILY PLANNING					
ACCEPTORS, ANNUAL (THOUSANDS)	..	..	..	.	.
USERS (PERCENT OF MARRIED WOMEN)	..	..	3.0	44.1	..
FOOD AND NUTRITION					
INDEX OF FOOD PRODUCTION PER CAPITA (1969-71=100)	100.0	100.0	106.0	123.7	108.3
PER CAPITA SUPPLY OF					
CALORIES (PERCENT OF REQUIREMENTS)	76.0	83.0	85.0	112.6	107.6
PROTEINS (GRAMS PER DAY)	40.0	46.0	46.0	62.5	65.8
OF WHICH ANIMAL AND PULSE	22.0	20.0	20.0	19.7	34.0
CHILD (AGES 1-4) MORTALITY RATE	28.5	20.9	16.3	4.8	7.6
HEALTH					
LIFE EXPECTANCY AT BIRTH (YEARS)	40.6	46.6	50.5	64.0	64.1
INFANT MORTALITY RATE (PER THOUSAND)	159.0	106.0	..	50.2	70.9
ACCESS TO SAFE WATER (PERCENT OF POPULATION)					
TOTAL	..	..	20.0	45.9	65.7
URBAN	..	..	30.0	68.0	79.7
RURAL	..	..	19.0	34.4	43.9
ACCESS TO EXCRETA DISPOSAL (PERCENT OF POPULATION)					
TOTAL	..	14.0	18.0	53.4	59.9
URBAN	..	..	..	71.0	75.7
RURAL	..	5.0	5.0	42.4	30.4
POPULATION PER PHYSICIAN	14390.0/d	11630.0	14040.0	4428.7	1728.2
POPULATION PER NURSING PERSON	2450.0/d	2370.0	1934.0	2229.7	1288.2
POPULATION PER HOSPITAL BED					
TOTAL	170.0/d	150.0/e	214.9	588.5	471.2
URBAN	..	..	101.1	579.6	558.0
RURAL	..	..	270.5	1138.5	..
ADMISSIONS PER HOSPITAL BED	..	..	..	36.7	..
HOUSING					
AVERAGE SIZE OF HOUSEHOLD					
TOTAL	3.1	..	5.0	..	..
URBAN	..	..	..	..	..
RURAL	..	..	..	..	..
AVERAGE NUMBER OF PERSONS PER ROOM					
TOTAL	0.7	..	..	..	..
URBAN	..	..	..	..	..
RURAL	..	..	..	..	..
ACCESS TO ELECTRICITY (PERCENT OF DWELLINGS)					
TOTAL	80.0	..	..	..	..
URBAN	..	..	..	..	..
RURAL	..	..	..	..	..

TABLE 3A
PAPUA NEW GUINEA - SOCIAL INDICATORS DATA SHEET

	PAPUA NEW GUINEA			REFERENCE GROUPS (WEIGHTED AVERAGES - MOST RECENT ESTIMATE) /a	
	1960 /b	1970 /b	MOST RECENT ESTIMATE /b	MIDDLE INCOME ASIA & PACIFIC	MIDDLE INCOME LATIN AMERICA & CARIBBEAN
EDUCATION					
ADJUSTED ENROLLMENT RATIOS					
PRIMARY: TOTAL	32.0	52.0	60.0	99.8	101.7
MALE	59.0	64.0	70.0	100.6	103.0
FEMALE	7.0	39.0	49.0	98.8	101.5
SECONDARY: TOTAL	1.0	8.0	13.0	53.5	35.3
MALE	2.0	11.0	18.0	58.4	34.9
FEMALE	0.5	4.0	8.0	48.6	35.6
VOCATIONAL ENROL. (% OF SECONDARY)	16.0	19.0	26.0	21.1	30.1
PUPIL-TEACHER RATIO					
PRIMARY	35.0	30.0	30.0	34.2	29.6
SECONDARY	18.0	23.0	23.0	31.7	15.7
ADULT LITERACY RATE (PERCENT)	29.4	32.1	32.1	86.5	80.0
CONSUMPTION					
PASSENGER CARS PER THOUSAND POPULATION	2.0	7.3	6.2	12.7	42.6
RADIO RECEIVERS PER THOUSAND POPULATION	..	..	44.5	174.1	215.0
TV RECEIVERS PER THOUSAND POPULATION	..	..	..	50.6	89.0
NEWSPAPER ("DAILY GENERAL INTEREST") CIRCULATION PER THOUSAND POPULATION	..	..	8.9	106.8	62.8
CINEMA ANNUAL ATTENDANCE PER CAPITA	..	1.0	..	4.3	3.2
LABOR FORCE					
TOTAL LABOR FORCE (THOUSANDS)	1058.4	1244.9	1464.6	.	.
FEMALE (PERCENT)	41.4	41.3	41.0	37.4	22.6
AGRICULTURE (PERCENT)	89.0	86.0	82.4	50.2	35.0
INDUSTRY (PERCENT)	4.3	5.8	7.5	21.9	23.2
PARTICIPATION RATE (PERCENT)					
TOTAL	54.8	52.0	49.8	40.2	31.8
MALE	61.2	58.5	56.7	49.8	49.0
FEMALE	47.7	44.9	42.5	31.1	14.6
ECONOMIC DEPENDENCY RATIO	0.8	0.9	0.9	1.1	1.4
INCOME DISTRIBUTION					
PERCENT OF PRIVATE INCOME RECEIVED BY					
HIGHEST 5 PERCENT OF HOUSEHOLDS	..	..	..	..	..
HIGHEST 20 PERCENT OF HOUSEHOLDS	..	..	..	..	..
LOWEST 20 PERCENT OF HOUSEHOLDS	..	..	..	..	..
LOWEST 40 PERCENT OF HOUSEHOLDS	..	..	..	..	..
POVERTY TARGET GROUPS					
ESTIMATED ABSOLUTE POVERTY INCOME LEVEL (US$ PER CAPITA)					
URBAN	..	..	400.0	248.6	..
RURAL	..	..	275.0	193.7	187.6
ESTIMATED RELATIVE POVERTY INCOME LEVEL (US$ PER CAPITA)					
URBAN	..	..	..	249.8	513.9
RURAL	..	..	..	234.3	362.2
ESTIMATED POPULATION BELOW ABSOLUTE POVERTY INCOME LEVEL (PERCENT)					
URBAN	..	..	10.0	21.2	..
RURAL	..	..	75.0	32.2	..

.. Not available
. Not applicable.

NOTES

/a The group averages for each indicator are population-weighted arithmetic means. Coverage of countries among the indicators depends on availability of data and is not uniform.

/b Unless otherwise noted, data for 1960 refer to any year between 1959 and 1961; for 1970, between 1969 and 1971; and for Most Recent Estimate, between 1976 and 1979.

/c Indigenous population growth rate is 2.8%; /d 1964; /e 1966.

* The updated 1980 GNP per capita and population estimates to be shown in the 1981 World Bank Atlas May, 1981 are $780.0 (at 1978-80 prices) and 3,007.0 thousands.

DEFINITIONS OF SOCIAL INDICATORS

Notes: Although the data are drawn from sources generally judged the most authoritative and reliable, it should also be noted that they may not be internationally comparable because of the lack of standardized definitions and concepts used by different countries in collecting the data. The data are, nonetheless, useful to describe orders of magnitude, indicate trends, and characterize certain major differences between countries.

The reference groups are (1) the same country group of the subject country and (2) a country group with somewhat higher average income than the country group of the subject country (except for "Capital Surplus Oil Exporters" group where "Middle Income North Africa and Middle East" is chosen because of stronger socio-cultural affinities). In the reference group data the averages are population weighted arithmetic means for each indicator and shown only when majority of the countries in a group has data for that indicator. Since the coverage of countries among the indicators depends on the availability of data and is not uniform, caution must be exercised in relating averages of one indicator to another. These averages are only useful in comparing the value of one indicator at a time among the country and reference groups.

LAND AREA (thousand sq.km.)

Total - Total surface area comprising land area and inland waters.

Agricultural - Estimate of agricultural area used temporarily or permanently for crops, pastures, market and kitchen gardens or to lie fallow; 1978 data.

GNP PER CAPITA (US$)

GNP PER CAPITA (US$) - GNP per capita estimates at current market prices, calculated by same conversion method as World Bank Atlas (1977-79 basis); 1960, 1970, and 1979 data.

ENERGY CONSUMPTION PER CAPITA

ENERGY CONSUMPTION PER CAPITA - Annual consumption of commercial energy (coal and lignite, petroleum, natural gas and hydro-, nuclear and geothermal electricity) in kilograms of coal equivalent per capita; 1960, 1970, and 1979 data.

POPULATION AND VITAL STATISTICS

Total Population, Mid-Year (thousands) - As of July 1; 1960, 1970, and 1979 data.

Urban Population (percent of total) - Ratio of urban to total population; different definitions of urban areas may affect comparability of data among countries; 1960, 1970, and 1979 data.

Population Projections

Population in year 2000 - Current population projections are based on 1980 total population by age and sex and their mortality and fertility rates. Projection parameters for mortality rates comprise of three levels assuming life expectancy at birth increasing with country's per capita income level, and female life expectancy stabilizing at 77.5 years. The parameters for fertility rate also have three levels assuming decline in fertility according to income level and past family planning performance. Each country is then assigned one of these nine combinations of mortality and fertility trends for projection purposes.

Stationary population - In a stationary population there is no growth since the birth rate is equal to the death rate, and also the age structure remains constant. This is achieved only after fertility rates decline to the replacement level of unit net reproduction rate, when each generation of women replaces itself exactly. The stationary population size was estimated on the basis of the projected characteristics of the population in the year 2000, and the rate of decline of fertility rate to replacement level.

Year stationary population is reached - The year when stationary population size has been reached.

Population Density

Per sq. km. - Mid-year population per square kilometer (100 hectares) of total area; 1960, 1970 and 1979 data.

Per sq. km. agricultural land - Computed as above for agricultural land only; 1960, 1970 and 1978 data.

Population Age Structure (percent) - Children (0-14 years), working-age (15-64 years), and retired (65 years and over) as percentages of mid-year population; 1960, 1970, and 1979 data.

Population Growth Rate (percent) - total - Annual growth rates of total mid-year populations for 1950-60, 1960-70, and 1970-79.

Population Growth Rate (percent) - urban - Annual growth rates of urban populations for 1950-60, 1960-70, and 1970-79.

Crude Birth Rate (per thousand) - Annual live births per thousand of mid-year population; 1960, 1970, and 1979 data.

Crude Death Rate (per thousand) - Annual deaths per thousands of mid-year population; 1960, 1970, and 1979 data.

Gross Reproduction Rate - Average number of daughters a woman will bear in her normal reproductive period if she experiences present age-specific fertility rates; usually five-year averages ending in 1960, 1970, and 1979.

Family Planning - Acceptors, Annual (thousands) - Annual number of acceptors of birth-control devices under auspices of national family planning program.

Family Planning - Users (percent of married women) - Percentage of married women of child-bearing age (15-44 years) who use birth-control devices to all married women in same age group.

FOOD AND NUTRITION

Index of Food Production per Capita (1969-71=100) - Index of per capita annual production of all food commodities. Production excludes seed and feed and is on calendar year basis. Commodities cover primary goods (e.g. sugarcane instead of sugar) which are edible and contain nutrients (e.g. coffee and tea are excluded). Aggregate production of each country is based on national average producer price weights; 1961-65, 1970, and 1979 data.

Per capita supply of calories (percent of requirements) - Computed from energy equivalent of net food supplies available in country per capita per day. Available supplies comprise domestic production, imports less exports, and changes in stock. Net supplies exclude animal feed, seeds, quantities used in food processing, and losses in distribution. Requirements were estimated by FAO based on physiological needs for normal activity and health considering environmental temperature, body weights, age and sex distribution of population, and allowing 10 percent for waste at household level; 1961-65, 1970, and 1977 data.

Per capita supply of protein (grams per day) - Protein content of per capita net supply of food per day. Net supply of food is defined as above. Requirements for all countries established by USDA provide for minimum allowance of 60 grams of total protein per day and 20 grams of animal and pulse protein, of which 10 grams should be animal protein. These standards are lower than those of 75 grams of total protein and 23 grams of animal protein as an average for the world, proposed by FAO in the Third World Food Survey; 1961-65, 1970 and 1977 data.

Per capita protein supply from animal and pulse - Protein supply of food derived from animals and pulses in grams per day; 1961-65, 1970 and 1977 data.

Child (ages 1-4) Mortality Rate (per thousand) - Annual deaths per thousand in age group 1-4 years, to children in this age group; for most developing countries data derived from life tables; 1960, 1970 and 1979 data.

HEALTH

Life Expectancy at Birth (years) - Average number of years of life remaining at birth; 1960, 1970 and 1979 data.

Infant Mortality Rate (per thousand) - Annual deaths of infants under one year of age per thousand live births.

Access to Safe Water (percent of population) - total, urban, and rural - Number of people (total, urban, and rural) with reasonable access to safe water supply (includes treated surface waters or untreated but uncontaminated water such as that from protected boreholes, springs, and sanitary wells) as percentages of their respective populations. In an urban area a public fountain or standpost located not more than 200 meters from a house may be considered as being within reasonable access of that house. In rural areas reasonable access would imply that the housewife or members of the household do not have to spend a disproportionate part of the day in fetching the family's water needs.

Access to Excreta Disposal (percent of population - total, urban, and rural - Number of people (total, urban, and rural) served by excreta disposal as percentages of their respective populations. Excreta disposal may include the collection and disposal, with or without treatment, of human excreta and waste-water by water-borne systems or the use of pit privies and similar installations.

Population per Physician - Population divided by number of practicing physicians qualified from a medical school at university level.

Population per Nursing Person - Population divided by number of practicing male and female graduate nurses, practical nurses, and assistant nurses.

Population per Hospital Bed - total, urban, and rural - Population (total, urban, and rural) divided by thier respective number of hospital beds available in public and private general and specialized hospital and rehabilitation centers. Hospitals are establishments permanently staffed by at least one physician. Establishments providing principally custodial care are not included. Rural hospitals, however, include health and medical centers not permanently staffed by a physician (but by a medical assistant, nurse, midwife, etc.) which offer in-patient accommodation and provide a limited range of medical facilities. For statistical purposes urban hospitals include WHOs principal/general hospitals, and rural hospitals local or rural hospitals and medical and maternity centers. Specialized hospitals are included only under total.

Admissions per Hospital Bed - Total number of admissions to or discharges from hospitals divided by the number of beds.

HOUSING

Average Size of Household (persons per household) - total, urban, and rural - A household consists of a group of individuals who share living quaters and their main meals. A boarder or lodger may or may not be included in the household for statistical purposes.

Average number of persons per room - total, urban, and rural - Average number of persons per room in all urban, and rural occupied conventional dwellings, respectively. Dwellings exclude non-permanent structures and unoccupied parts.

Access to Electricity (percent of dwellings) - total, urban, and rural - Conventional dwellings with electricity in living quarters as percentage of total, urban, and rural dwellings respectively.

EDUCATION

Adjusted Enrollment Ratios

Primary school - total, male and female - Gross total, male and female enrollment of all ages at the primary level as percentages of respective primary school-age populations; normally includes children aged 6-11 years but adjusted for different lengths of primary education; for countries with universal education enrollment may exceed 100 percent since some pupils are below or above the official school age.

Secondary school - total, male and female - Computed as above; secondary education requires at least four years of approved primary instruction; provides general, vocational, or teacher training instructions for pupils usually of 12 to 17 years of age; correspondence courses are generally excluded.

