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Loan Committee Memos and Special Committee Minutes - 1971 - Volume 2

LOAN COMMITTEE: 1971
Memos, Special Committee minutes
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Loan Committee Memos and Special Committee Minutes - 1971 - Volume 2

FORM No. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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December 29, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Indonesia - Agricultural Education Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 29, 1971 from the East Asia and Pacific Department, entitled "Indonesia - Agricultural Education Project" (LC/O/71-142).

2. Comments, if any, should be sent to reach Mr. de Silva (ext.2409) by 3:00 p.m. on Tuesday, January 4, 1972.

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

Dag F. Wittusen
Secretary
Loan Committee

DISTRIBUTION

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director, Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
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Mr. J.H. Williams
Directors, Other Departments and EDI
Meeting Participants (minutes)
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General and Loan Committee Files
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LC/O/71-142

December 29, 1971

LOAN COMMITTEE

Memorandum from the East Asia and Pacific Department

INDONESIA: Agricultural Education Project

Introduction

1. Attached for the consideration of the Loan Committee is an Appraisal Report entitled "Appraisal of a Second Education Project: Agricultural Education, Indonesia" (No. PE-40) dated December 27, 1971, which recommends an IDA credit of $6.3 million to the Republic of Indonesia to help finance the improvement of agricultural education and training facilities in Indonesia.

The Lending Program

2. The Association has made seventeen credits to Indonesia for a total amount of $231.4 million. The proposed IDA lending program through 1976 is attached. In FY 72, a third credit for technical assistance to help finance pre-investment studies was approved by the Executive Directors on December 21. Plans for further lending in FY 72 include more credits for irrigation rehabilitation, agricultural estates, highways and power distribution; and credits in the new fields of population, development finance, marine transport and smallholder rubber.

The Economy

3. The latest Bank economic reports on Indonesia are those of March 25, 1971 (EAP-22) on longer term development perspectives, and of November 30, 1971 (EAP-27a) on the aid requirements of the economy for FY 1972/73. The latter report focuses on recent economic performance, particularly in 1971, and the prospects for 1972.

The Education Sector

4. With the exception of technical assistance, external aid to Indonesia for the improvement of educational facilities has thus far been minimal. In preparation for fundamental reform of the educational system and with assistance from UNESCO and the Ford Foundation, the Government is conducting an intensive review to assess the educational structure, organization and curricula, and their relevance to the country's manpower requirements. Until the review is completed in 1973, the Association is assisting in the financing of only those education projects whose priority is obvious and which clearly deserve immediate attention.

5. As the development process gathers momentum and because of the demand for improved skills to help meet plan targets, there is a growing need for supervisors and middle-level trained manpower. The Association's first education credit of $4.6 million made on November 1970 (No. 219-IND) was designed to improve the facilities for such training primarily in the mechanical, electrical and civil engineering fields. The proposed project will assist the Ministry of Agriculture in reorganizing the administration of agricultural training to improve its efficiency and effectiveness; and to upgrade and expand selected middle level agricultural training institutions to meet the most pressing manpower needs. The project is justified by the importance of agriculture in the economy.

6. In support of the Government's agricultural programs, the Association has made several credits mainly for the rehabilitation of irrigation systems and of tea, rubber and palm oil estates, as well as for the production and distribution of fertilizer and of high quality seeds and for the expansion of fishery output. Agricultural training and extension need to be improved in order to implement successfully the development plans in agriculture.

7. Responsibility for education in Indonesia is centered essentially within the Ministry of Education, but the Ministry does not co-ordinate education and training in specialized sectors at all levels. The Ministry of Education administers university level agricultural education, but a number of General Directorates in the Ministry of Agriculture, provincial and local governments and private groups provide a variety of agricultural training programs below university level. Because of the lack of a co-ordinating office within the Ministry of Agriculture to plan and direct all agricultural training and rationalize the expenditure of limited financial resources, the present system has led to duplication of training facilities and programs.

The Project

8. The proposed project would consist of (a) the establishment in the Ministry of Agriculture of a National Office for Agricultural Education and Training and a Project Implementation Unit, and provision of necessary furniture and equipment, (b) the construction and equipping of 2 new and 12 expanded agricultural senior secondary schools, of 13 expanded or rehabilitated agricultural in-service training centers and of one agricultural training institute, and of two forestry technician training centers one of which is new; and (c) technical assistance for the foregoing institutions.

9. The total cost of the project is estimated at $12.33 million, including a foreign exchange component of $6.25 million (approximately 51 percent of the total cost). The proposed credit would cover all the foreign exchange expenditures while the Indonesian Government would meet

the local costs of the project, estimated at $6.08 million. Civil works contracts for the project institutions estimated to cost over $200,000 would be awarded on the basis of international competitive bidding. Since the other civil works are small in size and dispersed over a large area, they do not lend themselves to such bidding. These contracts would be submitted to domestic competitive bidding by pre-qualified contractors.

10. Furniture and equipment would be procured after international competitive bidding in accordance with the Association's guidelines. The type of equipment required for the project, largely laboratory, teaching and farm field equipment, is not manufactured in Indonesia and it is not therefore expected that contracts for the supply of equipment will be won by local bidders. In the case of furniture, however, it is estimated that most of the items procured for the project will have been manufactured locally. Imported materials or components used in local manufacture are exempted from duty under a decree of the Minister of Finance. It is also Government policy to encourage manufacturing industry in Indonesia. Local manufacturers of furniture would be allowed a margin of preference of 15 percent or the actual customs duty payable by non-exempt importers, whichever is lower, provided we were satisfied that the domestic value added was substantial.

11. The Association would disburse the c.i.f. cost of directly imported goods, the foreign exchange cost of specialists' services and fellowships and a percentage (to be agreed with the Government during negotiations) of the cost of civil works, furniture and professional services, representing the estimated foreign exchange cost. The Association would have the right to cancel savings from the proposed credit resulting from procurement inconsistent with the Association's procedures. Other savings would be made available, subject to our approval, to meet the foreign exchange cost of additional goods and services required for the project.

12. An important feature of the project would be the establishment by Presidential Decree of a National Office for Agricultural Education and Training in the Ministry of Agriculture, within six months of signing the proposed credit. The organization and powers of the National Office would be agreed with the Association. The Office would centralize and co-ordinate planning, administration, and supervision of agricultural education. It would also set priorities for, develop and implement programs for agricultural education and training, consistent with national objectives. The Office would also correct the current misallocation of resources and duplication of effort in agricultural training facilities.

13. A project implementation unit would be set up in the Ministry of Agriculture, staffed by a project director, architect, accountant and procurement officer. The unit, the establishment

of which would be a condition of effectiveness of the proposed credit, would be responsible for supervision of the project, co-ordination with concerned government and other agencies and liaison with the Association.

14. The project would include provision of 24 man-years of specialist services and 28 man-years of overseas fellowships for the training of local personnel together estimated to cost $1.02 million. Eight specialists would assist the National Office in agricultural education and training plans, in the introduction of new curricula and improvement of administration of project institutions, in the expansion of the agricultural teacher training program and in the initial operations of the forestry training center. The specialists would serve the Government in an advisory capacity and would have no management functions. Eight Indonesians appointed in consultation with the Association would be trained overseas and on their return become counterparts to the specialists. In addition selected staff of the project institutions would receive training in management and organization of agricultural schools, and in the development and introduction of new curricula.

15. The appointments of the project director, architect and counterparts to the specialists would be made in consultation with the Association. The Government has agreed in previous credits to consult with the Association on the suitability of key local personnel. The appraisal report recommends (para 6.15) that the specialists be "acceptable" to the Association. I would appreciate the guidance of the Loan Committee whether we should require such approval or whether in their case too we should be satisfied with consultation.

16. With respect to qualifications and salaries of the resident staff teaching at the project institutions, assurances would be sought during negotiations from the Government that after 1974 the qualifications for new teaching staff would be a university degree in agriculture and a course in pedagogy, and that salary supplements would be provided to ensure the availability of full time teaching staff when the new facilities become operational at the project institutions.

Recommendation

17. I concur in the findings of the appraisal that the project forms a suitable basis for an IDA credit of $6.3 million equivalent, and recommend that the Government of Indonesia be invited to send representatives to negotiate such a credit.

Douglas J. Fontein
Deputy Director
East Asia and Pacific Department

POPULATION: 112.8M

GNP PER CAP: $ 100

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

OPERATIONS PROGRAM			1972	1973	1974	1975	1976
6-INS-AF-02	AGRIC.FISHERIES II	IDA		3.0			
6-INS-AI-04	IRRIGATION REHAB.IV	IDA	11.5				
6-INS-AI-05	IRRIG.REHAB.V	IDA		15.0			
6-INS-AL-01	LIVESTOCK	IDA		5.0			
6-INS-AP-03	AGRIC.ESTATES IV	IDA	12.0				
6-INS-AP-05	SMALLHOLDER RUBBER	IDA	4.0				
6-INS-AP-06	AGRIC.ESTATES V	IDA		10.0			
6-INS-AP-07	SUGAR INDUSTRY REHAB.	IDA		11.0			
6-INS-AX-02	AGRIC.UNIDENT.II	IDA			35.0		
6-INS-AX-03	AGRIC.UNIDENT.III	IDA				35.0	
6-INS-AX-04	AGRIC.UNIDENT.IV	IDA					35.0
6-INS-CC-02	TELECOMMUNICATION II	IDA		20.0			
6-INS-CC-03	TELECOMMUNICATION III	IDA					10.0
6-INS-DD-01	DFC I	IDA	10.0				
6-INS-DD-02	DFC II	IDA		10.0			
6-IMS-DD-03	DFC III	IDA				20.0	
6-INS-EE-02	EDUCATION II	IDA	6.4				
6-INS-EE-03	EDUCATION III	IDA		5.0			
6-INS-EE-04	EDUCATION IV	IDA				10.0	
6-INS-IL-01	INDUSTRIAL ESTATES I	IDA		5.0			
6-INS-IL-02	INDUSTRIAL ESTATES II	IDA			5.0		
6-INS-IL-03	INDUSTRIAL ESTATES III	IDA					5.0
6-INS-IX-01	INDUSTRY UNIDENT.I	IDA				30.0	
6-INS-IX-02	INDUSTRY UNIDENT.II	IDA					30.0
6-INS-NN-01	POPULATION I	IDA	10.0				
6-INS-NN-02	POPULATION II	IDA			10.0		
6-INS-NN-03	POPULATION III	IDA					10.0
6-INS-PD-02	POWER DIST.DJAKARTA II	IDA	30.0				
6-INS-PP-01	POWER TJIREBON	IDA		30.0			
6-INS-PP-02	POWER UNIDENT.I	IDA			30.0		
6-INS-PP-03	POWER UNIDENT.II	IDA					30.0
6-INS-PP-04	POWER UNIDENT.III	IDA			30.0		
6-INS-QQ-01	BALI TOURISM	IDA		15.0			
6-INS-QX-01	TOURISM UNIDENT.I	IDA			10.0		
6-INS-QX-02	TOURISM UNIDENT.II	IDA					10.0
6-INS-TH-03	HIGHWAYS III	IDA	40.0				
6-INS-TH-04	HIGHWAYS IV	IDA		30.0			
6-INS-TH-05	HIGHWAYS V	IDA				30.0	
6-INS-TP-01	MARINE TRANSPORT I	IDA	10.0				
6-INS-TP-02	MARINE TRANSPORT II	IDA			30.0		
6-INS-TX-01	TRANSPORT UNIDENT.I	IDA				30.0	
6-INS-TX-02	TRANSPORT UNIDENT.II	IDA					45.0
6-INS-WW-01	WATER SUPPLY I	IDA			5.0		
6-INS-WW-02	WATER SUPPLY II	IDA				10.0	

POPULATION: 112.8M

GNP PER CAP: $ 100

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

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

	1964-68	1969-73	1972-76
IBRD			
IDA		524.3	795.9
TOTAL		524.3	795.9
NO		38	46

	1972	1973	1974	1975	1976
IBRD					
IDA	137.9	159.0	159.0	165.0	175.0
TOTAL	137.9	159.0	159.0	165.0	175.0
NO	10	12	9	7	8

LENDING PROGRAM (10/14/71)

	1964-68	1969-73	1972-76
IBRD			
IDA		406.5	615.0
TOTAL		406.5	615.0
NO		30	37

	1972	1973	1974	1975	1976
IBRD					
IDA	115.0	100.0	100.0	150.0	150.0
TOTAL	115.0	100.0	100.0	150.0	150.0
NO	8	8	7	7	7

FORM NO. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

December 28, 1971

MEMORANDUM TO THE LOAN COMMITTEE

India - Shipping Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 28, 1971 from the South Asia Department, entitled "India - Shipping Project" (LC/O/71-141).

2. Comments, if any, should be sent to reach Mr. Clevenger (ext. 2019) by 3:00 p.m. on Monday, January 3, 1972.

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

Dag F. Wittusen
Secretary
Loan Committee

DISTRIBUTION

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

Copies for Information:
President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Economic Adviser to the President
Special Adviser to the President
Mr. J.H. Williams
Directors, Other Departments and EDI
Meeting Participants (minutes)
Overseas Offices and Missions
General and Loan Committee Files
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/O/71-141

December 28, 1971

LOAN COMMITTEE

Memorandum from South Asia Department

India - Shipping Project

1. I attach a draft appraisal report entitled "India Appraisal of First Shipping Project" (No.PTR-102 dated December 6, 1971), recommending that the Association make a credit to India of US$80 million equivalent.

Background

2. This project would be the Bank Group's first lending for ships in recent years. The Bank has financed ships directly for the Netherlands (Loan Nos. 7-10 NE) in 1948 and indirectly through DFC intermediaries in India and elsewhere. It has also financed fishing vessels for the Republic of China (Loan Nos. 356 and 498 CHA) in 1963 and 1967. In a special meeting on February 5, 1971, the Loan Committee considered India's request for a shipping credit and authorized the processing of a project with a view of presentation for approval in FY 1972 (LM/M/71-13 dated February 23, 1971). The project was appraised during July and August 1971. A further mission which included representatives from the Transportation Projects, Legal and Area Departments visited India in November to discuss in detail the on-lending arrangements and technical aspects of the project. The results of this mission could not be taken into account in the appraisal report without considerable delays for re-writing and are, instead, reflected in this memorandum. We understand that the Government of India is prepared to agree to all the recommendations in Chapter 7 of the Appraisal Report. Agreement will be confirmed during negotiations.

3. The Bank Group has participated actively in financing the development of the transportation sector in India. Ten loans and credits have been made for the Indian Railways (totalling US$631 million); a further credit for US$75 million was negotiated in November. Three loans and one credit were approved for the ports of Calcutta, Madras and Bombay (US$82 million total), one credit for roads (US$60 million), and one loan for civil aviation (US$5.6 million). In addition, through the six industrial imports credits approved between 1964 and 1970, a total of about US$130 million has been provided to assist local production of commercial vehicles. Apart from the proposed shipping project, a second road project and a second shipping credit for iron ore carriers are under consideration.

Bank/IDA Lending Program

4. So far, during the current financial year, five credits to India totalling US$114.0 million (Pochampad Irrigation, Cochin II Fertilizer, Wheat Storage, Mysore Agricultural Credit, and Gorakhpur Fertilizer), and a US$60 million loan to ICICI have been approved. The credit for an eleventh railway project will be presented to the Executive Directors for approval on January 11, 1972. In keeping with the priorities of the Government of India, the operations program for the remainder of the year includes US$121.5 million of IDA lending for projects in agriculture and related industries - US$30 million for agricultural credit in Maharashtra, US$13.5 million for wholesale markets in Bihar, US$43 million for the Tawa irrigation project, US$15 million for the expansion and modernization of the Trombay and US$20 million for the Nangal fertilizer plants of the Fertilizer Corporation of India. Other lending operations are in preparation in the fields of family planning (US$12 million), industrial imports (US$75 million), a first credit to the Government's Industrial Development Bank of India (US$20 million), and power transmission (US$60 million). A copy of the current five-year lending program is attached.

The Economy

5. The most recent economic report on India, dated May 11, 1971, indicated that growth during 1970/71 was likely to be marginally below the estimated 5.3 percent for 1969/70. The report was optimistic that continued growth at around 5 percent could be maintained. This would compare favorably with the much lower trend rate of 3.5 percent experienced over the preceding decade, which of course included the recession years of 1966 to 1968. An important potential constraint on future growth, however, is the rapid decline in net aid disbursements, which has resulted from the combination of stagnant or falling commitments, the drawdown of the non-project aid pipeline and mounting debt service obligations.

6. Since the economic report was written, problems have arisen which have affected the availability of financial resources for economic development in India. The budgetary cost of caring for the refugees from East Pakistan was estimated at approximately US$700 million through the end of the current fiscal year. Toward this figure, the international community had committed a total of about $250 million equivalent by the time the armed conflict between India and Pakistan broke out on December 3. A final assessment of the refugee cost as well as a judgment of the financial and economic implications of the recent conflict will only be possible further in the future. No doubt, the need for rapidly disbursing development assistance has become more urgent than was indicated in the economic report.

The Sector

7. The transport sector plays an important role in the Indian economy. While it accounts for only some 4 percent of GNP, it absorbs about 40 percent of total national investment. Railways have long provided the dominant mode of transport. However, the pattern of transportation has begun to shift in recent years, mainly because of an accelerated expansion of the road transport system. In the circumstances, transport planning and transport coordination have become important. Improved transport coordination is especially needed in a transport system the size of India's and in a situation where pricing and regulation of services are determined by wider economic goals, such as employment, generation of public savings and income redistribution. Matters of transport policy and coordination were recently discussed at length with the Government of India during the negotiations for the eleventh railway project. The Government has decided to undertake a full review of the transport sector and the Association will contribute to this review by means of a comprehensive sector mission. The review is expected to take about 18 months and would lead to an understanding between the Government and the Association on the basic policies to be followed in the sector as a framework for future Bank Group lending for India's transportation system. A letter confirming this has been received from the Government.

8. Shipping is a major industry in India. The Indian merchant fleet ranks fifteenth in tonnage among those of the world and includes about 250 ships, totalling 2.4 million gross registered tons (grt) or 3.8 million deadweight tons (dwt). Nevertheless, although India's share in world trade is about 2.5 percent, her share in world shipping tonnage is only about 1.1 percent, and her ships carry only 15 percent of her overseas trade. The proportion of crude oil imports carried by Indian ships is even smaller at about 5 percent. Imports of crude oil are expected to double between 1971 and 1976. India would thus have to make substantial investments to maintain even the small proportion of crude oil traffic carried by Indian ships.

9. Imports, exports and coastal movements of refined petroleum products are expected to grow no less rapidly than imports of crude oil. The growth of coastal movements of petroleum products, which offers scope for substantial expansion, is likely to be particularly impressive. Of the total Indian demand of 17.6 million tons for refined products in 1970, only between one and two million tons were distributed by coastal tankers. Indian demand for refined products is expected to reach 32 million tons in 1976. We estimate that the proportion of refined products distributed along the coast could be increased with economic advantage, and investments in coastal equipment should be substantial in the coming years. The Government and IOC will be asked to undertake a detailed study of the use of tugs and barges on such services in the context of a coordinated approach to the transport sector.

The Project

10. The proposed project forms part of the Indian Fourth Plan (1969-74) investment program to increase oil refinery capacity and, at the same time, provide added Indian flag tanker capacity. The project tankers will be used to import and distribute crude oil and oil products needed to meet, in part, India's growing demand for fuel and energy. The project consists of the following elements :

(a) the purchase of four crude oil tankers each of about 80,000 dwt. for use between the Persian Gulf and Haldia,

(b) the provision of a crude oil transfer vessel,

(c) the purchase of two refined oil product tankers each of about 19,500 dwt. for the import, export and coastal distribution of refined petroleum products, and

(d) the provision of pollution control equipment at various Indian ports.

The four crude oil tankers will be capable of transporting about 4.1 million metric tons (mt) per year. They would be meeting most of the demand for crude oil delivery at the Haldia terminal for use at both the Haldia and Barauni Refineries which is expected to be 4.1 million mt per year in 1975 rising, according to present plan, to 5.1 million mt per year in 1977 and after. The proposed product tankers will be capable of transporting a maximum of about one million tons per year or about 22 percent of the estimated import demand in 1978 calculated on the basis of current plans for domestic refining capacity expansion.

11. The cost of the total project is estimated at US$82 million equivalent. Crude oil tankers of the proposed size could cost up to US$200 per dwt according to preliminary indications received by the Shipping Corporation of India (SCI), the beneficiary of the project. The four crude oil tankers are most likely to cost approximately US$60 million. Recent published prices indicate that product tankers of the desired tonnage would cost about US$8 million each. The cost of the crude oil transfer vessel, which would cover the acquisition and conversion in India of a suitable small coastal tanker, is estimated at US$1.3 million equivalent. The pollution control equipment to be installed at Cochin would cost about US$0.5million equivalent. Contingencies of $4.2 million equivalent are included in the cost estimate. Except for the cost of the transfer vessel, the pollution control equipment, and a fraction of the contingencies, the cost of the project will be in foreign exchange. The proposed $80 million credit to the Government would be the equivalent of the foreign exchange expenditures related to the project. If the entire US$80 million is not required to meet the foreign exchange costs of the proposed tankers, the remaining portion will be cancelled. If the cost exceeds the amount of the credit, the Government has agreed to make sufficient additional foreign exchange available to meet the overrun.

12. SCI would purchase and own all six tankers provided by the project with a rupee payment equivalent to 20 percent of the price of the tankers and a rupee loan for the balance from the Government, through the Shipping Development Fund Committee (SDFC), a corporate entity created by the Government to facilitate the growth of the Indian shipping industry through long-term loans. Thus, the Government would receive a credit from the Association for the full cost of the ships in foreign exchange, but, in rupee equivalent funds would expend only 80 percent, retaining the balance in GOI accounts for unrestricted use. SCI would finance the transfer vessel and the Government would ensure installation of the pollution control equipment.

13. The Government would lend 80 percent of the cost of the ships to SDFC at 5½ percent repayable in one payment after fifteen years. The terms resemble those applicable to all Government lending to Indian institutions, such as the Industrial Development Bank of India, or the Agricultural Refinance Corporation. SDFC in turn would lend to SCI at 9 percent with repayments in sixteen equal annual instalments beginning one year after delivery. The loan to SCI will be secured by mortgages on each of the tankers as well as through the right of assignment of charter revenues. We would propose that SCI as beneficiary of the credit should bear the foreign exchange risk. The Government of India, we understand, because it is the sole owner of all the entities involved, may wish to carry the exchange risk itself in order to avoid complications over the charter arrangements. I propose that during negotiations we state our preference for passing on the exchange risk, but retain a flexible position and accept the Government's retention of the exchange risk if it becomes apparent that this approach is sensible under the circumstances.

14. SDFC, which was established under the Merchant Shipping Act of 1958 is staffed by senior civil servants. Although its charter would permit SDFC to borrow funds in the market, it has in practice been a channel for Government loans and grants made available to it in accordance with the requirements resulting from approved loan applications by public and private shipping companies. SDFC lending to shipping companies is typically for periods of from seventeen years for large bulk cargo vessels to two-thirds of the residual life of used ships with one to two years grace period at 4½ percent interest. The negative spread is made up by annual grants from the Government which also cover administrative expenses. The fact that SDFC is not required to repay its loans from the Government until they are due after fifteen years has enabled it to extend loans to the shipping industry for periods slightly in excess of fifteen years.

15. SCI is the largest Indian shipping company; it operates general cargo vessels, dry bulk cargo vessels, tankers and passenger ships. It is a well-managed public sector coporation and its performance compares favorably with many shipping companies in developed countries. In June 1971, its total fleet consisted of 78 ships totalling 1.4 million dwt; a further 29 ships totalling over 1 million dwt are on order. SCI's financial position is sound. Operating profits are satisfactory but have declined in recent years, reflecting greater world-wide competition in the industry. SCI's financial forecasts show a steady improvement

of operating profits as more modern ships come into operation. SCI's debt equity ratio will increase from a present 54:46 to a peak of 77:23 in 1975 as a result of the heavy expansion program. Existing SDFC conditions provide for the maintenance of a debt equity ratio of 4:1.

