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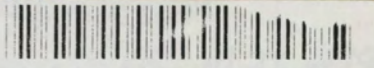
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McNair Papers

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East African Community - Debt Service Payment - Correspondence 01

Folder No. 1

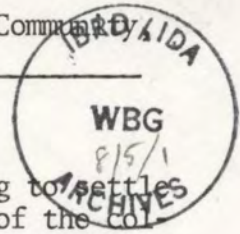
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815
ARCHIVES

OFFICE OF THE PRESIDENT

815/19/6

Meeting with Mr. Victor Umbricht on Intermediation in East African Community
February 5, 1980



Present: Messrs. McNamara and Umbricht

Mr. Umbricht reported on his intermediation role in trying to settle the disputes among the three governments involved in the aftermath of the lapse of the East African Community. In his view, the difficulty of the task had been underestimated:

- (a) Antagonism among the governments involved was huge.
- (b) There had been no records of assets which made it very difficult to establish lists; however, he was now satisfied with the amount of information in hand.
- (c) The Kenyans had been reluctant to cooperate because they had kept most assets of the Community; however, he had received outside information on those assets. He concluded that, as his report would reveal in two weeks, he knew more than the three governments thought he did. Therefore, the report would be well founded. He expected the governments to attack the report and not to accept its conclusions, because of either wanting more or not wanting to give assets back. As pointed out, Kenya had too large a share of assets whereas Uganda had by far too little; Tanzania probably had slightly more than justified. Tanzania's argument of "economic damage"--resulting from the dissolution of the Community and for which Tanzania requested compensation--was not acceptable. He concluded that the negotiations lying ahead would be most difficult and he asked whether the Bank could provide a person to help in these negotiations. Mr. McNamara promised that the Bank would provide such an individual.

CKW
February 26, 1980

WORLD BANK / IFC
OUTGOING MESSAGE FORM
(TELEGRAM/CABLE/TELEX)

895/1/5

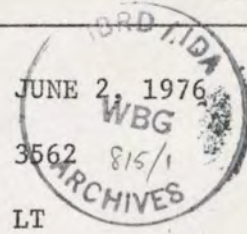
- IBRD
- IDA
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- ICSID

TO: HONORABLE KIINGE
FINSEC
KAMPALA

DATE: JUNE 2, 1976

ORIGINATOR'S EXT.: 3562 815/1

CLASS OF SERVICE: LT



COUNTRY: UGANDA

CABLE NO. & TEXT:

(Page 1 of 2)

DEAR MR. MINISTER:

I HAVE BEEN DELIGHTED TO LEARN FROM MR. DAMRY OF THE AGREEMENT YOU REACHED ON MAY 28 IN ARUSHA CONCERNING THE DEBT SERVICE PAYMENT PROBLEMS OF THE EAC CORPORATIONS. YOU ARE AWARE OF THE BANK'S DEEP INVOLVEMENT IN THESE CORPORATIONS AND OUR INTEREST IN THE FURTHER DEVELOPMENT OF THE COMMUNITY'S RELATIONSHIPS AND ITS INSTITUTIONS. IT IS BECAUSE OF THE IMPORTANCE THAT I ATTACH TO OUR OPERATIONS BOTH IN THE COMMUNITY AND IN THE PARTNER STATES THAT I HAD SENT MR. DAMRY AS MY SPECIAL EMISSARY TO DISCUSS OUR MUTUAL PROBLEMS. I APPRECIATE THE COURTESY WITH WHICH YOU RECEIVED HIM AND THE COOPERATION YOU EXTENDED DURING HIS MISSION.