Vocational enrollment (percent of secondary) - Vocational institutions include technical, industrial, or other programs which operate independently or as departments of secondary institutions.

Pupil-teacher ratio - primary, and secondary - Total students enrolled in primary and secondary levels divided by numbers of teachers in the corresponding levels.

Adult literacy rate (percent) - Literate adults (able to read and write) as a percentage of total adult population aged 15 years and over.

CONSUMPTION

Passenger Cars (per thousand population) - Passenger cars comprise motor cars seating less than eight persons; excludes ambulances, hearses and military vehicles.

Radio Receivers (per thousand population) - All types of receivers for radio broadcasts to general public per thousand of population; excludes unlicensed receivers in countries and in years when registration of radio sets was in effect; data for recent years may not be comparable since most countries abolished licensing.

TV Receivers (per thousand population) - TV receivers for broadcast to general public per thousand population; excludes unlicensed TV receivers in countries and in years when registration of TV sets was in effect.

Newspaper Circulation (per thousand population) - Shows the average circulation of "daily general interest newspaper", defined as a periodical publication devoted primarily to recording general news. It is considered to be "daily" if it appears at least four times a week.

Cinema Annual Attendance per Capita per Year - Based on the number of tickets sold during the year, including admissions to drive-in cinemas and mobile units.

LABOR FORCE

Total Labor Force (thousands) - Economically active persons, including armed forces and unemployed but excluding housewives, students, etc., covering population of all ages. Definitions in various countries are not comparable; 1960, 1970 and 1979 data.

Female (percent) - Female labor force as percentage of total labor force.

Agriculture (percent) - Labor force in farming, forestry, hunting and fishing as percentage of total labor force; 1960, 1970 and 1979 data.

Industry (percent) - Labor force in mining, construction, manufacturing and electricity, water and gas as percentage of total labor force; 1960, 1970 and 1979 data.

Participation Rate (percent) - total, male, and female - Participation or activity rates are computed as total, male, and female labor force as percentages of total, male and female population of all ages respectively; 1960, 1970, and 1979 data. These are based on ILO's participation rates reflecting age-sex structure of the population, and long time trend. A few estimates are from national sources.

Economic Dependency Ratio - Ratio of population under 15 and 65 and over to the total labor force.

INCOME DISTRIBUTION

Percentage of Private Income (both in cash and kind) - Received by richest 5 percent, richest 20 percent, poorest 20 percent, and poorest 40 percent of households.

POVERTY TARGET GROUPS

The following estimates are very approximate measures of poverty levels, and should be interpreted with considerable caution.

Estimated Absolute Poverty Income Level (US$ per capita) - urban and rural - Absolute poverty income level is that income level below which a minimal nutritionally adequate diet plus essential non-food requirements is not affordable.

Estimated Relative Poverty Income Level (US$ per capita) - urban and rural - Rural relative poverty income level is one-third of average per capita personal income of the country. Urban level is derived from the rural level with adjustment for higher cost of living in urban areas.

Estimated Population Below Absolute Poverty Income Level (percent) - urban and rural - Percent of population (urban and rural) who are "absolute poor".

Economic and Social Data Division
Economic Analysis and Projections Department
May 1981

Population : 3,076 (mid-1981, thousands)
GNP per capita: US$786 (1981)

Attachment 3
Table 1

PAPUA NEW GUINEA

Economic Indicators

Indicator	Amount (US$ mln. at current prices) 1979	Annual growth rate (%) at constant 1979 prices — Actual 1975	1976	1977	1978	1979	Projected 1980	1981	1982	1983	1984	1985
National Accounts												
Gross domestic product /a	2,269	-0.9	-3.4	0.8	5.9	2.9	2.0	2.2	2.6	1.6	-0.2	5.5
Agriculture	765	3.5	4.1	1.6	3.2	3.0	3.6	-2.0	-	2.0	3.0	3.5
Industry	674	-1.4	16.6	-0.3	8.3	1.1	2.6	6.0	11.2	6.5	-4.0	11.4
Services	752	-4.9	-11.4	0.5	3.9	2.0	0.0	3.0	-3.0	-4.0	1.0	1.0
Consumption	1,747	2.5	0.1	3.3	1.3	4.8	11.1	-8.2	3.7	2.7	2.2	-3.0
Gross investment	525	-1.0	-9.6	7.9	8.7	12.8	-7.8	22.2	13.5	-4.5	-9.2	11.5
Exports of GNFS	1,043	-3.5	-8.7	4.0	9.0	-0.5	-0.5	8.8	-0.2	0.7	1.7	14.2
Imports of GNFS	1,046	2.1	-6.4	11.5	2.1	7.8	9.4	-0.9	7.3	-1.0	0.5	3.1
Gross national savings	467	-23.0	15.3	7.8	7.8	5.1	-	-	-	-	-	-
Prices												
GDP deflator (1979 = 100)		68.2	81.6	87.7	88.1	100.0						
Exchange rate (US$)		0.7	0.8	0.8	0.8	0.71						

	Share of GDP at market prices (%) (at current prices) /b 1965	1970	1975	1980	1985	1990	Average annual increase (%) (at constant 1979 prices) 1965-70	1970-75	1975-80	1980-85	1985-90
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	6.7	4.3	1.8	2.1	4.9
Agriculture	41.6	37.2	29.7	35.4	33.7	31.7	-	3.9	3.0	1.4	3.5
Industry	17.9	22.1	28.5	30.0	37.0	43.8	-	10.6	4.9	5.6	8.8
Services	40.5	40.7	41.8	33.6	29.3	24.5	-	3.6	-0.2	-1.0	1.0
Consumption	98.3	93.9	86.1	83.7	72.2	75.0	5.9	1.3	3.7	0.4	5.6
Gross investment	21.6	41.6	20.0	20.9	25.0	16.9	21.9	-16.9	4.1	4.0	-2.4
Exports GNFS	18.0	18.5	40.0	44.9	50.8	49.5	10.1	27.5	1.6	3.7	4.2
Imports GNFS	38.0	53.9	46.2	49.4	48.0	41.4	17.5	-3.4	5.2	1.8	1.8
Gross national savings	-	20.3	23.4	21.9	16.2	17.5	-	-	-	-	-

	As % of GDP 1960	1970	1975
Public Finance			
Current revenues	15.4	11.8	17.8
Current expenditures	33.7	28.9	33.8
Surplus (+) or deficit (-)	-18.3	-17.1	-16.0
Capital expenditure	16.1	7.7	3.2
Foreign financing	34.4	24.8	19.2

-	1965-70	1970-75	1975-80	1980-85	1985-90
Other Indicators					
GNP growth rate (%)	6.3	4.3	1.8	1.1	5.4
GNP per capita growth rate (%)	2.4	1.9	-0.5	-1.2	3.0
Energy consumption growth rate (%)	-	-	-	-	-
ICOR	3.2	9.0	12.6	10.5	4.4
Marginal savings rate	-0.6	0.3	-0.8	-	-
Import elasticity	2.6	-0.8	2.4	0.9	0.4

/a At market prices; components may be expressed at factor cost and will not add due to exclusion of net indirect taxes and subsidies.

/b Projected years at constant 1979 prices.

- = not available

Population : 3,076 (mid-1981, thousands)
GNP per capita: US$786 (1981)

Attachment 3
Table 2

PAPUA NEW GUINEA

External Trade

Indicator	Amount (US$ mln. at current prices) 1979	Annual growth rates (%) at constant 1979 prices — Actual 1976	1977	1978	1979	Projected 1980	1981	1982	1983	1984	1985
External Trade											
Merchandise exports	989.3	-14.0	8.9	16.1	-3.2	-2.2	9.1	-0.3	0.6	1.6	14.7
Primary	989.3	-14.0	8.9	16.1	-3.2	-2.2	9.1	-0.3	0.6	1.6	14.7
Manufactures	-	-	-	-	-	-	-	-	-	-	-
Merchandise imports	791.8	-14.8	20.3	10.2	14.7	6.9	-1.2	10.2	-1.1	0.1	3.4
Food	n.a.	-18.9	n.a.	n.a.	n.a.	12.3	-0.4	-1.5	-0.7	2.4	3.2
Petroleum	n.a.	5.6	n.a.	n.a.	n.a.	-23.3	-0.3	-1.3	-0.6	2.1	2.7
Machinery and equipment	n.a.	-15.0	n.a.	n.a.	n.a.	12.5	-2.4	29.9	-0.2	-3.5	5.2
Others	n.a.	-20.3	n.a.	n.a.	n.a.	12.3	-0.3	-4.0	-3.5	4.4	0.3
Prices											
Export price index		-	-	-	100.0	102.5	92.5	106.2	119.5	134.3	155.3
Import price index		-	-	-	100.0	117.8	130.1	140.5	152.0	164.0	175.9
Terms of trade index		-	-	-	100.0	87.0	71.1	75.6	78.6	81.9	88.3

	Composition of merchandise trade (%) (at current prices) /a 1960	1970	1975	1980	1985	1990	Average annual increase (%) (at constant 1979 prices) 1966-70	1970-75	1975-80	1980-85	1985-90
Exports	100.0	100.0	100.0	100.0	100.0	100.0	3.1	27.1	0.5	3.7	4.2
Primary	100.0	100.0	100.0	100.0	100.0	100.0	3.1	27.1	0.5	3.7	4.2
Manufactures	-	-	-	-	-	-	-	-	-	-	-
Imports	100.0	100.0	100.0	100.0	100.0	100.0	12.1	-1.4	2.2	2.3	1.6
Food	22.8	16.9	21.0	23.1	21.4	23.4	6.5	2.8	4.2	0.4	3.3
Petroleum	12.8	14.7	12.0	11.1	10.2	10.9	16.2	-5.5	0.6	0.4	2.9
Machinery and equipment	25.7	42.3	38.8	39.6	45.7	40.0	27.0	-3.1	-6.1	5.6	-0.9
Others	38.7	26.1	28.2	26.2	22.7	25.7	1.6	0.1	-3.1	-0.9	3.9

	Share of trade with industrial countries (%) 1965	1970	1975	Share of trade with developing countries (%) 1965	1970	1975	Share of trade with capital surplus oil exporters (%) 1965	1970	1975
Exports	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Primary	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Manufactures	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Imports	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

/a Projected years at constant prices.

/b Data on direction of trade is not available.

Population : 3,076 (mid-1981, thousands)
GNP per capita: US$786 (1981)

Attachment 3
Table 3

PAPUA NEW GUINEA

Balance of Payments, External Capital and Debt
(US$ million at current prices)

Indicator	Actual						Projected						
	1970	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1990
Balance of Payments													
Exports of goods and services	-	-	666	776	835	1,101	1,111	1,094	1,244	1,402	1,589	2,068	3,600
Of which: Merchandise f.o.b.	-	-	563	699	752	969	989	974	1,114	1,262	1,441	1,911	3,347
Imports of goods and services	-	-	710	848	1,039	1,179	1,528	1,570	1,828	2,019	2,200	2,478	3,508
Of which: Merchandise f.o.b.	-	-	434	559	687	760	983	1,073	1,277	1,366	1,474	1,634	2,434
Net transfers	-	-	97	188	190	185	163	190	184	182	182	174	242
Current account balance	-	-	53	115	-14	107	-253	-285	-400	-436	-429	-235	335
Private direct investment	-	-	23	18	34	40	61	156	179	106	68	72	97
MLT loans (net)	25	40	24	32	19	34	99	170	264	362	392	209	7
Official	4	16	8	11	23	13	53	26	134	123	285	140	-3
Private	21	23	16	22	-4	21	46	144	130	239	107	70	10
Other capital	-25	115	-57	-26	-32	-65	43	-	-	-0	-	-	-0
Change in reserves	-	-154	-43	-140	-7	-116	50	-41	-43	-32	-30	-46	-439
International reserves	-	179	257	431	431	555	473	514	557	589	619	665	1,693
Of which gold													
Reserves as months imports	-	-	4	6	5	6	4	4	4	3	3	3	6
External Capital and Debt													
Gross Disbursements													
Official grants	-	-	-	-	-	-	269	283	293	301	310	313	332
Concessional loans	1	6	6	12	21	10	41	24	30	40	43	39	13
DAC	-	-	-	-	-	-	2	6	13	22	28	27	12
OPEC	-	-	-	-	-	-	3	1	-	-	-	-	-
IDA	1	5	2	8	5	6	13	10	11	11	10	7	1
Other	-	1	4	4	16	3	24	7	6	6	6	5	1
Nonconcessional loans	24	28	26	29	7	43	93	175	270	361	409	275	112
Official exports credits	2	-	-	-	-	-	5	1	0	-	-	-	-
IBRD	1	13	6	4	5	5	2	4	7	10	14	22	74
Other multilateral	-	-	-	-	3	3	11	5	105	84	239	111	27
Private	21	25	20	25	-	35	75	165	158	267	156	142	10
External Debt													
Debt outstanding and disbursed	36	275	286	335	370	393	534	687	933	1,274	1,598	1,661	1,418
Official	4	99	103	115	139	147	212	238	372	495	780	919	872
Private	32	176	183	220	231	246	322	448	561	779	819	742	546
Undisbursed debt	41	35	47	76	93	85	117	147	163	173	195	223	404
Debt Service													
Total service payments	1	20	26	27	32	46	65	71	91	102	131	193	172
Interest	1	16	19	19	22	26	30	43	54	63	70	88	54
Payments as % exports	-	-	4.0	3.5	3.8	4.2	5.8	6.5	7.3	7.2	8.2	9.3	4.8
Average interest rate on new loans (%)	6.0	9.6	5.5	5.7	1.3	11.3	-	8.4	8.9	9.3	9.3	9.0	7.8
Official	5.0	-	4.1	3.8	1.3	7.6	-	-	-	-	-	-	-
Private	7.7	9.6	8.3	9.2	-	12.0	-	-	-	-	-	-	-
Average maturity of new loans (years)	23.8	7.4	24.1	26.8	35.9	11.0	-	15.0	12.8	11.0	11.2	12.4	20.1
Official	24.3	-	33.0	37.9	35.9	25.3	-	-	-	-	-	-	-
Private	22.9	7.4	6.4	7.0	-	8.4	-	-	-	-	-	-	-

	As % of debt oustanding at end of most recent year (1980)
Maturity structure of debt outstanding	
Principal due within 5 years	27.1
Principal due within 10 years	42.4
Interest structure of debt outstanding	
Interest due within first year	4.0

PAPUA NEW GUINEA

Country Economic and Sector Work Program FY83-87

1. Economic Work. A substantial Country Economic Memorandum was completed in December 1981 and this, together with the Agricultural Services Review, will form the principal background of economic work in FY83. As indicated in the body of this CPP, Papua New Guinea's growth record has been inadequate given its substantial endowment in agricultural and mineral resources. While this relatively poor performance can in part be ascribed to the birth pains associated with independence, localization (particularly as it concerns plantation agriculture) and the increasing drive toward decentralization, there is little doubt that the weak institutional framework for the management of economic development has also played a considerable role in inhibiting Papua New Guinea's growth prospects. In part this reflects a conservative and basically laissez-faire development policy born of the mid-1970s when agriculture and mineral exports were booming; in part it also reflects the virtually wholesale importation of Australian administrative practices laying heavy stress on regulatory intervention more suited to a developed economy with its own inherent dynamism.