16. All six tankers financed with the proceeds of the proposed credit will be on charter to the Indian Oil Company (IOC) for approximately sixteen years or most of the economic life of the ships. The charter rates cannot be determined until the cost of the ships are known. The charter rates would be based on a formula, the basic elements of which would be (i) base year operating costs plus allowance for escalation over the charter period, (ii) the capital recovery factor (the amortization of the capital sum in equal instalments, each composed of interest and principal portions) for the loan from SDFC to SCI and (iii) the return on SCI's equity contribution. On a variety of assumptions about tanker size, prices and operating costs, the financial return on the investment by SCI would be approximately 12 percent in the case of crude oil tankers and 9 percent in the case of product tankers, both before tax. Delivery prices of oil would be competitive with alternative foreign charter arrangements.

17. IOC, like SCI a Government-owned corporation, is the largest oil company in India. Its financial position is sound. While net profit margins, presently 3.2 percent of total income may contract, owing to rising prices of imported crude oil and Government control of refined product prices, it can be assumed that this would not be allowed to impair the financial strength of IOC.

18. The economic justification of the project rests on the relative merits of India owning and operating ships compared to chartering ships from foreign shipowners. Based upon an estimate of the minimum charter rates that India would have to pay for comparable services if the proposed ships were not acquired and given our analysis of Indian operating costs, it is estimated that the internal economic rate of return of the project is about 12 percent. Even under adverse circumstances the rate of return would not fall below 10 percent.

19. IDA will conclude a credit agreement with the Government and a project agreement with SDFC.

20. The tankers financed by the proposed credit would be procured through international competitive bidding. The Government of India is anxious to place orders as soon as possible in early 1972 for delivery to start in 1974. The Haldia refinery is scheduled to go on stream in 1973 and the Government would like to be able to transport its crude oil requirements as well as the crude oil requirements of the Barauni refinery as early as possible. For this reason, the Government already has submitted to us a draft cable which it wishes to send inviting bids for the tankers, and we have replied with our comments. The cables will not make any reference to IDA as a likely source of finance for the tankers in view of the uncertainty of IDA replenishment. On present

expectations the Government would receive firm bids in late January or early February, and these would be valid for a period of two months. Customarily, a substantial down payment to the successful shipyards would have to be made on signing of the contract. Thus, it is possible that some expenditures under this project will be incurred toward the end of March or in early April, 1972. The proposed credit would be disbursed against payments under the shipbuilding contracts. Up to 20 percent of the contract price might be payable on signing of the purchase contract; further payments would be made during construction and on delivery of the ships. Disbursements should be completed by March 1976.

21. The appraisal mission recommends a number of improvements in port installations and operation which are essential for the success of the project. These have been discussed with the Government; agreement, that the necessary measures would be taken, would be confirmed during negotiations. The provision of a suitable transfer vessel as part of the project is especially important. The Hooghly Estuary channel between the refinery and deepwater in the Bay of Bengal will not be deepened to its full potential, 41 feet, before 1980. Therefore, during the first five years of the project, the project oil tankers will have to be lightened by up to 16,000 tons of crude oil on each voyage in order to cross the bars and enter the channel. This volume will gradually decline until, in 1980, lightening will no longer be necessary. The lightening and transfer operation will be similar to that currently carried out for grain in the same waters and is technically feasible. This approach is more economical than operating the tankers with a part load from the Persian Gulf to the refinery. Pollution control devices would be installed on board the crude oil tankers and at all Indian oil handling ports. In order to realize the full benefits of the product tankers, pipe sizes from the waters' edge to storage tanks will have to be increased at various ports and shore pumping facilities modernized. The required improvements would be carried out before the delivery of the first ships. Finally, IOC has agreed to establish a Marine Department by December 31, 1972, and the Government and other responsible agencies would take steps to improve tanker turn around time at Indian ports.

Recommendation

22. I recommend that representatives of the Government and the Shipping Corporation of India be invited to negotiate a credit agreement for a US$80 million credit along the lines of the recommendation made in the appraisal report.

I. P. M. Cargill
Director
South Asia Department

Attachments

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

INDIA - FIVE-YEAR LENDING PROGRAM

($ millions)

		Fiscal Year						Total	Total	Total
		1972	1973	1974	1975	1976	1977	1964-68	1969-73	1974-77
Agric. Credit - Mysore	IDA	40.0								
Agric. Credit - Maharashtra	IDA	30.0								
Agric. Credit - Bihar	IDA		30.0							
Agric. Credit - Punjab II	IDA		30.0							
Agric. Credit - Madhya Pradesh	IDA		30.0							
Agric. Credit - Uttar Pradesh	IDA			25.0						
Irrigation - Pochampad	IDA	39.0								
Irrigation - Tawa	IDA	43.0								
Irrigation - Jayakwadi	IDA		20.0							
Irrigation - Pamba	IDA		15.0							
Irrigation - Krishna	IDA			30.0						
Irrigation - Kuttiyadi	IDA			5.0						
Grain Storage	IDA	5.0								
Bihar Marketing	IDA	13.5								
Lake Chilka Fisheries	IDA		10.0							
Mysore Marketing	IDA			20.0						
Mysore Fisheries	IDA			40.0						
Uttar Pradesh Forestry	IDA			7.0						
Apple Processing & Marketing	IDA			9.0						
	IDA									
Agric. Unidentified	IDA			25.0						
Agric. Unidentified (10 projects)	IDA				270.0					
Agric. Unidentified (10 projects)	IDA					270.0				
Agric. Unidentified (10 projects)	IDA						270.0			
Telecommunications V	IDA		40.0							
Telecommunications VI	IDA			50.0						
Telecommunications VII	IDA				40.0					
Telecommunications VIII	IDA					40.0				
Telecommunications IX	IDA						40.0			

INDIA - FIVE-YEAR LENDING PROGRAM

($ millions)

(Continued)		1972	1973	Fiscal Year 1974	1975	1976	1977	Total 1964-68	Total 1969-73	Total 1974-77
Education - Agric. Universities	IDA		20.0							
Education Unidentified	IDA				20.0					
DFC - ICICI IX	IBRD	60.0								
DFC - ICICI X	IBRD			55.0						
DFC - ICICI XI	IBRD					50.0				
DFC - IDBI	IDA	25.0								
Fertilizer - Cochin	IDA	20.0								
Fertilizer - Nangal	IDA	20.0								
Fertilizer - Gorakhpur	IDA	10.0								
Fertilizer - Trombay	IDA	15.0								
Fertilizer - Tata	IBRD			25.0						
Iron Ore- Marcona	IDA		40.0							
Industrial Imports VII	IDA	75.0								
Industrial Imports VIII	IDA		75.0							
Industrial Imports IX	IDA			75.0						
Industrial Imports X	IDA				100.0					
Industrial Imports XI	IDA					100.0				
Industrial Imports XII	IDA						100.0			
Small Scale Industry	IDA		20.0							
Industry - Unidentified	IDA			20.0						
Industry - Unidentified	IDA				20.0					
Industry - Unidentified	IDA					20.0				
Industry - Unidentified	IDA						20.0			
Family Planning	IDA	12.0								
Power Transmission III	IDA	60.0								
Power - Unidentified	IDA			50.0						
Power - Unidentified	IDA				60.0					
Power - Unidentified	IDA					60.0				
Power - Unidentified	IDA						60.0			

INDIA - FIVE-YEAR LENDING PROGRAM

(Continued)		($ millions) Fiscal Year 1972	1973	1974	1975	1976	1977	Total 1964-68	Total 1969073	Total 1974-77
Water Supply - Bombay	IDA		30.0							
Water Supply - Unidentified	IDA			15.0						
Water Supply - Unidentified	IDA				15.0					
Shipping I	IDA	80.0								
Shipping II	IDA		80.0							
Highways II	IDA		30.0							
Railways XI	IDA	75.0								
Railways XII	IDA			45.0						
Transportation - Unidentified	IDA					55.0				
Tourism - Unidentified	IDA				10.0					
Tourism - Unidentified	IDA					10.0				
Unallocated	IDA				20.0		50.0			
	IBRD	60.0		80.0		50.0		159.0	140.5	125.0
	IDA	562.5	470.0	416.0	555.0	555.0	540.0	591.0	1,727.9	2,025.0
	Total	622.5	470.0	496.0	555.0	605.0	540.0	750.0	1,868.4	2,150.0
	No.	17	14	16	18	17	15			
Note: the IDA lending program is to be adjusted to --		420.0	375.0	375.0	540.0	540.0	540.0		1,373.4	1,995.0

FORM No. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

December 27, 1971

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MEMORANDUM TO THE LOAN COMMITTEE

Philippines - First Livestock Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 27, 1971 from the East Asia and Pacific Department, entitled "Philippines - First Livestock Project" (LC/0/71-140).

2. Comments, if any, should be sent to reach Mr. Gould (ext. 4049) by 5:00 p.m. on Thursday, December 30-

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

Dag F. Wittusen
Secretary
Loan Committee

DISTRIBUTION

Committee:
Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director, Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
Director, Economics Department
Director, Economic Program Department
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Copies for Information:
President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Economic Adviser to the President
Special Adviser to the President
Mr. J.H. Williams
Directors, Other Departments and EDI
Meeting Participants (minutes)
Overseas Offices and Missions
General and Loan Committee Files
Executive Vice President (IFC)
Vice President (IFC)

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LC/O/71-140 AUG 2 9 2014

December 27, 1971 WBG ARCHIVES

LOAN COMMITTEE

Memorandum from East Asia and Pacific Department

Philippines: First Livestock Project

1. Attached is an appraisal report entitled "Appraisal of Livestock Development Project" (PA-117) dated December 10, 1971 recommending a loan of $7.6 million to the Government of the Philippines.

Background

2. In my memorandum of December 15, 1971, I asked the Committee's approval to negotiate a loan of $22.0 million and an IDA credit of $10.0 million for the Fifth Power Project. Assuming that these go forward as scheduled, the proposed livestock loan would be the Bank's seventeenth for the Philippines and would bring Bank/IDA lending in the country to $278.4 million, net of cancellations. It would be the sixth loan for agriculture, but the first specifically for livestock development.

3. The Country Program Paper reviewed with Mr. McNamara last August set out our views of the Philippine economy and these were summarized in my memorandum for the Fifth Power Project. Agriculture remains the leading sector in the Philippine economy accounting for 35 percent of GDP and 75 percent of export earnings. A series of devastating typhoons in 1970 slowed growth from 6.8 percent in 1969 to 3.9 percent in 1970 but, on average, the agricultural sector has grown more rapidly than GNP during the last few years. The stimulus for this growth has been the breakthrough in rice production following the increased use of high yielding varieties, fertilizers and irrigation water. The Government's Four-Year Development Plan, 1970-74, aims at diversifying agriculture production with increased emphasis on feed grain and livestock production.

4. One-third of the total lending provided for under our Operations Program during the period 1972-76 (copy attached) is for agriculture. Included in the program are repeater loans for rural credit, rice processing and livestock, and new loans for fisheries, irrigation and other projects to be identified by the sector mission scheduled to visit the Philippines during the coming year.

Issues

5. Local Cost Financing. At the Country Program Paper review, it was pointed out that while there was a potential for raising additional taxes in the Philippines, the Government had made significant efforts both to improve tax collections and to reform the system, and as a result public revenues had significantly increased in recent years. Despite this improvement, the Philippines development program would require funds in excess of

expected local savings and the foreign capital which could be made available for financing the foreign exchange requirements of development projects. It was agreed at the CPP review that the Bank should support Philippine efforts to diversify agricultural production and towards this end would be justified in financing some local costs under its loans. The general improvement in the Philippines fiscal performance appears to be continuing. Tax revenues increased by 36 percent in FY 1971 over the level of the previous year. Despite an 8.8 percent rise in current expenditures, public savings for FY 1971 reached a record high of ₱506 million (US $79 million). Accordingly, I agree with the recommendation of the Appraisal Report that the Bank finance about 50 percent of the total cost of the livestock project, estimated at $15.5 million, although the foreign exchange component is not expected to exceed $4.8 million. A loan of $7.6 million would thus cover approximately $2.8 million of local costs. This would be the first time that the Bank has included local cost expenditures in a loan in the Philippines, although some such costs may also be financed under the Fifth Power Project in the event that contracts are won by Filipino bidders.

6. Terms of the Bank Loan. The Appraisal Report recommends on project grounds that the Bank loan have a term of 13 years including 6 years of grace and that the proceeds be relent to DBP on the same terms and conditions. In view of the Philippines' difficult debt situation, I consider that a longer term for the Bank loan is justified. While the situation has improved during the last year, since the Central Bank began to regulate the terms of new foreign borrowings, it remains difficult. The debt service ratio is believed to have exceeded 33 percent during 1971 and it will remain above 20 percent until after 1980 even under optimistic assumptions regarding the terms of future aid. While Bank loans are not subject to IMF restrictions, other foreign borrowing in the Philippines on terms of 15 years or less is limited under the IMF Standby Agreement. More favorable terms on the Bank loan would not only provide some relief during the late 1970s and early 1980s when debt service obligations will still be substantial but would also allow the Bank to comply with the spirit of the Standby Agreement and assist us in our efforts to encourage other members of the Philippine Consultative Group to provide assistance on more concessional terms. Accordingly, I propose, and the Agriculture Projects Department concurs, that the Bank loan have a term of 20 years including 6 years of grace and that the proceeds be relent to DBP on the terms suggested by the appraisal mission. This arrangement would also generate badly needed local resources which the Government could use for public development purposes.

7. Lending Channel. The proposed project would provide medium and long-term loans to sub-borrowers for development of about 1,450 medium size pig, poultry and integrated coconut/beef cattle farms; 25 larger beef cattle breeding ranches; and three small slaughterhouses. The loan would be made to the Government which would bear the foreign exchange risk and relend the proceeds to DBP under the terms of a subsidiary loan agreement. DBP would be responsible for adminstering the project and would onlend Bank funds either directly to sub-borrowers or to private development banks for relending. On average, the Bank loan would provide 50 percent of project costs, DBP and the private development banks 35 percent and sub-borrowers about 15 percent. The Appraisal Report recommends, and I agree, that "large" farmers be required to contribute 50 percent of the costs of their

investments as well as pay a 2 percent technical service charge over and above DBP's normal interest rate of 12 percent.

8. DBP has wider experience in livestock lending in the Philippines than any other institution and is the organization most capable of promoting and implementing this project. At the same time, DBP's overall financial position and the quality of its existing loan portfolio have in the past given us cause for concern. With the deterioration in the overall economic situation in late 1969, DBP's financial position came under further pressure as DBP was required during 1969-70 to honor obligations under guarantees of foreign loans to private parties, incurred at the old rate of exchange, amounting to about $100 million. In the circumstances the Bank under its Rice Processing and Storage Loan (Loan 720 PH), signed on February 4, 1971, was unwilling to make a direct loan to DBP and insisted on the establishment of a special grain processing unit and a separate project account as a means of insulating our project from the rest of DBP's operations.

9. In early 1970, as part of the President's policy of bringing in well-qualified "Technocrats" to run the economic ministries and agencies of Government, DBP came under new management and the organization's financial situation has steadily improved during the last year and a half. The rate of collection on direct loans has practically doubled over the past year and DBP is receiving substantial repayments against advances previously made under foreign loan guarantees. DBP's interest rate was raised from 9 to 12 percent in August 1970.

10. As I indicated to you in my memorandum of April 13, 1971, it would be desirable for the Bank to assist in building up DBP, at least on the agricultural side, not only because we have been informally requested to do so by both Government and the Management of DBP, but also because the Bank has a strong interest in the development of a sound institution in the Philippines capable of handling our substantial agricultural lending activities (our Operations Program for 1973-78 includes four loans totalling $45.0 million for which DBP would appear to be the natural lending channel). I had asked the livestock appraisal mission to look into this question, but it concluded that a serious attempt at reforming DBP would need to be supported by a more intensive investigation than could be provided by the mission and for the purposes of this project recommended arrangements for lending similar to those adopted under the Rice Processing Project. While I accept this recommendation in order not to hold up the project, I intend to ask the Government and DBP to send senior representatives to negotiations who could explore this question with us and map out a joint program of work aimed at improving DBP's policies and effectiveness. It may be appropriate to begin on the agricultural side of DBP's operations, but I would hope that we could extend our advice and assistance to its other activities in due course.

11. Project Unit. The appraisal mission has recommended that under this project DBP be required to establish and staff a project unit within the Livestock Divison of its Agriculture Department; appoint before the loan becomes effective a technical director, acceptable to the Bank, with line responsibility for administering the unit; employ two livestock production experts and two short-term consultants acceptable to the Bank; consult with the Bank on the appointment of a Chief of the Livestock and

Poultry Division; maintain separate project accounts; and decentralize loan processing procedures. DBP is likely to resist this project unit concept as it is unhappy about the fragmenting effect of separate units created within DBP to administer Bank projects. In order to help offset these effects, I think that we should agree wherever possible that the positions referred to above be filled from among the growing number of capable Filipinos having had previous livestock training and experience. The Agriculture Projects Department has reservations about finding Filipinos suitably qualified, particularly in the case of the two livestock production experts and the two short-term consultants. We have, however, agreed that Filipino proposals in this regard will be considered during negotiations. Finally, the technical director and two production experts will perform largely management functions and I therefore consider, though Projects Department does not agree, that we should apply the Bank's usual policy in such cases of asking only for the right of prior consultation rather than the right of approval of these appointments.

12. Lending Restrictions. Under the terms of the general borrowing act, R. A. 6142, DBP would be able to use the proceeds of the Bank loan only for relending to cooperatives, corporations and associations, but not to farmers as individuals. As this legislation was passed in 1970 only after a major Congressional debate, there is little prospect of securing an early amendment to the Act. The Government has, however, provided a legal opinion that limited partnerships would be eligible to receive sub-loans under the project and considers that the procedures for forming partnerships are sufficiently simple and inexpensive so as not to impede the demand for sub-loans. Our preliminary assessment tends to confirm that this may be the case, but we will want to review this matter carefully during negotiations.

13. Procurement. The Appraisal Report recommends that international competitive bidding not be required for most project items due to the fact that there is a good network of local dealers in the Philippines able to provide the broad diversity of items to be financed under the Bank loan. International competitive bidding would, however, be required for feed grains ($2.3 million) and for slaughterhouses ($600,000). The Philippine feed grain imports have risen from an annual level of about 30,000 tons to about 175,000 tons in 1971, but the Government has been successful in negotiating bilateral contracts providing for prices and terms of purchase which are favorable by international standards. Under the appraisal mission's proposal, the Rice and Corn Administration (RCA), the Government agency responsible for feed grains, would be required to procure under international competitive bidding procedures feed grains having a value of $2.3 million which would then be sold to private dealers for resale to the general public. An amount equivalent to the local currency generated by the sale of feed grains would be lent by the Government to DBP for relending to farmers under the project. I do not agree with this proposal because it would add to the administrative complications of an already difficult project and there is no evidence in the report supporting the contention that the Government would receive significantly better feed grain prices and terms after international competitive bidding. I also have reservations about the Bank's associating itself so closely with RCA which has a widespread reputation in the Philippines for inefficiency and corruption, particularly

since we do not have a particular interest in building up RCA's institutional capacity. In the circumstances, I recommend that project sub-borrowers purchase feed grains from local dealers in the same way that they would purchase other project items and that international competitive bidding not be required. I have no objection to international competitive bidding for slaughterhouses, but as the individual contracts of $225,000 would not be bulked and each would have a foreign exchange component of only about $70,000, it appears to be a marginal case and I propose that we be prepared to relax this requirement if this point is pressed during negotiations.

Recommendation

14. With the agreed changes in the proposed terms noted in paragraph 6 and reservations noted in paragraphs 11 and 13, I agree with the conclusions and recommendations of the Appraisal Report and recommend that the Government and DBP be invited to send representatives to Washington to negotiate a loan of $7.6 million.

Raymond J. Goodman
Director

Attachments.

POPULATION: 35.9M

GNP PER CAP: $ 180

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

OPERATIONS PROGRAM			1972	1973	1974	1975	1976
6-PHL-AC-03	AGRICULTURAL CREDIT III	IBRD			15.0		
6-PHL-AC-04	AGRIC. CREDIT IV	IDA					15.0
6-PHL-AF-01	FISHERIES	IBRD		5.0			
6-PHL-AF-02	FISHERIES II	IBRD					10.0
6-PHL-AI-02	IRRIG.II(NUEVA ECIJA)	IBRD			10.0		
6-PHL-AI-03	IRRIGATION III MAGAT	IBRD					35.0
6-PHL-AL-01	LIVESTOCK	IBRD	8.0				
6-PHL-AL-02	LIVESTOCK II	IBRD				10.0	
6-PHL-AN-02	RICE PROCESSING II	IBRD				20.0	
6-PHL-AP-01	COCONUT REHABILITATION	IBRD			5.0		
6-PHL-AX-01	AGRIC.UNIDENTIFIED I	IDA				5.0	
6-PHL-AX-02	AGRIC.UNIDENTIFIED II	IDA					10.0
6-PHL-CX-01	TELECOMM.UNIDENTIFIED	IBRD			10.0		
6-PHL-DD-04	PDCP IV (DFC)	IBRD	20.0				
6-PHL-DD-05	PDCP V (DFC)	IBRD			20.0		
6-PHL-DD-06	PDCP VI (DFC)	IBRD					20.0
6-PHL-EE-02	EDUCATION II	IDA	10.0				
6-PHL-EE-03	EDUCATION III	IBRD				10.0	
6-PHL-NN-01	POPULATION	IDA			4.0		
6-PHL-PP-02	POWER VI	IBRD			20.0		
6-PHL-PT-01	POWER V	IBRD/I	30.5				
6-PHL-QQ-01	TOURISM	IBRD				10.0	
6-PHL-TH-02	HIGHWAYS II	IBRD		35.0			
6-PHL-TH-03	HIGHWAYS III	IDA				25.0	
6-PHL-TP-02	PORTS II	IDA		10.0			
6-PHL-TP-03	PORTS III	IDA				10.0	
6-PHL-UX-01	URBANIZATION-UNIDENT.	IDA					5.0
6-PHL-WU-02	WATER SUPPLY II	IDA			20.0		

GNP PER CAP: $ 180

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

OPERATIONS PROGRAM

	1964-68	1969-73	1972-76		1972	1973	1974	1975	1976
IBRD	68.2	182.3	283.5	IBRD	48.5	40.0	80.0	50.0	65.0
IDA		30.0	124.0	IDA	20.0	10.0	24.0	40.0	30.0
TOTAL	68.2	212.3	407.5	TOTAL	68.5	50.0	104.0	90.0	95.0
NO	5	12	28	NO	4	3	8	7	6

LENDING PROGRAM (8/12/71)

	1964-68	1969-73	1972-76		1972	1973	1974	1975	1976
IBRD	68.2	180.8	217.0	IBRD	47.0	40.0	60.0	40.0	30.0
IDA		30.0	109.0	IDA	10.0	20.0	20.0	29.0	30.0
TOTAL	68.2	210.8	326.0	TOTAL	57.0	60.0	80.0	69.0	60.0
NO	5	12	22	NO	3	4	5	5	5

Form No. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

December 22, 1971

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MEMORANDUM TO THE LOAN COMMITTEE

Liberia - First Education Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 22, 1971 from the Western Africa Department, entitled "Liberia - Proposed First Education Project" (LC/O/71-139).

2. Comments, if any, should be sent to reach Mr. Blinkhorn (ext. 4788) by 3:00 p.m. on Tuesday, December 28.

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

Dag F. Wittusen
Secretary
Loan Committee

DISTRIBUTION

Committee:

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

Copies for Information:

President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Economic Adviser to the President
Special Adviser to the President
Mr. J.H. Williams
Directors, Other Departments and EDI
Meeting Participants (minutes)
Overseas Offices and Missions
General and Loan Committee Files
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/0/71-139

December 22, 1971

LOAN COMMITTEE

Memorandum from the Western Africa Department

LIBERIA: Proposed First Education Project

INTRODUCTION

1. Attached is an Appraisal Report (No. PE-39), dated December 13, 1971, recommending a credit of some US $6.8 million to the Government of Liberia to help finance improvements in the education system. The proposed credit would be the first Bank Group activity in education in Liberia and the first IDA financing operation in that country. The project was appraised in April/May 1971.

2. Bank Group lending to Liberia to date has totalled US $20 million. A road project, financed in 1964 under the first loan of $4.25 million has been completed and the loan is fully disbursed. A second loan for $3.6 million was made in June 1969 for the Monrovia Port project. Progress has been generally satisfactory and the loan is 89 percent disbursed. Two loans to the Liberian Public Utilities Authority to help finance generation, transmission and distribution facilities are being executed without significant problems. IFC has made an equity investment in the Liberian Bank for Industrial Development and Investment (LBIDI).