I AM GLAD INDEED TO NOTE THAT YOU HAVE REACHED AGREEMENT ON FUNDAMENTAL POINTS, NAMELY, AGREEMENT ON FIXED CONTRIBUTIONS BY THE PARTNER STATES ON SHARING OF THE DEBT BURDEN, ASSUMPTION OF RESPONSIBILITY FOR ENSURING REMITTANCE OF THE EXTERNAL DEBT SERVICE PAYMENTS IN 1976, AND AGREEMENT ON A MECHANISM AND PROCEDURE FOR TIMELY PAYMENT TOGETHER WITH STANDING INSTRUCTIONS TO THE CENTRAL BANKS TO PROVIDE FOREIGN EXCHANGE COVER TO THE DEBT PAYMENTS INVOLVED. I AM SURE THAT DECISIONS ON THESE MATTERS WILL SIGNIFICANTLY AND POSITIVELY AFFECT THE TIMELINESS OF FUTURE DEBT SERVICE PAYMENTS BY THE EAC CORPORATIONS.

PAYMENTS ON THE THREE OVERDUE IBRD LOANS TO EAC CORPORATIONS -- ONE EACH TO THE RAILWAYS, P & T AND HARBOURS CORPORATIONS -- HAVE BEEN COMPLETED AS OF JUNE 1, AND THE BANK IS IMMEDIATELY RESUMING DISBURSEMENT ON THE LOANS TO THE EAC INSTITUTIONS WHICH WERE SUSPENDED ON APRIL 28.

NOT TO BE TRANSMITTED

REFERENCE: 428-1EA, 483-EA, 865EA	AUTHORIZED BY (Name): <i>[Signature]</i> Robert S. McNamara, President
DRAFTED BY: <i>[Signature]</i> M. Jalil/S. Please:bjw	DEPARTMENT:
REFERENCES AND COPY DISTRIBUTION: cc: Messrs. Knapp, Proches, Please cc: Messrs. Cargill, Rotberg, Gabriel, Clark, Adler cc: Moh, Jalil, Koromzay, Mrs. Harris	SIGNATURE (Of individual authorized to approve): SECTION BELOW FOR USE OF CABLE SECTION CHECKED FOR DISPATCH:

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(PAGE 2 of 2)

MR. DAMRY WILL VISIT EAST AFRICA AGAIN ~~XXXX~~ AROUND JUNE 10. HE WOULD EXPECT TO BE ASSURED THAT ALL PAYMENTS DUE ON JUNE 15 FOR THE THREE IBRD LOANS TO THE EAC CORPORATIONS HAVE BEEN REMITTED BY THAT DATE AS PER YOUR AGREEMENT OF MAY 28. I AM CONFIDENT THAT HE WILL RECEIVE YOUR CONTINUED COOPERATION IN THE MATTER.

SINCERELY,

ROBERT S. McNAMARA
PRESIDENT
INTBAFRAD

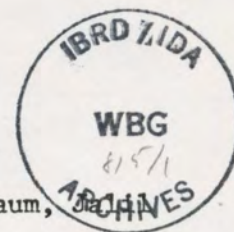
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895/1/2

MEMORANDUM FOR THE RECORD

Second Meeting on the East African Community, May 4, 1976



Present: Messrs. McNamara, Broches, Cargill, Wm. Clark, Please, Baum,

Mr. McNamara said that the daily reports on the debt payments of the East African Community made it clear that the governments did not understand the urgency of paying the Bank on time. Further action was therefore required. It was decided that a senior negotiator should go to East Africa as soon as possible. A thorough brief for the negotiator and a suggested talking paper should be prepared within the next four or five days. Messrs. Knapp, Shoab, Gaud and Chadenet were mentioned as possible candidates for the negotiator job. Mr. McNamara said that he was willing to meet the negotiator in East Africa on his way to or from the Middle East. Together they should see Presidents Kenyatta and Nyerere to explain the matter. While preparing the papers, the Region should give further thought to the tactics to be applied, and should contact the appropriate Ministers in East Africa. Mr. Clark would talk to Messrs. Jamal, Kibaki and McKenzie in Nairobi and report back to Washington, possibly by May 7.