2. Major economic work on public administration, already beginning in FY82, is planned for FY83-84. Although the issue is a sensitive one, and details must yet be worked out with the Government, principal areas of economic work are likely to be two: (a) analyzing the ways in which public administration institutions might be restructured in order to increase their ability to focus on development planning, which now only takes place on an ad hoc-basis. In practical fact this may involve examining ways in which project identification and implementation capabilities can be strengthened in the relevant ministries and coordinated with the National Planning Office. However, this may also involve (i) the establishment of intragovernmental forums to examine and discuss development priorities; (ii) consolidation of a number of now overlapping functions encumbering decision-making in this area; (iii) vitalizing and strengthening the role of the NPO; and (iv) introduction of mechanism for integrating macro-economic policy-making with forward development planning; (b) identification of the principal regulatory constraints to development. These are, among others, the independent minimum wage boards, the regulation of road, air and water transport, regulation of all industrial activity, stringent environmental controls, etc. Analysis of possible ways in which these constraints might be loosened consistent with the economic environment of Papua New Guinea will be undertaken.

3. An initial mission will take place during FY82 to establish detailed terms of reference for future work in these areas with Papua New Guinean leaders and their expatriate staffs. It is possible that other aspects of public administration from those described above, including localization, and regulation of foreign direct investment (NIDA) and decentralization, may be brought up as well. However, NIDA's activities will be the object of study by the Commonwealth Secretariat, and the other

areas may prove too politically sensitive, so that it may be prudent not to get involved with them. Nonetheless, given the importance of decentralization on the economy as a whole and on its future development prospects, this is an area where some careful input by the Bank may be desirable.

4. Assuming approval of the terms of reference to include making the public administration apparatus more growth and less regulation-oriented (and possibly including the management of decentralization as well) a substantial mission will take place in early FY83 to carry out a thoroughgoing analysis of the situation and to prepare detailed recommendations. It is entirely possible that these recommendations will lead to further technical assistance, either within the framework of CESW or as an actual technical assistance project.

5. Sector Work. Major sector work for FY83 will concentrate on manpower and training needs in PNG. A primary reference document for this work will be the study recently published by the National Planning Office, the National Manpower Assessment. Among others, this study focuses on the projected growing mismatch between secondary level graduates and the jobs which are projected to be available to them. While the document shows some analytical problems, it does provide some basis for projecting future education and training needs in a wide spectrum of areas. It is possible that sectoral analysis in this area may dovetail with the economic work planned for public administration, particularly where intensified, and more specific training may be required for the localization of jobs currently held by expatriates.

6. While no more sector work in agriculture is contemplated for the coming fiscal year, the agricultural services review pinpoints a number of areas where improvements in planning, administration, project identification and research are needed. Because actions to be taken in these areas will be complementary with those likely to be recommended under economic work planned for overall public administration, collateral work - possibly within the framework of an agricultural support services project - may be required.

7. Sector work in forestry is complicated by the fact that much of the problems associated with exploitation of this renewable resource have to do with national government regulation, a large number of institutions with partial responsibility, the conflict between national and provincial governments, and issues of land ownership and access. As such, the technical problems are probably less of an issue than those of public administration.

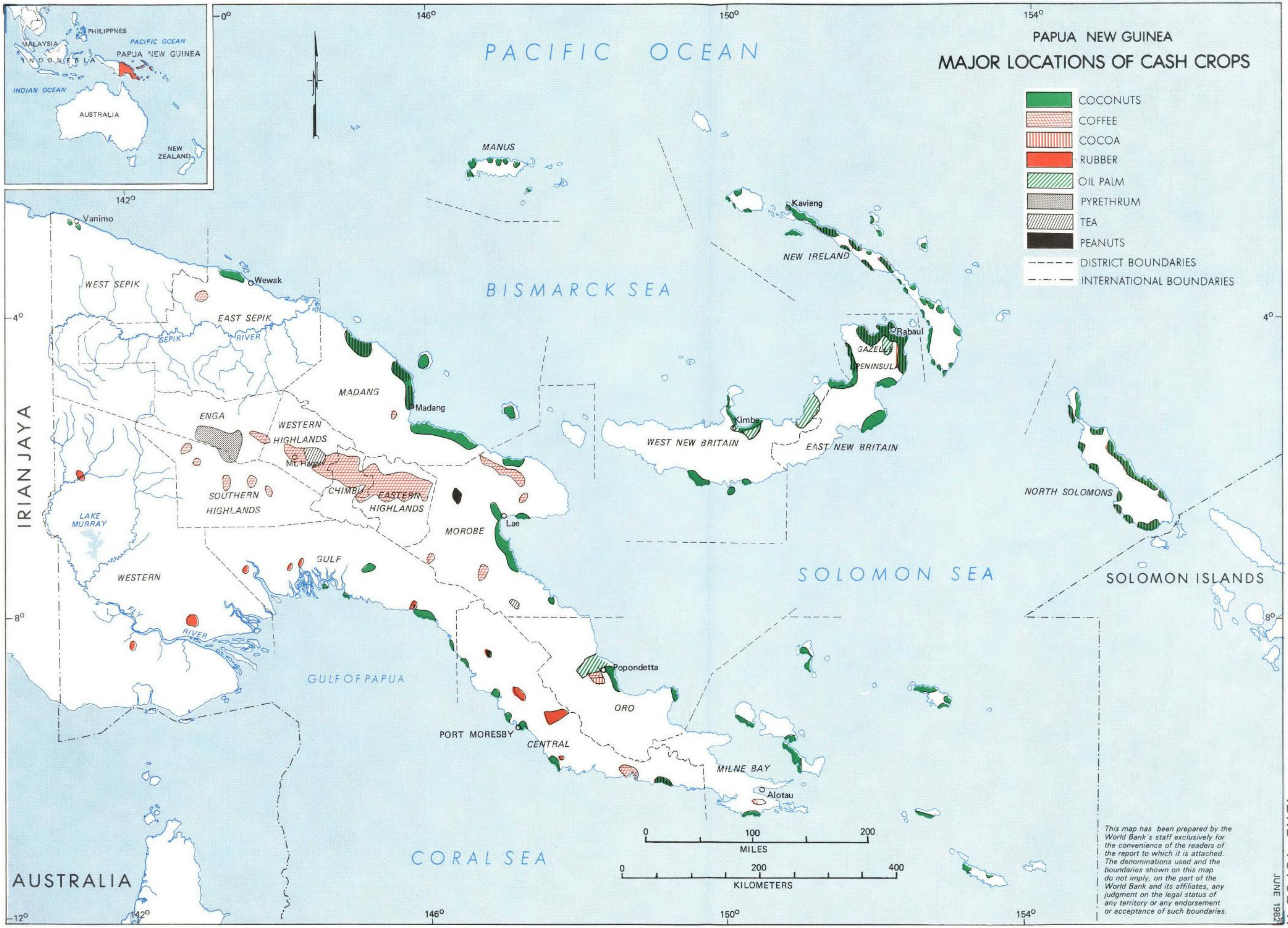
8. Sector work in energy is being undertaken in the form of an energy survey financed by a joint UNDP/Bank program. Rather than program a small follow-up operation to the FY83 petroleum technical assistance loan it might make more sense to include funds for support of hydro power and thermal development as well and initiate a comprehensive energy loan.

PAPUA NEW GUINEA

COUNTRY PROGRAM PAPER

Economic and Sector Work Program by Task, FY82-84

Task	Aims and coverage	Managing division	Total staffweeks required FY82 (Estimate)	FY83 (Budget)	FY84 (Plan)
I. Regionally Managed					
A. Economic Reports (ERA)					
a. Country Economic Memo	To review long-term strategic options and prospects for development. Work will draw on recently completed agricultural sector review.	AEADD	10	-	-
b. Public Administration	Review will primarily focus on institutional aspects, implications of localization and the technical and professional manpower requirements to improve the efficiency and effectiveness of public administration.	AEADD	10	45	10
B. Sector Reports (SRA)					
1. Special Studies					
a. Technical and Professional Manpower	The survey will assess the manpower and training needs of PNG.	-	-	20	-
b. Food Crops Reviews	Review will examine economics of domestic production vs. imports and help government to develop a food policy.	AEADD	-	-	44
C. CPP			15	-	-
D. Other Economic and Sector Work (EWO and SWO)			15	15	15
Total			50	80	79
II. COPD-Managed					
A. Sector Reports (SRA)					
1. Energy Assessment	Review to focus on development of an energy policy for the development of oil and gas and renewable energy sources.		27	-	-
Total			27	-	-



PAPUA NEW GUINEA
MAJOR LOCATIONS OF CASH CROPS
COCONUTS
COFFEE
COCOA
RUBBER
OIL PALM
PYRETHRUM
TEA
PEANUTS
DISTRICT BOUNDARIES
INTERNATIONAL BOUNDARIES
PACIFIC OCEAN
BISMARCK SEA
SOLOMON SEA
CORAL SEA
GULF OF PAPUA
SOLOMON ISLANDS
AUSTRALIA
IRIAN JAYA
MANUS
NEW IRELAND
Kavieng
Rabaul
GAZELLE PENINSULA
Kimbe
WEST NEW BRITAIN
EAST NEW BRITAIN
NORTH SOLOMONS
Vanimo
WEST SEPIK
Wewak
EAST SEPIK
SEPIK RIVER
MADANG
Madang
ENGA
WESTERN HIGHLANDS
Mt. Hagen
CHIMBU
EASTERN HIGHLANDS
SOUTHERN HIGHLANDS
LAKE MURRAY
WESTERN
FLY RIVER
GULF
MOROBE
Lae
Popondetta
ORO
PORT MORESBY
CENTRAL
MILNE BAY
Alotau
PHILIPPNES
MALAYSIA
INDONESIA
PAPUA NEW GUINEA
PACIFIC OCEAN
INDIAN OCEAN
AUSTRALIA
NEW ZEALAND
142°
146°
150°
154°
4°
8°
12°
0
100
200
MILES
0
200
400
KILOMETERS
This map has been prepared by the World Bank's staff exclusively for the convenience of the readers of the report to which it is attached. The denominations used and the boundaries shown on this map do not imply, on the part of the World Bank and its affiliates, any judgment on the legal status of any territory or any endorsement or acceptance of such boundaries.
IBRD 13732 R
JUNE 1982

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Mr. Humphrey

E 1231

TO: Members of the Operations Policy Sub-Committee

DATE: August 20, 1982

FROM: E. Bevan Waide, Director, CPD

SUBJECT: URUGUAY and YUGOSLAVIA Graduation Papers

MB
File with OPSC papers with 8/24

The Operations Policy Sub-Committee will meet on Wednesday, August 25, at 9:30 a.m. in Room E-1208 to consider the attached graduation papers on Uruguay and Yugoslavia.

Also attached are an agenda and comments on major policy issues identified by the Country Policy Department for consideration by the Sub-Committee. Mr. Stern's paper is attached for information.

Attachments:
1) Uruguay - Graduation from the Bank
2) Yugoslavia - Graduation Program & Strategy
3) Agenda
4) Mr. Stern's memo dated April 5, 1982.

cc: Regional Offices (with attachment #3 only)

LAC: Messrs. Pfeffermann
Lerdau
van der Meer
Perez
Levy
Schloss
Johnson

EMENA: Messrs. Dubey
Karaosmanoglu
Finzi
Picciotto
Colaco
Chopra

cc: Ms. Pratt
Mr. Humphrey
Mr. Robless

Messrs. Chernick o/r
Edelman

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: August 12, 1982

TO: Mr. E. Stern, Senior Vice President

FROM: Attila Karaosmanoglu, Acting Regional Vice President, EMENA

SUBJECT: YUGOSLAVIA: Graduation Program and Strategy

1. In accordance with your instructions on procedures to be followed for graduating countries, attached is the paper on the graduation program and strategy for Yugoslavia for consideration by the OPSC. Preliminary discussions were held with the Government in June and the attached paper incorporates the results of these discussions.

2. Sufficient copies of the paper have been sent to CPD for distribution and arrangement of the necessary procedure for consideration of the paper.

cc: Messrs Waide/Chernick (CPD) (13 copies),
Chaufournier (EMNVP), Picciotto (EMP) (8 copies), Dubey (EMNVP),
Finzi (EMNVP), Colaco (EM1).

RChopra/bsw.

YUGOSLAVIA - GRADUATION PROGRAM AND STRATEGY

Introduction

1. Following the Board decision of January 26, 1982 to consider a country eligible for graduation from the Bank when it reaches a level of per capita income of $2650 in 1980 dollars, this paper proposes the approach to be followed in the case of Yugoslavia. Preliminary discussions were held with the Yugoslav Government in June 1982 and this paper reflects the results of those discussions.

2. Yugoslavia had a per capita income of $2620 in 1980 prices, marginally below the threshold level set by the Board. The per capita income reported to the Board in the "Per Capita Income Guidelines for Operational Purposes," (July 28, 1982), was $2790 in 1981 prices. The threshold level in 1981 prices for graduation has not yet been finalized but is likely to be in the range of $2850-2880, that is somewhat above the Yugoslav per capita income. With the slow growth of about 2-3% per annum expected for the next few years and the likely devaluation of the dinar as a result of the presently floating exchange rate, per capita income is likely to hover around or may conceivably remain marginally below the threshold level established for 1982 and possibly 1983. Secondly, the Government has sent a technical note to the Bank questioning the Atlas calculation of the per capita income of Yugoslavia. Our preliminary assessment is that some points made in the note are valid, while others suggest a misunderstanding of Bank methodology by the Yugoslavs. While any adjustments ultimately made will not lead to a significant change in Yugoslavia's per capita income, a reduction of up to 3% cannot be ruled out.

3. The Board decision on graduation comes at a time when the Yugoslav Government is attempting major structural adjustments in response to the severe economic difficulties over the last two to three years. The Government strategy is based on the need to reduce balance of payments deficits as quickly as possible. Its stabilization program, fully supported by the IMF, implies a significant reduction in overall growth rates compared to the seventies. These developments in Yugoslavia as well as the adverse international economic climate have led to a review of the Bank strategy followed in the past. The proposals contained in this paper address both the changes required in the light of the new graduation policy as well as those emerging from this review of Bank strategy. Thus, a number of changes proposed in this paper would be called for irrespective of recent developments on graduation. The main additional dimensions arising from graduation are (i) to limit the time period over which lending can continue and (ii) to reorient to the extent necessary the financial and non-financial assistance of the World Bank to facilitate Yugoslavia's access to the capital markets and more broadly to help Yugoslavia prepare for the post-graduation period. The changes in the lending strategy, apart from the time period and lending levels involved, are dominantly based on the structural adjustment needs of the country. Technical assistance requirements on the other hand are partly a result of graduation and partly a result of structural adjustment needs. As is discussed more fully below, the financial situation of the Bank and graduation are closely linked to the proposals for increased emphasis on co-financing, reorientation of some

parts of the Economic and Sector Work (ESW) and some components of reimbursable technical assistance. On the other hand, project related and non-project technical assistance components in agriculture proposed in this paper are based on country needs irrespective of graduation, as is the proposal to assist the Yugoslav Bank for International Economic Cooperation (YBIEC).

A. ECONOMIC SITUATION AND PROSPECTS

4. Yugoslavia's postwar economic development record is among the most impressive of the developing countries. The rate of economic growth has averaged over 6% in the past three decades and Yugoslavia has transformed itself from an essentially rural, traditional society into a modern industrial state. Notwithstanding these achievements, however, Yugoslavia today faces perhaps its most difficult economic situation since it liberalized its economy in 1965.

5. Although the economic stabilization program has succeeded in reducing the balance of payments current account deficit -- from a record $3.7 billion in 1979 to only $0.8 billion in 1981 -- the economy has paid a high cost. Economic growth slowed to about 2% per annum in 1980 and 1981, while gross investment decreased by 3.2% and 1.2% in 1980 and 1981 respectively.