3. The CPP review in March 1971 concluded that, in view of past performance, Bank Group participation should be limited to $9.5 million through FY 1973. It was agreed that subsequent Bank Group lending would depend on improvements in government economic policies and planning. Since the CPP review, there have been some encouraging developments. The Government demonstrated more vigorous enforcement of the concession agreements and has pressed for greater benefits in renegotiating several existing agreements. It is reorganizing government machinery in this area and has obtained UNDP assistance to improve the competence of those formulating concession policies and supervising their operation. There has been progress on the budgetary and fiscal side. The new President has tried to instill a new sense of discipline in the civil service. Some of his other first measures indicated a distinct departure from other past policies in, for example, his announcement of the sale of the luxurious presidential yacht. More significantly, President Tolbert

recently cancelled Liberia's agreements for the construction of Port Harper. Based on developments since the CPP review, the Chairman of the Loan Committee has approved increases in the lending program.

4. The proposed credit would be the first of two Bank Group operations expected in Liberia in the current fiscal year. The appraisal report for a pilot rubber and agricultural project preparation credit (estimated at $1 million) is now being reviewed. The sum total of proposed Bank Group financing for that and the proposed education project, added to the $4.7 million power loan of July 1971 would be approximately $12.5 million for FY 1971-72. A DFC mission has just been to Liberia to assess the needs of LBIDI (a possible loan for fiscal year 1973 had been contemplated earlier). A highway maintenance project is also tentatively contemplated for FY 1973 ($2.5 million). However, a revised lending program will be submitted in connection with the next country program paper review in February 1972.

THE ECONOMY

5. Liberia has a dualistic economy, with a prosperous enclave sector of iron ore mining and rubber plantations alongside a large underdeveloped stagnating rural economy consisting primarily of subsistence agriculture. The per capita GDP level of about $260 obscures the real poverty of the country. Income distribution is highly skewed in favor of expatriates and Liberia's elite. The 70 percent of the population who are engaged in subsistence agriculture have an average per capita income of about $50.

6. The country's fiscal position improved considerably in 1969 and 1970. This was mainly due to higher prices for iron ore, improved tax enforcement and new tax measures introduced in the preceding two years. As a result, budgetary resources were able to finance about 20 percent of public capital formation. In 1971, however, the budgetary situation tightened somewhat due primarily to a drop in iron ore shipments and rubber prices. Government finances continued in the past several years to be strained by heavy debt service payments which absorbed about 25% of current revenues. They will continue to be strained by this burden in the next few years.

7. The balance of payments position also improved in 1969 and 1970 as a result of rapid rise in iron ore, rubber and log exports but there was a slight deterioration in 1971 due to the drop in iron ore shipments. But, as in the past, the large trade surplus continued to be offset by sizeable net factor payments abroad from the enclave sectors. Debt service payments absorbed about 14 percent of "net" export proceeds in 1970.

8. A lack of formulated investment projects caused a sharp drop in public investment in the past several years to an average of about $10 million a year. Attempts are now being made to formulate a set of development objectives and strategy which will be followed by the drawing up of sectoral programs. On the basis of projects available, public investment in the next several years will continue to be dominated by infrastructural investment, particularly roads, ports, and power. Agriculture and education will absorb only a small share due to the shortage of identified and prepared projects.

9. While noting Liberia's improved creditworthiness, as a result of the improved fiscal and balance of payments position in 1969 and 1970 the 1971 CPP recommended that the bulk of external assistance to Liberia in the next several years be on concessionary terms, in view of the particularly heavy debt burden on the budget. Although unfavorable prospects in the iron ore and rubber markets are likely to have a depressing effect on budget revenues, the Government should be able to meet its share of development financing, especially in view of the new administration's serious intentions to exercise stricter expenditure control and introduce tax reform measures. An economic mission has just returned from Liberia and is currently reviewing its findings.

THE PROJECT

10. Liberia, governed by descendants of freed American slaves who first settled in the early 1800s, patterns its educational system after that of the United States -- kindergarten, six years of elementary school, three years each of junior high and senior high school and a four or five year university program. The system suffers from serious deficiencies, and is ill-suited to the needs of the country. Teachers are underpaid and poorly trained. Physical facilities are generally unsuitable and teaching materials are in short supply. Curricula emphasize academic, mainly liberal arts subjects; effective technical and agricultural training with practical orientation is lacking. Absence of manpower planning has impeded the development of an effective educational policy. While a few good educational institutions exist, they mainly serve Liberian elites and expatriates. Educational opportunities for the majority of Liberians are limited and of poor quality. In general, the education system has failed to supply the country's manpower needs, as is evident from the widespread shortage of skilled workers.

11. The central government, responsible for the financing of public education at all levels, has recently adopted a more receptive attitude towards the need for educational improvement and reform. There is a growing appreciation of the importance of manpower and education planning.

There is more general acceptance of the need for development of education outside the capital city, Monrovia, and a willingness to redirect the emphasis in school curricula to help meet manpower needs. While the Government's total expenditure on education -- 12 percent of the total budget in 1970 -- and its recurrent educational expenditures -- 11.3 percent of the total recurrent budget -- are low by international standard, the proportions are expected to rise. The Government recognizes this need, as indicated in the progressive increase in these expenditures in recent years. At the same time, the United States, Liberia's principal foreign aid donor, has been substantially reducing its once substantial aid in education.

12. The proposed project is designed to initiate significant improvement in, and expansion of, the education system by strengthening manpower and educational planning and by providing for the establishment or expansion of a limited number of new and existing institutions. These would offer more pertinent curricula and education methods and would set a pattern for development of similar institutions. The combination of these activities would help reshape the educational system to serve the nation better and to meet urgent manpower needs.

13. Specifically, the proposed project would consist:

(a) Construction and equipment for:

- two multilateral high schools in the north and the east offering a wide curriculum in three basic streams: academic subjects, automechanics, and agriculture;

- a college of agriculture and forestry.

(b) Extension of an elementary teacher training institute, including a demonstration school;

(c) Equipment for science and technical teacher training;

(d) 62 man-years of technical assistance and seven man-years of fellowships for manpower and education planning, technical teacher training, secondary education and project implementation.

14. The new multilateral high schools (which will necessitate closing several existing smaller uneconomical high schools) would represent an innovation in secondary education. They would accommodate 360 pupils at the junior level (grades 7-9) and 240 pupils at the senior level (grades 10-12). A total of 56 teachers would be required; they

would be obtained from existing schools in the area and from the output of various schools of the University and the technical teacher training program proposed under the project. The new College of Agriculture and Forestry would provide academic and communal facilities and boarding accommodation for 200 students. Expansion of the teacher training institute would permit some 35 supervisors, 210 school principals and 2,600 teachers of different categories to be trained during an initial five-year program. In addition, the enrolment in pre-service courses would be increased from 158 to 300, thus almost tripling the output of trained teachers from the present 33 to about 90 per annum. The demonstration school would accommodate 240 elementary pupils.

15. The project would be implemented by a project unit to be established within the Department of Education and under the charge of a project director. The unit would include a project architect, a project educator, an educational equipment procurement specialist and a qualified accountant. All appointments, likely to be expatriates, would be acceptable to the Association. Key project unit members -- director, architect, educator -- and their counterparts would be recruited prior to presentation of this credit to the Board. All contracts for the supply of furniture and equipment for construction of schools would be awarded on the basis of international competitive bidding. Domestic manufacturers should be accorded a margin of preference -- either the existing rate of customs and import duties applicable to imported goods, or 15 percent of the c.i.f. cost of imports, whichever is lower.

16. Total project cost, excluding duties and taxes, is estimated at $9.7 million including foreign exchange costs of US $6.8 million, or 70 percent of total cost, to be financed by the proposed IDA credit. The Government would contribute the remaining 30 percent of total cost. This cost-sharing formula is appropriate on the budgetary grounds cited in paragraphs six and nine. There is, in fact, a possibility that the Bank Group may be requested to increase its share of the project cost. The Government has recently raised by cable the question of its portion and we have requested clarification. Based on Government's response and on the report of our recent economic mission, we shall consider whether to put a case to the Chairman of the Loan Committee for a higher proportion of Bank Group financing, for example, 75 percent instead of 70 percent. In this connection, the project also entails for Government an 8 percent increase in annual recurrent expenditures for education, estimated at about $570,000, beginning in 1977.

ISSUES

17. The Committee is invited to pay particular attention to the following aspects of the proposed project:

A. Status of Teachers

One of the major problems inhibiting improvement of the educational system is the low status of the teaching profession. During negotiations, assurances would be sought from the Government to establish a graduated salary structure for teachers based on job descriptions and which takes into account qualifications and length of service. Assurances would have to be obtained that the teaching staff of the project multilateral high schools would be appointed on the new salary scale and that the Government would introduce it progressively in other schools. This is the principal element of reform in the Liberian education system which might be raised during negotiations, although it has been agreed to by Government's representatives in earlier discussions.

B. Technical Assistance

The extensive technical assistance envisaged in the project is normal for such a large project in the conditions of Liberia's education system. Paragraph 4.01 of the appraisal report underscores the weaknesses of the education system. Because of this and the fact that the country suffers from a serious shortage of trained personnel, substantial technical assistance is needed for satisfactory implementation. Such assistance is not likely to be forthcoming from other donors -- bilateral or multilateral. We believe it is practicable to recruit the necessary technical staff, although it will take coordinated effort on the part of the Government and the Bank. In order to accelerate project implementation, Government would be encouraged to initiate the selection of a consulting firm immediately after negotiations. Therefore, retroactive disbursement may be needed for a small part of the cost of the professional services (estimated at less than $100,000) related to the design of the project schools and incurred prior to signing of the credit.

C. University Planning

The movement of the University of Liberia from its present central Monrovia site to a new location 17 miles away has been under discussion for many years. The present facility is overcrowded, its rooms are poorly designed for teaching, and it has no space for expansion. There has been considerable controversy within Liberian circles over the proposed relocation, exacerbated by the preparation in the early 1960's of plans for an overly expensive new university. This matter was resolved by a government decision last year to resettle the University 17 miles from its present location. The Government's request to the Bank included technical assistance for implementing that decision. After extensive discussion, it has been decided to provide a team which would help to draw up a plan for the University's development. Although the Government's representatives have been adamant on the necessity for a complete relocation, they agreed to linking these future plans to results of the future manpower and education studies. This is likely to raise some contentious problems about the existing university development plan whose relationship to Liberian manpower needs and resources, as well as financial implications, is questionable. We believe, nonetheless, that a close link between future university planning and overall manpower studies is essential to help rationalize and properly direct Liberian higher education.

RECOMMENDATION

18. I recommend that the Association invite representatives of the Government of Liberia to negotiate a credit of some US $6.8 million on the terms and conditions set forth in paragraphs 7.01 through 7.05 of the appraisal report. The conditions described are quite extensive but we believe the package is realistic and has good prospects of being put into effect. Should the Government's clarification of the project cost question, described in paragraph 16 above, lead to a request for an increased Bank Group share of the total costs, I will recommend a suitable increase to the Chairman of the Loan Committee, if justified.

Bruce M. Cheek
Deputy Director

Attached:
Appraisal Report No. PE-39
Lending Program

Attachment 1

Population 1.5 m
Per Capita GNP $210

LIBERIA - ACTUAL AND PROPOSED LENDING THROUGH 1976

($ millions)

		Fiscal Years																
		Through 1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	Total 1964-1968	Total 1969-1973	Total 1972-1976
Rubber	IDA										4.0							
Agriculture - Unidentified	IDA													3.0				
Agriculture - Unidentified	IDA														3.0			
Education I	IDA										3.0							
Education II	IBRD													4.0				
Power I	IBRD								7.4									
Power II	IBRD									3.0								
Power III	IBRD												3.0					
Roads I (including increase)	IBRD		4.3															
Roads Engineering	IBRD										2.5							
Roads II	IBRD												4.0					
"	IDA												3.0					
Port of Monrovia	IBRD							3.6										
Operations Program	IBRD									3.0	2.5		7.0	4,0			16.5	13.5
	IDA										7.0		3.0	3.0	3.0		7.0	16.0
	Total									3.0	9.5		10.0	7.0	3.0		23.5	29.5
	No.									1	3	0	2	2	1		6	8
Lending Program	IBRD		4.3					3.6	7.4							4.3	14.0	10.0
	IDA																3.5	10.0
	Total		4.3					3.6	7.4							4.3	17.5	20.0
	No.		1					1	1							1	4	6
African Development Bank								1.4										
IBRD o/s inc. undisbursed			3.3	3.3	4.3	4.0	4.0	7.6	14.9	16.9	18.5	18.0	22.4	24.6	23.2			
exc. undisbursed			-	0.2	1.6	2.9	3.8	3.9	5.9	7.5	9.9	12.0	13.9	15.8	16.5			
IBRD - gross disbursements			-	0.2	1.5	1.5	0.9	0.1	2.1	1.6	2.8	2.6	2.5	2.7	2.1			
- net disbursement			-	0.2	1.5	1.5	0.9	0.1	2.1	1.5	2.4	2.1	1.9	1.9	0.7			
- net transfer			-	0.2	1.4	1.4	0.7	-0.1	1.8	1.1	1.8	1.4	1.1	1.0	-0.3			
IBRD/IDA - gross disbursements			-	0.2	1.5	1.5	0.9	0.1	2.1	1.6	2.8	3.1	3.5	3.9	3.8			
- net disbursements			-	0.2	1.5	1.5	0.9	0.1	2.1	1.5	2.4	2.6	2.9	3.1	2.4			
- net transfer			-	0.2	1.4	1.4	0.7	-0.1	1.8	1.1	1.8	1.9	2.1	2.1	1.2			

Western Africa Department
February 12, 1971

Form No. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/71-54

December 22, 1971

Minutes of Special Loan Meeting to consider "Indonesia - Fourth Irrigation Rehabilitation Project" held on December 13, 1971 in Conference Room B.

1. Present: Messrs. Knapp (Chairman), Cope, Williams, Broches, Chadenet, Baum, Goodman, Nurick, Street, Wapenhans, Duval, Foster Haynes, Sella and Wittusen (Secretary).

2. Issues: The meeting was called to consider the following three issues described in the East Asia and Pacific Department's memorandum to the Loan Committee of December 8, 1971 entitled "Indonesia - Fourth Irrigation Rehabilitation Project" (LC/O/71-133) and the appraisal report attached to it (PA-113):

(i) whether the Association should have the option to cancel or reallocate savings resulting from ineligible procurement or whether such savings should automatically be cancelled;

(ii) whether to require the Government to present to the Association for approval proposals for the recovery of a reasonable portion of investment costs from the farmers, or whether to be satisfied with an undertaking from the Government to study the issue and consult with the Association on the study's conclusions; and

(iii) whether to provide for consultation on or approval of the project management appointments.

3. Savings. The meeting noted that:

(i) The appraisal report recommended that savings resulting from ineligible procurement should automatically be cancelled from the credit account, while the Area Department recommended that the Association should have the option to cancel or reallocate such savings.

DISTRIBUTION

Committee:

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

Copies for Information:

President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Economic Adviser to the President
Special Adviser to the President
Mr. J.H. Williams
Directors, Other Departments and EDI
Meeting Participants (minutes)
Overseas Offices and Missions
General and Loan Committee Files
Executive Vice President (IFC)
Vice President (IFC)

(ii) Automatic cancellation of savings from ineligible procurement was thought too restrictive. The Association should have the right to cancel such savings (which was now provided for in new standard provisions in loan and credit documents) but should also retain the option, depending upon the circumstances of the "mis-procurement," to reallocate such savings for additional civil works which were consistent with the purpose of the project.

4. Decision: For the reason stated in para. 3(ii) above, it was agreed that the Association should have the option to cancel or reallocate savings resultings from ineligible procurement. The option to cancel would be exercised if procurement were made over the Association's objection. If savings not subject to cancellation under the above provision became available, the Association would consider their use for works related to the purpose of the project, but would not increase the disbursement percentage against civil works in Part A beyond 50%.

5. Recovery of investment costs. The meeting noted that:

(i) While the first two irrigation rehabilitation credits to Indonesia had provided for recovery of operation, maintenance and some investment costs from the farmers in the project areas, the third had excluded recovery of any investment costs, on the ground that farmers had paid for the investment through the land taxes and that rehabilitation was only needed because maintenance had not been carried out. This time the appraisal report recommended that, within two years of credit signature, the Government present to the Association for approval proposals for the recovery of a reasonable portion of investment costs, having due regard to the ability of the farmers to repay.

(ii) In view of the problem's complexity and the farmers' poverty, the Area Department proposed that the Association should be satisfied with an undertaking by the Government to study the issue and, within two years of credit signature, to consult with the Association on the study's conclusions.

6. Decision: Accepting the Area Department's reasons, it was agreed that the Association should be satisfied with an undertaking by the Government to study the issue and consult with the Association on the study's conclusions. In addition, it was agreed that the Association should raise during negotiations the necessity of a country-wide study of water charges as a guideline to future irrigation projects.

7. Management appointments. The meeting noted that:

(i) The appraisal report recommended that the Association reserve the right to approve the appointment of the general manager of PROSIDA. Agriculture Projects Department believed that a mere exchange of views between the Government and the Association would not prevent the appointment of a person whom the Association considered unsuitable. The appointment of an unsuitable manager could be detrimental not only to this project but also to the entire irrigation rehabilitation program, and the Department considered that this was one of the difficult cases envisaged in O.M. 2.30 where prior approval by the Association was necessary.

(ii) The Area Department noted that prior approval by the Association of such appointments had not been acceptable to the Government in the past. The recommendation therefore went farther than in other credits to Indonesia and was contrary to our usual practice in these matters, which was to provide for consultation on rather than approval of management appointments.

(iii) The Legal Department pointed out that it was as difficult in practice to ensure against unsuitable management when management appointments required prior approval as when they only required consultation, and that the Bank had seldom exercised its right to veto appointments submitted to it for approval.

8. Decision: For the reasons stated in para. 7(ii)-(iii) above, it was agreed that the Association should be satisfied with the right to prior consultation on management appointments and with its usual right to suspend disbursements in the event that management turned out to be incompetent and the Government were to take no remedy. The Government should be informed that, even though the Association would not require prior approval of management appointments, the Association took the management covenant most seriously.

Dag F. Wittusen
Secretary

JFoster/DFWittusen:as

Cleared by: Messrs. Knapp
Broches
Wapenhans/Chadenet
Street

Form No. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

December 21, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Uruguay - Fourth Livestock Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 21, 1971 from the South America Department, entitled "Uruguay - Proposed Bank Loan to the Republica Oriental del Uruguay for a Fourth Livestock Project" (LC/O/71-138).

2. Comments, if any, should be sent to reach Mr. Dosik (ext. 2443) by 12:00 noon on Tuesday, December 28.

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

Dag F. Wittusen
Secretary
Loan Committee

DISTRIBUTION

Committee:

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

CONFIDENTIAL

LC/0/71-138

December 21, 1971

LOAN COMMITTEE

Memorandum from the South America Department

URUGUAY - Proposed Bank Loan to the Republica Oriental del Uruguay for a Fourth Livestock Project

1. Attached is Appraisal Report No. PA-110a recommending Bank lending of US$ 26 million to the Government of Uruguay to assist in financing a Fourth Livestock Development Project. Although the Appraisal Report has been prepared on the basis of a two-year project, it is recommended, on country grounds, that the Loan Committee authorize negotiations now only for a loan of $11.2 million to help finance the first year of the project. In view of the political and economic uncertainties currently prevailing in Uruguay - centering about the national elections held on November 28 and the inauguration of a new government in March - it was earlier agreed with the Chairman of the Loan Committee that a two-tranche approach to the financing of the project would be advisable as a means of enabling us to limit our initial loan commitment, while limiting the need to devote scarce resources to additional appraisal work next year. Although the Chairman of the Loan Committee previously agreed to a loan of $10 million in the current fiscal year, the Appraisal Report recommends a loan of $11.2 million as the minimum amount necessary to carry on the first year of the project. If country and project considerations so warrant, a second loan in the amount of $14.4 million would be recommended to the Loan Committee and presented to the Executive Directors in FY 1972 with simply an updating of the information contained in this appraisal, unless project developments require a new analysis.

2. The proposed loan would be the Bank's tenth operation in Uruguay and would bring the amount of Bank lending to $141.5 million. The last operation was the $4.0 million supplementary loan (773-UR) for the Third Livestock Development Project approved in June 1971.

The Lending Program

3. The livestock sector which looms so large in the economy of Uruguay has responded most favorably to Bank financing and the proposed loan is needed to maintain the momentum of development built up through the previous three Bank projects. The funds made available for the third project are expected to be fully committed by the end of this year and additional funds will be needed to carry on the program in the 1972 sowing

season that begins in February. The recommendation that we proceed with another loan now, despite the uncertainties on the Uruguayan scene, is consistent with strategy suggested in the CPP, and accepted at the Country Review, that the Bank should continue its support for the livestock sector so long as sector conditions remain favorable and overall economic performance is adequate to maintain Uruguay's basic creditworthiness. The proposed loans for the fourth livestock project would, under the lending program, be followed by similar operations in FY 1974 and 1976. In addition to livestock, the lending program includes projects in power, highway maintenance, tourism and industrial financing.

The Economy

4. The most recent economic report on Uruguay (WH205a) was distributed to the Executive Directors on February 8, 1971. The report described the impressive progress that had been made in 1969 and the first half of 1970 in stimulating economic growth, restoring internal financial stability and strengthening the balance of payments. Output increased by about 5 percent in 1969 and 1970, in marked contrast to the economic stagnation of the previous 15 years, and inflation was sharply reduced to the 15-20 percent level. After mid-1970, however, the economic situation began to deteriorate and a sharp drain on the foreign exchange reserves developed, mainly as the result of the flight of capital which began after the authorities failed to adjust the exchange rate in the wake of the June 1970 devaluation of the Argentine peso. The capital outflow was aggravated by a relaxation of credit policy and by a loss of confidence stemming from internal terrorist activities and the approaching national elections. By the end of 1970, the net reserves of the monetary authorities (IMF definition) had declined by about $21 million to the $10 million level.

5. In the first ten months of this year the net reserve position deteriorated further to minus $16 million, despite continued good export performance, mainly reflecting strong world demand for beef, and the imposition of restrictions on import payments and exchange surcharges. The latter have resulted in a partial devaluation of the peso and the creation of the system of multiple exchange rates. The highest authorized exchange rate, for tourism and travel transactions, is now 40 percent above the official rate of UR$250/dollar; the latter rate now applies mainly to certain restricted import transactions and to traditional exports. In the case of the latter, the Government has recently moved to improve incentives for wool exporters by allowing them to sell one-half of their foreign exchange earnings at the highest rate and it has indicated that it intends shortly to make similar benefits available to meat exporters. One of the most serious aspects of the balance of payments situation is that, in order to bolster the foreign exchange position and meet debt service requirements, the authorities have been borrowing abroad at short-term and allowing some arrears in commercial payments to develop. Internally, the budget deficit has grown to major proportions despite a sharp cutback in public investment and the monetary authorities have had

to finance virtually all of the fiscal shortfall. Inflation has, however, not accelerated markedly, the 16 percent increase in prices through September being only slightly greater than that recorded in the same period a year ago.

6. The build-up of inflationary pressures, decline in reserves, and accumulation of short-term debt that has occurred over the past 12-15 months will obviously make most difficult the task of the new government, which is to take office at the beginning of March. On the other hand, what was achieved prior to mid-1970 indicates that the Uruguayan economy can respond rapidly to a modicum of good economic management. The major groups in the government party - which won the election - appear to fully recognize the damage that has been done by subordinating economic policy to electoral considerations and to appreciate the extent of the adjustments which need to be made in exchange rate and other policies. As soon as feasible after the election, and prior to the submission of the proposed loan to the Executive Directors, we intend to send a small economic mission to Uruguay to assess the situation and to learn as much as possible of the policies likely to be followed by the new government. Nevertheless, lending to Uruguay in the prevailing circumstances clearly involves an element of risk. We believe, however, that Uruguay remains creditworthy for the amount of additional lending proposed and that the risk is justified by the long term importance to the Uruguayan economy of a healthy livestock sector and by the importance of continued Bank support to the further progress of the sector.