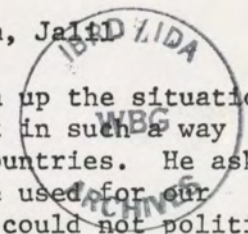
SB
May 5, 1976

cc: Mr. Knapp

815/1/1

Meeting on the East African Community, May 3, 1976

Present: Messrs. McNamara, Broches, Cargill, WClark, Please, Baum, Jalil



Mr. McNamara said that our objectives should be to clean up the situation with the East African Community by June 30, 1976, and to handle it in such a way that we would not weaken our relationship with the East African countries. He asked Mr. Jalil and Mr. Broches to put down a list of alternatives to be used for our negotiators. The problem was, of course, that Tanzania and Kenya could not politically agree to say that they had paid Uganda's share, but that we, on the other hand, would have to get paid anyway. As an illustration, Mr. McNamara gave as a possible formula that we could ask for advance payments on other loans and an agreement that these payments could be used for "other obligations." Mr. Jalil would prepare a daily report on the situation and send copies to all participants. The group should meet again on May 15, 1976. If the situation had not been settled by then, a senior official, such as Mr. Please or Mr. Sommers, should spend full time on the problem thereafter. Mr. McNamara said that he was willing to go to Nairobi to stress the urgency of the situation with the Governments on his way to or from Saudi Arabia. Mr. Clark could check on the situation while in Nairobi but he should not act as a negotiator.

cc: Mr. Knapp
Mr. Clark

SB
May 4, 1976

815/1/3

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara
THROUGH: Mr. Warren Baum
FROM: Stanley Please

DATE: May 5, 1976

SUBJECT: EAC - Proposals for Resolving the Problems of Delays in
Debt Service Payment



1. In response to your request, the Task Force on EAC Matters has reviewed the current problems of delays in debt service payments from EAC Corporations and recommended alternative proposals for resolving the problem. Attached is a memorandum dated May 5, 1976, from the Task Force to me on this subject.
2. I endorse the proposals made by the Task Force on the medium/long-term solution to debt service payment, i.e., the Community should make direct payment to the Bank to cover any default by the Corporations from custom revenues. We will pursue this actively both directly and through the Demas Commission (Mr. Demas has been alerted) but it is not relevant to our immediate problem.
3. With regard to the urgent short-term problem, the proposals can be classified into two main categories. Firstly, those by which the Partner States would make arrangements to cure the defaults and, secondly, those by which the Bank would de facto meet the defaults through a modification of its procedures.
4. So far we have told the Governments that the legal "joint and several guarantee" responsibility must be honored. If we continue to take this view then I believe we must pursue the first set of options and insist that Kenya and Tanzania make payments or advanced repayments into an escrow account for meeting unpaid EAC debt service.
5. However, at the end of our meeting on Tuesday afternoon there appeared to be a growing willingness to consider a more limited responsibility than the legal 100% liability of each country particularly because of the recognition of the Ugandan problem. If this view were taken, then we should be insistent on Kenya and Tanzania paying either their own "fair" share or their own fair share plus an appropriate share of the Ugandan default but we would refrain from suspending on each of their national programs providing they were meeting the share attributed to them. While not relenting on the joint and several responsibility of the Partner States, we would then confront the residual default problem by the adaptation of our procedures such as recommended in para 6B(c) of the Task Force Report. In effect these adaptations would amount to the Bank providing funds to the Corporations to enable them to make debt payments to the Bank. The most straight-forward way of accomplishing this would be by making provision for disbursement against foreign exchange costs of the Corporations's

working capital requirements in an amount equal to uncovered debt service payments. However, I think the critical decision is not the precise adaptations required to achieve the objective but whether we are willing to go this route at all. The Bank does, of course, regularly pay interest during construction to itself but this is markedly different from doing so in a situation of default by a debtor.

6. I reject completely the option raised by the Task Force that we should accelerate the processing of the program credits to Tanzania and Kenya for the expediency of resolving EAC debt service problems. It was included, I believe, for the sake of completeness in coverage of options. It is important that we separate the two issues of program lending and EAC default so that we can retain our strong position with the Governments on country policy dialogue through the program credit discussions.