6. Domestic inflation has been a substantial problem in the last two years. Following a substantial devaluation and the dismantling of domestic price controls, the rate of inflation accelerated to 56% in the first half of 1981. As a result of the stabilization program and the reimposition of stricter price controls, the inflation rate was reduced to 25% in the second half of the year, resulting in an average inflation of 39% throughout the year. In 1982 the original target was to limit price increases to 15%. However, the efforts to restrain inflation have been complicated by the attempts of policymakers to move in other areas, such as adjusting relative prices, reducing subsidies and altering the exchange rate. To take account of the divergent pulls of these conflicting objectives and in an effort to control inflation, the Government announced, starting in early August, a price freeze till the end of 1982. Despite adoption of a comprehensive anti-inflation program in June this year, inflation could be about 25% for the year, unless the price freeze effectively puts the lid on price increases for the rest of the year.

7. Yugoslavia has encountered serious constraints in the international capital markets in the last two years. Although the country made substantial use of foreign capital over the 1970's, its relationship with commercial banks, particularly in the area of syndicated financial credits, has remained somewhat uneasy. Commercial bank perceptions of Yugoslavia have been colored by the belief that the system of borrowing was too decentralized for effective control, a view lent substance by uncoordinated approaches to the markets by Yugoslav borrowers and banks, and perceived weaknesses in negotiating strategy. These underlying negative perceptions have been compounded by other factors. These include the large current account deficits in 1979 and 1980 and consequent losses

in reserves; the death of President Tito in May 1980 and uncertainty on the smoothness of the succession; the acceleration of domestic inflation; and the effects of events in Poland, and more recently Romania. As a consequence of these developments since 1980 Yugoslavia has found itself unable to borrow medium- and long-term financial credits on a purely commercial basis. In response the government has negotiated credit lines on a government to government basis, has made heavy use of IMF resources and has used short-term borrowing more actively than in the past. At the same time, the experience of such a marked shift in commercial bank sentiments has motivated the authorities to control the growth of indebtedness by a rapid reduction in balance of payments deficits - in other words to adopt a strategy of extreme caution on the external side, with concommitant costs in growth. The attitude of the banks toward Yugoslavia has remained cool throughout 1981, and has been further influenced by some delays in payments to suppliers, and by liquidity problems encountered by a Croatian bank in April 1982. As against this there is growing appreciation within the banking community of the very tough short-term measures Yugoslavia has undertaken and this may lead to a reappraisal of Yugoslavia by the banks in due course. Even if such a shift in sentiment does occur, the amount of commercial lending to Yugoslavia is likely to remain limited in the near future and Yugoslavia may in any event choose to proceed with restraint because it has decided on reduced use of external finance as a basic orientation of the plan.

8. These difficulties greatly amplify Yugoslavia's problems of regional income disparities and unemployment. Although transfers from the more developed regions (MDR) amount to about 10% of the income of the less developed regions (LDR) and regional development and growth performance throughout Yugoslavia has been impressive, large regional income disparities still persist. In the case of Kosovo -- the country's least developed region -- per capita income is declining relative to the national average (see Annex III for a detailed table on regional disparity indicators). Linked to the issue of regional income disparities has been the problem of providing adequate employment opportunities in the modern sector. Despite an impressive employment record (employment growth of 4% per annum in the social sector during 1970-80), substantial productivity and income differentials remain between the modern (mainly social) and the traditional (private or individual agricultural) sectors. The persistence of these differentials results in high demand for modern sector employment on the part of the rural labor force. Unemployment rates have risen rapidly from about 7% in 1971 to over 12% in 1980. The incidence of unemployment is highly regionalized, because population and labor force growth rates, as well as the proportion of agricultural employment, are all much higher in the LDR 1/. Given the slowdown in economic growth in

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1/ In 1980 unemployment rates ranged from 28.0% in Kosovo to 1.4% in Slovenia. These rates are not strictly comparable to those in other countries. They represent the ratio of registered job seekers (including some currently employed) to social sector labor force. The ratio of registered job seekers to total resident labor force would be about 9% in 1980.

Yugoslavia, unemployment will remain a serious economic problem in the future, particularly in the LDR.

9. These problems pose difficult choices for Yugoslavia's political leadership. At present external constraints provide only limited room for maneuver, and longer term goals of restoring growth, stimulating employment and fostering balanced regional development have to be sacrificed to more immediate objectives of strengthening the balance of payments and countering inflation. At the same time the process of developing an overall system which enables the country to manage its economy efficiently, consistent with the objectives of regional autonomy and worker self-management is only partially complete. Over the past plan period a series of institutional changes were introduced designed to strengthen the process of self-management in economic decision-making. One of the key problems for the country is to make these new structures work more effectively and to develop additional tools to improve the economic efficiency of investment, particularly as the stabilization program entails a lower investment effort than in the past.

10. In recognition of these deficiencies, the last year has seen a wave of activity, aimed at resolving interrepublican differences on medium-term strategy, increasing discipline in economic management, and creating public acceptance of a period of prolonged austerity. Certain general orientations have emerged from this activity. Slow growth will be maintained for at least the next two years, and exports will be strongly supported. In addition decisions have apparently been taken to increase the role of the market in resource allocation. As against this there has been little visible progress made in articulating more coherent investment strategies in major sectors, or in promoting investment efficiency more generally.

Plan Strategy, 1981-85 and Prospects

11. The federal five-year plan, covering the 1981-85 period, was formally adopted in March 1981, and stressed external adjustment and stabilization, rather than growth, as its main objectives. Developments in 1981 and 1982 both in the domestic economy and in external credit availability soon invalidated the plan's assumptions and a revised plan is soon to be issued. This will reflect an even faster elimination of the current account deficit, and a transition to net surplus before the end of the plan. Economic growth over the plan is likely to be considerably lower than the original target of 4.5%; the attempt to reconcile this with fast growth of exports and maintenance of real social sector wages implies continued pressure on investment expenditure. While continued progress on the balance of payments, control of investment and reduction in inflation are likely to be achieved, the cost in growth is likely to be high. The following paragraphs discuss the main elements needed to return the economy to a higher growth path over the medium-term.

12. One of the lessons of the 1976-80 plan is that it is very difficult to pursue a policy of export expansion within a framework

oriented to import substitution. In the last plan, the incentive framework greatly increased the attractiveness of production for the home market as opposed to exporting. In addition, the orientation of investment policy was toward import substitution, particularly in raw materials and energy. For a variety of reasons, including the low cost of borrowed funds, investment projects were begun on a very broad front and a large number of projects were incomplete at the end of the Plan. Although Yugoslavia is currently in the process of narrowing down its investment priorities to make room for new export projects, it is likely that at least 40% of investment expenditures in the current plan period will be required to complete the unfinished projects from the last plan. Given the experience of the last plan this is likely to be an underestimate. Nevertheless, relatively little thought has been given to reevaluating these projects and ranking them consistently from the point of view of their expected net benefits to the economy and setting priorities accordingly. In addition the gestation lags involved in completing new investment projects mean that it will take some time before any new export oriented projects can be expected to come on stream. Therefore, although the redirection of investment toward exporting activities represents an important long term adjustment, in the shorter term balance of payments considerations dictate a shift in the pattern of current production away from home market sales into export markets.

13. This shift in market orientation requires a sustained restructuring of the pattern of economic incentives away from import substitution. This has been recognized in a series of devaluations since June 1980 and in the decision to link future adjustments in the exchange rate to relative price trends between Yugoslavia and its major trading partners. A continued commitment to realistic exchange rate policies will be needed to ensure sustained export growth. Nevertheless, there is understandable concern within Yugoslavia that further exchange rate changes in the absence of sufficient foreign exchange effectively to liberalize imports will simply exacerbate inflation. The increase in deposit interest rates announced earlier this year, though still insufficient to lead to positive lending rates in real terms in all sectors, is also a step in the right direction to limit investment demand. Further increases in interest rates are likely to occur only gradually. However, with a decline in the rate of inflation, interest rates should play a more meaningful role in the future as an instrument for resource allocation.

14. Over the medium term, Yugoslavia needs gradually to dismantle the complex edifice of trade and payments restrictions which pull resources toward production for the home market and away from export activities. Although there are clear and justified reasons against immediate and wholesale liberalization, there is a need to prepare a package of reforms that can be implemented over the medium term. This needs to be complemented by moves to strengthen Yugoslavia's investment planning framework, and continuing efforts to increase the role of interest rates in allocation.

15. The introduction of the domestic stabilization program, which has considerably dampened domestic demand, coupled with movements in the

exchange rate, have generated a revival in Yugoslav exports. Merchandise exports increased by 11.2% and 10.6% in 1980 and 1981 respectively. However, exports to the OECD area remained essentially flat in volume terms during both years and there was a strong reorientation of commodity trade toward the Centrally Planned Economies (CPE) and the Developing Countries (LDC) markets although exports to the convertible currency area picked up in the last half of 1981 and the first quarter of 1982. The shift toward the CPE and LDC markets and the weak performance in the OECD market reflects a continued lack of export competitiveness. This shift has increased concern both within and outside Yugoslavia over the ability of the country to service its external debt (which is largely denominated in convertible currency) and to some extent has offset the favorable recognition by the international capital markets of Yugoslavia's success in reducing the current account deficit. While the convertible currency debt service ratio at about 25% in 1981 is higher than the total debt service ratio at 17.8%, even the former debt-service burden would by no means be excessively onerous for a country at Yugoslavia's level of development under normal circumstances. However the unwillingness of some commercial banks to roll over their debt has created a serious liquidity squeeze at present, a situation which is complicated by the relative immobility of foreign exchange across republican boundaries. The Yugoslav authorities have repeated their resolve to meet all debt-service obligations and have take administrative action to pool foreign exchange resources to meet debt-service obligations.

16. Projections shown in Table 1 provide an indication of the range of possible outcomes for Yugoslavia under alternate assumptions on export performance and trends in the real price of oil. Case A assumes that the Yugoslavs are successful in achieving a fairly high merchandise export growth rate of 7.4%, approximately equal to their original targets for the plan, and also assumes that oil prices continue to rise at 3% per annum through 1990. (Details of Case A are provided in Annex III). This projection suggests that Yugoslavia can achieve a current account deficit under $2 billion during the current (1981-85) plan, while maintaining an average GDP growth rate of 3.1%. This assumes that the envisaged import growth rate of 2.7% will be adequate to meet the economy's needs for essential intermediate and capital goods. The projected elasticity of merchandise imports to GDP of 0.87 over the period compares with levels of 1.14 in the 1971-75 and 0.72 in the 1976-80 periods. Given the current softening in oil prices, Cases B and C explore the implications for the balance of payments of a reduction in the real price of oil in the 1982-85 period, along the lines recently projected by the ERS, with a return to 3% real growth in oil prices in the 1986-90 period. Case B maintains the export assumption of Case A, while Case C takes a more pessimistic view of export outcomes throughout the decade. On the assumption that merchandise import growth is maintained at the same level thoughout, Case B projects a current account surplus even in the 1981-85 period, of $2.0 billion, and a growing surplus through the 1986-90 period. Case C indicates that while in the 1981-85 period a poorer export performance is offset by a weakening of oil prices, the lower export base puts Yugoslavia at a disadvantage in the later period, once real oil price growth resumes. Thus, while a levelling

off of oil prices would be extremely helpful over the next few years, the economy must basically rely on an improved export performance. Although the Case A and B export growth rate of 7.4% is higher than that achieved during the last plan (5.1%), with appropriate policies this is well within the capabilities of the economy, given Yugoslavia's diverse export structure and its wide geographical representation in the world market. As a marginal exporter in most markets, Yugoslavia is in a position significantly to expand its market share without encountering significant demand constraints. If the assumption regarding the growth of exports at 7.4% per annum turns out to be too optimistic, there is a reasonable basis to expect the actual outcome to be somewhere in between Case B and Case C in terms of the balance of payments and debt indicators. The major downside risk is that Yugoslavia will be unable to lift its export growth rate in the convertible currency area, thereby obliging it to curb imports further and accept a lower rate of economic growth. Given the Yugoslav responses to this and past crises, they are likely to accept lower growth rates rather than the borrowing and debt service implied over the medium term in Case C. However, if Yugoslavia can generate the required export growth, it should be in a position to increase the rate of growth of output in the latter half of the decade. A better export performance should also succeed in reversing the current unfavorable attitude of the international capital markets toward Yugoslavia.

Table 1: YUGOSLAVIA: EXTERNAL FINANCING REQUIREMENTS AND CREDITWORTHINESS INDICATORS, 1981-90

	1981-85			1986-90		
	Case A	Case B	Case C	Case A	Case B	Case C
Annual Rates of growth (%)						
Merchandise Exports	7.4	7.4	4.0	6.5	6.5	4.0
Real Petroleum Price	3.0 1/	-2.4 1/	-2.4 1/	3.0	3.0	3.0
Merchandise Imports	2.7	2.7	2.7	5.7	5.7	5.7
GDP	3.1	3.1	3.1	5.7	5.7	5.7
Cumulative Current Account Balance (US$ billion)	-1.9	2.0	-2.4	-2.0	10.9	-17.4
Cumulative Gross MLT Inflows (US$ billion)	17.2	14.4	17.6	33.7	25.7	49.3
End of Period Indicators						
Debt Outstanding and Disbursed MLT: (US$ bil.)	20.1	17.3	20.4	30.9	22.2	46.6
Debt Outstanding and Disbursed (% of Total Exports of Goods and Services)	55.9	48.2	59.8	49.9	35.8	84.7
Debt Service Ratio (total)	15.3	14.8	16.1	12.7	9.5	16.9
Convertible Currency Debt Service Ratio 2/	18.5	17.7	19.1	15.6	11.7	20.1

1/ 1982-85
2/ Assuming 60 percent of merchandise exports and all service exports are in convertible currency, and that 95 percent of total debt service is in convertible currency.

B. DURATION OF PHASE-OUT AND PHASING OF LENDING

17. In the preceding paragraphs, we have attempted to show the severity of the economic problems and structural adjustment needs in Yugoslavia. The need to reduce balance of payments deficits and the rate of inflation, combined with the acute foreign exchange shortages have significantly reduced the country's room for maneuver and forced it into a low growth strategy. The Government has done an extremely good job in its short term economic management. It has also taken various corrective measures to control investment and encourage exports over the medium term.

While we have tried to identify the main additional elements of policy reform still needed for a return to high growth without disruptive cyclical swings, Yugoslavia's economic performance deserves continued financial support from the World Bank to provide the critically needed foreign exchange and non-financial assistance to ensure higher growth, faster exports and more efficient investment policies in the medium term.

Duration of the Phase-out period

18. Assuming the Board decision on the graduation of Yugoslavia will be taken sometime around December 1982, we recommend that the phase-out period should start July 1, 1983. Since the per capita income of Yugoslavia did not reach the threshold level for graduation in 1981, and is likely to hover around it, or possibly stay marginally below it, in 1982 and 1983, (see para. 2), starting the phase-out period any earlier than that would be inappropriate. We also recommend that the phase-out period for Yugoslavia be the maximum of five years allowed by the Board decision. This would imply that lending would cease at the end of FY88. This recommendation is based on the following considerations.