The Sector and the Project

7. In the context of negotiations for Bank financing of the Third Livestock Development Project, agreement was reached with the Government on measures to restore investment incentives for livestock producers and to rationalize and modernize the meat packing industry. The result of these measures, together with a substantial and continuing rise in world market prices for beef, has been a dramatic increase in Uruguayan meat production and exports and a surge in demand for investment loans under the project, which increased from $4.0 million in 1969 to an estimated $11.0 million this year. With the planned further acceleration of lending and technical assistance under the livestock program, and assuming the maintenance of favorable sector conditions, it should be possible to more than triple the amount of improved pasture in Uruguay over the next five years.

8. The proposed new project would provide technical and financial assistance to continue the livestock development program begun under the three previous Bank projects. On-ranch development loans for about 3,600 ranches would be made each year. As in the past, investments would be mainly in pasture improvement, breeding stock, fencing, machinery, water supply and other ranch infrastructure. However, three new elements are included in the proposed project - the financing of investments in dairy beef production and pig raising and loans to farmers to

permit them to retain and/or purchase heifers for breeding purposes. The objective of the dairy beef program is the raising of male calves currently killed at birth to 14 - 18 months of age for slaughter and export as baby beef. The increase in pork production would make possible greater substitution for beef in domestic consumptions. Heifer financing was excluded under previous Bank projects as it was assumed that most ranchers were unlikely to have more than 10 percent of their ranches developed with improved pasture, an area sufficient only to meet the requirements of existing breeding herds. However, it appears that ranch development has proceeded more rapidly over the last two-and-a-half years than was originally contemplated and that on many ranches much more than 10 percent of the pasture has now been improved. In these circumstances, an increase in the size of breeding herds beyond that provided by normal biological growth is required to fully utilize the pasture improvements and maximize the increase in production and exports over the longer run. It is, therefore, proposed that the new project includes loans to enable project ranchers to retain and/or purchase breeding heifers that would now otherwise be slaughtered. The Bank would finance 40 percent of such loans, the assumed foreign exchange cost for Uruguay, in the form of immediate exports foregone, of retaining the heifers.

9. As in the previous loans, credit to ranchers would be extended only on the basis of approved development plans and the term of sub-loans would be 7 - 11 years, including a grace period of 2 - 4 years. As in the third project, the principal of all sub-loans would be adjusted in accordance with an index based on the ranch-gate price of cattle and wool; readjustment will be 100 percent for loans to borrowers with ranches in excess of 500 hectares, 75 percent of the increase in the index for borrowers with ranches of 300-500 hectares, and 50 percent for borrowers with smaller ranches. Since the smaller ranchers account for only a minor portion of the total volume of lending under the project, it is estimated that about 90 percent of the total amount of ranch loans will be fully indexed. The Appraisal Report recommends the maintenance of the 11 percent rate of interest established under the last project. The Government, however, has requested that this be reduced to 9 percent on the grounds that an 11 percent real rate is extremely high and may act as a disincentive. The Agriculture Projects Department maintains: (i) that the recent increase in effective demand for medium- and long-term credit under the earlier project would indicate otherwise; and, (ii) that a lowering of the rate on fully indexed loans would encourage even heavier borrowing by large ranchers. Nevertheless, I propose that we carefully review the situation with the Borrower during negotiations to determine whether the optimum pace of development is not being achieved because of the present interest rate level. Although we would want the Borrower to make a convincing case for this before we would consider reducing the rate of interest, we should recognize that the 11 percent real rate applied to the bulk of project loans is very high in comparison with the real rate of interest charged in most Bank agricultural credit projects.

10. Under the third project, arrangements were made to enable commercial banks to act as financial intermediaries in addition to the state-owned Bank of the Republic. However, only three commercial banks have shown interest in the project and none have so far agreed to participate. In the new loan we propose to encourage banks to participate by offering them more attractive terms, such as higher reimbursement rates, a graduated scale of discount rates, and a provision for discounting incremental working capital loans (paragraph 4.23 and Annex 3, of the Appraisal Report). The primary responsibility for the preparation, appraisal, approval and supervision of ranch development plans will continue to rest with the "Honorary Livestock Commission" assisted by internationally recruited livestock experts.

11. The Appraisal Report recommends that the Government submit to the Bank by June 1, 1973, a plan to phase out its phosphate fertilizer subsidy program since this should no longer be needed once 20 percent of the country's total pasture area has been improved. The Agriculture Projects Department states that the prevailing high meat prices and resulting high income levels should make a phasing out of the subsidy entirely feasible. It also feels that there is now a general acceptance of the benefit of fertilizer application and no more direct subsidies are required. While agreeing in principle with the position taken in the report, I would like to point out that this matter may need to be approached more gradually in order to avoid jeopardizing negotiations, since it deals with a change in a long established and politically sensitive element in Uruguayan agricultural policy which we have not previously discussed with the Government. In these circumstances, I believe we should recognize in advance that we may not be able to negotiate the type of commitment recommended by the Agriculture Projects Department. If this should prove to be the case, I would recommend that we put the Government on notice that we would want to reach an understanding on a program for phasing out the fertilizer subsidy in connection with the proposed FY 1973 loan.

12. The total cost of the project is estimated at $55.7 million and the Bank would finance the foreign exchange cost estimated at 46 percent of the total project. The remaining cost of the project would be financed as follows: Government, 7 percent; Central Bank, 13 percent; participating banks, 18 percent; and ranchers, 16 percent.

Recommendations

13. I recommend that the Bank inform the Government that it is prepared to negotiate a loan of $11.2 million equivalent for the Fourth Livestock Development Project for a term of 14 years, including a four-year grace period, substantially along the lines set forth in the attached Appraisal Report and discussed above.

Gerald Alter
Director

Attachment

FV

POPULATION: 2.8M

GNP PER CAP: $ 520

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

OPERATIONS PROGRAM			1972	1973	1974	1975	1976
2-URU-AL-05	LIVESTOCK IV	IBRD	10.0				
2-URU-AL-06	LIVESTOCK V	IBRD			12.0		
2-URU-AL-07	LIVESTOCK VI	IBRD					12.0
2-URU-AL-08	LIVESTOCK IV 2ND.STAGE	IBRD		10.0			
2-URU-DD-01	DFC	IBRD					4.0
2-URU-PP-01	POWER IV	IBRD		25.0			
2-URU-PP-02	POWER V	IBRD				10.0	
2-URU-QQ-01	TOURISM I	IBRD			8.0		
2-URU-QQ-02	TOURISM II	IBRD					10.0
2-URU-TH-02	HIGWAY MAINTENANCE	IBRD		5.0			

	1964-68	1969-73	1972-76		1972	1973	1974	1975	1976
IBRD	12.7	78.3	106.0	IBRD	10.0	40.0	20.0	10.0	26.0
IDA				IDA					
TOTAL	12.7	78.3	106.0	TOTAL	10.0	40.0	20.0	10.0	26.0
NO	1	7	10	NO	1	3	2	1	3

LENDING PROGRAM (2/12/71)

	1964-68	1969-73	1972-76		1972	1973	1974	1975	1976
IBRD	12.7	70.3	87.0	IBRD	12.0	30.0	15.0	15.0	15.0
IDA				IDA					
TOTAL	12.7	70.3	87.0	TOTAL	12.0	30.0	15.0	15.0	15.0
O	1	6	6	NO	1	2	1	1	1

LOAN COMMITTEE

LM/M/71-53

December 20, 1971

Minutes of Special Loan Meeting to consider "Argentina - Railways" (733-AR) and "Argentina - SEGBA Power" (644-AR) held on December 13, 1971 in Conference Room B.

1. Present: Messrs. Knapp (Chairman), Cope, Williams, Broches, Chadenet, Baum, Ripman, Alter, Knox, Weiner, Howell, Jaycox, Rovani, Wiese, Blumstein, Cabezas, Cancio, Chapman, Fajans, Moini, Nercissiantz, Oursin, Ribi, Sheehan, van der Heijden and Wittusen (Secretary).

2. Issues: The meeting was called to consider Mr. Wiese's memorandum of December 8 to Mr. Knapp entitled "Argentina - Power and Railway Rates." The accelerating process of inflation made it necessary for the Railways and SEGBA to raise tariffs in order to meet financial targets written into the Loan Agreement with the Railways and the 8 percent rate of return stipulated in SEGBA's Concession. Since the middle of 1971, both the Railways and SEGBA had repeatedly sought the Government's approval for higher tariffs but this approval had been consistently withheld. Despite Bank staff representations in Buenos Aires in June, August and October, and despite assurances given the Bank by the Argentine Delegation during the Annual Meeting and later, the Government had postponed again and again adopting the necessary decisions. As a result, the financial position of the Railways and SEGBA had deteriorated drastically, putting in jeopardy the Railways' rehabilitation program and SEGBA's expansion program supported by Bank loans. In addition, the Government decided to proceed with costly suburban railway electrification and to revise the corporate structure of SEGBA without seeking prior Bank approval. In these circumstances, the issues for discussion were:

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Committee:

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

Copies for Information:

President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Economic Adviser to the President
Special Adviser to the President
Mr. J.H. Williams
Directors, Other Departments and EDI
Meeting Participants (minutes)
Overseas Offices and Missions
General and Loan Committee Files
Executive Vice President (IFC)
Vice President (IFC)

(i) Whether the Bank should advise the Government and the Railways not to present withdrawal applications under Loan 733-AR until the railway rate issue has been resolved; and

(ii) whether the Bank should advise the Government and SEGBA not to present withdrawal applications under Loan 644-AR until the SEGBA rate issue has been resolved and the Bank's comments on the proposed revision of SEGBA's statutes are duly taken into account.

3. The Railway Project. The meeting noted that:

(i) The recommendation that the Bank advise the Argentines forthwith not to present withdrawal applications was formulated on the assumption that the Government would take, within a few weeks, a decision on rate increases. This recommendation had the advantage of avoiding a confrontation which a formal suspension of disbursements by the Bank might precipitate. The Argentines would also be advised that the informal step implied the Bank's serious intent to take formal action, if the decision on adequate rate increases were not taken soon.

(ii) To date, contracts for $170,000 only had been approved by the Bank. Some larger contracts, totalling about $25 million, were expected to be submitted for Bank approval shortly. In these circumstances, the Bank should tell the Railways that, for the time being, it would not approve any more contracts; this would be only fair to suppliers in view of a possible suspension of disbursements if rates were not raised shortly.

(iii) If put into effect on November 1, 1971, a 45 percent increase in railway rates would have been adequate and might still be within an acceptable range, although it should be noted that the most recent proposal by the Railways, taking into account only cost increases already in effect, was for increases averaging some 50 to 55%. It would be difficult to ask for much more at this time, because of the likely loss of traffic to the highways. However, there must be a clear understanding that railway rates would be kept in step with future cost increases, so as to ensure progress towards financial rehabilitation and agreed targets.

(iv) The Bank should accept in good faith the decision of the Minister of Public Works to proceed with an economic study of the electrification of suburban railways in Buenos Aires, even though an engineering contract for the project had already been signed with the Japanese.

(v) No further action could be taken by the Bank at this time on the matter of rehabilitating diesel locomotives. A supervision mission scheduled for January 1972 would ascertain whether progress was being made with the rehabilitation.

(vi) The highway appraisal mission, which was originally scheduled to visit Argentina in early December but subsequently cancelled, could be sent in late January or early February, 1972, if warranted by performance on the railway project. However, the deferral meant that the proposed fourth highway loan could not be presented to Executive Directors in FY 1972.

4. Decision: It was agreed that:

(i) The Government and the Railways would be advised not to present withdrawal applications under Loan 733-AR, and that the Bank would not approve any further contracts, until the railway rate issue was satisfactorily resolved; and that the Bank would proceed with formal suspension of disbursements unless the issue were satisfactorily resolved.

(ii) The Bank should keep under careful review the situation with respect to future wage awards and tariff action, the suburban electrification scheme and the economic study, and the program of diesel rehabilitation.

5. SEGBA Power Project. The meeting noted that:

(i) The economic program, as prepared by the Government, apparently provided for an increase of about 45% in SEGBA rates, but this would not meet the provisions of the Concession and could not be said to be adequate as a first step without knowing what further measures were contemplated.

(ii) To assure SEGBA of an 8% return in 1972 and cover the 1971 shortfall in earnings, a rate increase of about 100% would be required as of January 1, 1972. This was derived from certain assumptions regarding sales, wage increases, fuel prices, etc., in 1972, and assumed that the exchange rate would not be depreciated beyond the current level of 6.50 pesos to the dollar. At the exchange rate of 6.50 and allowing for a 10% wage increase only, an increase in power rates of about 50% would give SEGBA the 8% return in 1972 without making up for past earnings deficiency. Eventually, further rate increases would have to follow in 1972, in step with the rising level of wages, fuel prices and the exchange rate.

(iii) The Bank should not insist on an increase in rates which would enable SEGBA to recover in one year the earnings deficiency, even though that was what would be required by its Concession. Instead, it should seek that rate increase which, in combination with other measures, would satisfy SEGBA's financing and investment requirements, particularly since the pace of SEGBA's expansion program would have to be maintained to absorb in full the power generated by El Chocon.

(iv) Unless more strenuous tax measures were taken, the present fiscal situation made it difficult for the Government to cover the past deficiency in earnings by way of a special contribution to SEGBA, as had been done in 1968. In these circumstances, the possibility of the Government assuming responsibility for the recently contracted short-term debt of SEGBA, or arranging for its roll over, should be explored by the Government.

(v) Recent developments indicated that the Government intended to modify substantially the statutes of SEGBA without seeking the Bank's approval. While the draft made available to the staff by SEGBA without the Government's knowledge was not a final draft, it was fairly clear that the provisions of the new statutes were unsatisfactory as far as management arrangements were concerned. Another draft, sent by the Minister of Public Works, was on its way to the Bank, but all indications were that this draft was even less satisfactory than the one the staff had commented upon. The General Shareholders' Meeting had been called for December 30. Once the shareholders (i.e. the Government) have approved the new statutes, it would be hard to reverse their action. Therefore, the Government and SEGBA should be put on notice that precipitous action might lead to suspension of disbursements.

6. Decision: It was agreed that:

(i) The Government and SEGBA would be advised not to present withdrawal applications to the Bank until SEGBA's rates have been raised to a level which would make possible a financing plan adequate to sustain SEGBA's construction program; and that the Bank would proceed with formal suspension of disbursements unless this issue were satisfactorily resolved.

(ii) The Government and SEGBA should be requested to submit a letter to the Bank explaining how they proposed to meet SEGBA's financial commitments.

(iii) A formal request should be made by the Bank to the Government and SEGBA to defer the General Meeting of Shareholders in order to afford the Bank an opportunity to review and approve the draft statutes, which had now been sent to the Bank.

7. Postscript: According to information transmitted by Dr. Mey, Executive Director of the Bank, two decrees were promulgated by the Government on December 16 which provided for an average 45% increase in Railway rates and a 52% increase in SEGBA's rates. These increases would be effective as of January 1, 1972. The decrees were being sent to the Bank and would require analysis with a view to determining the adequacy of the increases in the light of the financial targets written into the Loan Agreement with the Railways and the financial requirements of SEGBA.

Dag F. Wittusen
Secretary

JFajans/DFWittusen:as

Cleared with: Messrs. Knapp
Broches
Baum
Alter
Knox
Howell

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

December 16, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Singapore - Education Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 16, 1971 from the East Asia and Pacific Department, entitled "Singapore - Education Project" (LC/O/71-137).

2. Comments, if any, should be sent to reach Mr. Amin-Arsala (ext. 2226) by 12:00 noon, December 21.

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

Dag F. Wittusen
Secretary
Loan Committee

DISTRIBUTION

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director, Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
Director, Economics Department
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Economic Adviser to the President
Special Adviser to the President
Mr. J.H. Williams
Directors, Other Departments and EDI
Meeting Participants (minutes)
Overseas Offices and Missions
General and Loan Committee Files
Executive Vice President (IFC)
Vice President (IFC)

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LC/O/71-137

LOAN COMMITTEE

December 16, 1971

Memorandum from East Asia and Pacific Department

SINGAPORE: EDUCATION PROJECT

1. There is attached for the consideration of the Committee a draft report "Appraisal of an Education Project in Singapore" dated December 13, 1971. The report recommends a Bank loan of US$10.5 million equivalent to cover the foreign exchange cost of the first phase of the planned relocation and expansion of the University of Singapore. The proposed loan would include approximately US$700,000 for technical assistance.

2. The loan would be the Bank's eleventh to Singapore and its first for education. Other loans have been made for power, port expansion, water supply, telephone services, sewerage and industrial development, amounting in all to US$114.2 million of which the Bank held US$105.9 million at October 31, 1971, net of cancellations, sales and repayments. The execution of these projects has been satisfactory.

The Economy

3. An economic mission visited Singapore in September and expects to complete its report on the prospects of the economy by the end of the year. The following paragraphs are based on the preliminary findings of that mission. The Country Program Paper is scheduled to be reviewed at the end of January 1972.

4. Very rapid growth of GDP in the 1960s (10% annually increasing to 15% in 1967-70) has been combined with a structural transformation of the economy, which historically has depended on entrepot trade, particularly with Malaysia and Indonesia, and on the presence of military and naval bases. Although the share of entrepot trade in GDP has declined from 17% (1965) to 11% (1970), it is still a very important part of Singapore's economy. The potential instability of this trade, together with the rundown of British military bases, which was completed in November 1971, led the Government to make a strong effort to diversify the economy primarily by promoting the growth of manufacturing. The Government of Singapore has conducted a vigorous and successful campaign to attract foreign investment in export oriented industries. As a result manufacturing increased its share of GDP from 10% (1965) to over 20% (1970).

5. The success of the Government's economic policy is primarily attributable to the ingenuity and enterprise of the people of Singapore in conjunction with industrial investment undertaken by large foreign and multinational companies attracted by the disciplined and highly trainable work force, good communications, strategic position and a tax structure favorable to new businesses. In addition, rapid growth of private and public savings supported the increase in investment activity.

6. The Government's development strategy has further increased Singapore's dependence on foreign trade. In 1970 it constituted 250% of GDP and domestic manufactures were one-third of total imports. A current account surplus was achieved every year during 1966-69 and the deficit in 1970 was fully financed by the large inflow of private long-term capital. Net foreign exchange reserves reached US$1.36 billion at June 30, 1971 equivalent to nine months of retained imports in 1970. However, because of its external orientation, the Singapore economy is particularly vulnerable to fluctuations in world trade and in flows of foreign capital and for this reason the Government has felt obliged to maintain a high level of foreign exchange reserves.

7. In order to maintain the high growth rate the Government intends to make Singapore the financial and technical center of Southeast Asia and to raise the overall level of productivity of the economy by attracting more capital intensive and technologically advanced industries. To further this aim the Government is being more selective in granting the privileges of pioneer status to foreign businesses and more strict in requiring them to train the local labor force. In spite of these measures the skilled manpower required by the development program (indicated in paragraphs 2.08 and 2.09 of the Appraisal Report) will be forthcoming only if vocational and tertiary education is expanded quickly. The Bank economic mission reported that Singapore's economy will be able to continue to grow at a rate of about 12 to 15 percent provided the already strained manpower and management resources can be increased and upgraded, and the inflow of foreign capital can be increased.

8. Most of the finance required for the development program is expected to be provided from within or by private foreign investment as in the past. To sustain a 12% rate of growth, it is estimated that an annual gross inflow of some US$75 million will be required for the public sector. Suppliers' credits are a potentially large source of funds which might cover as much as half of the annual foreign exchange requirements of the public sector. Since bilateral aid is not available to Singapore, multilateral agencies such as the Bank and ADB will be called upon to fill the remaining resource gap. The Bank's lending program will provide part of these financial resources and is designed to assist Singapore in solving some sectoral problems in new and difficult fields such as urban development, including urban mass transport, and higher education.

The Project

9. The existing facilities of the University of Singapore occupy four widely scattered sites and available space on the main campus is not adequate for the expansion needed to serve the growing economy. To provide for long-term development and integration of academic facilities, the Government has decided to relocate the entire university on a new site at Kent Ridge recently vacated by the British Forces. A master plan for the physical development of the new site, prepared by a UNDP-financed campus planning consultant, provides a framework and architectural guidelines for the design of component buildings by architects of the University of Singapore Development Unit which has already been established by the Government to handle all construction aspects of development. The unit has started to prepare sketch plans.

10. The proposed project is the first of several phases in the relocation and development of the University on the new Kent Ridge site and consists of: (i) construction, furnishing and equipping of academic facilities for 3,100 student places in the Faculties of Engineering and Architecture and the School of Accountancy and Business Administration, supporting administrative and communal premises, and boarding facilities for 900 students together with 51 related graduate and staff quarters; (ii) construction and peripheral equipment for a computer center but not the computer itself; and (iii) technical assistance and overseas fellowships.

11. The planning of this first phase of university development is based on estimates of future demand for skilled high-level manpower in Singapore, assuming an 8% annual growth rate in the economy with manufacturing output growing at 15% and employment by 6%. These assumptions are more modest than the forecasts of the economic mission, which suggests that the growth rate may be between 12% and 15%. Nevertheless, they indicate (in paragraph 2.09 of the Appraisal Report), that by 1980 the expanded output of the University of Singapore from the faculties to be financed by the proposed loan will still fall short of demand, the difference being supplied by polytechnic students, upgraded technicians and expatriates.

12. The total cost of the proposed project is estimated at US$21.0 million equivalent. The Government of Singapore would finance the local cost of the project. Contracts for construction and for the supply of furniture and equipment would be awarded on the basis of international competitive bidding. Domestic furniture and equipment manufacturers would be allowed a preferential margin of 15 percent over the c.i.f. price of competing imports, or the actual customs duty whichever is the lower. Since Singapore has a highly competitive construction industry all construction contracts are expected to be awarded to local contractors. It is also expected that almost all of the furniture would be procured from

local manufacturers while the equipment would be procured abroad. On this assumption the foreign exchange cost, including the foreign exchange component of the locally procured goods, would be US$10.5 million, or 50 percent of the total project cost. For foreign contractors the foreign exchange component would be slightly higher than indicated because the profit would be paid in foreign exchange. In the unlikely event that some of the major construction contracts were awarded to foreign firms there would be a small short-fall in foreign exchange which the Government should have no difficulty in providing. On the other hand, if some equipment is procured locally, the resulting savings in foreign exchange would be available for cancellation.

13. The Appraisal Report indicates (paragraph 5.09) that the disbursement percentages would be adjusted as necessary to disburse US$10.5 million equivalent or 50% of the actual project cost, whichever is lower, over the estimated project period of about five years. Depending on relative prices and procurement, at home or abroad, this might mean the financing of some local costs from the loan. Since there is no justification for Bank financing of local costs in Singapore, I recommend that the disbursement percentage be adjusted only to ensure disbursement over the full period of the project. Any amounts not required for the project would be cancelled.

14. The addition of a procurement officer, an accountant and some supporting staff would enable the existing University of Singapore Development Unit, staffed by architects and engineers seconded from the Public Works Department and the Housing and Development Board, to assume responsibility for the execution of all aspects of the project.

Recommendation

15. With the qualification noted in paragraph 13 above, I agree with the recommendations of the Appraisal Report and recommend the Government of Singapore be invited to send representatives to Washington to negotiate a Bank loan of US$10.5 million for the University of Singapore Project, to be amortized over 20 years after a 5-year period of grace, and on the other terms and conditions set forth in the attached report.

Attachment

Raymond J. Goodman
Director
East Asia and Pacific Department

Population: 2.1 million
GNP per capita: $950 1/

ANNEX I

SINGAPORE: Operations and Lending Programs through FY1976
($ millions)

		1972	1973	1974	1975	1976	1964-68	1969-73	1972-76
Telecommunications III	IBRD		8.0						
Higher Technical Education I	IBRD	10.5							
Higher Technical Education II	IBRD				5.0				
Ports II	IBRD	11.0							
Mass Rapid Transit I	IBRD			25.0					
Mass Rapid Transit II	IBRD					25.0			
Urban Development I	IBRD				15.0				
Sewerage II	IBRD		5.0						
Operations Program	Total	21.5	13.0	25.0	20.0	25.0		77.0	104.5
	No.	2	2	1	2	1		8	8
Lending Program	Total	21.5	8.0	30.0	5.0	15.0	57.8	72.0	79.5
	No.	2	1	2	1	1	5	7	7

1/ End 1970

East Asia and Pacific Department
12/16/71

FORM No. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

December 16, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Ireland - Third Power Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 16, 1971 from the Europe, Middle East and North Africa Department, entitled "Ireland - Third Power Project" (LC/0/71-136).