Recommendations

7. I recommend:

(a) That you proceed immediately to appoint a personal emissary (Mr. Shoaib) to convey to the Presidents and the Ministers the seriousness of the default situation both to the countries and to the Bank, that we together should be willing to work out suitable mechanism to resolve payment problems. The Governments should be told in no uncertain terms of the inevitability of total suspension if the minimum objectives set forth below are not attained within a short period. He should proceed to East Africa as soon as possible and be accompanied by Mr. Jalil (or Mr. Loh, Division Chief for EAC and Partner States). The background, technical details, nuances, etc. of the EAC are so complex that no briefing paper will be adequate to guide your emissary. The discussions should reach a point within a week (say, from 12 to 19 May) where it will be possible to judge whether a visit from yourself to Presidents Kenyatta and Nyerere, on your return from the Middle East is necessary.

(b) The tactics should be along the following lines:

(i) The exploration of the arrangements under para 4 above whereby Kenya and Tanzania would make advance payments to the Bank to meet the possibility of a Corporation default resulting from Uganda's unwillingness or inability to pay;

(ii) Insistence that Kenya and Tanzania make arrangements for ensuring that their agreed shares of P & T debt service are met punctually;

(iii) Insistence that agreement is reached immediately on the fair shares for harbours debt service and arrangements for ensuring these shares are met punctually (Trust Account in Central Bank);

(iv) Insistence that agreement is reached immediately on the fair shares for railway debt service. At the moment Kenya and Tanzania are claiming that these shares should be equal for all three countries. We should, however, start discussions from a position that the sharing be based on fixed asset ratio under which Uganda share will be reduced from one third to 15 percent. Arrangements for ensuring these shares are met punctually (Trust Account in Central Bank) would also have to be agreed.

(v) Agreement on ii, iii and iv would represent a major breakthrough in that it would (a) fix firm national commitments and (b) establish procedures for punctual payment. If, therefore, these objectives can be achieved then if Kenya and Tanzania are unwilling to make advance payments to meet any Uganda default as proposed as an initial negotiating position in (i) above, then the alternatives of limiting Kenya and Tanzania's individual responsibility to a fixed share of the Uganda default or the Bank making adaptations to its disbursement procedures for dealing with the problem should be explored. The important objectives are that Kenya and Tanzania's individual financial responsibilities should be fixed amounts and that procedures for prompt payment be established through the device of a Trust Account in Central Banks;

(vi) Having determined fixed national commitments, it be made clear that delays in payments will no longer be tolerated in the manner in which we have tolerated them over the past few years. Immediate settlement of arrears would be part of this undertaking, and prompt payment of the June 15 payments the first major test of the sincerity and credibility of the agreement upon which our decision to consider partial or total suspension of disbursements on national programs will be based. The anticipated Uganda delays would, in terms of the package deal, will be covered by any of the alternatives mentioned in sub-paragraph (v).

cc: Messrs. Knapp (o/r), Broches, Cargill, Rotberg, Gabriel,
Loh, Adler, Ahmad and Task Force members

PCLoh/MJalil/SPlease/imm

OFFICE MEMORANDUM

TO: Mr. Stanley Please, Acting RVP, EAfrica

FROM: Task Force on EAC Matters, EAfrica *Done*

SUBJECT: EAC - Proposals for Resolving the Problem of Delays in Debt Service Payments

DATE: May 5, 1976

Introduction

1. Since February 1973 the Bank has experienced delays in receiving debt service payments from the East African Community Corporations. The Bank for a number of times exercised its legal rights to suspend disbursements to EARC, EAHC and recently to all East African Community Corporations including EADB. Events which occurred before February 1976 indicated there were three major causes leading to such delays in payments by the Corporations:

- (a) the financial insolvency of EARC;
- (b) failure to reach agreement on, and to fully implement the formula for sharing of debt service burden among the three Partner States; and
- (c) failure to make transfers due to foreign exchange shortage.

