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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

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

October 3, 1956

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATIONS OF THE PRESIDENT
TO THE EXECUTIVE DIRECTORS CONCERNING A
PROPOSED LOAN FOR SOUTHERN ITALY DEVELOPMENT PROJECTS

1. I submit the following report and recommendations with regard to a proposed loan in an amount in various currencies equivalent to \$74,628,000 to the Cassa per Opere Straordinarie di Pubblico Interesse nell'Italia Meridionale (Cassa per il Mezzogiorno) for the purpose of financing fifteen Southern Italy development projects.

PART I - HISTORICAL

2. The Italian Twelve-Year Development Program for the development of Southern Italy has been in existence since 1950. The Program was designed to raise the standard of living in the relatively less developed part of Italy lying south of Rome and including the large islands of Sicily and Sardinia and the smaller island of Elba, by the investment of a sum equivalent to about two billion dollars. The Cassa per il Mezzogiorno (the Fund for the South) was created as the agency for executing the Program.

3. The Bank has made three loans totalling \$90,000,000 to the Cassa. The first loan (50 IT) of \$10,000,000 was made on October 10, 1951, and was for 25 years at 4-1/2%; the second, also for \$10,000,000 (88 IT), was made on October 6, 1953, and was for 25 years at 5%. The third Cassa loan (117 IT) was of \$70,000,000 and was made on June 1, 1955. It was for 20 years at 4-3/4%.

4. Disbursement, all in dollars, on the first two loans was completed in September 1954. As of October 1, 1956, \$27,200,000 in various currencies had been disbursed on the third loan: \$15,500,000 in U.S. dollars; \$8,200,000 in Netherlands guilders; \$2,000,000 in French francs and \$1,500,000 in Swiss francs. One industrial project had been cancelled at the borrower's request, reducing the loan to \$68,400,000.

5. In September 1955, I spent ten days travelling in Southern Italy and made visits to Sicily and Sardinia. I was impressed by the scale of the Cassa's activity, by the evidence of the work already accomplished, by the size and difficulty of the work still ahead, and by the energy and ability of those charged with carrying it forward.

6. Following my tour of the Cassa area, I had meetings in Rome with the Prime Minister and with other members of the Italian Government, who expressed the wish that the Bank make a loan in 1956 similar in size and composition to the one made in 1955. I therefore arranged for members of the Bank staff to visit Italy to bring our assessment of the economic position up to date and to examine projects which could serve as the basis for a loan.

7. By the middle of June, the Bank had completed an economic report and its technical studies of the projects which had been submitted, and a mission

went to Rome to discuss draft loan documents embodying the proposals presently before you. Final agreement was reached when Italian representatives came to Washington early in September.

PART II - DESCRIPTION OF THE PROPOSED LOAN

Borrower

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

Guarantor

9. The Guarantor would be the Republic of Italy.

Amount

10. The loan would be in an amount in various currencies equivalent to \$74,628,000.

Purpose

11. The purpose of the loan would be to aid the development of Southern Italy by providing financing for a selected group of electric power, irrigation and private industrial projects. The loan would also cover part of the cost of certain technical services required by the Cassa.

The Projects

12. A study of the projects is contained in the Appraisal of Italian Industrial, Irrigation and Power Projects (TO 121) (No. 10). They may be summarized as follows:

13. Electric power: The \$25,200,000 to be provided for power would finance about 60% of the cost of three hydro plants with a combined installed capacity of 77,100 kw, a 140,000 kw thermal plant, high tension transmission lines, and the necessary transformer stations and related facilities. These, when completed, will add 13.5% to the generating capacity existing at the end of 1955 in the area of Cassa competence, and production should increase by 17%.

14. Industry: The \$23,963,000 provided for industrial projects would finance about 50% of the cost of ten new plants. Seven of them are on the mainland, two in Sicily and one on the island of Sardinia. They comprise a fertilizer factory, a hardboard plant, a plant for assembling truck and bus bodies and building trailers, an automotive assembly plant, and a plant for the production of polyethylene and special cements. Three of them are being built by large northern industrial concerns (Fiat, Saint-Gobain and Viberti) for the first time expanding their operations by moving into the south of Italy.