2. Comments, if any, should be sent to reach Mr. Riedl (ext. 4725) by 12:00 noon on Wednesday, December 22.

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

Dag F. Wittusen
Secretary
Loan Committee

DISTRIBUTION

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director, Development Services Department
Directors of the Area Departments
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Directors, Other Departments and EDI
Meeting Participants (minutes)
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Vice President (IFC)

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LC/O/71-136

December 16, 1971

LOAN COMMITTEE

Memorandum from the Europe, Middle East and North Africa Department

IRELAND -- Third Power Project

1. This memorandum recommends a Bank loan of US$ 15 million to Ireland for a term of 17 years, including five years grace, to assist in financing the supply and installation of a single 250 MW oil-fired generation unit and associated equipment. A report entitled "Appraisal of the Third Power Project (Tarbert 4)" (PU-80), dated December 8, 1971, is attached in support of the recommendation.

Background

2. The Bank has made four loans to Ireland since 1969 totalling $57.5 million. Two were made to the Electricity Supply Board (ESB) for power projects. One loan in FY 1969 amounted to $14.5 million and a second one in FY 1971 to $20 million. On November 30, 1971, the undisbursed balances were $4.8 million and $18.9 million, respectively. Performance under these loans has been satisfactory and there are no outstanding problems. The two other loans to Ireland were $10 million to The Industrial Credit Company Ltd. (ICC), which became effective on August 2, 1971, and a $13 million loan for education, effective since November 24, 1971. The education loan and the proposed third power loan are the only projects scheduled this fiscal year. For FY 1973 a livestock development project and a follow-up loan to ICC are envisaged for Bank financing. The Five-Year Lending Program for 1972-1976 is attached. An updating memorandum on the economic situation of Ireland (EMA-23a), dated July 27, 1970, and Part V of the recent President's Report on the education loan (P-982), dated July 21, 1971, discussed Ireland's recent economic performance and future prospects and concluded that the country is creditworthy for additional Bank lending. The preliminary findings of the recent economic mission also support the creditworthiness of Ireland. The green cover economic report is scheduled for January.

3. Bank operations in Ireland aim to support the country's development effort in overcoming critical constraints to expansion. The lending program comprises projects in industry, agriculture and education. The industrial sector traditionally lacks sufficient long-term capital and needs larger economically viable and internationally competitive enterprises. In agriculture the program is intended to induce more economically oriented policies to develop a large beef cattle industry, and to upgrade the level of farmers' education to increase productivity and keep rural migration under control. In education the emphasis is directed towards the implementation of the

educational reform, which aims at greater efficiency and productivity of the system to meet the manpower demand of the economy, and at a better distribution of educational opportunities.

4. In the past Bank lending focused on the power sector where shortage of capital might otherwise have delayed the long run electrification program which provided a much-needed improvement in the country's infrastructure and a basis for the industrial development in the seventies. The financial participation of the Bank, though marginal (about 8 percent of ESB's investment program between 1972-77), has already had some marked beneficial effects. Formerly ESB satisfied its capital needs by relying exclusively on Government finances in the form of long-term repayable advances, and bond issues on the domestic capital market. Since the first Bank loan, however, the company began to meet its growing capital requirements through borrowing on foreign capital markets and by using supplier credits. In this way more of the scarce funds on the domestic market are now becoming available for the country's other investment requirements. The availability of projects in the power sector also allowed the Bank to respond quickly to Ireland's needs for foreign capital. Inasmuch as the intended objectives have been achieved, no further power projects are being included in the lending program.

The Project

5. The proposed project is an essential part in a series of new generating facilities required to meet the increase in demand for electricity in the 1970's. Its main item, the new 250 MW oil-fired generating unit Tarbert No. 4, would be identical to its immediate predecessor, Tarbert No. 3. No unusual project issues are involved; however, three special features are discussed in paragraphs 7-9 below.

Project Cost

6. The total cost of the project, including physical and price contingencies and after updating to recover the effective devaluation of the dollar, is estimated at $38.8 million, of which $25.6 million would be in foreign exchange. The proposed loan would cover 59 percent of the foreign exchange requirements and would be equivalent to about 39 percent of the estimated project cost. It would finance the equipment for Tarbert No. 4 Station, including associated transmission and substation equipment, with the exception of the turbo-generator which would be financed by a supplier's credit. As in the previous loans, interest during construction on the Bank loan has been excluded from Bank financing. The size of the loan has been determined on country grounds and the partial financing of the foreign exchange requirements is a consequence of ESB's ability to raise parts of its capital needs through other external sources.

Tariff Covenant

7. In the past, ESB's financial situation has been generally satisfactory due to the conservative manner in which the Electricity (Supply) Act 1927 and the tariff provisions contained in it have been applied by the Government and ESB. In FY 1971 the Government, as part of an attempt to control inflation, refused to permit ESB to raise its tariffs by the requested 10 percent and granted only a 7 percent rate increase. It also indicated that future tariff applications would be examined in the context of the overall economic situation. This changing attitude of the Government towards ESB could have an adverse effect upon ESB's future financial position. It is, therefore, proposed to include a tariff covenant in the proposed loan to ensure that future earnings are improved and maintained at a satisfactory level. During negotiations, the Government and ESB should agree to set tariffs so that at least 40 percent of ESB's investment requirements over any consecutive three-year period, consisting of one actual and two forecast years, would be financed by internal cash generation, including consumers' contributions. The contribution to investment covenant has been selected since this concept is consistent with ESB's establishment Act and should therefore meet with no objection on this score from the Government. The level of internal cash generation proposed should allow ESB to carry out its development program and at the same time further reduce its dependence on funds from the domestic capital market.

Sinking Fund

8. The 591-IRE Loan Agreement of March 24, 1969 included a covenant stipulating that ESB would make adequate provision for the repayment of any stock issue by the latest applicable redemption date. Recently, however, ESB has been experiencing considerable difficulty in raising sufficient long-term money on the domestic capital market, a situation which might also occur in future, forcing ESB to depend partially on medium-term issues. The Bank therefore agreed in Loan 726-IRE of March 3, 1971 to ease this covenant by agreeing that for any issue of redeemable stock of 15 years or less, sinking fund provision will be made on a 15-year basis. In the unlikely event that these medium-term stock issues should in total exceed 20 percent of the total amount borrowed outstanding, presently about 5 percent of total debt outstanding, the Bank would be consulted before any further issues were made. This covenant is proposed again for the loan under consideration.

Procurement

9. In connection with the preceding loans ESB informed the Bank that in the course of execution of its long-term investment program it wished to take advantage of the possible financial benefits from ordering more than one unit at a time. ESB, therefore, with the Bank's concurrence, invited bids in August 1970 for the boiler and turbo-generator for Tarbert No. 3 providing at the same time for the simultaneous purchase of an additional

boiler and turbo-generator. Procurement was in accordance with international competitive bidding procedures. An order for both boilers was placed in June 1971 with M.A.N. of Germany, the lowest evaluated bidder. The Executive Directors have been kept informed of the status of procurement through the Monthly Operational Summary.

10. The remaining items financed by the proposed loan would be procured on the basis of international competitive bidding, except for components required to be compatible with existing equipment and some small goods, for which such bidding would be impractical; the total cost of both categories is estimated not to exceed US$500,000 equivalent. Procurement arrangements are similar to those for the last loan.

Issues for Negotiations

11. ESB and the Irish Government have been informed about the need for a tariff covenant and they seem prepared to agree to it. Except for the amount of the loan no major difficulties are foreseen during negotiations. Because of the depreciation of the dollar and the possibility of further currency realignments (an additional 5 percent devaluation would require an increase in the loan amount of $750,000), ESB might request to have the cost of interest during construction included in the loan amount to help cover this contingency.

Recommendation

12. I propose that the Bank invite the Government of Ireland and the Electricity Supply Board to negotiate a $15 million loan along the lines of the recommendations in Chapter 6 of the attached appraisal report.

M. P. Benjenk
Director

Attachments

POPULATION: 2.9M

GNP PER CAP: $ 980

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

OPERATIONS PROGRAM			1972	1973	1974	1975	1976
4-IRR-AL-01	LIVESTOCK I	IBRD		10.0			
4-IRR-AL-02	LIVESTOCK II	IBRD				10.0	
4-IRR-DD-02	ICC II (DFC)	IBRD		15.0			
4-IRR-DD-03	DFC III	IBRD				15.0	
4-IRR-EE-01	EDUCATION I	IBRD	13.0				
4-IRR-EE-02	EDUCATION II	IBRD			10.0		
4-IRR-EE-03	EDUCATION III	IBRD					10.0
4-IRR-PT-02	POWER-PIGEON HOUSE B	IBRD	15.0				
4-IRR-XX-01	UNALLOCATED	IBRD			17.0		

	1964-68	1969-73	1972-76						
IBRD		97.5	115.0	IBRD	28.0	25.0	27.0	25.0	10.0
IDA				IDA					
TOTAL		97.5	115.0	TOTAL	28.0	25.0	27.0	25.0	10.0
NO		7	9	NO	2	2	2	2	1

LENDING PROGRAM (1/29/71)

IBRD		97.5	115.0	IBRD	28.0	25.0	27.0	25.0	10.0
IDA				IDA					
TOTAL		97.5	115.0	TOTAL	28.0	25.0	27.0	25.0	10.0
NO		7	9	NO	2	2	2	2	1

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

December 15, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Philippines - Fifth Power Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 15, 1971 from the East Asia and Pacific Department, entitled "Philippines - Fifth Power Project" (LC/O/71-135).

2. Comments, if any, should be sent to reach Mr. Wang (ext. 4046) by 12:00 noon on Monday, December 20.

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

Dag F. Wittusen
Secretary
Loan Committee

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LC/0/71-135

December 15, 1971

LOAN COMMITTEE

Memorandum from East Asia and Pacific Department

PHILIPPINES: Fifth Power Project

1. Attached is an appraisal report (No. PU-79) on the above project, dated December 2, 1971, recommending a proposed loan of $20.5 million to the National Power Corporation (NPC) and a proposed credit of $10 million to the Government which would be relent to NPC on the same terms as those of the proposed loan.

Background

2. This loan would be the Bank's fifth to NPC and the sixteenth for the Philippines, and the proposed credit would be the Association's first to the Government. These would bring total Bank/IDA lending in the country to $269.3 million, net of cancellations. Of the 15 loans previously made, four were for power, three for private industry through PDCP, two for rural credit, and one each for port dredging, water supply, education, irrigation, rice processing and highways. At the end of November 1971, the net amount of loans held by the Bank was $205.3 million and the undisbursed amount $72.1 million.

3. The proposed project is one of four in our operations program for FY 1972. The other three are for livestock development (the appraisal report will be submitted to the Committee shortly), education (the appraisal report is being prepared), and the Private Development Corporation of the Philippines (an appraisal mission is in the field).

4. The Bank Group's operations and lending program for FY 1973-77 was set forth in the Country Program Paper reviewed with Mr. McNamara in August. A copy of the program dated November 18, 1971 is attached. The strategy of the Bank/IDA plan is to help bridge the resource gap by concentrating our lending in priority projects in the public sector. The CPP review concluded that the Philippines in principle was eligible for IDA lending, because, apart from poverty grounds, the country would be faced with serious debt service problems at least until the early 1980's, but that a decision on the amount of IDA funds to be allocated should be made in the light of the Government's efforts to improve fiscal performance. The operations program for FY 1972 therefore tentatively included, in addition to proposed Bank lending of some $48.5 million, an IDA allocation of $20 million for two projects--the present power project and a second education project.

5. An economic mission found in October that the economy appears to have adjusted to the peso devaluation of February 1970 and to be recovering from the inevitable slowdown following the stringent stabilization program

which has been vigorously implemented since then. The balance of payments position is no longer critical. New foreign borrowings are under close scrutiny and regulation, and the external debt problem, though still serious, seems to be under control. Fiscal performance, on the whole, has also shown improvement. Tax revenue was estimated to have risen by as much as 36% in FY 1971 ending June 30 due in part to improved tax collections. Despite an 8.8% rise in current expenditures, public savings in FY 1971 reached a record high of ₱506 million (nearly $80 million), as against a deficit of ₱237 million in the previous year. In FY 1972 revenue might well rise by more than the 7% estimated by the administration and therefore public savings could conceivably be higher than in FY 1971, despite the fact that Congress failed this year to approve new tax bills as well as a Bank-supported proposal to maintain the export tax without the scheduled reduction. However, the Government is determined to push hard for these tax measures in 1972, a non-election year. Given the overall improved fiscal performance and the Government's determination to press for further tax measures in 1972, there is no reason to change our plan to make an IDA credit of $10 million to the Government for this project. IDA financing for other projects in the future would be subject to continued good performance in the fiscal field.

Power Sector

6. The power sector is dominated by two utilities - NPC and the Manila Electric Company (Meralco), which together account for about 90% of total generation. Meralco, serving the Manila metropolitan area, is privately owned and the largest utility in the sector, with a total installed capacity of 1,200 MW, mainly thermal. NPC is government-owned and has a total installed capacity of about 655 MW, mainly hydro. It sells bulk power to industrial users and local utilities, including Meralco. In addition, there are about 460 small private or municipal utilities that distribute power received from NPC and Meralco or produced by their own generating facilities. The Government has in recent years given high priority to rural electrification. In 1969 a National Electrification Administration (NEA) was established to help accelerate the electrification of the country, with priority given to providing assistance in creating and financing rural electric cooperatives. As a result of initiatives taken at the recent meeting of the Consultative Group for the Philippines, an informal division of labor has been worked out between the ADB, USAID and ourselves, according to which ADB would concentrate on lending for generation and transmission in Mindanao, USAID would assist rural electrification and the Bank would lend for generation and transmission in Luzon.

7. NPC and Meralco interchange substantial amounts of power, but there is no coordination in the planning and development of hydro and thermal power schemes for the expansion of the Luzon grid. Coordination is also needed for the planning and development of small utilities and the electric cooperatives now being sponsored by NEA. In an attempt to meet these needs, a Power Development Council was established by the Government in 1970. However, the Council has not been given adequate power, funding or staffing to be able to provide the required coordination. Accordingly, the report proposes, and

I concur, that the Bank require the Government to submit proposals which would provide the Council with the necessary means to function effectively. Assistance in the technical aspects of the coordination will be provided for in the study of a long term plan for the development of the Luzon grid included in the proposed project.

National Power Corporation

8. The Bank has made four loans to NPC totalling $67.3 million, net of cancellations. The first three projects (Binga, Angat and Maria Cristina) were for hydro power development and were completed after considerable delays because of NPC's and contractors' poor performance. The fourth project, for the construction of a 75-MW thermal plant on Bataan peninsula, has progressed satisfactorily and is expected to be placed in operation in December 1971.

9. NPC has chronic financial problems arising primarily from difficulties in securing adequate rate increases. The latter have been a subject of discussions with NPC and the Government over the last several years which led to a new NPC bill providing for improved procedures to facilitate rate increases. In fact the situation was so bad that the Bank took the position with NPC and the Government that the enactment of the NPC bill would be a prior condition for any further Bank lending to NPC. The bill, finally enacted last September, provides not only for improved rate making procedures but also for exemption of NPC from all taxes, including income tax and franchise tax, reflecting the Government's determination to help NPC overcome its financial difficulties.

10. NPC's management and operations have been hampered by administrative restrictions and lack of adequate authority and of management information. These shortcomings have been studied by consultants employed under the previous Bank loans. The new NPC Act has provided a framework for effective management. The consultants have recommended a reorganization of NPC's management and operating procedures, including an overhaul of its accounting system. These recommendations have been or are being implemented.

The Project

11. The project forms part of the Government's four-year (FY 1972-75) infrastructure program, of which public investment in power development is the largest after transport, accounting for some $200 million or 18% of the total. It will expand NPC's generating and transmission facilities in Luzon and provide consultants' services for technical assistance to NPC. More specifically, it will consist of the following components:

(a) Generation - a second thermal unit (150 MW) at Bataan station together with three 75-MW transformers and other ancillary equipment;

(b) Transmission - five regional sub-projects covering construction of 24 sub-stations and over 1,400 km of transmission lines; and

(c) Consultants' services for (i) the final design and supervision of the project construction; (ii) feasibility studies of further hydroelectric schemes in Luzon; (iii) the preparation of a long-term plan for expansion of the Luzon grid; (iv) a follow-up review of NPC's accounting systems and procedures and a review of the current value of fixed assets; and (v) improving NPC's technical operations.

12. The total cost of the project is estimated at $44.5 million, as follows:

	$ million equivalent		
	Local	Foreign	Total
Generation	4.7	17.9	22.6
Transmission	11.1	9.8	20.9
Consultants' services	.2	.8	1.0
	16.0	28.5	44.5
Interest during construction		2.0	
		30.5	

The proposed Bank/IDA lending of $30.5 million would cover the entire foreign exchange cost of the project and interest during construction. The latter is included because of NPC's poor financial situation and the time involved before the new facilities will earn revenues. The foreign exchange costs of generation and transmission include about $100,000 for retroactive financing of expenditures for engineering services from January 1, 1972 for the preparation of the final design and tender documents of the project. These costs also include, in addition to a 7% price contingency, another 7% to allow for the effective depreciation of the dollar which had taken place at the time of writing the appraisal report. Based on present expectations that in terms of other major trading currencies the dollar may ultimately be stabilized at between 10% and 15% below its present par value, I propose, and the Public Utilities Projects Department agrees, that an additional contingency of 5% or $1.5 million be included in the proposed loan, thereby increasing it to $22.0 million.

13. NPC's load in Luzon has been growing steadily by 21% annually over the past six years. However, its load growth during 1972-77 is projected at 14.5% annually on the basis of realistic estimates of economic and industrial growth and other considerations. As NPC's generating capacity is mainly hydroelectric, it needs thermal units to firm up its capacity as well as for expansion. The 75MW unit at Bataan financed under the last Bank loan is NPC's first sizable thermal unit. The proposed project would include the second thermal unit, which is the most economic way to meet the expected load increase since no hydro alternative of suitable size could be prepared and developed in time. The proposed size of 150 MW is appropriate in relation to the combined capacity of the NPC/Meralco system. This unit will increase NPC's installed generating capacity in Luzon by about 30% and will enable NPC to meet demand until 1977. Expansion in Luzon beyond 1977 will consist of further thermal plants for base load and hydro plants for peaking.

14. NPC's power supply thus far has been largely limited to Central Luzon and a small part of Mindanao. In line with the priority given by the

Government to rural electrification, NPC's expansion program includes considerable transmission extension to supply electricity to other regions. The proposed project thus includes installation of 1,400 km of lines which will increase NPC's transmission in Luzon by about 60% in length and cover 80 towns and 20 large users, in addition to the 250 towns and 27 large users that NPC is now serving.

15. Although encouraging progress has been made in implementing the consultants' recommendations for improving NPC's operations, there is still room for improvement. The Project includes further technical assistance by consultants for this purpose as well as for the preparation of feasibility studies for further hydro schemes and a long term plan for the development of the Luzon grid.

16. Construction of the project including transmission subprojects would be done by contractors. Contracts for civil works and for equipment would be awarded after international competitive bidding. It is likely that the civil works contracts would be won by local contractors, while equipment contracts would go to foreign suppliers since none of the equipment is manufactured locally. The IDA credit would be disbursed first. Foreign exchange savings, if any, would result in cancellation which would be applied first against the Bank loan.

16. Construction is expected to take about three years and to be completed by mid 1975. It is proposed that the loan should have a term of 20 years, including a grace period of four years which would correspond to the period of disbursement. The proposed credit would be on standard terms.

17. Under the latest Bank loan, NPC was required to earn by FY 1969 a minimum annual rate of return of 8% on the average current value of its net fixed assets in operation. This rate has never been achieved largely because of delays in securing rate increases; the rate of return was only 3.04% in FY 1969 and fell to 1.5% in FY 1970 after a revaluation of assets following the peso devaluation of 1970. A 42% rate increase was finally put into effect in May 1971. This would result in a return of 1.9% in FY 1971 rising to between 4.5% and 5.7% during FY 1972-77. To achieve the 8% return envisaged NPC will need a further rate increase. Taking into account NPC's tax exempt status, this increase is estimated at about 28%. This increase could not be brought about at one time following the sizable increase of 42% in 1971, but could be implemented in two steps over the next two years. The report proposes, and I concur, that the Bank require that:

(a) as a condition of our presentation of the proposed loan and credit to the Executive Directors, NPC should have taken all actions necessary under its charter to effect a moderate rate increase of not less than 10% to become effective not later than September 1, 1972; and

(b) NPC should undertake to implement further rate increases after FY 1973 in order to achieve an 8% return for its entire system in FY 1974 and to maintain such return thereafter.

18. On the basis of the expected income from the sale of the additional energy generated under the proposed project at the increased tariffs envisaged in paragraph 17 above, the internal financial rate of return is estimated at about 15%.

19. Since the appraisal report was written, NPC has informed us that the Philippine Electric Plant Owners Association (PEPOA) has refused to pay the 42% rate increase put into effect in May 1971 on the ground that the latter is covered by an injunction issued in 1964 against NPC's rate increases. NPC estimates that its revenue loss from PEPOA's refusal to pay would amount to about ₱6 million in FY 1972 or about 15% of its total revenue. NPC is challenging PEPOA's position in court, but the case is unlikely to be resolved soon. Meanwhile, to get around this obstacle NPC is taking advantage of the improved rate making procedures under the new NPC Act described below by filing a new rate schedule which incorporates the 42% increase referred to above plus an additional ₱0.005 per kwh or roughly 10% applicable to all its clients in Luzon. The effect of the new rate will be that PEPOA members in Luzon, the majority of its membership, will have to pay the 42% rate increase and the new 10% over the rate they have been paying, while for NPC's other clients in Luzon the increase will only amount to 10% since they have been paying the 42% since May 1971. NPC estimates that the new rate would result in additional revenue of ₱9 million annually which, after making up the revenue loss from PEPOA's refusal to pay the 42% increase in effect since May 1971, would go part way in fulfilling the condition of presentation set forth in paragraph 17(a). The exact effect, however, cannot be calculated on the basis of present information but will be discussed during negotiations.

20. The new rate now awaits clearance by the Office of Economic Coordination (OEC). NPC expects to receive the clearance before the end of this year and will then publish the new rate in a newspaper of general circulation. The new rate will become effective 15 days after such publication, i.e., shortly after mid-January 1972. Under the new NPC Act complaints against rate increases can be lodged only with the Public Service Commission (PSC) and such increases no longer subject to injunction by ordinary courts. PSC is required to make a ruling within 90 days after the lodging of such complaint. While the rulings of PSC may be appealed to the Supreme Court, lodging of a complaint no longer stays the effectiveness of a rate increase.

21. Since NPC is taking effective action to increase its rates, I propose that we proceed with the project but that we not present the proposed loan and credit to the Executive Directors until the new rate is implemented. As stated above, this is expected to come about shortly after mid-January.

Recommendation

22. I agree with the conclusions and recommendations of the appraisal report with the modifications proposed in paragraph 12 and 21, and recommend that we invite the Government and NPC to send representatives to Washington to negotiate a Bank loan of $22 million and an IDA credit of $10 million.

Raymond J. Goodman
Director

Attachments.

