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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

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REPORT AND RECOMMENDATIONS  
of the  
PRESIDENT  
to the  
EXECUTIVE DIRECTORS  
on the  
LOAN APPLICATION  
of the  
CASSA PER OPERE STRAORDINARIE DI PUBBLICO  
INTERESSE NELL'ITALIA MERIDIONALE  
(CASSA PER IL MEZZOGIORNO)  
guaranteed  
by the  
REPUBLIC OF ITALY

May 24, 1955

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATIONS OF THE PRESIDENT  
TO THE EXECUTIVE DIRECTORS  
CONCERNING A PROPOSED LOAN  
FOR ELECTRIC POWER, INDUSTRIAL AND IRRIGATION PROJECTS  
IN SOUTHERN ITALY AND IN SICILY

1. I submit the following report and recommendations with regard to a proposed loan in an amount in various currencies equivalent to \$70 million to the Cassa per Opere Straordinarie di Pubblico Interesse nell'Italia Meridionale (Cassa per il Mezzogiorno) for the purpose of financing electric power, industrial and irrigation projects in Southern Italy and in Sicily.

PART I - HISTORICAL

2. In August 1950, a 10-year Development Plan (since enlarged to a 12-year Plan) for the development of Southern Italy was enacted by the Italian Parliament. Thereby for the first time, the Italian nation commenced a massive and integrated attack on the centuries-old problem of the relative underdevelopment of Southern Italy and the Islands of Sicily, Sardinia, and Elba. The law establishing the Plan also created a new agency, the Cassa per il Mezzogiorno, charged with carrying out the Plan. The Cassa was set up independently of existing ministries, with a freedom of action going considerably beyond existing departmental procedures.

3. The Bank has already made two loans of \$10 million each to the Cassa. The first loan (50 IT) was made on October 10, 1951, and was for 25 years at 4½%; the second (88 IT) was made on October 6, 1953, and was for 25 years at 5%.

4. These two loans to the Cassa were designed to assist Italy in carrying forward the 12-year Plan by covering a part of the impact on Italy's balance of payments in dollars and other convertible currencies, arising from the execution of the Cassa investment effort. Disbursements were made in dollars, based on lire expenditures of the Cassa on its over-all program in the proportion of \$10 million to lire 100 billion.

5. Last year the Italian Government proposed that the rate of Bank lending to Italy should be substantially increased in view of Italy's increased needs and Italy's ability to service larger loans, and requested consideration of a loan of \$70 million for the next year. The Government also indicated it would wish to present similar loan proposals during the following few years, if Italy's creditworthiness should continue to improve, and if the Bank agreed that Italy's financial needs would justify assistance of this magnitude.

6. In May and June 1954, a Bank mission visited Italy to bring the Bank's assessment of Italy's creditworthiness up to date. The report of this mission, which has been brought up to date to include the most recent economic information available to the Bank, was circulated to the Board on May 23, 1955 (R-879/1).

7. After considering the review of the creditworthiness of Italy made by this mission, I discussed the Italian loan proposal with Budget Minister Vanoni and Governor Menichella in Washington at the time of the Bank's Ninth Annual Meeting. I told them that I would be prepared to recommend to the Board a loan of this magnitude to finance specific projects in the program of the Cassa per il Mezzogiorno or related to the program, providing that projects of this magnitude suitable for Bank financing could be found. The Italian representatives were also informed that, although no commitment could be taken with respect to possible further loans, I expected the Bank's relationship with Italy to be a continuing one and future loan requests would be studied in the light of the then existing situation.

8. A group of projects in the fields of electric power, irrigation and industry was prepared by the Italian Government and by the Cassa during October and November of 1954. In December 1954, on the invitation of the Italian Government, a member of the Bank's staff went to Italy for a preliminary discussion of this list. Simultaneously, another member of the Bank's staff went to Italy to make an appraisal of the economic effects of the whole Cassa program. This appraisal was circulated to the Board on May 20, 1955 (R-879).