19. Prospective graduating countries, such as Yugoslavia, face a more difficult situation regarding their access to capital markets compared to those countries which graduated in the early seventies. Commercial markets are now comparatively more restricted and borrowing costs are high. President Tito's death and the period of political consolidation which has followed has added additional uncertainty. Yugoslavia is also suffering from the backlash of events in Poland. Yugoslavia's program of structural adjustment, which is being undertaken during a period of political consolidation, would take a number of years to complete, and the Yugoslavs have mobilized themselves administratively and politically for the task of adjustment. These adjustments are unfortunately taking place at a time when export markets are less favorable than they were in the early seventies. Another factor of concern both to Yugoslavia and to Western creditors is the recent increasing dependence of Yugoslav exports on CPE markets, both in terms of its political implications as well as increased difficulties in servicing convertible currency debt. In these circumstances, Yugoslavia is more vulnerable to the adverse international climate and needs continued and substantial support from the World Bank to the maximum level permitted by the graduation policy.

20. Although all of the potential graduating countries face the same difficult economic environment as Yugoslavia and all of them have significant regional disparities, the following features distinguish Yugoslavia from others: (i) Yugoslavia has more focussed and sustained policies to address the issue of regional disparities; (ii) it is less well endowed in natural resources compared to some other potential graduates; (iii) in common only with Romania, the adverse effects for Yugoslavia of developments in Eastern Europe; (iv) the comparative success of recent stabilization policies in the face of severe adjustment problems; and (v) comparatively less sophistication and experience in its approach to international capital markets.

Phasing of lending during the phase-out period

21. The Yugoslav Government officials have indicated that (i) they accept the need to graduate countries at their income level, and (ii) they strongly urge the Bank to maintain lending levels at $340 million per year in nominal terms through FY 1990.

22. We feel that the Yugoslav proposals for extension of lending beyond a five year period and increase of the annual lending volumes to $340 million from the current $325 million per year are not acceptable in view of the Board discussion on graduation. However, there is a persuasive case for maintaining lending at current levels of $325 million per year in nominal terms during the entire period of FY84-88. This would be based, in addition to the comments on Yugoslavia's situation made above, on the following considerations. Our current lending program, which already reflects a continuing reduction in real terms, implies negative net transfers from the Bank beginning in FY83. Any further reductions in the lending program would obviously increase the extent of negative net transfers, in a period in which severe structural adjustment problems are being addressed and the balance of payments is under pressure. The net transfer implications of lending $325 million per year in nominal terms during FY 83-87 are shown in Annex I, Table 3, which shows negative net transfers of $307 million during FY83-87.

23. Finally, Yugoslavia's relationship with the World Bank has been rather special in terms of its contributions to IDA, purchases of Bank bonds and consistent support of Bank initiatives in various international fora. Overall receptivity to Bank staff and their advice has also been good, although due to reasons explained more fully later, there have been difficulties in carrying out the energy and agricultural sector surveys. Maintenance of this special relationship should be an explicit objective in trying to accommodate Yugoslavia in this difficult period to the maximum extent allowed by the financial constraints of the World Bank and the limits imposed by the graduation policy.

24. The continuation of levels of lending at $325 million per year for the entire phase-out period would assume progress made with the Yugoslav authorities on the energy sector study (see paras. 36-37), the agricultural sector study and policy dialogue in agriculture (see para. 32), progress on co-financing under Bank financed projects (see paras. 44-47) and a continued satisfactory dialogue on macroeconomic and industrial policies (see paras. 33-35). It would also assume continuation of progress on stablization programs in line with the conditionality of the IMF agreements.

25. In view of the per capita income level in Yugoslavia (para. 2), the difficulties that the country faces in raising money on the capital markets and slow economic recovery of Yugoslavia's major export markets, we propose to prepare towards the end of FY85 a brief paper reviewing development in these areas. The Yugoslavs will no doubt press for continuation of lending beyond FY88, based on these factors. We should respond that at this stage we can only agree to a five year program but

that if the external environment continues to deteriorate, we would review the situation by the end of 1985 and be willing to consider then the extension of the phase-out period beyond 1988, if it is justified. The progress in energy, agriculture, cofinancing and the dialogue on macroeconomic and industrial policies will also be reviewed in that paper.

C. OPERATIONAL STRATEGY

26. Over the last five years, the Bank's country assistance strategy in Yugoslavia has pursued a variety of objectives. These have included: (i) redressing regional disparities and unemployment; (ii) promoting agricultural development (iii) encouraging structural reforms and improved coordination in the major sectors; (iv) closing gaps in infrastructure; (v) widening Yugoslavia's access to foreign capital. This broad spectrum of objectives made sense in the context of a large ongoing program. The first question to be raised is whether these objectives need to be modified in any major way in the phase out period.

27. In view of the limited time period and financial resources available in the graduation process, a narrowing of priorities is needed. In addition, the review of Bank strategy suggests that within the narrower priorities chosen, we should focus on the areas where maximum Bank impact is possible. These considerations suggest the following objectives:

(i) increasing exports and improving the efficiency of import substitution;

(ii) increasing the efficiency of domestic investment with a view to increasing production with the more limited investment resources available;

(iii) improving access to capital markets;

(iv) reducing unemployment, particularly in the less developed regions.

28. During the June preliminary discussions for graduation, the Government expressed complete agreement with the choice of these priority objectives. These objectives are not mutually exclusive. Decreasing unemployment requires policy action to affect the capital intensity of investment choices, which is one of the components of investment efficiency. Improving Yugoslavia's access to capital markets is not really a question of introducing a new borrower to the banks, but one of enhancing creditworthiness and improving the perception and evaluation of Yugoslavia's creditworthiness by the commercial banks. Finally, policy actions which affect the efficiency of domestic investment also have strong balance of payments implications.

29. The implications of the revisions in priority objectives for the lending program are spelt out in Annex I, and Tables 1 and 2 in that Annex present the previous and revised lending programs. The number of projects

has been reduced in the revised lending program, which would imply higher average loan amounts per project compared to the existing lending program.

I. SECTORAL IMPLICATIONS

30. The five year plan's investment priorities are: export activities, energy and agriculture. We agree with these priorities, which are consistent with the objectives outlined above. Our economic and sector work and the present needs of Yugoslavia have helped us establish the investment orientation in different sectors. Consistent with the revised strategy and emphasis on exports and increasing efficiency of investment in critical areas with high balance of payments impact, we propose to increase the shares of industry (from 14% to 17%), and power/energy (from 18% to over 25%) in the revised FY1983-87 lending program compared to the existing lending program (see Annex I, Tables 1 and 2). The share of agriculture would fall from the existing 50% to around 35%-40%.

Agriculture

31. Review of the agricultural projects during the last year has led to refocussing of projects as well as to initiation of studies, even prior to the Board discussion on graduation. The basic thrust of agricultural lending in the future will be to continue the current emphasis on promoting agricultural development, particularly in the individual sector and the LDR to (i) help reduce regional disparities; (ii) meet food requirements -- domestic and export; and (iii) create employment and reduce under-employment. Within the framework of this overall strategy we propose to increase the emphasis on policy dialogue and institution building aspects in the projects we finance during the graduation phase. Among the policy aspects, we expect to initiate discussions with the government on price policy, land policy and agroindustries development in the 1980's. Among the institutional aspects, we expect to focus our efforts on improvements in extension services, credit delivery mechanisms for small farmers, and research on ways to increase efficiency of livestock production and farming systems for smallholder agriculture.

32. In response to changing needs of Yugoslav agriculture and to integrate the lessons learnt from our ongoing activites in the sector, we expect to make some adjustments in the mix of the directly productive activities we finance under the remaining projects in the graduation phase. In view of the foreign exchange shortages in Yugoslavia and the expected emergence of negative net transfers, we plan to consider the possibility of a quick disbursing agricultural import program loan, for example in the areas of fertiliser and animal feed. The Government has indicated that it attaches high priority to preparing an agricultural import program loan and a mission will visit Yugoslavia in September to examine the case for such a loan in a high income country like Yugoslavia. Bank investment in large-scale irrigation will be reduced and new investment in agro-processing will be severely limited. We will support the modernization and rehabilitation of agro-industries where there are strong marketing possibilities, especially for exports. Primary agricultural production, especially cereals, will be emphasized. We will

support labor intensive agricultural production in the individual sector (beef and dairy, sheep and fruit and vegetables production). In the social sector, we will support investments for those activities in which the social sector has a comparative advantage, namely cereal production and poultry. In all projects, priority will be given to those investment activities which emphasize exports and efficient import substitution and creation of employment. The five projects included in our lending program for FY82 - 84 are all in the LDR or less developed areas of the MDR and have been refocussed to fit the above criteria. Through our four and possibly five projects for FY85 - 87, in addition to the above mentioned criteria for productive activities, we propose to focus on policy dialogue and institution building aspects listed above. Some of these projects, or components of projects, could be in the MDR (see para. 42). We will also encourage joint ventures between the LDR and the MDR. We plan to expand the sector work to support our initiatives and to lay the basis for possible technical assistance to Yugoslavia in the post-graduation period. While undue sensitivity on the part of some Government officials and our initial approach to an agricultural study through focus on the individual sector led to resistance and delay in starting the study, agreement has now been reached with the Government to prepare an issue-oriented study. Satisfactory completion of the agricultural sector study, willingness by the Government to include institutional development components, such as extension services, research and credit delivery in forthcoming projects and agreement to include policy oriented studies in the Fourth Agricultural Credit Project would be the main criteria to judge progress in agriculture to justify continued high levels of lending in this sector (para. 24).

Industry

33. We propose to focus future lending in industry primarily on export promotion, energy savings and to a lesser extent on labor-intensive industries. Based on experience with past IDF lending, we also propose to move from the traditional DFC/pipeline approach to a regional subsector approach, in order to have a greater impact on industrial policies, strategy, and institutional and technical assistance needs before the country's graduation. This strategy would entail: (i) undertaking limited subsector work in cooperation with the regional authorities, the borrowing banks and the enterprises, in each region concerned; and (ii) undertaking, at the national level, a review of industrial incentives to establish policy guidelines.

34. An eighth industrial credit project would consist of sub-sctor loans for Bosnia and Macedonia, based on investment programs and appropriate policy packages in two or three selected sub-sectors which have comparative advantages for export. In view of the critical need to increase exports and the dominance of the MDR, such as Slovenia and Vojvojdina, in the total exports of Yugoslavia, we plan to explore their inclusion along with the LDR, in such sub-sector focussed loans. Subject to discussions with Yugoslav authorities, we propose to select metal processing, mechanical and electrical industries for the two republics, plus wood processing industries in Bosnia and textiles and clothing

industries in Macedonia. A ninth industrial credit for Kosovo and Montenegro would assist primarily a pipeline of export-oriented and labor-intensive projects, which would have been developed under the technical assistance program of IC-VII. In future industrial lending we plan to increase our support to joint ventures among enterprises of different regions of Yugoslavia. We also plan to explore the inclusion of institutional support in marketing and research for export activities in future IDF lending. Another area that we plan to consider is development of an industrial RD&E loan, as was done in Spain and more recently Korea, to enhance the technological capability of manufacturing industries in Yugoslavia.

35. An exports industries loan, unidentified, is also proposed. This could be either a loan to a single enterprise or a number of exporting enterprises in a high priority sector with export potential. If a number of enterprises in a given sub-sector are selected, then these enterprises could be partly located in the MDR and partly in the LDR. An alternative that will be considered is a joint venture operation between the MDR and LDR, which has significant export potential. We intend to continue to coordinate closely with the IFC to avoid any duplication of effort and ensure maximum impact of the combined Bank/IFC efforts in encouraging exports in Yugoslavia.

Energy

36. There is broad based agreement between the Yugoslav authorities and the Bank that the development of the country's energy resources is central to the success of Yugoslavia's development plans. In order to set its future lending for energy in a proper sectoral context, the Bank decided in 1980 to carry out a comprehensive energy sector study. However, given the protracted negotiations within Yugoslavia - both at the federal and the republican level - on reaching an agreement on a national energy plan and the sensitivity of releasing data in this field, the study has been delayed. Nevertheless, in the context of the appraisal for a Third Power Transmission project in late 1981, the Bank was able to gather sufficient relevant information in the power sector and more limited information in the coal subsector. With some additional information on coal expected to be shortly provided, there would be sufficient basis to lend for future projects in coal and power.

37. The federal authorities have also agreed to further work in the energy sector. The sector information provided in conjunction with an identification mission for petroleum projects in late March was encouraging and we hope to complete evaluation of the petroleum subsector later this year. The inclusion of petroleum exploration or development projects in the lending program would therefore be justified, if we can obtain a comprehensive overview of this sub-sector. Sub-sectoral missions, together with the information already provided to the energy sector mission, plus a small follow up mission to complete the overview of the energy sector, could form the basis of significant lending in this sector. However, the decision on the scale of lending in the energy sector and on the

sub-sectors chosen can be taken only after the results of the energy missions are available.

Transport

38. The Bank has had an active role in strengthening the transport system of Yugoslavia through loans for expansion of capacity in the railway, port and highway sub-sectors and through assistance in institution building. Such assistance has provided critical infrastructure support for the country's industrial and agricultural growth and for export expansion. One last loan each to railways and highways is included in the revised lending program to consolidate past gains.

39. There have been seven railway loans since 1963 which together have helped to increase railways capacity and efficiency. The proposed railway project in FY83, which has been appraised, aims to further modernize and strengthen the railway system and to reduce compensation payments by increasing tariffs. Railway development needs special emphasis since railways are the optimal economic choice for long distance bulk movement of lignite and other minerals, the production of which receives a high priority in the Plan both nationally and in the less developed regions which have rich mineral deposits.

40. The main emphasis of Bank lending in highways has been on the improvement of key links in the primary road network, including many sections of the Trans-Yugoslav Highway (TYH), which is the country's principal transport artery as well as a major transit route between Europe and the Middle East. Bank highway projects have enabled the Yugoslav authorities to introduce and establish on a systematic basis the major administrative functions such as analysis, planning, project preparation, evaluation and programs for highway safety. Recently, highway lending in the LDR has been within a broader sector type lending approach, which has provided greater flexibility and control in the implementation of balanced road investment programs. The thrust of the last loan mainly for TYH will be to consolidate progress in institutional development and to provide a catalyst in aiding Yugoslavia to obtain co-financing from other sources. The Bank will continue to support the implementation of balanced road investment programs including adequate provisions for rehabilitation and maintenenace programs, as well as providing continuity in the dialogue on road user charges and the implementation of toll systems and in consolidating the highway safety program.

II. COUNTRY CIRCUMSTANCES

41. The existing pipeline and the extent of project preparation work make changes in FY83 difficult. For FY84, major surgery is also difficult but identified projects have been redefined in terms of focus to accord with strategy revisions. In addition high level discussions held with the Federal and Republican Governments last year led to an agreed program of project priorities over the FY82-86 period. Moreover, Bank funds, with our agreement, have been allocated over the five-year period among the

Republics with about two-thirds going to the LDR. The Government's allocation of their investment funds also gives priority to the LDR. The independence of the eight Republics and Provinces in Yugoslavia should not be underestimated and any revisions must take account of this special country circumstance. These factors imply the need for discussions between the Government and the Bank to reach agreement on proposed changes.

42. In the light of these country circumstances, we propose to continue to concentrate our lending largely to the LDR, but to replace projects and redefine components of remaining projects to accord with the strategy revisions. A somewhat increased share of lending to the MDR, compared to about one-third of Bank funds in the past five years, could be considered if there are strong grounds to do so in terms of Bank impact in the priority objectives defined in para. 27. If justified by the sector analyses being done and by project specific considerations, some projects or project components in energy, agriculture and export industries could be developed for the MDR as well as the LDR. However, overall we expect these changes to lead to only a marginal increase in the share of MDR in Bank lending compared to the past.