POPULATION: 35.9M

GNP PER CAP: $ 180

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

OPERATIONS PROGRAM			1972	1973	1974	1975	1976
6-PHL-AC-03	AGRICULTURAL CREDIT III	IBRD			15.0		
6-PHL-AC-04	AGRIC. CREDIT IV	IDA					15.0
6-PHL-AF-01	FISHERIES	IBRD		5.0			
6-PHL-AF-02	FISHERIES II	IBRD					10.0
6-PHL-AI-02	IRRIG.II(NUEVA ECIJA)	IBRD			10.0		
6-PHL-AI-03	IRRIGATION III MAGAT	IBRD					35.0
6-PHL-AL-01	LIVESTOCK	IBRD	8.0				
6-PHL-AL-02	LIVESTOCK II	IBRD				10.0	
6-PHL-AN-02	RICE PROCESSING II	IBRD				20.0	
6-PHL-AP-01	COCONUT REHABILITATION	IBRD			5.0		
6-PHL-AX-01	AGRIC.UNIDENTIFIED I	IDA				5.0	
6-PHL-AX-02	AGRIC.UNIDENTIFIED II	IDA					10.0
6-PHL-CX-01	TELECOMM.UNIDENTIFIED	IBRD			10.0		
6-PHL-DD-04	PDCP IV (DFC)	IBRD	20.0				
6-PHL-DD-05	PDCP V (DFC)	IBRD			20.0		
6-PHL-DD-06	PDCP VI (DFC)	IBRD					20.0
6-PHL-EE-02	EDUCATION II	IDA	10.0				
6-PHL-EE-03	EDUCATION III	IBRD				10.0	
6-PHL-NN-01	POPULATION	IDA			4.0		
6-PHL-PP-02	POWER VI	IBRD			20.0		
6-PHL-PT-01	POWER V	IBRD/I	30.5				
6-PHL-QQ-01	TOURISM	IBRD				10.0	
6-PHL-TH-02	HIGHWAYS II	IBRD		35.0			
6-PHL-TH-03	HIGHWAYS III	IDA				25.0	
6-PHL-TP-02	PORTS II	IDA		10.0			
6-PHL-TP-03	PORTS III	IDA				10.0	
6-PHL-UX-01	URBANIZATION-UNIDENT.	IDA					5.0
6-PHL-WU-02	WATER SUPPLY II	IDA			20.0		

POPULATION: 35.9M

GNP PER CAP: $ 180

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

OPERATIONS PROGRAM

	1964-68	1969-73	1972-76		1972	1973	1974	1975	1976
IBRD	68.2	182.3	283.5	IBRD	48.5	40.0	80.0	50.0	65.0
IDA		30.0	124.0	IDA	20.0	10.0	24.0	40.0	30.0
TOTAL	68.2	212.3	407.5	TOTAL	68.5	50.0	104.0	90.0	95.0
NO	5	12	28	NO	4	3	8	7	6

LENDING PROGRAM (8/12/71)

	1964-68	1969-73	1972-76		1972	1973	1974	1975	1976
IBRD	68.2	180.8	217.0	IBRD	47.0	40.0	60.0	40.0	30.0
IDA		30.0	109.0	IDA	10.0	20.0	20.0	29.0	30.0
TOTAL	68.2	210.8	326.0	TOTAL	57.0	60.0	80.0	69.0	60.0
NO	5	12	22	NO	3	4	5	5	5

FORM No. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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LM/M/71-52

December 15, 1971

Minutes of Special Loan Meeting to consider "Brazil - Proposed Bank Loan for CSN Steel Project" held on December 3, 1971 in Conference Room A.

1. Present: Messrs. Knapp (Chairman), Williams, Broches, Chadenet, Fuchs, Kalmanoff, Wiese, Cancio, Fernandes, Jaffe, Loh, Nayar, Paschke, Perram and Skillings.

2. Issues: The meeting was called to consider the South America Department's memorandum to the Loan Committee of December 1, 1971 entitled "Brazil - Proposed Bank Loan for CSN Steel Project" (LC/O/71-130) and the attached appraisal report (PI-15) and draft general report. The issues for discussion are underlined below.

3. Waiver of withholding taxes and import duties. The meeting noted that:

(i) The draft general report recommended that assurances be sought from the Government that withholding taxes on interest payments on bilateral credits and on the engineering component of equipment contracts as well as import duties on plant and equipment would be waived.

(ii) The purpose of the assurance was to confirm the Government's announced intention of waiving withholding taxes and import duties for the steel expansion project.

4. Decision: Since it was contrary to the Bank's policy to request the Government to grant special tax treatment to Bank-financed projects, the meeting agreed that no waiver of withholding taxes and import duties should be sought from the Government. Moreover, the Bank would not wish to press for action which would have a direct bearing on the system applied to the evaluation of parallel financing offers.

DISTRIBUTION

Committee:

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

Copies for Information:

President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Economic Adviser to the President
Special Adviser to the President
Mr. J.H. Williams
Directors, Other Departments and EDI
Meeting Participants (minutes)
Overseas Offices and Missions
General and Loan Committee Files
Executive Vice President (IFC)
Vice President (IFC)

5. <u>Financing of Coordinating Consultants</u>. The meeting noted that:

(i) It was recommended that the Bank, together with the Inter-American Development Bank (IDB), engage the services of a consultants' firm to monitor and coordinate the execution of the three Brazilian steel projects. The meeting considered the justification for supplementing the Bank's normal supervision work in this case and discussed the merits of charging the cost of the consultants to the borrowers, a procedure normally followed by IDB.

6. <u>Decision</u>: The meeting concluded that the estimated cost of the coordinating consultants was not excessive either in terms of man-year charges or in terms of of the aggregate cost of supervision in relation to the size of the project; hence the proposed Bank share of this cost (60%) should properly be borne by the Bank, and, subject to the concurrence of the Programming and Budgeting Department, carried on the budget of the Industrial Projects Department.

7. <u>Competitive Bidding on Civil Works</u>. The meeting noted that:

(i) It was proposed to seek assurances from the Government that, should the evaluation of bids by local contractors show that prices were rising excessively in relation to contracts placed in Stage I, and/or that construction time schedules were incompatible with the project schedules, international competitive bidding would be required on subsequent civil engineering, building and erection work contracts.

(ii) Brazilian legislation precluded internatioanl competitive bidding on civil works when such works were being financed by foreign credits of less than 15 years maturity. However, the Government could, in special circumstances, open bidding for civil works contracts to foreign firms. In such cases, the Government normally required an association between the foreign firm and a Brazilian contractor.

8. <u>Decision</u>: The meeting concluded that the Bank would seek assurances that civil engineering, building and erection work would be put out to international competitive bidding in the circumstances outlined in para. 7(i) above.

9. Subject to the above modifications, the Chairman approved the South America Department's recommendation that negotiators be invited for the proposed loan.

Dag F. Wittusen
Secretary

RMFernandes/DFWittusen:as

Cleared with: Messrs. Knapp
Broches
Fuchs/Chadenet
Wiese

FORM No. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

December 10, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Republic of Zaire - Second Highway Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 10, 1971 from the Eastern Africa Department, entitled "Republic of Zaire - Proposed IDA Credit for a Second Highway Project" (LC/O/71-134).

2. Comments, if any, should be sent to reach Mr. Moreau (ext. 3615) by 2:00 p.m. on Tuesday, December 14.

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

Dag F. Wittusen
Secretary
Loan Committee

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LC/0/71-134

LOAN COMMITTEE

December 10, 1971

MEMORANDUM FROM THE EASTERN AFRICA DEPARTMENT
REPUBLIC OF ZAIRE
PROPOSED IDA CREDIT FOR A SECOND HIGHWAY PROJECT

1. Attached for consideration by the Loan Committee is the Appraisal Report (No PTR-101) dated November 30, 1971, recommending a $18.2 million IDA credit to the Republic of Zaire (formerly the Democratic Republic of the Congo) for a second highway project, which is estimated to cost about $45.4 million. The Republic of Zaire (Zaire) would finance the local costs of the project, estimated at $10.5 million. The US Agency for International Development (USAID) has already provided a loan of $10 million to Zaire, $9.8 of which would be available for the project. The balance of the foreign exchange cost is expected to be financed by the following external aid agencies, which have all given their agreements in principle to participate in the indicated amounts: the United Nations Development Programme (UNDP), $2.2 million, the Canadian International Development Agency (CIDA), $3.6 million, and the French Fonds d'aide et de coopération (FAC), $1.1 million.

2. The proposed credit would be the second IDA participation in the highway sector in Zaire. In 1969, IDA provided a $6 million credit (No. 152-CK) for the Technical Assistance and Highway Administration Project. The technical assistance provided under that project led to the proposed project.

3. The five-year lending program for Zaire is attached. In addition to the proposed project, the FY-1972 lending program provided for the second development finance company project, which was signed on September 24 (Credit No 271-CK for $10 million), and for the education credit for $6.5 million which was approved by the Executive Directors on November 30.

4. Furthermore, a proposal to provide a second Bank technical assistance grant of $200,000 to Zaire is expected to be submitted shortly to the Executive Directors. The grant, together with a French Government grant of $220,000 for the same purpose, would help to continue financing a team of experts in the Office of the President of the Republic, to assist in preparing annual development budgets and to advise on public investment decisions.

The Economy

5. An economic report entitled "The Congo's Economy: Evolution and Prospects" (AE-13a) dated December 8, 1970, was distributed to the Executive Directors on March 29, 1971 (R 71-62). An updated statement on the economic situation of Zaire was made in the President's Report on the Education Project, No P-991, dated November 17, 1971. No new developments have occurred since that time.

6. With a GDP per head of around $110, economic development in Zaire will clearly be dependent on external capital for a considerable time and hence the avoidance of substantial indebtedness in the future is dependent on the continuation of foreign assistance on concessionary terms. The provision of finance from IDA is therefore appropriate at this time.

The Transport Sector

7. The Transport sector in Zaire is a complex one, and its problems are a function of the size of the country, the multiplicity of the modes of transport utilized and a serious shortage of competent managerial and technical staff. The capacity and efficiency of the transport system have declined since Zaire attained its independence in 1960, as a result of damage to infrastructure and equipment during the period of disorders, inadequate repair and maintenance, the departure of many qualified personnel and reduced labor efficiency.

8. The transport network has been built around Zaire's great natural advantages - 15,000 kms of lakes and rivers which are navigable all the year round, and provide the main arteries. Some 5,000 kms of railways by-pass river sections which are not navigable, or carry traffic to and from the waterways. Some 140,000 kms of roads and tracks in turn feed into the rail and waterways systems, except in the northeast of the country, where they make up the primary means of transport. In addition, civil aviation is playing an increasingly important role, especially in the transport of persons between the country's main centers of population and economic activity, which are separated by considerable distances within the 2,345,000 square kilometers of Zaire.

9. The proposed project would be the Bank Group's third operation in the transport sector of Zaire since independence. The first was the $6 million IDA Credit (152-CK), a joint operation with the UNDP, for the improvement of highway administration, and the rehabilitation and maintenance of priority roads, on the basis of which the major organizational changes to be implemented under the proposed project were developed. The Appraisal Report for this 1969 Credit, the first in independent Zaire, was overly optimistic in its estimated disbursement timetable. The original forecast was that the full amount of the Credit would be disbursed by the end of 1971, although this was already tempered by the provision in the Credit Agreement that the closing date for the Credit would be January 15, 1973. Since the signature of the Credit, eight missions to Zaire have looked into the execution of this project; two of them were full-scale supervision missions, following which the Credit was expected to be fully disbursed by the end of 1972. At present, only $1.08 million or 18% of the Credit amount has been disbursed, but we know that the Government has made payments of about $1.9 million which qualify for reimbursement. The delays in submitting withdrawal applications prompted a recent visit to Kinshasa of a representative of the Controller's Department. As a result thereof, we feel confident that by the end of March, 50% of the

Credit will have been disbursed. The next supervision mission is scheduled for March 1972, and will update the disbursement schedule taking into account the delays in physical project execution, which are estimated at present at six to eight months. An extension of the closing date is expected to become necessary, but the project at last seems to be progressing satisfactorily.

10. The second IDA operation in this sector was the $7 million River Transport Project, for which Credit 255-CK was signed on June 21, 1971, with a deadline for effectiveness now set for December 15. The project consists in improvements to navigation; rehabilitation of the river fleet of the Office d'Exploitation des Transports du Congo (OTRACO), Zaire's largest multi-modal transport enterprise; the provision of experts to Otraco and the two other Government agencies responsible for the waterways, to put into effect the reorganization measures recently taken by the Government; and a study of the Voie Nationale, the rail-river route linking the mining province of Katanga to the Atlantic Ocean over Zairan territory. The deadline for the effectiveness of this credit has already been postponed twice, from October 6, 1971 to November 15, and then to December 15, 1971. We have informed the Government that we would find it difficult to postpone it again. However, we understand from our Resident Representative in Kinshasa that most of the conditions of effectiveness have been met and that the necessary proof will be sent to us soon. We therefore feel confident that this credit will be effective early in calendar year 1972. However, it is clear from a recent project supervision mission that this project is off to a slow and difficult start. We face major problems in terms of general efficiency of Otraco and of its financial position. We are just beginning our supervision of this difficult project.

The Project

11. The proposed project is based on consultants' studies executed under Credit 152-CK and the parallel UNDP grant. The consultants recommended the creation of an autonomous highway agency, which the Government implemented by establishing the Bureau of Roads (Office des Routes) under the Minister of Public Works. In addition, the consultants recommended a ten-year program of road rehabilitation, from which the rehabilitation work included in the proposed project had been taken.

12. The proposed project is intended to strengthen highway administration and provide the means to carry out highway maintenance and rehabilitation work. It is to be carried out over a period of about two and one half years and would consist in (a) the provision of technical assistance to the Bureau of Roads, (b) the purchase of equipment and vehicles for highway maintenance, workshops and a highway laboratory, (c) the rehabilitation of about 1,900 km of high priority roads located in six of Zaire's eight provinces, and (d) the carrying out of feasibility and detailed engineering studies for about 1000 km of future road construction or rehabilitation.

13. The Government has announced that the Bureau of Roads will begin operations on January 1, 1972. The Government is reported to have appointed a Zairan national as Director General of the Bureau, confirmation of which should reach us soon. The bureau has been headed since March by an American interim Director General, who is a transport economist and planner, and who is likely to remain in the Bureau, as a Deputy Director General in charge of administration. This is acceptable to us.

14. One part of the technical assistance which would be provided to the Bureau of Roads would consist in providing a Deputy Director General for the Bureau, who would be responsible to the Director General and the Minister of Public Works for all technical aspects of the Bureau's operations. IDA, with CIDA's active cooperation, has proposed a candidate for that position, who was accepted by the Government. It is hoped that he will be able to take up his duties before the end of December so as to help finalize the Bureau's organization structure. The foreign cost of his services would be financed initially out of funds available for such purposes in Credit 152-CK and, once the proposed credit is signed, would be financed under the latter.

15. In the absence of sufficient qualified Zairans to fill the executive positions in the Bureau, both at the central and at the provincial levels, the proposed credit would provide, with UNDP participation, about 45 experts for an initial period of 2 1/2 years, in addition to a specialized training team. These 45 experts, who would have training as well as administrative and operational responsibilities, would be phased out as qualified Zairans become vailable. A joint venture of consulting firms, Zaire-Routes, would provide these experts and specialists. Zaire-Routes is composed of a Belgian firm, Research and Development, a French firm, BCEOM/SCET International and a US firm, Louis Berger. Proposals for a contract with Zaire-Routes have been received and negotiation of a consultants' contract began on December 6 in Washington.

16. More detailed information on the components of the proposed project can be found in paragraphs 4.02 to 4.12 of the Appraisal Report. The various elements of the proposed project are designed to form a package, with financing coming from different sources, which would provide the expert manpower needed for the Bureau's efficient operation, and at the same time, would enable the Bureau to undertake a worthwhile program of work, commensurate with the input of technical assistance.

17. The total cost of the proposed project is estimated at $45.4 million, with an estimated foreign exchange component of $34.9 million. Financing for the foreign exchange component will come from a number of sources, in addition to IDA. The Government has obtained agreements in principle for UNDP, USAID, CIDA and FAC participation.

18. The proposed financing plan is as follows:

	Government	CIDA	FAC	UNDP	USAID	IDA	TOTAL
I. Technical assistance and training	2.09	-	0.80	2.20	3.50	5.27	13.86
II. Maintenance and other equipment	0.80	1.70	0.30	-	6.30	-	9.10
III. Road Rehabilitation	6.91	-	-	-	-	12.94	19.85
IV. Feasibility studies and detailed engineering.	0.65	1.90	-	-	-	-	2.55
Total	10.45	3.60	1.10	2.20	9.80	18.21	45.36
Percentage of total cost	23.04	7.94	2.42	4.85	21.60	40.15	100%

19. The proposed credit of $18.2 million would therefore finance the full foreign cost of road rehabilitation work and close to 45% of the foreign cost of the total technical assistance included in the proposed project, and would represent about 40% of the estimated total cost.

20. The cost of the consultants' contract with Zaire-Routes is presently estimated at about $8.5 million, with a foreign component of about $5.8 million. It would be financed about 70% by IDA and for the balance by the UNDP, for whom the Bank would be the executing agency.

21. The road rehabilitation work would be carried out by contractors selected after international competitive bidding following the Bank Group's procurement guidelines.

22. The procurement of equipment will be tied to the country providing the financing, Canada, France and the U.S. respectively, and the list of equipment to be procured will be reviewed by the Bureau of Roads and IDA.

23. The local cost of the project, estimated at $10.5 million, does not include the recurrent expenditures of the Bureau of Roads, except those in respect of the services of the experts referred to in paragraph 15 of this memorandum. These recurrent expenditures will be covered by Government budgetary allocations, and are estimated, for the 2 1/2 year period of construction, at about $50 million, which is substantially higher than budgetary allocations in previous years.

24. Although the institution-building aspects of the proposed project are of crucial importance and constitute a necessary condition for obtaining the benefits expected from the other project elements, it is difficult to quantify the economic benefits of these institutional aspects. The two elements of the proposed project for which economic benefits can be quantified are the road rehabilitation works, for which the Internal Economic Returns (IER) vary from a minimum of 14% to over 50%, and the maintenance equipment element of the project which would have a rate of return of 37%, or a benefit/cost ratio of 1.6 at a 10% discount rate. The economic benefits of these two project elements concern mainly reductions in the presently excessive road transport costs and the improvement of access to isolated productive areas and, in particular, to agriculturally important zones where the economic justification of on-going or forthcoming agricultural development projects will to a substantial extent depend on reliable access routes.

25. We do not intend to complete credit negotiations before a draft consultants' contract is negotiated and found acceptable by IDA. The purpose of this is to provide an accurate figure for the Zaire-Routes contract, which on present estimates accounts for close to 20% of total project costs, and to ensure that the start of project will not be delayed by lack of timely agreement on this crucial contract.

26. Arrangements have still to be made with the Government, and with each of the other external financing agencies involved, to ensure proper coordination and supervision of all phases of the project, timely execution of its various components and exchange of information on matters related to project execution. At the time of negotiations, discussions on these matters will be held with these agencies. We intend to be flexible about the legal forms for the recommended arrangements, fitting in as much as possible with the requirements of each of the agencies concerned.

27. The effectiveness of the proposed credit is to be conditional upon (i) enactment of administrative regulations for the Bureau of Roads, (ii) the prior or concurrent effectiveness of each of the other external financing agreements involved in the proposed project, which must not be inconsistent with the IDA Credit agreement, (iii) the effectiveness of the consultants contract with Zaire-Routes and (iv) the signature of a contract for the laboratory component of the proposed project, to be financed by FAC. All of these proposed conditions are expected to be met by the end of March 1972, at the latest.

28. Paragraph 4.10 of the Appraisal Report indicates that it is hoped some of the experts to be provided to the Bureau of Roads by Zaire-Routes will be on the job before the signing of the proposed credit, expected to take place around February 15,1972, and that retroactive financing for paying the foreign cost of their services may be required. I recommend that retroactive financing on this account, up to a maximum of $100,000,be authorized.

Recommendation

29. I propose that the Association invite the Government of Zaire to negotiate a credit in an amount of $18.2 million, for a second highway project, along the lines of the recommendations set forth in paragraphs 6.03, 6.04, 6.07 and 6.08 of the Appraisal Report, and providing for retroactive financing of up to $100,000 as recommended in paragraph 28 of this memorandum, and that the Association work out arrangements with the other lending agencies on matters of common interest, as discussed in paragraph 26 of this memorandum.

Michael L. Lejeune
Director

December 8, 1971

Attachments

POPULATION: 18.5M

GNP PER CAP: $ 90

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

OPERATIONS PROGRAM

			1972	1973	1974	1975	1976
8-COK-AD-02	COTTON DEVELOPMENT	IDA			5.0		
8-COK-AL-01	LIVESTOCK	IDA		5.0			
8-COK-AP-01	RUBBER DEVELOPMENT	IDA		3.7			
8-COK-AX-01	AGRIC. UNIDENT.	IDA			20.0		
8-COK-AX-02	AGRIC. UNIDENT.	IDA				10.0	
8-COK-AX-03	AGRIC.UNIDENT	IDA					15.0
8-COK-CC-01	COMMUNICATION	IDA			10.0		
8-COK-DD-02	DFC II	IDA	10.0				
8-COK-DD-03	DFC III	IDA		15.0			
8-COK-DD-04	DFC IV	IDA					15.0
8-COK-EE-01	EDUCATION	IDA	6.5				
8-COK-EE-02	EDUCATION II	IDA				15.0	
8-COK-QQ-01	TOURISM I	IDA					15.0
8-COK-TH-03	HIGHWAYS II	IDA	17.0				
8-COK-TH-04	HIGHWAYS III	IDA			15.0		
8-COK-TH-05	HIGHWAYS IV	IDA				35.0	
8-COK-TX-01	TRANSP. UNIDENT.	IDA		25.0			
8-COK-UU-01	SPECIAL PROJECT (URBAN)	IDA				10.0	
8-COK-WW-01	WATER SUPPLY	IDA			10.0		
8-COK-XX-01	UNALLOCATED	IDA					15.0

	1964-68	1969-73	1972-76
IBRD			
IDA		100.2	272.2
TOTAL		100.2	272.2
NO		10	20

	1972	1973	1974	1975	1976
IBRD					
IDA	33.5	48.7	60.0	70.0	60.0
TOTAL	33.5	48.7	60.0	70.0	60.0
NO	3	4	5	4	4

LENDING PROGRAM (12/ 7/70)

	1964-68	1969-73	1972-76
IBRD			
IDA		82.0	135.0
TOTAL		82.0	135.0
NO		10	13

	1972	1973	1974	1975	1976
IBRD					
IDA	36.0	25.0	14.0	30.0	30.0
TOTAL	36.0	25.0	14.0	30.0	30.0
NO	4	3	2	2	2

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/71-51

December 10, 1971

Minutes of Special Loan Meeting to consider "UAR - Nile Delta Drainage Project" (Cr. 181-UAR) and the proposed "UAR - Upper Egypt Drainage Project" held on December 2, 1971 in Conference Room B.

1. Present: Messrs. Knapp (Chairman), Williams, Chadenet, Benjenk, Evans, Ripman, Wapenhans, Sir Kenelm Guinness, Messrs. Sella and Wittusen (Secretary).

2. Issues: The meeting was called to consider Sir Kenelm's Supervision Report of November 12, 1971 to Mr. Haynes on the Nile Delta Drainage Project. Project implementation continued to fall behind schedule with little evidence that the program for substantially increased field drainage would be achieved next year. The preparation and issue of contract documents was seriously behind schedule. The organization and management of the Nile Delta Authority for Drainage Projects was inadequate in quantity and quality to execute the project on schedule. The consultants were under-utilized and played a minimal role. The issues for discussion were therefore:

(i) how to improve the performance of the borrower, and

(ii) whether to go ahead with appraisal of the Upper Egypt Drainage Project in view of the borrower's present performance.

3. Performance of Borrower: The meeting noted that:

(i) The Nile Delta Authority had completed some 40,000 feddans of tile drainage this year and the work program called for an increase to 130,000 feddans next year, an increase which the Projects Department and the consultants thought the Authority incapable of achieving. Technically it was not a complicated project but it was being poorly handled logistically and managerially.

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Special Adviser to the President
Mr. J.H. Williams
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(ii) It was generally agreed that the poor organization and management of the Authority was the major constraint to successful implementation of the project. The Chairman had neither the technical nor the managerial competence required by a chief executive of such an organization. Several Directors suffered from the same limitations and there were no deputies to act in their absence. The Planning Office was virtually non-existent and the Authority's supporting staff was mediocre. Supervision missions had repeatedly pointed out the need to improve the staff and make more extensive use of the consultants, but to no avail. Lately, similar representations had been made to the Deputy Prime Minister (also the Minister of Agriculture).

(iii) Preparation of bid documents had particularly suffered from the shortcomings of the Authority and its reluctance to seek the consultants' advice. With respect to the documents for tile laying machines, which were crucial to the implementation of the project, the technical specifications had been drafted in such a way that retendering was necessary. The Authority had agreed to redraft the documents with the active participation of the consultants. Retendering would result in a minimum of 5-6 months' delay in machine deliveries.

4. Decision: It was agreed that:

(i) Consideration should be given to a high-level representation to the Egyptian Government that the management of the Authority should be replaced. The Chairman asked that a draft aide memoire for this purpose be prepared. (The draft letter attached to Sir Kenelm's Supervision Report and addressed to the Deputy Prime Minister should therefore not be sent.)

(ii) To minimize delay in the retendering of tile laying machines (cf. para. 3(iii) above), the representation to be made to the Deputy Prime Minister should emphasize the urgency of procuring these machines and the need to enlist the consultants' active participation to meet the revised schedule of procurement for the remaining items.