9. The list of projects proposed for Bank examination was brought back to the Bank at the end of December, together with such technical material supporting the applications as was readily available when the list of projects was discussed. An examination of the lists and the supporting material by the Bank staff in January 1955 resulted in a decision to prepare questionnaires to obtain the detailed information necessary for appraisals of projects and a mission, headed by Mr. Sidney P. Wheelock, went to Rome in February 1955 to obtain this information. Evaluation of the material was made jointly by the Mission in the field and by the Bank's staff in Washington. On the basis of this evaluation, the allocation of the loan to the three sectors and the selections of projects within each sector were made.

10. Agreement in principle on the broad aspects of the setup of the proposed loan was reached during April and I visited Rome on May 2 and 3 to discuss other general matters affecting future relations between the Bank and the Government of Italy.

11. Meanwhile it had become apparent that because of the complexity of the operation and of the number of negotiations and interests involved, the Bank's usual practice of negotiating loans in Washington would not be appropriate in this case. Therefore, Mr. Martin M. Rosen, Assistant Director of the Department of Operations Europe, Africa and Australasia, arrived in Rome on May 1 to carry the negotiations to the final stage. Negotiations proceeded smoothly and agreement was reached on the draft documents by May 18, 1955.

## PART II - DESCRIPTION OF PROPOSED LOAN

### Borrower

12. The Borrower would be the Cassa per Opere Straordinarie di Pubblico Interesse nell'Italia Meridionale (Cassa per il Mezzogiorno).

Guarantor

13. The Guarantor would be the Republic of Italy.

Amount

14. The loan would be in an amount in various currencies equivalent to \$70 million.

Purpose

15. The purpose of the loan is further to assist the Borrower and the Republic of Italy in promoting the economic and social development of Southern Italy and Sicily, by providing financial assistance for selected, sound projects in the sectors of power, private industry and irrigation. A detailed review of the projects is contained in the "Appraisal of Italian Industrial, Irrigation and Power Projects," TO-84 (No. 6). The loan will also have the supplementary effects of improving Italy's foreign exchange position and increasing the availability of non-inflationary investment resources to the Cassa, to the power companies and private industries concerned.

16. Electric Power - The \$30 million allocated to the power sector will finance about 60% of the cost of six hydro plants, with an installed capacity of 101,700 KW, a 120,000 KW thermal plant, 312 kilometers of high tension transmission line, necessary transformer stations and related facilities. The projects are being constructed by Societa Meridionale di Elettricita, Societa Generale Pugliese di Elettricita, and Unione Esercizi Elettrici. As a result of these projects, installed generating capacity in Southern Italy will increase by 16.5% from the level existing at the end of 1954 and production should increase by 18.5% from 1954. Power is essential to the development of Southern Italy and these projects will make an important contribution towards meeting these needs.

17. Industry - The \$20 million allocated to the industrial sector will provide approximately 50% of the financial requirements of seven new industries, two on the mainland of Southern Italy and five on the island of Sicily. These projects comprise two fertilizer plants, one cement plant, one paper mill, one plant to produce wool yarns, one plant for pharmaceutical products and agricultural chemical products, and one plant to process citrus juices. The allocation of about \$1.5 million of the \$20 million to projects proposed by the Italian Government for consideration will be decided subsequently.

18. Irrigation - The \$20 million allocated to the irrigation sector will cover some 40% of the cost of the Catania Plain Irrigation Project, on the east coast of the island of Sicily, near the city of Catania. This project will result in the irrigation of 31,000 hectares of the Catania Plain.

19. The impact of the proposed loan on the island of Sicily will be very considerable. The irrigation project will greatly increase the quantity and value of the agricultural output of this underdeveloped area and will induce

a radical shift of the crop pattern towards highly profitable production of citrus fruits, since about 8,000 hectares of the irrigated area are expected to be devoted to citrus production. As a result of the project, it is estimated that the income of farmers and farm laborers employed in the area to be irrigated will increase from the present level of 2.5 billion lire annually (\$4.0 million equivalent) to about 10 billion lire annually (\$16 million equivalent) when it has been completed and is yielding its full returns.