43. Finally, with an advanced borrower like Yugoslavia, the Bank will need to be conscious of reduced leverage during the phase-out period. Moreover, it would be inadvisable to hope to achieve policy reform over the more limited phase-out period that would normally take a longer time and a number of successive loans. The implication of these remarks is not to reduce conditionality on future loans but merely to recognize more limited Bank leverage in the present circumstances and, therefore, the need for more selectivity in choosing only the high priority areas of policy reform needed.

III. Co-financing

44. In our future lending to Yugoslavia we intend to give increasing emphasis to identify and pursue, whenever possible, co-financing opportunities. In order to do so we need to (i) convince the Yugoslav authorities of the need and benefits of such co-financing and (ii) engage the financial community (which would include both commercial banks and export credit institutions) in a greater and more systematic fashion than in the past.

45. However, any co-financing effort will have to be seen in the context of the overall constraints confronting Yugoslavia (see para. 7). Yugoslavia's current credit rating is unlikely to generate substantial co-financing on attractive terms from commercial banks. Similarly, Yugoslav banking laws, which at present preclude banks from borrowing subtstantial amounts except for specifically identified investments, and the entry of the Yugoslav Natonal Bank into the market as a "jumbo" borrower, have at least temporarily inhibited the activities of the Yugoslav commercial banks. Both these factors have made it difficult for the World Bank to generate the necessary commitment from the responsible

Yugoslav authorities to an adequate co-financing program. Thus no co-financing other than suppliers' credit financing related to industrial and agricultural credit projects, has been arranged during FY81 and FY82. In fact, the only substantial amount of co-financing during recent years took place in FY80 in connection with the $125 million loan for the Highways XI project for which a banking consortium provided $110 million. Aside from the overall constraints referred to above, other reasons for the low level of co-financing in the past were the limited attractiveness for co-financing of agricultural projects which formed the core of the lending program during recent years, and inadequate contacts with potential sources of co-financing such as commercial banks and export credit institutions.

46. While it may be difficult and take time to overcome all of these constraints, a more systematic approach towards co-financing should bring about improvements over past performance. Moreover, we believe that with the higher share of energy and industry and a lower share of agriculture in the revised lending program, more projects in the proposed lending program should be suitable for co-financing. In our discussions, the Yugoslav Government has already agreed, that in a period of general shortage of Bank funds and during the graduation phase, more co-financing will be needed. Apart from the projects in the FY83 lending program for which we have advised the Yugoslavs that co-financing will be required - Third Power Transmission, Sixth Railways and Tuzla/Ohrid Water Supply and Sewerage projects - we intend to reach an agreement with the Yugoslav authorities on the specific projects that are suitable candidates for co-financing. Such early agreement should enable the respective republican/provincial secretariats for finance and the federal authorities to obtain the necessary internal clearances for co-financing.

47. In order to generate greater interest of the international financial community, we intend to have closer contacts with commercial banks and export credit institutions and to provide them with necessary information on the most recent economic developments and the projects in question. Overall, we plan to be flexible in the forms and extent of co-financing, focussing during the immediate future on suppliers' credits and exports credits, since, as stated above, commercial loans on suitable terms are unlikely to be available to any significant extent in the near future. As the constraints on Yugoslavia's access to commercial banks ease, co-financing with commercial banks can be increasingly considered.

IV. Economic and Sector Work (ESW)

48. Continued ESW at roughly the existing levels will be required to provide the evolving basis for strategy formulation, analytical support for the lending program and to inform our Managment, Board and other sources of external finance. Particular focus will be needed on balance of payments, energy, agriculture, industry and employment issues. In the context of the review of the Regional Indicative Statement in February 1982, Mr. Stern accepted these proposals. However, some rephasing and refocussing has been required to take account of new directions in the lending program (particularly in industry), Yugoslav approval of the agriculture sector

study, and a revised strategy on the energy sector study. In the course of the June graduation discussions, the Yugoslavs expressed considerable interest in continued cooperation with the Bank in economic and sector work, singling out the areas of industrial sub-sector studies, investment appraisal and efficiency and export promotion as areas of particular interest. In addition several research institutes have expressed interest in participating in the Bank's program of economic research and studies. (see Annex II for a fuller discussion).

V. Technical Assistance (TA)

49. The TA proposals contained in this paper are more preliminary than those related to lending strategy. First, past graduation history offers little practical guidance in this area. This is partly because the present graduation policy is the first systematic attempt clearly to spell out Bank-wide criteria to be applied during the phase-out period and the post-graduation relationship. Second, past efforts at TA to graduating countries have been very limited in scope. Finally, further discussions are needed with the Government to get a clearer idea of their perceived needs.

50. Continuing ESW at high levels would have a high TA component (see Annex II). Second, more active participation by the Bank in cofinancing activities compared to the past could also be an important area. This could involve assistance in arranging cofinancing, private bond placements and other forms of private capital financing. Third, participation in EDI activities during the phase out period as well as the period after lending has ceased would represent a continuing relationship with the Bank. Fourth, if the Yugoslavs desire, the Bank should be prepared to provide assistance in the identification and preparation of projects beyond the scope of Bank lending. This would raise issues relating to the payment for such services during the phase-out period, and such preparation activity may need to be financed under Bank loans. Moreover, in the present position of budgetary stringency in the Bank, there is also the issue of the relative need of Yugoslavia compared to other countries. In any event, the TA components in Bank projects financed during the graduation period will be critically reviewed to try and have as much impact as possible through project related TA. Fifth, continuing assistance in improving investment criteria beyond the phase-out period would be an important Bank contribution. Given the high decentralization of decision making and the limited role of free market prices, further thought will be needed on the most appropriate way to structure such assistance, particularly to the apex banks in the Republics; it could be done by EDI courses, Bank staff visits and Yugoslav officials visiting the Bank for limited periods. This type of TA would be particularly useful for the LDR like Kosovo. During the graduation discussions in June, various banks in Yugoslavia and regional government officials showed considerable interest in Bank TA to improve the quality of their project evaluation and implementation.

51. Moreover, other non-project TA could be provided in areas such as institution-building. Examples of such activities in agriculture include

an issue-oriented agricultural sector survey, on-farm surveys, improvements in agricultural research and extension services and economics of agro-processing industries to extend the agro-industrial capacity utilization study done under a previous agricultural loan. Agricultural pricing policy is another important area for consideration. However, apart from analysing and evaluating agricultural price policies in the context of the agricultural sector survey, this issue requires continued attention to overall price formulation policies in our macroeconomic work.

52. Finally, as part of the process of improving export orientation, the Bank should be prepared to provide assistance to improve the knowledge of Bank ICB procedures within the industrial sector. Participation of Yugoslav industry in Bank/IDA projects outside of Yugoslavia has been disappointingly low. This apparently stems partly from the fact that industry has not been highly export oriented, and as a result, there has been little effort made to disseminate information of invitations to tender on a timely basis. A most useful service could be provided by Bank staff participating in a seminar on "Tendering for Bank-financed Projects under ICB procedure" for the benefit of the industrial sector. During the June discussions, various republics and provinces expressed great interest in such seminars.

53. On several occasions in the past, Yugoslav officials (particularly staff members of the Yugoslav Bank for International Cooperation (YBIEC)) have expressed the view that they would like to use the good offices of the Bank to forge closer relationships with developing countries, so that they can provide technical assistance to the least developed countries and discover opportunities for the sale of their consulting and engineering services. The issue needs further discussion between the Bank and the Yugoslav Goverment. Bank assistance can be provided only to a limited extent and will need to be coordinated with the U.N. (TCDC), which has primary responsibility in this area.

IFC Activities

54. While Yugoslavia has reached the point of initiating the graduation process from the Bank, there are nevertheless various indicators which suggest the need for continued IFC investment in the country. There is the obvious resource gap evident in the shortage of foreign funds, and IFC can help overcome this by being a catalyst in attracting foreign capital for the larger projects in which IFC is involved. There is also the need for assistance in project formulation to meet effectively the requirements of the economy. Finally, there remains the need for assistance to industry in the lesser developed regions. IFC, therefore, foresees a continuing role for itself in the country, not only during the graduation period but beyond.

55. IFC's project pipeline in Yugoslavia is satisfactory, but as a consequence of the Yugoslav stablization and consolidation efforts, the lack of Government approvals to start new projects and the limited availability of local dinar funds are now delaying project preparation.

The volume of IFC's investments, particularly during the graduation period, will therefore essentially be determined by Yugoslav industrial investment policy. IFC's present priorities are to assist in the financing of projects that have good export prospects; preference is given to such projects in the less developed regions but strong export projects in the more developed Republics are not excluded. Second, IFC is in discussion with project sponsors for critical food and energy projects, the latter focussed primarily on commercial energy development.

56. IFC sees the need to continue its past role of paying special attention to facilitating joint venture financing and to syndicating loans where practicable. During the years immediately following graduation, IFC will continue to participate in selected priority investments where it can make a special contribution, just as IFC has done in other countries which have graduated from the Bank.

PROPOSED FY 83-87 LENDING PROGRAM IMPLICATIONS

1. The attached tables show the previous lending program and the lending program that emerge as a result of the strategy revisions proposed. Brief explanatory comments follow to explain the link between the proposed strategy and projects dropped, refocussed or replaced. Evaluative remarks and reasons are also provided where projects are proposed for continued inclusion in the lending program, although they do not fully correspond to the proposed strategy.

FY83

2. Given the advanced stage of preparation of FY83 projects, it is not feasible to make major changes at this stage. Moreover, most of the projects correspond to the revised strategy, with the exception of the Ohrid/Tuzla water supply projects (although we do expect to attract export credit financing for this project). Railways VI is the last multi-republic loan in a series of Railways loans designed to improve the efficiency of a relatively energy efficient mode, and the loan also seeks tariff reform as an additional objective. Regional Development-Kosovo seeks to enhance productivity in the least developed region of Yugoslavia and contains strong institutional development objectives. Project design also emphasizes employment impact. Power III focusses on the development of an integrated load dispatch facility, which would improve efficiency in the central area of power, and offers cofinancing possibilities with EIB and other sources. DFC VII includes two LDR's, Kosovo and Montenegro, and subprojects are limited to export oriented, labor intensive and energy saving activities with the added benefit of encouraging joint ventures between MDR and LDR in these areas. To accommodate higher loan amounts needed for other projects and reduce the number of projects in FY83, this project is slipped to FY84.

FY84

3. Although major surgery is precluded by the level of preparation of some of the projects, every effort is being made to refocus the projects to accord with strategy revisions. Highways XII which was previously a sector loan for 4-5 republics has been redefined to mainly finance high priority sections of the Trans Yugoslav Highway, which has balance of payments implications and is an attractive project for substantial cofinancing with EIB and commercial sources. Serbia Agricultural Development project is being critically reviewed so that project components emphasize balance of payments, productivity and institutional development aspects, in addition to poverty alleviation. Montenegro Agricultural Development project is also being critically reviewed. However, given the low and scattered population in the republic, the cost of production will remain high compared to the MDR. Nevertheless, project components are being reviewed

to emphasize productivity components where Montenegro has a comparative advantage (citrus fruits, olives), increase productivity in the low productivity, mountainous areas (beef, livestock and sheep) and develop the rich but underexploited forestry resources. We propose to slip this project to FY85 and combine high priority components in Montenegro with another multi-republic project such as the presently unidentified Agricultural IV project. The reason for the proposed slippage is to reduce the number of projects in FY84. Bosnia Forestry fits the new strategy because of the its export potential and is in accord with the Bank's energy policy regarding the development of forest resources. Kosovska Mitrovica Water Supply and Pollution Control project does not fit the revised strategy, and there has been substantial lending in this sector already. However, among the water supply/pollution projects in Yugoslavia, this has clearly the highest priority, because of the catastrophic human misery involved and the concomitant international attention recently focussed on this critical situation. We recommend that this project be retained as an exception to the overall strategy, but be slipped to FY85 to accommodate lending program constraints.

FY85

4. The Energy/Power I and Export Industries projects clearly are in line with the revised strategy. However, the Export Industries project is slipped to FY86 in view of the status of project preparation. Agricultural Credit IV is being formulated to focus on storage, credit delivery systems and other components, which are presently weak areas and could include elements from Montenegro. Serbia Regional Development II should be dropped, because it would merely be an extension of Serbia I in design and be in the same regions. Consequently incremental impact is likely to be low.

FY86

5. The Energy/Power II and DFC VIII projects are in line with revised strategy. Kosovo Irrigation and Macedonia Irrigation II should be dropped in line with the revised strategy to reduce investments in large scale irrigation, because of the serious implementation difficulties we have had with most previous large scale irrigation projects (Ibar, Metohija) and the difficulty of financing large scale projects in the stabilization period ahead. Two Agricultural Projects should be added, which are still to be defined.

FY87

6. Energy III corresponds with the revised strategy objectives and should be retained. The general purpose Agricultural Development projects in Macedonia and Montenegro/Bosnia should be dropped because of their

repeater nature. Kosovo is a marginal candidate and its inclusion would depend on Kosovo's absorptive capacity. These three projects should be replaced by: DFC IX, one agricultural project (unidentified) and another unidentified project, which would either be in energy if the sector work is adequately completed or in agriculture.

Table 1 - YUGOSLAVIA - FIVE YEAR LENDING PROGRAM (PREVIOUS)

FY82		FY83		FY84		FY85		FY86		FY87	
Lonjsko Polje Drainage	78.2	Railways VI	85.0	Highways XII	95.0*	Energy I	100.0*	Kosovo Irr.	70.0	Kosovo Reg Dev.II	80.0
Semberija Drainage	34.5	Regional Dev. -Kosovo.	38.0	Serbia Reg. Dev.	75.0*	Ag. Credit IV	90.0*	Macedonia Irr. II	60.0*	Ag. Dev Macedonia IV.	70.0*
DFC VI	66.0	Power III	75.0	Kosovoska Mitrovica W/S and Sew	50.0	Serbia Reg. Dev. II	75.0*	Energy II	90.0	Ag. Dev Montenegro/ Bosnia	80.0
Kosovo W/S	41.0	DFC VII	55.0	Reg. Dev. Montenegro	50.0*	Export Industries	65.0*	DFC VII	110.0*	Energy III	100.0*
Ag. Dev. Bosnia	35.0	W/S and Sew Tuzla/Ohrid	65.0	Bosnia For.	70.0*						
Ag. Dev. Macedonia III	80.0										
									110.0*		
	334.7		318.0		340.0		330.0		330.0		330.0
	(6)		(5)		(5)		(4)		(4)		(4)

February 1982
EMENA CPIC

Reserve Project Ports II 60.0

Table 2 - YUGOSLAVIA - REVISED FIVE YEAR LENDING PROGRAM

FY83		FY84		FY85		FY86		FY87	
Reg. Dev. Kosovo	60	Serbia Reg. Dev.	100*	DFC VIII	65	Ag. Unident I	75*	Energy III	90*
Railways VI	135	Bosnia Forestry	60*	Ag. Cr. IV/ Ag. Dev. Montenegro	120*	Ag. Unident II	75	Ag. Unident III	70*
Water Sup/Sew Ohrid/Tuzla	50	Highways XII	100	Water Sup/Sew Kosovoska Mitrovica	30*	Energy/Pow. II	100*	Energy IV or/ Ag. Unident.IV	90
Power Trans III	80	DFC VII	65*	Energy/Pow.I	110*	Export Ind.	75*	DFC IX	75
	325		325		325		325		325
	(4)		(4)		(4)		(4)		(4)

Reserve Project

Lonsko Polje Drainage	79.1

August 1982
EMENA CPIC

Table 3 - YUGOSLAVIA: Bank Lending and Size of Net Transfers FY78-87

						(US$ million)						
	FY78	FY79	FY80	FY81	FY82	FY83	FY84	FY85	FY86	FY87	FY78-82	FY83-87
IBRD: Incl. Undisb.	1843.0	2235.7	2556.9	2516.5	2735.5	2909.5	3061.7	3178.7	3271.1	3335.3	-	-
Excl. Undisb.	988.5	1219.2	1506.9	1377.4	1536.5	1670.8	1810.2	1922.2	2029.0	2136.3	-	-
IBRD: Gross Disb.	151.6	222.8	314.1	230.8	274.8	285.3	312.2	320.0	339.4	368.1	1194.1	1625.0
Repayments	36.9	44.2	54.1	79.5	115.7	151.0	172.8	208.0	232.6	260.8	330.4	1025.2
Net Disb.	114.7	178.6	260.0	151.3	159.1	134.3	139.4	112.0	106.8	107.3	863.7	599.8
Interest & Charges	63.5	83.9	101.0	113.2	134.7	149.2	167.2	182.6	197.1	211.1	496.3	907.2
Net Transfer	51.2	94.7	159.0	38.1	24.4	-14.9	-27.8	-70.6	-90.3	-103.8	367.4	-307.4

April 26, 1982

ECONOMIC AND SECTOR WORK PROGRAM

1. As indicated in the last CPP and in subsequent Indicative Statements, our economic and sector work program has been directed at three principal goals:

(i) Providing an analytical basis for the lending program;

(ii) Maintaining a dialogue with the Yugoslavs on issues of macroeconomic and sectoral policy;

(iii) Providing an informed and objective interpretation of the Yugoslav system and Yugoslav economic developments to outside observers, particularly those in the international financial community.