5. Upper Egypt Drainage Project: The meeting noted that:

(i) In view of the poor progress on the Nile Delta Drainage Project, the supervision mission had recommended postponement of the appraisal of the Upper Egypt Drainage Project. The Upper Egypt project was similar to the Delta project but spread over a more extensive area in which management and logistics would be more complicated.

(ii) Mr. Evans thought the Egyptians capable of handling both projects, providing they drew on better management manpower; good Egyptian managers were available. The project should therefore be appraised, but with the reservation that it would not be negotiated nor presented to the Board before performance on the Delta project had radically improved.

(iii) The Area Department, agreeing with Mr. Evans, emphasized the soundness of the Upper Egypt project and thought the Bank's willingness to appraise the project would demonstrate to the Deputy Prime Minister the Bank's faith in his ability to solve the problems surrounding the Delta project.

6. Decision: For the reasons stated in para. 5(ii)-(iii) above, the meeting concluded that the Projects Department should proceed with appraisal of the Upper Egypt Drainage project, but that the invitation to negotiate would not be issued until the Bank was satisfied with the borrower's performance under the Nile Delta project.

Dag F. Wittusen
Secretary

Cleared with: Messrs. Knapp
Benjenk
Wapenhans/Chadenet
Sella

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/71-50

December 9, 1971

Minutes of Special Loan Meeting to consider "Venezuela - Maiquetia International Airport Project" held on November 22, 1971 in Conference Room A, and of a subsequent meeting held on November 29, 1971.

1. Present: Messrs. Cope (Chairman), Williams, Broches, Chadenet, Knox, Rovani, Wright, Cancio, Cheryan, Douglas, Geli, Park, Schloss, Singh, Wyss and Wittusen (Secretary).

2. Issues: The meeting was called to consider the Central America and Caribbean Department's memorandum of November 15, 1971 to the Loan Committee entitled "Venezuela - Proposed Loan to the Republic of Venezuela for the Maiquetia International Airport Project" (LC/O/71-125) and attached appraisal report (PTR-99). The issues for discussion were:

(i) the economic justifications of the project, and

(ii) the proposed financial arrangements, including the level and structure of user charges and fees to be levied by the Airport Authority, financial covenants to be obtained, and the financial relationship between the Government and the Airport Authority.

3. Economic justifications. The meeting noted that:

(i) The Chairman questioned the appraisal report's economic rate of return calculations and suggested that the economic benefits analysis be extended to include other alternatives than those presently considered.

(ii) The Transportation Projects Department pointed out that, in addition to the proposed project, there were two basic alternative means of achieving the recognized airport safety requirements:

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Mr. S. Aldewereld, Vice President
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Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
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Director, Economic Program Department
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Vice President (IFC)

(a) the construction of a new international airport in the vicinity of Caracas, or

(b) the restriction of Maiquetia Airport as it was presently existing to the type of aircraft that could safely use it, i.e. propeller aircraft, which could be used to connect Maiquetia with other international airports that did meet the safety standards for jets, thus making it unnecessary to build a new runway at Maiquetia.

The rate of return calculation in the appraisal report attempted to measure alternative (b) against the proposed project, and thus represented an estimate of the least cost solution of the project. Alternative (a) had been excluded since it would clearly cost more than the proposed runway.

4. Decision: It was agreed that the grey cover appraisal report would be expanded to include a fuller discussion of the physical and economic aspects of using other international airports (alternative (b) above), in order to highlight more clearly the absence of any realistic alternative to the proposed runway.

5. Financial arrangements. The meeting noted that:

(i) The appraisal report recommended that airport user charges be established at a level sufficient to cover operating expenses including depreciation and to generate a rate of return on fixed assets in service. It was recommended that about 60% of the departure tax collected per Venezuelan passenger be treated as a user charge and credited to the airport as income for the purposes of a pro forma accounting system, to which the rates of return and other tests of financial performance would be applied as the basis for determining the levels of user charges.

(ii) It was agreed that one of the financial objectives would be a level of user charges which would ensure recovery by Venezuela of a significant amount of the project benefits, but that the cost of airport services required further study in order to define the appropriate level of user charges and to establish the ways and means by which airport benefits could be captured by the Venezuelan economy. The proposed loan included funds to undertake such a study.

(iii) However, the recommendation that a notional 60% of the departure tax be treated as an income of the airport for the purposes of a pro forma accounting system was considered ineffective as a means to ensure that the Airport Authority exercised financial discipline on its operational costs and presented a misleading picture of the actual financial arrangements. Instead, the Chairman proposed to establish a normal accounting system which would consider as revenues only income generated by user charges and draft a covenant which would permit the Airport Authority to cover its operating expenses and pay the Government a flat fee for the use of the facilities at least for the next 2-3 years after which the financial arrangements would be reviewed in the light of the proposed study financed under the loan. Such a flat fee would help finance the debt service which the Government contracted for the construction of the airport.

6. Decision: It was agreed that the Transportation Projects Department would examine the feasibility of the Chairman's proposal noted in para. 5(iii) above, to provide a basis for covenants which might seek to obtain operating cost control from the Authority without recourse to a pro forma accounting system. A final decision on the financial provisions would await consideration of revised proposals from the department.

7. Postscript: Messrs. Williams, Gutierrez, Knox, Geli, Park and Wyss met on November 29, 1971 to discuss Mr. Knox's memorandum of November 26 on the financial provisions (cf. para. 6 above). Agreement was reached on the following basis for negotiating the financial provisions:

(i) The Airport Authority would take over and own the airport installation which the Government was financing, subject to clarification, with particular reference to the runway, that there was no legal obstacle. The Government would receive permanent capital in the Authority to the value of the assets handed over.

(ii) The Authority would receive and retain all user charges, but not the departure tax on Venezuelan citizens.

(iii) The Bank would initially require the Authority to earn 8% on average net fixed assets in service, which would not require any change in the presently agreed level of user charges until the new runway came into service. Prior to that date the arrangement would be reviewed and revised in the light of consultants' recommendations on the appropriate structure and level of user charges. This review would require a decision by the Government on the most appropriate system of user charges (e.g. structure, level, method of collection), which might involve dropping or modifying the departure tax in order to impose a user charge on all passengers, and a decision by the Bank on whether a rate of return of less than 8% would be appropriate. The Central America and Caribbean Department and Transportation Projects Department would work out a specific timetable for the review and for the completion of the consultants' study.

(iv) The Authority would pay to the Government all cash surplus in excess of the Authority's requirement for working capital.

(v) The Government would remain responsible for servicing the debt it incurred to finance assets to be handed over to the Authority, and for assuring the availability of funds for future expansion. The Authority would not be required to make a contribution to the cost of future expansion over and above the cash payments to the Government noted in (iv) above.

It was also concluded that the Bank should not try to obligate the Government and the Authority to obtain the Bank's approval for the construction of the terminal building, but should negotiate a workable prior consultation clause.

Dag F. Wittusen
Secretary

MSchloss/DFWittusen:as

Cleared by: Messrs. Cope
Broches
Gutierrez
Knox/Chadenet
Williams

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

December 8, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Indonesia - Fourth Irrigation Rehabilitation Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 8, 1971 from the East Asia and Pacific Department, entitled "Indonesia - Fourth Irrigation Rehabilitation Project" (LC/O/71-133).

2. Comments, if any, should be sent to reach Mr. John Foster (ext. 2555) by 5:00 p.m. on Monday, December 13.

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

Dag F. Wittusen
Secretary
Loan Committee

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LC/0/71-133

December 8, 1971.

LOAN COMMITTEE

Memorandum from East Asia and Pacific Department.

INDONESIA: Fourth Irrigation Rehabilitation Project.

1. There is attached for the consideration of the Committee an Appraisal Report "Indonesia - Appraisal of Fourth Irrigation Rehabilitation Project" (PA-113) dated November 19, 1971. The report recommends that an IDA credit of US$ 11.5 million equivalent be made to Indonesia to assist in financing a fourth irrigation rehabilitation project.

The Economy.

2. The latest Bank economic reports on Indonesia are those of March 25, 1971 (EAP-22) on longer term development perspectives, and of November 30, 1971 (EAP-27a) on the economy's aid requirements for FY 1972/73. The second report, prepared primarily for the member countries of the Inter-Governmental Group for Indonesia (IGGI), focuses on recent economic performance, particularly in 1971, and the prospects for 1972. However, it contains an extensive annex on the oil sector.

The Lending Program

3. The latest Country Program Paper was approved on January 25, 1971 and the latest tabulation of our lending program is attached as Annex 1. Since the Association started operations in Indonesia in 1968, it has given emphasis to physical rehabilitation of infrastructure and of agricultural production capacity. The sixteen credits extended to date have helped to finance three projects each in irrigation rehabilitation and rehabilitation of agricultural estates, two for highways, and one each for fisheries, fertilizer production, seeds, telecommunications, technical education and power distribution, as well as two credits for technical assistance for pre-investment activities. As of November 30, total credits extended amounted to US$ 227.4 million; there has been no cancellation or repayment of principal.

4. In addition to the present project, nine others are expected to be ready for presentation to the Executive Directors in the current fiscal year. These include technical assistance III, agricultural education, population, development finance, smallholder rubber, agricultural estates IV, highways III, marine transport and power distribution II. Credits for these projects would amount to roughly $140 million, compared with the present IDA allocation for Indonesia of US$ 115 million, so that some may have to be held over until FY 1973.

The Agricultural Sector

5. The Government's current development program (1969-1974) gives highest priority to agriculture, with particular emphasis on rice production as rice imports are a severe foreign exchange drain. Rice production has increased markedly over the last four years and is expected to be bolstered in future by the works being carried out under three IDA credits for rehabilitation of irrigation systems covering almost 700,000 ha, the first of which is now partly completed. IDA has also made a credit to help increase rice yields throughout Indonesia by establishing a seed multiplication program for high yielding rice varieties. We have organized a consortium of lenders to finance a major expansion of the PUSRI fertilizer plant. To help bring about more systematic planning and policy making in the agricultural sector, we have financed a national fertilizer study and an evaluation of rice production and intensification programs, as well as a study of groundwater availability and potential uses. An agriculture sector survey mission to assess further needs in that sector, in coordination with the Resident Staff, is scheduled for the spring of 1972. Thus the Association is providing substantial help to Indonesia in its drive toward food self-sufficiency.

The Project

6. The project is composed of two parts. Part A would rehabilitate the Pekalen-Sampean irrigation system which serves 229,000 ha of important rice producing areas in East Java. This part would be executed by PROSIDA, an executive body in the Directorate General of Water Resources Development which implements projects financed by IDA.

7. Part B would investigate groundwater resources and alternative sources of supplementary water in the Sragen area (900 km^2) of the Upper Solo basin and in the Madium valley (1,600 km^2) to determine the most economical way of increasing water supplies for agricultural production in these water-scarce areas. This part would be executed by the Groundwater Group also in the Directorate

General of Water Resources Development. If the results are favorable, they could lead to a future irrigation project.

8. The estimated total cost of Part A is equivalent to US$ 20 million (not counting farmers' contributions in completing tertiary irrigation canals on their own land), of which the foreign exchange cost would be $6.3 million, or 32%. It is proposed that, as in earlier irrigation rehabilitation credits to Indonesia, the Association contribute 50% of the cost of Part A of the project. The case for financing an element of local currency costs was established for Indonesia on general economic grounds in the Country Program Paper of January 25. About $3.7 million of the IDA credit for Part A would on this basis be disbursed against local currency costs. During credit negotiations the Government delegation is believed likely to request IDA financing for up to 60% of the cost of Part A. However, since the lending program for FY 1972 appears large enough to absorb more than the allocation of IDA funds for Indonesia, and I do not expect that a case can be made on project grounds for raising the financing percentage, I propose to stick with the 50% formula.

9. The estimated cost of Part B is estimated at $ 2.2 million, of which the foreign exchange cost would be about 68% ($1.5 million) and would be covered by the proposed credit, with the local currency costs met by the Government.

10. The total project cost is thus equivalent to US$ 22.2 million, of which the Association would finance $11.5 million or 52% (including $3.7 million of local currency cost) and the Government would finance the remaining $10.7 million.

11. All goods in the project other than casings, pumps and certain other materials in Part B (paragraph13 below) would be procured after international competitive bidding in accordance with the Association's guidelines. All such items, or materials or components used in their assembly or manufacture in Indonesia, are expected to be exempted from duty under a decree of the Minister of Finance, in line with the Government's general policy for goods financed from project aid. However, it is Government policy to encourage manufacturing industry in Indonesia. If, therefore, the Association determined that the value added was sufficient to constitute local manufacture or processing, local bidders would be allowed a margin of preference of 15% or the actual customs duties payable by non-exempt importers, whichever is lower. On the other hand, bids for goods assembled in Indonesia with only insubstantial value added domestically would be treated in the same way as foreign bids and would receive no margin of preference in bid evaluation. Local manufacturers and

assemblers are expected to be successful bidders for only a small portion of the equipment procured under the project, though at present it is not possible to make a firm estimate of this portion.

12. The civil works under Part A, estimated to cost US$ 8.6 million, consist of a large number of small individual works scattered over the 139 systems. In many instances the exact scope of rehabilitation works cannot be specified in advance. Some of the works are seasonal, and each job must be scheduled to minimize interference with farming and to suit irrigation schedules. International competitive bidding would not be appropriate for such works. As in the Third Irrigation Rehabilitation Project (Credit 220-IND), the works would be grouped into contracts exceeding US$ 15,000 equivalent; and such contracts would be awarded after local competitive bidding by pre-qualified contractors. Foreign contractors would, of course, be free to pre-qualify.

13. Drilling under Part B would be for a small number of test-holes and wells at widely scattered sites and at a rate of work dictated by the investigation program; hence international bidding would not be appropriate for well drilling, and the consultants would sub-contract drilling to competent local firms. For Part B of the project, the types and quantities for casings, pumps and other materials needed to bring successful test wells into production cannot be determined until tests are completed. Therefore the consultants, as agents for the Government, would purchase the necessary items - which will cost no more than US$ 230,000 in total - as and when needed.

14. The Association would disburse against the cif price of imported goods and the foreign exchange cost of consultants' services and training. Where an award is made to a local manufacturer or assembler, disbursement would be made for the ex-factory price net of taxes on the sale of the goods involved. The Association would thus disburse a percentage (presently estimated at 95%) of the ex-factory price to take account of the local taxes involved; the local sales taxes are expected to be roughly 5% but their level will be further clarified during negotiations.

15. In order to finance 50% of the total cost of Part A of the project as proposed in paragraph 8 above, we would finance such proportion of the civil works in Part A as, together with our financing of imported or locally assembled goods, consultants services and training would bring us to that percentage. The proportion of civil works thus

to be financed is presently estimated at 43%, but the exact percentage would be determined in the light of the prices at which the civil works contracts, consultants' services and goods financed under the credit are obtained.

16. Savings from the proposed credit would be made available - subject to the Association's approval - for additional goods or services required for the project. The Appraisal Report also recommends (paragraph 4.18) that, if procurement were carried out by procedures not acceptable to the Association, the corresponding amount in the credit account would be cancelled. However, I propose that, if items were procured in this manner, it would be at the Association's option whether to cancel or to reallocate the savings resulting from ineligibility of such items.

17. The Appraisal Report sets forth in paragraph 5.09 what level of water rates would have to be charged in the project area to pay for the cost of operation and maintenance and also of investment costs. Farmers in Indonesia do not pay directly for capital costs of irrigation systems but contribute indirectly through the land tax. About 10% of the tax is used - but not specifically earmarked - for operation and maintenance of irrigation systems. The Appraisal Report recommends - and I concur - that, as was done in the third irrigation rehabilitation credit (220-IND) the Government should adopt and enforce legislation for the collection of charges on irrigated land or on its users in the project area, collect such charges within one year after each system is rehabilitated, and within two years of rehabilitation set the above charges at levels adequate to cover operating and maintenance costs.

18. No provision was made in Credit 220-IND for the recovery of investment costs, on the grounds that farmers had paid for maintenance through the land taxes and that rehabilitation was only needed because maintenance had not been carried out. This time the Appraisal Report recommends that, within two years of credit signature, the Government present to the Association for approval proposals for the recovery of a reasonable portion of investment costs, having due regard to the ability of the farmers to repay. However, this is a complex problem, and expectations should not be set too high. Some subsidy to farmers should not cause undue concern as land ownership in this area is relatively evenly distributed, land holdings are small, and the owners are among the lowest income sections of the population. I therefore propose that we should be satisfied with an undertaking by the Government to study the issue and, within two years of credit signature, to consult with the Association on the study's conclusions.

19. To ensure that PROSIDA maintains its capability, the Appraisal Report recommends (paragraph 5.02) that PROSIDA should at all times be headed by a fulltime General Manager whose qualifications and experience are acceptable to the Association. Agriculture Projects Department believes that a mere exchange of views between the Government and the Association would not prevent the appointment of a person whom we considered unsuitable. This could be, in their view, detrimental not only to this project but also to the entire irrigation rehabilitation program. The reason for their recommendation is that PROSIDA's current General Manager, who is acceptable to the Association, has been absent on military service and his present deputy has not shown the necessary competence. However, the General Manager is due to return in the next few months. Moreover, prior approval by the Association of such appointments has not in the past been acceptable to the Government; this recommendation thus goes further than other credits to Indonesia, and is also contrary to our usual practice in these matters, which is to provide for consultation rather than approval of management appointments. The Resident Staff therefore proposes - and I concur - that instead, in accordance with our usual practice, we should (i) provide that the Government have PROSIDA staffed with qualified personnel under the supervision of a competent and experienced General Manager; prior to the appointment of a General Manager, the Borrower would inform the Association of the names, qualifications and experience of candidates and would afford the Association a reasonable opportunity to exchange views on their qualifications and experience; and (ii) rely on our general right to suspend disbursements in the event that management turned out to be incompetent and the Government were to take no remedy.

20. We have extended two credits to Indonesia for technical assistance to finance pre-investment studies, and the Loan Committee is currently considering a third (area memorandum LC/O/71-131 dated December 1). As stated in paragraph 7 therein, there continues to be a pressing need for the funding of technical assistance in activities which those credits would provide, but we shall continue to the extent feasible to incorporate funds in project credits to finance studies for future lending in the respective fields. This matter is not referred to in the Appraisal Report because, at the time the present project was appraised, the next irrigation rehabilitation project had not been identified. However, the agricultural sector mission scheduled for the

spring of 1972 is expected to identify such a project, and the need is consequently foreseen for funds to finance the foreign exchange cost of consultants' services - estimated roughly at $450,000 - to prepare the sixth irrigation rehabilitation project. We and the Agriculture Projects Department propose that these funds should be included in the present project. This would bring the total amount of the proposed credit to $ 12.0 million. The appointment of consultants, and their terms and conditions of employment, would be agreed with the Association prior to any disbursement being made for that purpose.

21. The Appraisal Report notes the need (paragraphs 4.05 and 4.12) for consultants to be engaged no later than April 1972 to begin engineering services for the pre-construction period (April-October 1972) for rehabilitation under Part A, and to begin work on the groundwater investigation under Part B. It had envisaged that these services would be financed under Credit 216-IND (Technical Assistance II) unless the proposed credit could be made early in 1972. With Board consideration currently forecast for February 1972 (which is earlier than had been expected when the Appraisal Report was being drafted), Agriculture Projects Department and we propose that these services now be financed out of the proposed credit and that the credit agreement should provide for their employment by not later than April 1, 1972 or such later date as the Association may agree.

22. Subject to the qualifications made in paragraphs 16, 18, 19, 20 and 21, I agree with the Recommendations of the Appraisal Report that the project forms a suitable basis for an IDA Credit of $12.0 million and recommend that the Government of Indonesia be invited to send representatives to negotiate such an Agreement.

Raymond J. Goodman
Director
East Asia and Pacific Department

Attachment.

POPULATION: 112.8M

GNP PER CAP: $ 100

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

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

POPULATION: 112.8M

GNP PER CAP: $ 100

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

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

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

LENDING PROGRAM (1/25/71)

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

Form No. 60
(12-71)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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December 3, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Rwanda - Highway Maintenance Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 3, 1971 from the Eastern Africa Department, entitled "Rwanda - Highway Maintenance Project" (LC/O/71-132).

2. Comments, if any, should be sent to reach Mr. Lan (ext. 3603) by 12:00 noon on Thursday, December 9.

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

Dag F. Wittusen
Secretary
Loan Committee

DISTRIBUTION

Committee:
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CONFIDENTIAL

LC/O/71-132

December 3, 1971

LOAN COMMITTEE
MEMORANDUM FROM THE EASTERN AFRICA DEPARTMENT
RWANDA: HIGHWAY MAINTENANCE PROJECT

Introduction

1. Attached for consideration by the Loan Committee is a report (No.PTR-100) entitled "Rwanda - Appraisal of a highway maintenance project", recommending an IDA credit of $3.0 million equivalent to the Government of Rwanda to help finance a highway maintenance project.

2. The proposed credit would constitute the second Bank Group lending operation in Rwanda. An IDA credit (196-RW) of $9.3 million was made in June 1970 to finance the construction of a paved road between Kigali, the capital and Gatuna on the Uganda border. Another operation is planned for FY 1972 in the field of livestock and will be submitted shortly to the Loan Committee. The 1972-1976 Lending Program for Rwanda is attached.

The Sector and the Project

3. The economy of Rwanda is heavily dependent on roads, which provide the only means of communication between the different regions of the country as well as the main links between Rwanda and its foreign markets. There are no railways, and while there is some water transport on Lake Kivu, it is not of national significance. As is true of most landlocked countries, effective access to world markets is of primary importance to Rwanda. The IDA-financed Kigali-Gatuna road, when completed, will link Kigali, the capital and main commercial center, with the road/rail network in Uganda by which most of Rwandese imports and exports are shipped.

4. Although the highway network is rather extensive, it consists almost exclusively of low standard earth and gravel roads. The bulk of the network is in very poor condition, mainly as the result of inadequate maintenance. Traffic volumes are light and major construction on most roads cannot be justified at present. Improved maintenance is clearly the first step to be taken to satisfy the urgent needs of road transport. The Association has been concerned about the serious condition of road maintenance services in Rwanda for the last few years, and recommended a maintenance study leading to an improvement program. A

UNDP-financed highway maintenance study, for which the Bank was executing agency, was completed in February 1971 and formed the basis for the proposed project.

5. There is an acute shortage of experienced staff in the Directorate of Roads and Bridges (DRB). Five expatriate experts, to be provided by consultants, will be required in addition to those already in service under bilateral aid, to reorganize and strengthen the highway administration, and to build up a good maintenance system to meet the present and future needs of the country.

6. The project was appraised by an IDA mission in July 1971. It constitutes the first phase of an eight to ten-year maintenance program designed to improve road maintenance operations throughout the country. It would consist of a four-year program to be implemented with the assistance of consultants, and would provide for:

(i) reorganization and strengthening of maintenance operations including the training of maintenance personnel at all levels;

(ii) purchase of maintenance equipment, spare parts, fuel and materials;

(iii) construction and equipping of maintenance workshop facilities;

(iv) improvement of routine and periodic maintenance operations over the 2,200 km national road network; and

(v) betterment of selected roads and elimination of a backlog of deferred maintenance on about 600 km of the above roads.

7. The DRB, in the Ministry of Public Works and Power, will be responsible for executing the project. It will be assisted by consultants provided under the project and by nine expatriate experts who, under bilateral technical aid from the Federal Republic of Germany and Belgium, are now working in the Directorate. Both Germany and Belgium have assured continuation of these aid programs.

8. The project's estimated economic rate of return is about 30%, assuming an annual traffic growth of 7%. The rate of return remains satisfactory when tested with low estimates of future traffic growth and road user savings. However, the most significant benefit to be derived from the project is the establishment of a base on which a competent highway organization can be built.

9. The project is estimated to cost about $5.1 million equivalent, with a foreign exchange component of $4.6 million (about 90%). These foreign costs would be met by the Association, the UNDP and the Federal Republic of Germany. The proposed IDA credit of $3.0 million would be

used to finance the purchase of equipment, spare parts, fuel and materials and construction of a maintenance depot at Ruhengeri for equipment servicing; the UNDP would finance the cost of consultants ($1.1 million); and the Federal Republic of Germany would finance the construction and equipping of a central workshop at Kigali ($500,000). The local capital costs of about $500,000, of which 47% is for taxes and duties, would be financed by the Government.