15. Irrigation: The \$25,000,000 provided for irrigation would cover about 30% of the cost of the public works included in the Flumendosa project. This

project will result in the irrigation of 50,000 hectares of land in the Campidano di Cagliari in Sardinia. This project, with one of the cement projects mentioned above, marks the Bank's first assistance for projects in Sardinia, hitherto one of the most neglected areas in the Cassa's territory.

16. Technical services: The Cassa has signed a two-year contract with the Development and Resources Corporation of New York, effective October 1, 1956, which provides for advisory and consulting services to the Cassa. The Corporation, whose members and personnel have had wide experience with regional development problems and practices in other parts of the world, will be available to assist the Cassa in the coordination of its over-all programming, and for consultation on specific problems as they arise. The Bank will contribute \$35,000 to the cost of these services, the remaining cost over a two-year period, viz., \$465,000, being included in the loan now proposed.

Terms

17. The loan would be amortized by semi-annual payments commencing September 1, 1959, in the amounts set forth in Schedule 1 to the draft Loan Agreement (No. 1). These payments would retire the loan by maturity on September 1, 1976. The loan would bear interest, including 1% commission, at the rate of 5%.

18. 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 December 10, 1956, whichever is earlier.

Procurement

19. The irrigation project involves a few large and many small construction contracts using local labor and materials. These contracts have been let to Italian firms on a negotiated basis. Insofar as the power projects are concerned, bids have been requested on a broad international basis for the major items of equipment. In the industrial projects the conditions vary. In some cases they involve building branch plants by firms already established in Northern Italy who have their own sources of supply--in others they obtain machinery and equipment under licensing arrangements. In most cases, however, there has been active competition from suppliers in Italy and abroad.

Disbursement

20. There will be few imported goods for these projects, the bulk of the cost being represented by local expenditure. Disbursements under the loan will not be related to expenditures on particular goods but will be made against evidence of the progress of over-all expenditures on each project. For the most part, therefore, the foreign exchange provided by the proposed loan would not be required to cover a foreign exchange component in the projects themselves but would serve to increase the foreign exchange available to the Banca d'Italia for offsetting inflationary pressures upon Italy's available resources.

Legal Instruments and Legal Authority

21. 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).

22. The loan set-up and the Loan Documents are similar to those of last year's loan (117 IT) and, similarly, reflect the differences from the normal single project loan made directly to the enterprise which is to operate the project. These differences include:

- (a) Fifteen projects are described in Schedule 2 to the Loan Agreement. The specific amounts of the loan allocated to each project 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, and withdrawals from the Loan Account may be suspended, separately with respect to each project and the amount of the loan allocated thereto. Separate Closing Dates with respect to the various projects may also be agreed upon between the Bank and the Borrower.
- (c) 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 under the power and industrial sectors of the loan.
- (d) For each power project there will be a Project Agreement with the beneficiary enterprise. These are Societa Idroelettrica Alto Liri, TIFEO and Societa Meridionale di Elettricita. There will be additional parties to each Project Agreement who will guarantee performance of the Agreement and agree to become sureties for the performance of all obligations (including financial) of the power company to the Borrower. These additional parties are parent companies or owners of large blocks of shares in the enterprises and are as follows:

The SIAL Power Project: Societa Romana di Elettricita and "La Centrale" Societa per il Finanziamento di Imprese Elettriche e Telefoniche;

The TIFEO Power Project: Societa Generale Elettrica della Sicilia, Societa Finanziaria Elettrica Nazionale per Azioni ("Finelettrica") and Societa Italiana per le Strade Ferrate Meridionali ("Bastogi");

The SME Power Project: "Finelettrica" and
"Bastogi."

- (e) In Section 2.02 of the Guarantee Agreement the Guarantor agrees to cause the Irrigation Project to be completed and properly operated; water for irrigation uses to be available in adequate amounts; and water and land included in the Project to be properly utilized. In connection with Section 2.02, the Government will also give the Bank a letter in the form attached (No. 6).