2. Serving these objectives in the decentralized decision making environment of Yugoslavia has involved operating in two modes. An effective dialogue on issues of macroeconomic policy has required contact with analysts and policy makers at the Federal level and in the capitals of the MDR. On the other hand, given the bias of our lending toward the LDR, our analysis of both developmental issues and of issues in major sectors has been oriented toward problems and decision makers in the LDR.

3. Given the serious difficulties that Yugoslavia encountered toward the end of the 1970s in effecting a sustainable external adjustment, issues relating to the external sector, and to the sources of macroeconomic disequilibrium, have figured prominently in our economic work over the past three years. At the same time we have maintained our interest in issues of employment, regional development and LDR investment policy. Both sets of issues are extensively represented in the draft report of the plan review mission, discussed with the government in June 1982.

4. In designing an appropriate economic and sector work program in the period before graduation, it is necessary first to consider the Bank's needs. While the lending relationship continues we will need to provide the Board and senior management with standard documentation on macroeconomic developments and evaluations of country creditworthiness. This might be most conveniently done by making somewhat greater use of Country Economic Memoranda than has been the case in the past. Greater use of this device would also provide us with flexibility in packaging other pieces of economic and sector work that we undertake. These could then be more explicitly oriented to country dialogue and operational needs. They could form part of the CEMs, go forward as conventional grey cover reports or not be transmitted to the Board at all, depending on the item under

consideration. The availability of CEMs at reasonable intervals would also facilitate our interaction with commercial banks and other potential co-financiers.

5. Beyond this macroeconomic documentation and overall country assessment, the objectives of the lending program entail continued work in five general areas: industry, energy, agriculture, exports and regional development. In addition, given our past work on issues of efficient resource allocation and the continuing importance of this topic in Yugoslavia's adjustment efforts, we should continue work in this area.

6. Although the above topics constitute the core of the Bank's own needs, the scale and format of this work will be influenced by other audiences we seek to address. As regards the audience within Yugoslavia the key issues are receptivity, local capacity and the Bank's comparative advantage. Gauging impact in Yugoslavia is difficult, given the amorphous and largely invisible decision-making process. Our recent experiences in discussing a note on medium-term policies and in discussing the green cover economic report were, however, extremely encouraging. Both documents had been widely distributed and closely read by senior economic managers and leading academics, many of whom remarked both on the need for the Bank to make its views known and the seriousness with which these views were taken at the highest political level.

7. Yugoslav local capacity is reasonably well developed in the areas of physical investment planning, short-term cyclical analysis and in certain developmental areas such as demography and migration studies. It is considerably less well developed in analysis of incentive patterns and the role of the price system in medium-term resource allocation at both the macroeconomic and microeconomic levels, and there is substantial interest among academic and planning circles in tapping the Bank's expertise in these areas. Equally, similar services are not provided by other international organizations: the IMF and the OECD tend to focus on stabilization issues, while the Economic Commission for Europe (ECE) tends to cover Yugoslavia primarily in its cross-country work. There remains a case therefore for continuing our work on medium-term adjustment policies. The balance in our sector work between work designed to meet our own informational and evaluative needs and work performed as a service function would need to be decided on a case-by-case basis, on grounds of receptivity and interest. The present design of the sector work program primarily stresses our operational needs, particularly in the immediate future.

8. The needs of outside observers call more for shifts in the dissemination of our work than in its content. One step would be to publish more of our work of interest to outsiders. We could also take more initiative in contacting banks, holding seminars, preparing abstracts of our work, speaking more directly (and for attribution) to the press.

It is not certain that such a stance would be welcomed by the Yugoslavs and we would need to solicit their views in advance. In addition, country economist time would need to be set aside for contact with banks in the context of cofinancing operations.

9. The existing framework for ESW in FY83 and FY84 is set out in the Indicative Statement for FY83. In addition a notional program for FY85 was set out in the last CPP, prepared in FY80. The actual FY81 program amounted to 201 manweeks, while the FY82 program was estimated at 220 manweeks in the IS for FY83. The FY83 program was approved by Mr. Stern in February. However, slippage of the agricultural and energy sector surveys from FY82 (reflecting the lack of agreement on sectoral investment strategy within Yugoslavia), and additional industrial sector work (in response to the new stress on issues of industrial strategy and policy) have led to some expansion in the actual program for FY83, as indicated on page 6 of this annex. At the IS review meeting the Region expressed its preliminary view that the program would stay at approximately current levels in the near future, notwithstanding the run-up to graduation. As the DPS memo on the IS noted, this is a somewhat smaller ESW program than would be warranted given Yugoslavia's size and the volume of lending to it.

10. The major pieces of work currently planned through FY85 continue to make sense in the light of the criteria presented above, provided receptivity is assured. On the economic side the employment review now underway is going beyond the analysis of employment issues in the "Adjustment Policies" report to assess a variety of issues connected with employment and regional policy, including the policies of the Federal Fund, the operation of the joint venture mechanism, and the use of these and other instruments to facilitate the reallocation of labor intensive industries in line with regional factor endowments.

11. Given the importance of efficient industrial restructuring in the process of adjustment, several studies are proposed to examine this process from a variety of perspectives through both economic and sector work, with the general aim of underpinning the lending program in industry. The recent green cover economic report has argued for both better appraisal procedures and more detailed financial programming as ways of addressing weaknesses in the system of investment selection which were evident in the last plan. These issues are also of considerable relevance in our IDF (and agricultural) projects, and will be addressed by the proposed study of the role of the financial system in resource allocation. In support of the shift in our IDF operations toward the restructuring individual subsectors, a study of selected subsectors in the two more advanced republics, Bosnia-Herzegovina and Macedonia is proposed to begin in late FY83, and to continue to FY85. Similarly, in support of the orientation toward exports which has already been featured in the recent Industrial Credit VI, a study is proposed of the operations of the export incentive system at the enterprise level. Thought is being given to

amalgamating part or all of this study with the subsector reviews described above. The study of industrial structure and performance planned for late FY84 and early FY85 is designed to draw generalizations from the subsector studies on issues of investment coordination across republics, including the experience with the joint venture mechanism until that time. It would also be desirable to link this work with our efforts at direct lending to industry through the proposed export industries and energy projects. In addition there is also need for work in the area of technology choice and technology transfer between firms; this could appropriately be taken up following the study on industrial structure and performance.

12. In the agriculture sector the major activity currently planned is the agriculture sector survey, which, after considerable delay, appears ready to proceed in early FY83. This coincides with progress within Yugoslavia on the so-called 'Green Plan' - the five year social compact for agriculture. The present design calls for the study to be executed by the Yugoslavs under close supervision by Bank staff. We have also programmed resources to follow up on specific aspects of this work, particularly in the area of investment and pricing policy, aspects of land tenure, agricultural trade and agricultural credit. In addition time has been budgeted for full assimilation of the agroindustry study currently being prepared by the Yugoslavs.

13. As mentioned in the main text, in the energy sector our current strategy is to gather the information necessary for a well-reasoned lending program from the work of the first energy sector mission, together with information collected in the course of identification missions in the oil and gas subsector and in certain industrial subsectors. This would complement material already available on the coal and power subsectors. Following the completion of these elements, we have made provisions for reviews of selected issues in the outer years depending on our remaining needs and the interest of the authorities.

14. While we will monitor creditworthiness and capital account developments continuously, in association with the IMF, the CEM planned for late FY83 will look explicitly at issues connected with Yugoslavia's access to international capital markets, and will build upon the work of the financial sector mission in its examination of the internal coordination of external borrowing (including cofinancing) in Yugoslavia. A further CEM in late FY84 will look at aspects of Yugoslav policy toward foreign investment; a topic which is arousing interest within Yugoslavia at present and is of interest to us and to IFC. Following upon the macroeconomic modelling work initiated for the plan review mission, we are in the process of establishing collaborative links between research institutions in Yugoslavia and researchers at the Bank, in an effort both to transfer analytic technology in which the Bank is a leader and to create an instrument for more effective dialogue with Yugoslav planners and policy makers. Finally, some thought might be given to using the Bank's analytic

staff in providing concrete guidance to the Yugoslavs (and other graduating countries) on markets and commodities suitable for their export drive. In the first instance this could involve drawing upon existing analyses of shifting patterns of comparative advantage, and on prospects for protection in the industrial countries to define the elements of a medium-term export strategy.

15. The above program, if accepted by the Yugoslavs, would imply Bank input at approximately the current level through FY85, the end of the current plan period, with somewhat greater Yugoslav involvement in execution of work than has generally been the case. The program for the later years might decline somewhat thereafter, but this would need to be assessed closer to the time in the light of Yugoslavia's economic situation and our experience in the intervening period.

YUGOSLAVIA: FY83-85 ECONOMIC AND SECTOR WORK

Task	Aims and Coverage	Audience	Responsible Department	Total Staffweeks FY83	FY84	FY85
A. Economic Work (ERA)						
(i) "Adjustment Policies and Development Perspectives"	Review of 1976-80 plan and 1981-85 plan. Green cover discussed with government (ongoing).	Bank, country, financial community	EM1	6	-	-
(ii) Employment, Unemployment and Underemployment	Regional employment policies; factors influencing labor mobility (ongoing).	Bank, country	EM1	26	-	-
(iii) Financial System and Resource Allocation	Review role of banks in investment project evaluation and role of financial subsidies in resource allocation.	Bank, country, financial community	EM1	33	12	-
(iv) CEM/Access to International Capital Markets	CEM with special section on internal borrowing mechanisms, access to international capital markets and analysis of capital account developments.	Bank, IMF, financial community	EM1	32	10	-
(v) Industrial Structure and Performance	Examine aspects of Yugoslav industrial organization and consequences for industrial efficiency in key subsectors. Identify directions for restructuring.	Bank, country, IFC	EM1	-	20	25
(vi) CEM/Foreign Investment Policies	CEM with special section reviewing policies and success in attracting foreign investment.	Bank, country, IFC, foreign investors	EM1	-	20	30
(vii) Review of Technological Development in Industry	Review technological base and R & D activities in specific subsectors; mechanisms for acquisition and transfer of technology (continued in FY86).	Bank, country, IFC	EM1	-	-	25
(viii) CEM/Review of Plan	CEM with review of progress of 1981-85 plan (continued in FY86).	Bank, country	EM1	-	-	20
Total ERA				97	62	100
B. Sector Work (SRA)						
(i) Agroindustries Subsector Review	Review of current capacity in subsector and recommendations for future investment policies (ongoing).	Bank, country	EMP	10	-	-
(ii) Agricultural Sector Review	Review selected aspects of agricultural strategy. Bank will prepare sector memorandum and terms of reference for study to be conducted by Yugoslav institutes.	Bank, country	EMP	30	20	-
(iii) Agriculture: Selected Issues (Investment; Land Tenure; Agricultural Exports; Agricultural Credit)	Follow-up on agriculture sector survey	Bank, country	EMP	-	-	20
(iv) Energy Sector Study	Survey of domestic energy production potential and policies, including energy conservation possibilities and policies (ongoing).	Bank, country	EMP	36	-	-
(v) Energy: Selected Issues	Follow up on topics raised in Energy Sector Survey.	Bank, country	EMP		15	20
(vi) Review of Industrial Export Incentive System	Review incentives/institutional arrangements through detailed study of individual enterprises to provide basis for policy and institutional reforms.	Bank, country	EMP	20	20	-
(vii) Study of Industrial Subsectors in Macedonia and Bosnia-Herzegovina	To undertake detailed review of engineering and textile industries in Macedonia, and engineering and wood-processing industries in Bosnia-Herzegovina, with special emphasis on export possibilities.	Bank, country	EMP	20	57	30
Total SRA				116	112	70
C. Other (EWO, SWO, CPP)				35	35	35
TOTAL				248	209	205

Population: 22.3 million (mid-1980)
GNP Per Capita: US$2,620 (1980)

YUGOSLAVIA - ECONOMIC INDICATORS

Indicator	Amount (million US$ at current prices) 1980 c/	Annual Growth Rates (%) (at constant 1972 prices) Actual 1975	1976	1977	1978	1979	1980	1981 c/	Projected 1982	1983	1984	1985	1986
NATIONAL ACCOUNTS													
Gross domestic product a/	69,232	0.9	5.2	8.4	8.5	4.2	2.2	2.2	2.5	3.6	3.6	3.6	4.9
Agriculture	8,516	-2.6	6.4	5.7	-5.4	5.4	0.0	1.0	3.2	3.2	3.2	3.1	2.0
Industry	28,801	7.4	4.1	9.5	9.3	8.5	3.6	1.4	2.3	4.0	4.2	4.2	5.8
Services	24,993	1.4	5.3	7.1	13.1	-2.0	-2.2	3.4	2.5	3.3	3.1	3.1	4.8
Consumption	48,760	-3.3	0.0	9.8	13.0	3.8	0.6	-1.1	2.8	3.5	2.7	2.8	3.6
Gross investment	23,218	10.1	3.6	17.4	-3.2	12.0	-3.2	-1.2	-2.5	1.3	4.2	4.6	7.3
Exports of GNFS	14,053	1.1	10.4	-2.0	4.8	2.6	12.6	9.3	7.0	6.6	6.6	6.6	6.5
Imports of GNFS	16,799	-1.3	-8.6	16.1	2.5	12.0	-9.7	-2.6	2.6	4.3	5.2	5.7	5.8
Gross national savings	19,619	14.7	20.6	5.6	-3.1	3.4	5.8	-	-	-	-	-	-
PRICES													
GDP deflator (1972 =100)	411	170	204	232	260	313	411	-	-	-	-	-	-
Exchange rate	24.9	17.4	18.2	18.3	18.6	19.0	24.9	-	-	-	-	-	-

	Share of GDP at Market Prices (%) (at current prices) b/ 1960	1970	1975	1980	1985	1990	Average Annual Increase (%) (at constant 1972 prices) 1960-70	1970-75	1975-80	1980-85	1985-90
Gross Domestic Product a/	100.0	100.0	100.0	100.0	100.0	100.0	5.9	6.5	5.7	3.1	5.7
Agriculture	22.5	16.1	13.8	12.3	12.1	10.2	3.3	2.9	2.4	2.7	2.0
Industry	42.2	37.4	44.3	41.6	41.8	45.3	6.3	8.3	7.0	-3.2	7.5
Services	29.0	38.1	33.1	36.1	36.1	34.6	6.9	4.7	4.3	3.1	4.8
Consumption	67.2	72.8	74.3	70.4	69.8	68.1	6.5	6.9	5.4	2.1	5.3
Gross investment	36.5	32.3	33.5	30.5	27.8	28.4	4.7	5.5	5.3	1.3	6.1
Exports GNFS	13.9	18.5	20.2	27.7	33.7	35.0	10.2	6.7	5.7	7.2	6.5
Imports GNFS	17.5	23.5	28.0	31.4	31.3	31.5	9.8	6.7	2.5	3.1	5.8
Gross national savings	32.6	29.6	25.6	28.3	28.4	31.8	5.3	6.2	6.5	-	-

	As % of GDP 1960	1970	1975	1980
PUBLIC FINANCE				
Total revenues	27.9	33.1	36.8	37.6
Total expenditures	24.1	33.2	37.2	38.2
Surplus (+) or deficit (-)	3.3	0.1	-0.4	0.6
Foreign financing	0.0	0.0	-0.4	0.0

	1960-70	1970-75	1975-80	1980-85	1985-90
OTHER INDICATORS					
GNP growth rate (%)	6.1	6.7	5.7	2.8	5.8
GNP per capita growth rate	5.0	6.6	4.7	1.9	4.8
ICOR	5.4	4.6	5.8	9.1	5.0
Import elasticity	1.6	1.0	0.5	1.0	1.0

a/ At market prices; components are expressed at factor cost and will not add due to exclusion of net indirect taxes and subsidies.
b/ Projected years at constant 1972 prices.
c/ Estimate.