10. Additional recurrent expenditures called for under the project, which are to be borne by the Government, will total about $2.9 million over a five-year period (1972-1976). We will require the Government to confirm during negotiations that sufficient funds will be allocated in the annual budget for highway maintenance.

11. Equipment to be financed with IDA funds, will be procured on the basis of international competitive bidding in accordance with Bank/IDA's standard bidding procedures.

<u>Parallel financing arrangements</u>

12. The Federal Republic of Germany has agreed in principle to build the required workshop at Kigali and to stock it with the necessary machines and tools. We are seeking confirmation from: (i) the German Government that they will finance this portion of the project, and (ii) the German and Belgian Governments that they will continue to provide to the DRB the technical assistance required during the project period. However, in the event that we would not receive such confirmation by mid-December 1971, and to avoid an unnecessary delay in processing this project, I recommend, and the Transportation Projects Department agrees, that we proceed with negotiations in early January 1972 and finalize arrangements with the bilateral donors prior to Board presentation.

13. The Government is seeking UNDP financing for the consultants services, and the UNDP is agreeable in principle to this request. Formal approval, however, cannot be obtained before the June 1972 meeting of the UNDP Governing Council. We propose, prior to consideration of the proposed IDA credit by the Executive Directors, to obtain an undertaking from the UNDP that it will seek approval for the financing of the required technical assistance at the meeting of its Governing Council in June 1972. Furthermore, we will seek UNDP advance financing to enable the consultants to arrive in the field before June 1972, if the project is ready to start prior to that date. Signature of the consultants' contract would be a condition for effectiveness of the IDA credit. In view of the interdependence of the various project items, UNDP and the Government have suggested that the Association should act as the executing agency for the project component covered by UNDP financing.

The Economy

14. An economic mission visited Rwanda in May/June 1971 and its report will be distributed shortly to the Executive Directors.

15. The mission found that from 1968 to 1970 GDP in current prices had increased by 19%. Growth in constant prices is not known exactly but is likely to have exceeded 5% a year. This growth rate, however, stemmed from circumstances which are unlikely to recur. In this two-year period foreign exchange earnings from coffee increased by 50% as a result of the combination of a bumper crop with high world market prices. Moreover, the proceeds from the sale of minerals increased by 48% during the same period, owing to a very high price for wolfram which led mining companies to sell off their stocks. The country's 1970 export levels are not likely to be repeated in 1971, as prices of both coffee and wolfram have declined and the exportable quantities are likely to be smaller. Overall economic growth in 1971 thus will also be smaller than in the preceding year.

16. Because of the country's extreme poverty, budgetary resources for development are very limited and central Government current finances have been normally in deficit with the Treasury borrowing from the Central Bank. This financial situation improved dramatically in 1970 when, for the first time since independence, a surplus on current account appeared in the amount of $2.1 million, and the Treasury was able to reduce substantially its indebtedness towards the Central Bank. However, 1970 was an exceptional year, and a deficit on current account is likely to reappear in 1971.

17. Up to 1967 the development budget had no earmarked sources of revenue, and development budget expenditures were mainly financed, like the ordinary deficit, through Central Bank advances. Starting in 1968, however, the Rwandese authorities decided to cover the development budget expenditures with the proceeds of the sale of three-year development bonds. Total availability of domestic resources for public investment in the 1966-70 period amounted to US$5.9 million and financed 15% of public investment in the period; the remainder (US$33.0 million) was financed through foreign aid, of which the bulk came from Belgium and FED.

18. As far as prospects for public investment in the 1972-76 period are concerned, no new development plan has as yet been drawn up by the Government. However, projections undertaken by the mission indicate that total resources available for public investment in that period may amount to US$98.0 million. Under these circumstances and given an expected increase in private investment, GDP in the next five years should expand at a yearly rats of about 4%. This rate of increase is lower than the one registered in the last seven years. However, the yearly growth of 7% in the 1964-68 period was largely due to the recovery from the post-independence decline, and the performance in 1969 and 1970 was due to unusual factors. A steady growth at 4% a year would appear to correspond better to the country's medium-term potential.

However, given Rwanda's population growth at a rate of about 3% a year, this would represent only a minimal increase of per capita income.

19. Because of the country's limited saving potential the Government's financial ability to contribute to the cost of foreign-financed projects will continue to be very small. We estimate the maximum yearly disbursements from external aid sources, including the Bank Group, to amount in the next five years to $17.0 million. Provided these amounts can be absorbed and assuming that the investment budget resources will amount to $2.0 million per annum in the same period, the average contribution of the Government to public investment projects will be 10%. However, local resources available for public investment are highly sensitive to the price of coffee. If this price were to fall to 30 cts/lb, rather than to 40 cts/lb as assumed above, domestic resources available to the Government for investment would amount to only $1.1 million a year and the average Government contribution would drop to 6%.

20. On December 31, 1970 Rwanda's public external debt with a maturity of over one year, amounted to $1.86 million, excluding undisbursed amounts, and $11.64 million including undisbursed. In the 1966-70 period external debt service amounted to $2.5 million or less than 3% of total export receipts in the same period. This low debt service does not, however, justify any borrowing by the Government on conventional terms. Since the current budget is likely to remain in deficit in future years, conventional borrowing would lead directly to an increase in the deficit and therefore also to a larger drain on the balance of payments. Even after such an exceptional year as 1970, gross foreign exchange reserves represented less than four months of imports and could hardly be called excessive. Consequently, in view of Rwanda's relatively modest export prospects, external aid should be on as concessionary terms as possible.

Recommendation

21. I recommend that, subject to the conditions expressed in paragraph 6.01 of the attached appraisal report as amended in paragraph 12 above, the Association invite the Government of Rwanda to send representatives to Washington to negotiate a credit of $3.0 million for a highway maintenance project on the terms and conditions set forth in paragraphs 6.02 to 6.05 of the appraisal report.

Michael L. Lejeune
Director

Attachments

POPULATION: 3.4M

GNP PER CAP: $ 70

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

OPERATIONS PROGRAM			1972	1973	1974	1975	1976
8-RWA-AD-01	INTEGRATED AGRIC.DEVT	IDA			3.0		
8-RWA-AI-02	MARSHLAND RECLAMATION II	IDA				4.0	
8-RWA-AL-01	MUTARA LIVESTOCK	IDA	2.5				
8-RWA-EX-01	EDUCATION UNIDENT. I	IDA			3.0		
8-RWA-EX-02	EDUCATION UNIDENT.II	IDA					4.0
8-RWA-QX-01	TOURISM UNIDENT.	IDA				2.5	
8-RWA-TH-02	ROAD REHAB.GISENGI	IDA			3.0		
8-RWA-TH-03	ROAD MAINTENANCE	IDA	4.0				
8-RWA-XX-01	UNALLOCATED	IDA					6.0

	1964-68	1969-73	1972-76		1972	1973	1974	1975	1976
IBRD				IBRD					
IDA		15.8	32.0	IDA	6.5		9.0	6.5	10.0
TOTAL		15.8	32.0	TOTAL	6.5		9.0	6.5	10.0
NO		3	9	NO	2		3	2	2

LENDING PROGRAM (12/23/70)

	1964-68	1969-73	1972-76		1972	1973	1974	1975	1976
IBRD				IBRD					
IDA		22.8	30.0	IDA	4.0	9.5	3.0	6.5	7.0
TOTAL		22.8	30.0	TOTAL	4.0	9.5	3.0	6.5	7.0
NO		5	9	NO	1	3	1	2	2

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

December 1, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Brazil - CSN Steel Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 1, 1971 from the South America Department, entitled "Brazil - Proposed Bank Loan for CSN Steel Project" (LC/0/71-130).

2. Comments, if any, should be sent to reach Mr. Fernandes (ext. 4056) by 4:00 p.m. on Monday, December 6.

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

Dag F. Wittusen
Secretary
Loan Committee

- DISTRIBUTION -

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

CONFIDENTIAL

LC/O/71-130

December 1, 1971

LOAN COMMITTEE

Memorandum from South America Department

BRAZIL - Proposed Bank Loan for CSN Steel Project

1. Attached is a draft general report (Yellow Cover) on the Brazilian steel expansion program, together with Appraisal Report No. PI-15, recommending a Bank loan of $64.5 million to assist in the financing of the CSN steel project. That project consists of the expansion of Companhia Siderurgica Nacional's steel mill in Volta Redonda from a capacity of 1.7 to 2.5 million tons of raw steel per year. The proposed loan would form part of a larger financing package in which we would lend $186 million, the Inter-American Development Bank (IDB) $124 million and bilateral lenders up to $250 million for a steel expansion program designed to raise Brazil's total flat products capacity from 3.7 million in 1972 to 7.2 million tons of raw steel by 1976.

2. Two other projects (expansion of the COSIPA mill from 1.0 to 2.3 million tons and of the USIMINAS mill from 1.0 to 2.4 million tons of raw steel per year) complete the Government's expansion program. We expect to present to the Committee the Appraisal Reports of USIMINAS and of COSIPA in December and February, respectively.

The Lending Program

3. The current five-year lending program for Brazil is attached. A revised lending program calling for expanded lending in the fiscal years 1973-77 is incorporated in a Country Program Paper which will be considered by a Presidential Review Meeting on December 2. In any case, a large volume of lending is contemplated for FY72. Loans totalling $96 million have already been approved at the beginning of this fiscal year for the Mineracoes Brasileiras Reunidas (MBR) Iron Ore project and the related railways project. The appraisal report is now being prepared for a loan of $60 million for the Sao Simao hydroelectric project. Two missions are now in Brazil to appraise agricultural projects; one is a grain storage credit program which might involve as much as $30 million in lending and a second is a small land settlement scheme, for which a loan of $8-10 million may be appropriate. The appraisal is also nearing completion of a large new highway program which could involve lending of up to $140 million in FY72 and FY73. Finally, discussions are proceeding with respect to a loan of $12.5 million for a fund to help develop the Brazilian capital market (FUMCAP). Together with the proposed lending of $186 million for the steel expansion program, it appears probable that the Bank will lend well over $400 million to Brazil in the present fiscal year.

The Economy

4. The recent Economic Report on Brazil (WH-210) issued on September 30, 1971, indicates that in 1971 as in the past three years, the Brazilian economy sustained a rapid growth rate while inflation has been kept under control and the country's international liquidity position was strengthened. While certain risks arise from the country's heavy debt service, I have recently discussed this problem with the Minister of Finance, and I am convinced that the Government is alive to the dangers and, should the need arise, is prepared to take timely steps to avert serious balance-of-payments problems.

Brazil's Steel Sector and Bank Policy

5. The Bank's active interest in Brazil's steel industry dates back to 1965 when we made a technical assistance grant to finance a study designed to suggest an optimum expansion program for the period 1966-72. The study, which was carried out by the U.S. consulting firm Booz, Allen & Hamilton International, confirmed the economic viability of Brazil's steel industry and recommended a progressive expansion of the three existing flat products steel mills to their optimum balanced capacities.

6. The Brazilian Government is now attaching the highest priority to the coordination of the steel sector and the implementation of an expansion program for the seventies to forestall the need for massive importation of steel products. The Government's resolve was crystalized in the establishment in June 1970 of the Conselho Nacional da Industria Siderurgica (CONSIDER) as a steel coordinating agency with executive powers.

7. CONSIDER has coordinated the preparation by the steel companies of their expansion projects, made these projects compatible with one another and with the findings of a comprehensive market study commissioned by CONSIDER, coordinated arrangements with potential lenders such as the Bank, IDB, bilateral credit agencies and the BNDE. In an advisory capacity, CONSIDER plays a leading role in setting the Government's price control policy with respect to steel products.

8. When the Brazilian Government requested the Bank in September 1970 to consider financing the steel expansion program, Brazil could point, therefore, to substantial policy achievements. This fact, plus the massive size of the investment requirements whose equipment component alone is now estimated at about $590 million, led us to feel that the Bank's participation would enable Brazil to secure external financing on the most favorable terms and significantly lower investment costs through procurement of equipment on the basis of international competition. An added consideration is that the Bank's involvement would enable us to support further policy and operational improvements both at sector and at company levels. Some of the measures envisaged are reflected below in the list of principal issues for negotiation.

9. A Special Loan Meeting on April 1 and 2, 1971, decided that the Bank should conduct its appraisal work on the basis of a Brazilian proposal for the parallel financing of the equipment component of the three projects,

on the understanding that the Bank/IDB's contribution would not exceed $300 million and that the Brazilians would obtain suitable credit facilities from bilateral credit agencies for the equipment not financed by the two Banks. The $300 million limit was set on the basis of the Bank/IDB's estimated contribution under the previously envisaged joint financing arrangement at a time when the total equipment component of the three projects was estimated at approximately $470 million. This scheme has led to the division of the equipment component into two separate packages. One, whose content was tailored to the total amount of the proposed Bank/IDB loans, would be entirely financed by the Bank and the IDB in a 60:40 proportion. This package contains all of the equipment items which may be awarded to Brazilian suppliers, as well as a substantial number of items which must be imported. Procurement will be on the basis of full international competitive bidding with a 15 percent margin of preference for Brazilian bidders. The other package, containing the balance of the equipment, would be financed by bilateral credit agencies with international competition restricted to suppliers of countries willing to provide finance on suitable terms. For the second package, financial terms offered by competing bidders would be taken into account during bid evaluation. The Brazilian Government has indicated to us that it wants to follow a consultation procedure under which the Bank would informally review contract awards for the bilaterally-financed portion of the projects. The Brazilians have now received financing offers from eight major steel mill equipment producing countries, which indicate that credits will be available on 15-year terms to cover 90 percent of the cost of equipment orders (pertaining to the bilateral package) placed in those countries.

The Project

10. CSN is owned by the Brazilian Government which directly (Treasury) and indirectly (Social Security Institute and Public Savings Bank) holds 94 percent of the Company's shares.

11. The total cost of the project is estimated at $448 million (including interest during construction and incremental working capital) of which (even if Brazilian suppliers are quite successful in the bidding) up to $241 million would be the foreign exchange component. The proposed Bank loan of $64.5 million for a term of 15½ years, including a 4½-year grace period, would finance about 15 percent of total costs. A maximum of about 40 percent of the Bank loan would represent local expenditure financing. Of the developing economies, Brazil has one of the most sophisticated capital goods industries so that a substantial part of procurement under investment projects suitable for external financing is bound to be made internally. We have calculated that if Brazil's overall external resource requirements are to be met about 40 percent of external financing (on the average) will need to be devoted to local expenditures. This is particularly appropriate in the case of the steel sector where as much as 25 percent of total equipment procurement can be manufactured locally at competitive cost.

Principal Matters for Negotiation

12. The principal matters recommended for negotiation are stated in the general report on the steel industry (paragraph 15.01) and in the CSN Appraisal Report (paragraph 10.01). They are provisions which are usual for this type of project, except that the following matters call for special comment. The Industrial Projects Department and the other Departments concerned are in agreement with the recommendations made.

Guarantee Fee

13. The Government will be asked to charge a 1-3/4 percent per annum fee to the steel companies in connection with the guarantee by the Government of the Bank's loans. We are requesting the Government to charge this fee so as to bring the cost of the Bank's loans to the companies to 9 percent per annum, an interest rate which, taking into account insurance and other fees charged by export credit agencies, approximates the cost of suppliers' or buyers' credits available to Brazilian industry. The Government is aware of our thinking and has indicated that it will agree.

Guarantee of the Government

14. We will request the Government to provide a full performance guarantee for all three projects and a guarantee of provision of funds including both domestic and foreign currency components. In addition, BNDE will provide loans to finance part of the local construction cost of the COSIPA and USIMINAS projects, the Government will reinvest in CSN, up to 1975, Treasury dividends received from CSN, and the Government will provide satisfactory financing of the down payments required in connection with bilateral credits.

Price Policy

15. A commitment will be sought from the Government that (a) the prices of the steel products sold by CSN, COSIPA and USIMINAS on the domestic market will not be reduced in real terms before 1976, except after consultation with the Bank; (b) thereafter prices will be set at levels aimed at providing the companies with a long-term debt service coverage of approximately two times and if such coverage were to fall below two times for any one company, or rise significantly above two times for all three companies, the Government will consult with the Bank regarding appropriate action; and (c) a detailed study on future steel price structure will be carried out and its recommendations taken into account.

16. The Government is aware that the Bank will seek assurances with respect to prices designed to protect the companies. It has indicated that it is prepared to accept an appropriate commitment provided that it does not prevent the Government from causing the companies to pass on to consumers a part of the benefits expected from increased productivity, and, from bringing domestic prices of cold rolled steel products progressively into line with international prices.

17. I believe that the formula described above would protect the interests of the steel companies, while meeting the Government's preoccupation.

Future Expansion Programs

18. The Government's steel expansion program for the flat products sector calls for the expansion of the capacities of CSN, COSIPA and USIMINAS to balanced capacities by 1980 -- before any new integrated steel mills are constructed. The scale of some of the steel-making equipment (namely blast furnaces) to be installed under Stage II of the expansion program (the stage proposed for Bank financing) is justified only in the expectation that the companies concerned will subsequently expand their rolling mill installations in Stage III. Consequently, we should seek assurances from the Government that it will not establish nor provide incentives for the establishment of new steel companies operating integrated flat product mills before completion of Stage III, without prior consultation with the Bank.

Coal Consumption Quota

19. As part of a policy to protect national coal production, the Government has obliged the steel companies to procure domestically certain minimum percentages of their total coking coal requirements. Since domestic coking coal is more expensive and of poorer quality than imported coal, this policy has increased coal costs per ton of finished steel, thereby offsetting to some extent Brazil's comparative advantages stemming from relatively cheap iron ore and labor costs. The Government has recently frozen the production of coal in the Santa Catarina mines with the result that the domestic quotas of the steel companies have dropped from 40 percent to the present 30 percent, and are intended to fall to 20 percent by the end of the Stage II expansion. We intend, during negotiations, to seek assurances from the Government that the companies will not be required, as long as any part of our loans is outstanding, to consume an unreasonable proportion of low-grade high-cost coking coal.

Competitive Bidding on Civil Works

20. CSN intends to pre-qualify reputable contractors in Brazil, including Brazilian subsidiaries of foreign firms. Although the Bank loan will not finance civil works, we propose to seek assurances from the Government that (a) foreign contractors will continue to have the possibility of establishing themselves in Brazil, and (b) should there be evidence in connection with an actual award that prices are rising excessively and/or that construction time schedules are becoming too long in relation to contracts placed in Stage I, international competition would be required on subsequent contracts. During negotiations, objective tests regarding prices and construction schedules would be agreed indicating when they had become excessive.

Labor Productivity

21. CSN should be asked to submit to the Bank a plan for establishing reasonable manning targets with emphasis on retraining existing employees and retiring older personnel.

Amortization of Bank Loan

22. It is proposed that the Bank's loan be repaid in 22 equal semi-annual installments of principal. This method, which is a departure from the Bank's normal procedure, would make the terms of the Bank and IDB loans similar, and, while more demanding upon the Borrower, is consistent with its cash flow.

Coordinating Consultant

23. Both we and the IDB consider that the successful administration of the loans for the three projects requires, given their size and complexity, a continuous supervisory effort by an independent consultant in the field. To be independent, the consultant will have to be engaged by the two banks and report directly to them. In accordance with its normal procedures, the IDB will deduct 1 percent from its total loan amount to cover loan supervision costs. There is, however, no correspondence between the amount deducted and actual supervision costs. We estimate that the consultant's fee will be of the order of \$1.5 million. I recommend that, in order to engage the consultant on a joint basis with the IDB, the Bank consider allocating within its administrative budget for fiscal years 1972 to 1975 the amount of \$900,000 as its proportionate contribution towards covering the cost of the consultant's services.

Retroactive Financing of Engineering Fees

24. CSN has requested the Bank and the IDB to finance engineering fees retroactively to July 1971. The Bank's share of the amount due through February 1972 would be \$720,000. The Company prefers not to seek financing from bilateral sources (U.S. Eximbank) because it believes that (a) terms would be less favorable than those for equipment procurement, and (b) the independence of the consultant might be affected. I recommend that we agree to include the cost of the engineering fees in our loan. The Executive Directors have already been informed through the Monthly Operational Summary that this is being considered.

Coordination with the IDB

25. A close working relationship has been maintained with the IDB starting with a joint appraisal mission and presently continuing with consultation on the proposed negotiating positions of the two Banks.

26. A Memorandum of Understanding between the Bank and the IDB is being drafted. It will seek to ensure future joint action with respect to procurement, disbursement supervision procedures and exchange of information.

Recommendation

27. I recommend that the Government of Brazil and CSN be invited to send representatives to Washington to negotiate a loan of $64.5 million to CSN to help finance its expansion program, the loan to be guaranteed by the Federative Republic of Brazil.

Gerald Alter
Director

Attachments

Attachment I

POPULATION: 88.2M

GNP PER CAP: $ 250

IVA BRAZIL - 5 YEAR OPERATIONS AND LENDING PROGRAMS

(BY FISCAL YEAR - AMOUNTS IN $ MILLIONS)

OPERATIONS PROGRAM			1972	1973	1974	1975	1976
2-BRA-AC-02	AGRICULTURAL CREDIT I	IBRD		20.0			
2-BRA-AC-03	AGRICULTURAL CREDIT II	IBRD				30.0	
2-BRA-AD-01	LAND SETTLEMENT-MARANHAO	IBRD	10.0				
2-BRA-AD-02	LAND SETTLEMENT II	IBRD			30.0		
2-BRA-AL-02	LIVESTOCK II	IBRD					60.0
2-BRA-DD-02	CAPITAL MARKET FUND	IBRD	12.5				
2-BRA-DD-03	BNB II (DFC)	IBRD			25.0		
2-BRA-DD-04	OTHER DFC II	IBRD			50.0		
2-BRA-DD-05	BNB III (DFC)	IBRD				40.0	
2-BRA-DD-06	DFC-INDUST.FINANCE III	IBRD					60.0
2-BRA-EE-02	EDUCATION II	IBRD		20.0			
2-BRA-IF-02	STEEL- COSIPA	IBRD	58.0				
2-BRA-IF-03	STEEL-USIMINAS	IBRD	63.0				
2-BRA-IF-04	STEEL CSN	IBRD	65.0				
2-BRA-IM-01	MBR IRON ORE	IBRD	50.0				
2-BRA-IM-02	IRON ORE NORTH	IBRD			50.0		
2-BRA-PD-05	POWER DISTRIBUTION	IBRD		20.0			
2-BRA-PH-15	POWER-SAO SIMAO	IBRD	60.0				
2-BRA-PH-16	POWER-ITUMBIARA	IBRD			75.0		
2-BRA-PH-17	POWER-AGUA VERMELHA	IBRD				75.0	
2-BRA-PP-27	POWER UNIDENT.	IBRD					75.0
2-BRA-TH-04	HIGHWAYS III	IBRD	80.0				
2-BRA-TH-05	HIGHWAYS IV	IBRD			100.0		
2-BRA-TH-06	HIGHWAYS V	IBRD				100.0	
2-BRA-TH-08	HIGHWAYS VI	IBRD					100.0
2-BRA-TH-09	HIGHWAYS IVA	IBRD		60.0			
2-BRA-TP-02	PORTS II RIO AND RECIFE	IBRD		28.0			
2-BRA-TR-03	RAILWAYS I	IBRD	46.0				
2-BRA-TR-04	RAILWAYS II	IBRD		50.0			
2-BRA-TR-05	RAILWAYS III	IBRD			50.0		
2-BRA-TX-03	TRANSP.UNIDENT. I	IBRD			75.0		
2-BRA-TX-04	TRANSP UNIDENT. II	IBRD				75.0	
2-BRA-UT-01	SAO PAULO BELTWAY	IBRD		80.0			

POPULATION: 88.2M

GNP PER CAP: $ 250

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

OPERATIONS PROGRAM

	1964-68	1969-73	1972-76		1972	1973	1974	1975	1976
IBRD	291.1	1142.8	1772.5	IBRD	444.5	258.0	455.0	320.0	295.0
IDA				IDA					
TOTAL	291.1	1142.8	1772.5	TOTAL	444.5	258.0	455.0	320.0	295.0
NO	10	26	33	NO	9	7	8	5	4

LENDING PROGRAM (11/16/70)

IBRD	291.1		1250.0	IBRD	250.0	250.0	250.0	250.0	250.0
IDA				IDA					
TOTAL	291.1	1029.9	1250.0	TOTAL	250.0	250.0	250.0	250.0	250.0
NO	10			NO					

P & B 11/18/71