20. The irrigation project and the industrial projects on Sicily are closely interrelated. For example, the irrigation project will require substantial quantities of cement and a cement plant with a capacity of 130,000 tons is being assisted in an amount of \$1.700 million. The new agricultural pattern will require complex fertilizers, at present very little used in Sicily; two fertilizer plants are being assisted in an amount of \$8.160 million. A pharmaceutical plant which will produce insecticides and pesticides and which will include a research laboratory for the study of agricultural chemical products will be assisted to the extent of \$1.600 million. A fruit juice plant, which will process oranges and lemons for juice and produce cattle feed as by-product, will be assisted to the extent of nearly \$1.900 million. This activity, together with the other very considerable public and private investments known to the Bank to be going forward in Sicily, should have a profound effect on the economic structure of this island.

#### Terms

21. The loan would be amortized by semi-annual payments commencing July 15, 1958, in the amounts set forth in Schedule 1 to the Draft Loan Agreement (No. 1). These payments would retire the loan by maturity on July 15, 1975. The loan would bear interest, including 1% commission, at the rate of 4 3/4%.

22. The commitment charge would be at 3/4 of 1% per annum and would accrue from the respective date or dates on which the loan becomes effective or from August 2, 1955, whichever is earlier.

#### Legal Instruments and Legal Authority

23. The Loan Documents consist of the following:

- (a) Loan Agreement (No. 1);
- (b) Guarantee Agreement (No. 2); and
- (c) three Project Agreements (Nos. 3, 4, and 5).

24. These documents reflect the differences from the normal single project loan directly to the enterprise which is to operate the project. These include:

- (a) There are ten projects described in Schedule 2 to the Loan Agreement, and an unallocated amount of \$1,598,000 which may be allocated later to

one or more additional industrial projects by agreement with the Borrower. The specific amounts of the Loan allocated to each project and the unallocated amount are listed in Schedule 4 to the Loan Agreement. Section 3.01 (b) provides that these Schedules may be changed by agreement between the Bank and the Borrower.

(b) The Loan and Guarantee Agreements may become effective, and may be cancelled, separately with respect to each project and the amount of the loan allocated thereto.

(c) Except in the case of the Irrigation Project, which will be executed by the Cassa, the Documents provide for relending by the Cassa (under arrangements to be satisfactory to the Bank) to the enterprises which will be the ultimate beneficiaries of the loan.

(d) In the case of each Power Project there will be a Project Agreement with the beneficiary enterprise. Societa Finanziara Elettrica Nazionale per Azioni and Societa Italiana per le Strade Ferrate Meridionale will be parties to the Project Agreement, guaranteeing performance of the Agreement and agreeing to become sureties for the performance of all obligations (including financial) of the power company to the Borrower.

(e) In Section 2.02 of the Guarantee Agreement the Guarantor agrees to cause the Irrigation Project to be completed and properly operated.

### PART III - APPRAISAL OF PROPOSED LOAN

#### Justification of the Loan

25. The Cassa Plan as originally drawn up proposed a solution to a problem which had proved intractable for centuries. Our study and appraisal of this Plan convinced us that it would be a justified risk to give it some initial encouragement on a modest scale. In October 1951, at the time of the first loan, only the most preliminary work of organization and study had been carried out by the Cassa, and the loan was necessarily based more on the expectation of what the Cassa would be able to do than on any record of accomplishment. Even at the time of the second loan, in October 1953, it was still too early to make a critical evaluation of the results of the Cassa Program although by that time many of its operations were well under way. It was, however, at least clear at that time that the Cassa was beginning to live up to the responsibilities for which it had been created and the Bank believed that a continuation of its support would be appropriate until a more definitive judgment could be made.

26. In view of the magnitude of the loan requested by the Italian authorities, the fact that the Cassa had been in operation for over four years, and that the Plan had been modified and expanded to a 1,280 billion lire program over 12 years, rather than the original 1,000 billion lire for 10 years, I thought it necessary that a fresh review of the Cassa Program and its

contribution to the economic development of Southern Italy be undertaken. The results of this study are contained in the report on "The Cassa per il Mezzogiorno and the Economic Development of Southern Italy," EA-51a, circulated to the Board on May 20, 1955 (R-879). This report concludes that the Cassa Program is an appropriate means for the economic development of Southern Italy and a stimulating influence on the rest of the country. Some of the initial problems which retarded the progress of the Plan during the first two years have been overcome and progress has been considerable. In the agricultural sector, which is most important both from the standpoint of money allocated to it and from its contribution to the over-all goals of the Cassa, works have been completed for the drainage of about 18,000 hectares and the irrigation of about 30,000 hectares. Nearly 1,500 kilometers of rural roads have been built and more than 20,000 hectares reforested in mountainous areas.