The financial problem of EARC was caused mainly by a delay of tariff increase for almost nine years. With the assistance of the Bank and the service provided by Transmark, the Partner States finally approved several rate increases in 1974 and provided loans to EARC amounting to Sh150 million. The Bank also actively provided technical assistance to the Partner States in reaching agreements for debt service burden sharing in July 1974 and July 1975. The implementation of such agreements, however, was not faithfully carried out. The foreign exchange shortage has affected all the countries, with Uganda most severely affected. Nevertheless, Uganda performance has been better than our expectation until recently.

2. In addition to the efforts made by the Bank to resolve debt service payment problems, the Bank was instrumental in having the Partner States set up a Treaty Review Commission under the chairmanship of Mr. Demas to seek long term solutions to the problems of EAC. Notwithstanding political difficulties, progress has been made in reviewing the Treaty and the Commission's report will be distributed in November 1976.

3. Since February 1976, however, a new factor came into play. The deterioration of political relationship between Uganda and Kenya resulting from Amin's claim of Kenyan territory has caused severe strain between Kenya and Uganda. The immediate impact of this political development on EAC Corporations' debt service to the Bank is that both Kenya and Tanzania will no longer pay more than its "share" to cover "Uganda's share." Political leaders in Kenya and Tanzania have repeatedly told the Bank staff that they would pay their "share" but it would be politically naive for the Bank, under the present political situation, to expect Kenya and Tanzania to pay or have the appearance of paying for the Uganda share.

4. During March - April 1976, a Bank mission went around the capitals of the three countries for intensive negotiations based on a paper prepared by us. This paper gave the total external obligation as well as other headquarters requirements for CY1976 on a quarterly basis, its foreign exchange implication and showed about 5 different ratios on which the countries could share the burden. Kenya and Tanzania gave their positions and Uganda reserved its response for a formal meeting of the Joint Finance and Communications Councils. The Bank paper was circulated by the Community Finance Minister recommending its consideration which took place in the Joint Council meeting on April 10. At that meeting fixed asset distribution was agreed as the basis for sharing between the countries in respect of P&T, but Railways and Harbours cases could not be agreed. Meanwhile, as per their interim position, Kenya and Tanzania have paid about 33 percent of total amount due for Railways. Tanzania is now agreeable to pay about 41 percent of the Harbours loan (Kenya has paid 50 percent already). In our discussions in March - April, Kenya and Tanzania had agreed in principle to establish Trust Funds in Central Banks (except for EAPTC whose headquarters is in Kampala) into which funds in accordance with agreed ratios will be deposited quarterly in advance. The Central Banks would make automatic remittance to service debt payments on due dates.

5. The legal obligations, i.e., joint and several obligations are made clear to the officials of Kenya and Tanzania, and they are not questioning such obligations. The important issue to them is to devise a mechanism under which debt service payments may be made for a defaulting country without causing political embarrassment. This issue, of course, adds to the existing three problems mentioned in para 1 above.

Specific Proposals

6. In response to your instruction, the Task Force reviewed various alternatives to resolve the problem of current defaults.

These can be divided into two categories. First, a longer term solution and second, immediate interim solutions. In our view, not all the proposals will bring about an entirely satisfactory outcome for a variety of reasons. Nevertheless, we decided to list them so that the management can finally decide on this matter with all possible alternatives considered.

A. Longer Term Solution

Direct payment by the Community from custom revenues to the Bank

Under the Treaty the Community collects customs revenues on behalf of the three Partner States. The Community could allocate some of the custom revenues to cover unpaid debt service payments to the Bank. This, however, requires the authorization from the Legislative Assembly of the EAC and the approval of the Authority of EAC which consists of the three Heads of States.