EMENA 1C
April 8, 1982

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ANNEX III
Page 2 of 4

Population: 22.3 million (1980)
GNP Per Capita: US$2,620 (1980)

YUGOSLAVIA - EXTERNAL TRADE

Indicator	Amount (million US$ at current prices) (1980)	Annual Growth Rates (%) (at constant 1972 prices) Actual						e/	Projected				
		1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
EXTERNAL TRADE													
Merchandise exports	8,978	0.0	14.5	-5.3	1.0	4.4	11.2	10.6	7.0	6.4	6.4	6.4	6.5
Primary a/	1,940	-3.1	16.6	3.9	1.5	5.6	2.5	-10.7	5.0	5.0	5.0	5.0	6.5
Manufactures b/	7,038	0.4	13.9	-8.8	0.8	4.0	14.1	16.4	7.4	6.7	6.7	6.7	6.5
Merchandise Imports	15,065	-2.8	-6.5	18.5	3.8	18.8	-13.9	-4.9	2.5	4.3	5.4	6.0	5.7
Food	1,087	-40.9	45.8	4.3	-24.2	51.9	-3.1	-5.5	1.0	1.0	3.5	4.0	4.5
Petroleum c/	3,549	-5.0	10.1	12.0	11.6	10.6	-8.2	0.0	3.0	5.0	5.0	5.0	7.0
Machinery and equipment	4,216	22.3	-8.8	17.8	7.1	22.4	-23.1	-19.8	-5.0	3.0	3.0	5.0	7.0
Others	6,213	-11.9	-12.7	22.1	4.4	12.8	-9.3	4.3	6.5	5.4	6.5	6.9	5.2
PRICES (1972 = 100)													
Export price index		172	180	202	220	253	301	331	364	393	423	453	480
Import price index		184	189	216	226	269	319	351	385	419	452	486	521
Terms of trade index		93.5	95.2	93.5	97.3	94.0	94.4	94.4	94.7	94.0	93.5	93.1	92.0

	Composition of Merchandise Trade (%) (at current prices) d/						Average Annual Increase (%) (at constant 1972 prices)				
	1960	1970	1975	1980	1985	1990	1960-70	1970-75	1975-80	1980-85	1985-9[illegible]
Exports	100.0	100.0	100.0	100.0	100.0	100.0	8.1	5.7	5.1	7.4	6.5
Primary a/	49.6	29.4	19.5	22.0	16.0	16.4	-	-1.3	6.0	1.9	6.5
Manufactures b/	50.4	70.6	80.5	78.0	84.0	83.6	-	8.1	4.7	8.8	6.5
Imports	100.0	100.0	100.0	100.0	100.0	100.0	9.0	7.4	4.1	2.7	5.7
Food	9.1	7.2	5.5	7.2	8.6	8.1	-	5.0	14.9	0.8	4.5
Petroleum c/	5.4	4.8	12.3	23.6	7.9	8.4	-	8.2	7.2	3.6	7.0
Machinery and equipment	36.8	33.2	33.9	28.0	24.6	26.1	-	9.4	3.1	-2.8	7.0
Others	48.7	54.8	48.3	41.2	58.8	57.3	-	6.0	3.5	6.0	5.2

	Share of Trade with Industrial Countries (%)				Share of Trade with Developing Countries (%)				Share of Trade with Capital Surplus Oil Exporters (%)				Share of Trade with Centrally Planned Economies (%)			
	1965	1970	1975	1979	1965	1970	1975	1979	1965	1970	1975	1979	1965	1970	1975	1979
DIRECTION OF TRADE																
Exports	40.1	53.3	34.0	40.5	17.4	13.6	16.8	19.3	0.4	0.7	2.1	11.5	42.1	32.4	47.1	40.3
Primary	61.0	70.2	54.0	55.0	9.1	8.2	8.9	14.2	0.2	0.2	1.9	5.8	29.7	21.4	35.2	30.7
Manufactures	24.0	41.9	26.0	33.5	23.8	17.2	20.0	21.6	0.6	1.0	2.1	14.2	51.6	39.9	51.9	44.9
Imports	55.3	66.1	59.1	60.8	16.0	12.7	15.7	n.a.	0.1	0.1	0.6	n.a.	28.6	21.1	24.6	25.3

a/ SITC 0-4
b/ SITC 5-8
c/ SITC 3; includes lubricants, coal and electricity.
d/ Projected years at constant 1972 prices.
e/ Estimates. Owing to changes in the valuation of trade, components do not add up to totals, nor do aggregate price and volume indices equal value growth between 1978 and 1979 shown in next table.

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April 8, 1982

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YUGOSLAVIA - BALANCE OF PAYMENTS, EXTERNAL CAPITAL AND DEBT
(US$ millions)

Population: 22.3 million (mid-1980)
GNP Per Capita: US$2,620 (1980)

Indicator	Actual								Projected					
	1970	1975	1976	1977	1978	1979	1980	1981 a/	1982	1983	1984	1985	1986	1990
BALANCE OF PAYMENTS														
Exports of goods and services	3,037	8,012	9,142	10,586	12,069	14,276	18,300	22,207	25,325	28,482	32,023	35,921	39,983	61,884
of which: Merchandise f.o.b.	1,679	4,073	4,893	5,191	5,809	6,794	8,978	10,939	12,860	14,779	16,905	19,248	21,729	35,291
Imports of goods and services	3,385	9,013	8,977	11,932	13,352	17,937	20,592	22,957	25,862	28,828	32,221	35,972	40,095	62,701
of which: Merchandise c.i.f.	2,874	7,697	7,367	9,789	10,439	14,019	15,065	15,758	17,709	20,114	22,915	26,122	29,576	48,796
Net transfers	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Current account balance	-348	-1,001	165	-1,346	-1,283	-3,661	-2,292	-750	-537	-346	-198	-51	-112	-817
Private direct investment	-	-	-	-	-	-	-	-	-	-	-	-	-	-
MLT loans (net)	196	951	1,094	1,432	1,394	1,009	2,410	762	662	241	865	1,010	1,367	1,938
Official	18	246	213	61	128	131	59	1,097	1,280	451	654	642	888	-985
Private	178	705	881	1,371	1,266	878	2,351	-335	-618	-210	211	368	479	2,923
Other capital b/	38	135	119	45	541	1,487	657	143	360	600	-100	-333	-566	-
Change in reserves	114	85	-1,378	-131	-652	1,165	-775	-155	-485	-495	-567	-626	-689	-1,121
International reserves c/	276	1,502	2,880	3,011	3,663	2,498	3,273	3,428	3,913	4,408	4,975	5,601	6,290	10,065
Of which: Gold (official valuation)	51	62	62	64	69	73	78	78	78	78	78	78	78	78
Reserves as months imports	1.0	2.0	3.8	3.0	3.3	1.7	1.9	1.8	1.8	1.8	1.9	1.9	1.9	1.9
EXTERNAL CAPITAL AND DEBT														
Gross disbursements	611	1,647	2,096	2,665	2,800	2,438	4,156	3,223	3,282	2,660	3,642	4,423	5,840	7,429
Official grants	-	-	-	-	-	-	-	-	-	-	-	-		
Concessional loans	67	134	134	159	29	13	20	12	-	-	-	-		
DAC	0	71	62	66	11	11	15	8	-	-	-	-		
OPEC	-	-	-	-	-	-	-	-	-	-	-	-		
IDA	-	-	-	-	-	-	-	-	-	-	-	-		
Other	675	63	72	93	18	2	5	4	-	-	-	-		
Non-concessional loans	573	2,037	1,962	2,506	2,671	2,425	4,136	3,211	3,282	2,660	3,642	4,423	5,840	7,429
Official export credits d/	39	203	283	75	74	60	85	1,375	1,534	723	931	1,145	2,069	974
IBRD	37	154	119	133	180	294	258	240	285	341	330	337	330	147
Other multilateral	-	-	-	-	8	24	36	18	-	-	-	-	-	-
Private	497	1,680	1,560	2,298	2,409	2,047	3,757	1,578	1,463	1,623	2,381	2,941	3,441	6,308
Yugoslav export credit (net)	(-37)	(-82)	(-100)	(-183)	(-106)	(-125)	(-300)	(-250)	(-230)	(-220)	(-240)	(-156)	(-509)	(-404)
External debt														
Debt outstanding and disbursed e/	2,053	5,820	7,172	8,956	11,117	13,608	15,446	16,458	17,350	17,811	18,916	20,081	21,958	30,870
Official	854	2,327	2,792	3,085	3,410	3,662	4,552	4,982	6,492	7,163	8,057	8,855	10,252	11,776
Private	1,199	3,493	4,380	5,871	7,707	9,946	10,894	11,476	10,858	10,648	10,859	11,226	11,706	19,094
Undisbursed debt	948	2,971	2,525	4,438	3,713	3,817	2,542	3,666	4,705	5,627	6,247	6,747	7,377	10,290
Debt service f/														
Total service payments	503	1,441	1,440	1,595	1,886	2,125	2,441	3,961	4,456	4,320	4,720	5,483	6,206	7,847
Interest g/	128	289	302	367	578	821	995	1,750	2,066	2,121	2,183	2,225	2,242	2,760
Payments as % exports	16.6	18.0	15.8	15.6	14.9	14.9	13.3	17.8	17.6	15.2	14.7	15.3	15.5	12.7
Average interest rate on new loans (%)	7.1	8.1	7.1	7.4	7.7	8.0	8.4	9.2	9.1	8.2	8.5	8.6	9.1	8.7
Official	7.0	8.3	7.0	7.3	7.7	-	-	-	-	-	-	-	-	-
Private	7.5	7.5	8.6	9.3	8.7	9.5	-	-	-	-	-	-	-	-
Average maturity of new loans (years)	16.5	15.2	18.3	15.4	15.1	10.8	10.1	10.2	10.3	10.7	10.5	10.3	10.1	9.8
Official	18.5	16.5	10.0	15.9	15.1	-	-							
Private	10.9	10.9	5.7	7.5	-	-	-	-	-	-	-	-	-	-

a/ Estimates.
b/ Includes net use of IMF credit (drawings less repurchases), net use of short-term credit and changes in bilateral balances.
c/ Including gross foreign assets of commercial banks.
d/ After 1980, includes borrowings guaranteed by National Bank of Yugoslavia.
e/ External borrowing reported in the historical balance of payments is not consistent with external debt data.
f/ Debt service excludes amortization and interest on export credit extended by Yugoslavia.
g/ After 1981, includes interest payments on use of IMF resources.

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SELECTED REGIONAL INDICATORS
(in percent unless otherwise indicate)

	Yugo-slavia	Bosnia - Herze-govina	Serbia	Slovenia	Macedonia	Kosovo	Montenegro	Croatia	Vojvodina
Demography and Labor Force									
Population Growth (1952-79)	1.0	1.5	0.8	0.7	1.4	2.5	1.3	0.6	0.6
Share of Population Below 20 Years (1971)	36.0	45.4	31.0	33.0	43.0	53.0	43.0	31.5	30.0
Agricultural Population/ Total Population (1971)	38.0	40.0	44.0	20.0	40.0	52.0	35.0	32.3	39.0
Private Agricultural Labor Force/Total Labor Force (1971)	40.0	42.0	52.0	18.0	38.0	51.0	39.0	41.1	46.2
Active Population/Total Population (1971)	43.0	36.7	52.0	18.0	38.0	26.0	33.0	45.5	42.6
Registered Unemployment/ Social Sector Employment (1978)	12.3	14.9	16.5	1.3	22.3	28.1	16.0	5.9	13.6
Migrant Workers/Total Labor Force (1971)	10.0	93.0	6.0	8.0	12.0	10.0	6.0	11.1	7.3
Income									
Real Growth in GMP 1952-79	6.8	6.0	6.7	7.1	7.1	6.6	6.4	6.9	7.8
Real Growth in Per Capita GMP 1952-79	5.7	4.5	5.9	6.4	5.2	4.0	5.1	6.3	7.2
GNP Per Capita (Estimate) (1980) ($)	2620	1737	2534	5193	1721	812	2086	3314	3189
Net Personal Incomes Per Worker in Social Sector Per Annum (1979) ($)	3861	3466	3761	4986	3180	3033	3311	4150	3659
Economic Sectors (1981)									
Share of Industry in GMP	37.3	40.4	36.9	45.8	36.1	33.1	33.1	33.6	36.2
Share of Agriculture in GMP	11.8	8.6	12.5	4.8	14.3	27.4	6.7	10.0	18.6
Share of Construction in GMP	10.8	11.6	10.4	9.8	13.3	8.4	12.9	11.4	13.4
Share of Transportation and Communications in GMP	8.1	7.9	7.5	7.3	6.3	5.8	11.8	10.6	5.0
Social Indicators									
Life Expectancy (1979) (years)	70.0	69.6	71.4	70.6	69.6	70.8	73.7	70.5	68.8
Number of Persons per Physician (1979)	1795	2551	1722.0	1172.0	2432.0	1841.0	2081.0	1338.0	4993.0
Number of Persons per hospital bed (1979)	167.0	207.0	157.0	137.0	193.0	170.0	132.0	139.0	356.0
Illiteracy Rate (% of Population over 10 years of age) (1975)	15.0	23.2	18.0	1.0	18.0	32.0	17.0	4.7	9.0
Area of Dwelling per Person (1981)(sq. meters)	11.4	12.4	9.9	10.7	13.4	10.6	23.7	12.3	6.9
Dwellings with Water Supply and Sewerage Facilities (1975)	38.0	25.8	34.0	72.0	38.0	17.0	38	43.6	29.2