27. Most of the works are still in progress, however, and the rate of completion should increase rapidly during the next few years.

28. The economic effects of the Cassa Program have already been very significant, not only on the South but on all Italy. The execution of the Program has resulted in increased employment equivalent to about 200,000 full-time jobs and the income created by this additional employment is approximately 2% of total Italian national income. The stimulation to industry resulting from the Program has caused an investment of approximately 200 billion lire (\$320 million equivalent) in about 1,750 private industrial undertakings in the South, which should employ about 90,000 additional workers upon completion.

29. On the basis of this analysis, I believe that continued support by the Bank of the Program for the development of the South undertaken by the Cassa per il Mezzogiorno is well justified.

30. The proposed loan is in one respect similar to the earlier two loans to the Cassa in that it will be disbursed in foreign exchange to finance expenditures in Italian lire by the Cassa. The normal type of Bank loan, which is limited to the financing of the imported equipment requirements for specific projects, is not appropriate to Italy's requirements because Italy, although underdeveloped in the South, is highly industrialized in the North and produces almost all the equipment needed for the execution of the projects being financed. A local expenditure loan of the type proposed is the only effective way in which the Bank can make a significant contribution to meeting Italy's needs for foreign assistance in carrying out the investment program in Southern Italy. Unlike the earlier loans, the proceeds of this loan will be disbursed for the direct financing of specific projects in accordance with their needs rather than in relation to the total expenditures by the Cassa on the overall Plan.

31. A report of the Committee provided for in Article III, Section 4, paragraph (iii) of the Articles of Agreement of the Bank is attached (No. 7).

Prospect of Fulfillment of Obligations

32. The report on the "Current Economic Position and Prospects of Italy" EA-39b (R-879/1), shows that Italy has made substantial progress since 1950 when the reconstruction phase of the postwar period was completed. There has been an increase in real national income at the rate of about 5% per annum since then which has made possible an increase both in consumption and in investment. Agricultural production has been increasing, and during the next few years Italy should be able to achieve a balanced position in its exports and imports of agricultural products, thus eliminating the burden of the drain on its balance of payments arising from the need to import food-stuffs.

33. Recent discoveries of methane and petroleum indicate that Italy is richer in natural resources, especially in the field of energy resources, than had previously been known. The output of Italy's manufacturing industry has expanded considerably and has become more competitive. Italy's membership in the European Iron and Steel Community has resulted in its manufacturing industry having access to these important raw materials on terms equal to those of other European countries.

34. The expansion of activity which has occurred has resulted in an approach to the solution of the problem of chronic and growing unemployment in Italy. During the past two years, new employment opportunities were greater than the increase in the labor force so that there was not only no increase in unemployment but a reduction of about 100,000 in the number of unemployed.

35. The expansion has occurred without impairing monetary and financial stability. During recent years Italy has consistently followed sound monetary policies and the country is aware that a departure from these policies would have serious effects on the balance of payments. The deficit in the balance of payments was reduced from \$429 million in 1953 to \$274 million in 1954 and the analysis indicates there are good prospects that Italy can eliminate this deficit by the continued sound expansion of the economy.

PART IV - COMPLIANCE WITH ARTICLES OF AGREEMENT

36. I am satisfied that the proposed loan complies with the requirements of the Articles of Agreement of the Bank.

PART V - RECOMMENDATION

37. I recommend that the Bank at this time lend to the Casse per Opere Straordinarie di Pubblico Interesse nell'Italia Meridionale an amount in various currencies equivalent to \$70 million for a term of 20 years with interest, commission and commitment charges and on such other terms as are specified in the attached draft Loan and Guarantee Agreements, and that the Executive Directors adopt a resolution to that effect in the form attached (No. 8).

Eugene R. Black