The Task Force recommend that the proposal be pursued vigorously. This payment mechanism will become even more important in view of the likely recommendations by the Demas Commission to split the Railways and Harbours Corporations together with the strong requests by Kenya and Tanzania to have separate guarantees for the EAC loans. Even if the Partner States work out a satisfactory settlement after the Treaty Review and regardless of what form of guarantees will take, the proposal would still be an important and useful recourse for the Bank because it would provide a mechanism to ensure that debt service payments to the Bank would be made without resorting to guarantees of the Partner States.

In addition, the Bank could explore with the Partner States arrangements under which the Community would make loans to the Corporations to cover debt service payment shortfalls. The source of fund would still have to come from customs revenues. We have to review these proposals in more detail and there is considerable doubt in our mind that Amin would agree to make any accommodation. Nevertheless, as a longer term solution, we should follow this up with the Partner States and EAC both directly and through the Demas Commission.

B. Immediate Interim Solutions

(a) Advance Payment by Partner States

Both Kenya and Tanzania could be asked to make advance payments to the Bank and set aside such payments in an escrow account to meet present and future debt service payments not covered by the Corporations.

(b) Right of Set-Offs

The Bank could exercise its right of set-offs against disbursements under its loans and credit to the three Partner States. This set-offs should be limited to disbursements against local cost expenditures so as to avoid any payment problem to the foreign suppliers. The legal agreements with the Partner States do not provide this right explicitly. The legal member of the Task Force believes there will be substantive legal grounds for the Bank to exercise such right.

(c) Payments from disbursements under existing EAC Loans

There are several ongoing projects for the three Corporations in EAC. Under each project, the uncommitted and undisbursed amounts (i.e. amounts not yet allocated for any approved contracts) can be used to cover the contingency debt service payments of a defaulting Partner State for CY76. The disbursements can be made against (i) expenditures made by the EAC Corporations from their own resources for items included in the list of goods under existing loans to the EAC Corporations but not disbursed in the past; (ii) foreign exchange costs of the Corporations' working capital requirements in an amount equal to uncovered debt service payments; and (iii) civil works contracts by increasing percentage rate of disbursements. This would mean making disbursements that would not normally be made in order to make payments to the Bank itself for defaulted debt service payments. The disbursements can be made to the Crown Agent. The Crown Agent would then repay the Bank the amount received from the Bank for debt service payment under a standing instruction from the Corporation concerned.

The Legal Department is reviewing various requirements for amendments to the agreements and any necessity of involvement of the Board.

(d) Payments from the proceeds of the proposed program credits to Kenya and Tanzania

Kenya and Tanzania could use the proceeds of the proposed program credits to cover debt service defaults by the Corporations. Negotiations of the Tanzania have been substantially completed but Board presentation will be delayed due to our insistence that as a condition of Board consideration, the Government should reach an agreement with IMF on second Credit Trench. The Kenya program credit is still in the pre-appraisal stage and will be subject to the same conditions. The Bank could consider acceleration of the processing of the two credits by waiving the requirement on IMF linkage and work out a deal with the two Governments to the effect that they would set aside part of the proceeds of the program credits for payments of debt service defaults by the Corporations.

(e) Immediate Suspension of Country Programs

Before the Bank suspended disbursements to EAC Corporations, considerations were given to apply pressure to the Partner States for immediate payment by suspending all country program disbursements. It was decided to follow a "gradual escalation" response. As a final alternative, the Bank could reconsider its position and apply maximum pressure as soon as possible.

Conclusions

7. The Task Force recommend strongly to pursue the longer term solution with the Partner States and EAC on use of custom revenues for debt service defaults.

8. For immediate interim solutions, the Task Force recommend to follow up alternatives (a) - advance payments by Partner States, and (c) - payments from disbursements under existing EAC loans.

PCLoh/ebb

cc: Messrs. C. Morse/H. Adler
D. Koromzay/H. Scott
M. Jalil
C. Vasudevan

Messrs. B. Ahmad
L. Hansen
S. O'Brien
Mrs. S. Harris