PART III - APPRAISAL OF PROPOSED LOAN

Justification of the Loan

23. The Bank's interest in the Cassa program has been continuous since its inception. In my previous Reports and Recommendations I have given an account of its slow and careful beginnings and its more recently accelerating activities and have attempted to measure its achievements. Its record to date has been such that the Italian Government is giving serious consideration to prolonging the life of the Cassa for a further three years, i.e., until 1965. Consideration is also being given to placing more emphasis in Cassa activities on industrial development, the progress of which so far has been encouraging.

24. What account can the Cassa give of itself at the half-way mark? It has approved projects amounting to 51% of its planned resources and awarded more than 55,000 contracts. It has paid out against work in progress or completed work the equivalent of \$760,000,000 on work to be completed by itself, and disbursed an additional \$75,000,000 on loans to third parties. Induced private investments have added another 20% to the total of its own activities. In physical terms, it has completed 1,600 km of canals and improved river beds; 1,200 km of main and secondary irrigation canals; irrigated 46,000 ha. of land; constructed 2,100 km of new roads and improved 9,300 km of old ones; planted 67 million trees; and brought potable water to 245 villages with 1,350,000 inhabitants. It is estimated that farm improvement works already financed by the Cassa would provide the equivalent of 47,500 permanent farm jobs, and that more than 100,000 new permanent industrial jobs have been created by investments in the Cassa area.

25. The Cassa program is an appropriate means for the economic development of Southern Italy, and is going forward at a satisfactory pace. However, much work is still to be done and the capital available is still limited. I believe that the Bank is justified in continuing its support for the Cassa program through the proposed loan.

26. 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

27. The report on the "Current Economic Position and Prospects of Italy" (EA 64) (No. 9) shows that the real national income of Italy has continued to rise by about 5% per year since 1950. The present year is expected to show the same pattern. Rising real income has permitted rising levels of both savings and investment, the increase in investment showing most strongly in public works, housing and industry. As a consequence, there has been more employment and a measurable rise in personal incomes and living standards. The economy of Italy is healthy and is growing steadily.

28. Agriculture, the primary economic activity in Italy, continued to advance. Output continues to increase and markets continue to be found for exportable surpluses, which are now large enough to pay for food imports in normal years. Italian industry, too, is becoming increasingly productive and competitive, thanks to the heavy industrial investment of recent years. This is reflected in Italy's exports of industrial products both in European and overseas markets. Italy's fuel problem has yet to be solved. Hydro-electric power resources have been largely exploited and room for further exploitation is limited. Natural gas production grows apace, but not on a scale which can meet Italian needs. Imported coal and petroleum still account for nearly half of Italy's sources of energy. Foreign and private Italian investors still wait the long-debated petroleum legislation, and the need to provide adequate incentives to drill and exploit oil bearing areas becomes increasingly apparent. Sicily has passed local legislation to encourage private oil investment, and the wells at Ragusa are expected to produce at the rate of a million tons a year by the end of this year, representing some 10% of Italy's 1955 petroleum consumption.

29. Italy's foreign trade continues to expand. Both exports and imports increased substantially in 1955 over the previous year, imports increasing even more than exports. Earnings from freight, tourism, emigrant remittances and other invisible items reduced the trade deficit to a payments deficit of manageable proportions, and as a result of credit operations, Italy's net gold and foreign exchange holdings rose and are at a satisfactory level. The results for 1956 are not likely to be substantially different. Longer term projections are more tenuous, but lead to the conclusion that the elimination of Italy's balance of payments deficit within the next few years, while difficult, is by no means impossible.

30. Italy's debt record is good. Her present public internal debt is equivalent to \$810,000,000. The total annual debt service amounts to less than 3% of Italy's current foreign exchange earnings.

PART IV - COMPLIANCE WITH ARTICLES OF AGREEMENT

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

PART V - RECOMMENDATION

32. I recommend that the Bank at this time lend to the Cassa per Opere Straordinarie di Pubblico Interesse nell'Italia Meridionale an amount in various currencies equivalent to \$74,628,000 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