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INTERNATIONAL DEVELOPMENT ASSOCIATION

REPORT AND RECOMMENDATION OF THE PRESIDENT TO THE EXECUTIVE DIRECTORS ON A PROPOSED DEVELOPMENT CREDIT TO INDIA FOR A RAILWAY PROJECT

June 20, 1966

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ON A PROPOSED DEVELOPMENT CREDIT TO INDIA

1. I submit the following report and recommendation on a proposed credit in an amount in various currencies equivalent to U.S. $68 million to India.

PART I - HISTORICAL

2. The Government of India has requested that the Association continue to participate in the financing of the Railways' modernization and expansion program. The requirements of that program for the thirteen-month period ending December 31, 1966, were appraised by a mission in November/December 1965; and the proposed credit, combined with bilateral credits available to India, would provide the foreign exchange necessary to implement that program.

3. The Association has made 17 credits to India, including four which are fully disbursed. The Bank has made 34 loans, including 21 which are fully disbursed. The status of Bank loans and IDA credits to India as at May 31, 1966, is summarized below:

		Amounts ($ million)	
		Bank	IDA
Total (less cancellations)		971.9	584.5
Of which has been repaid		256.8	-
Total now outstanding		715.1	584.5
Amount sold	100.3		
Of which has been repaid	84.5	15.8	-
Total now held by Bank and IDA		699.3	584.5
Total undisbursed		169.7	140.9

4. The following loans made before July 1, 1960 are not yet fully disbursed:

Year	Loan/ Credit No.	Borrower	Purpose	Amount ($ million) Bank	IDA	Undisbursed on May 31/66
11/19 1954	106	Tata Power	Trombay I	16.2		0.04
5/29 1957	164	Tata Power	Trombay II	9.8		0.09
6/25 1958	199	Madras Port Trust	Equipment	14.0		0.95
7/15 1959	232	ICICI	Industry II	10.0		0.01

5. The following loans and credits were approved since July 1, 1960:

Year	Loan/ Credit No.	Borrower	Purpose	Amount ($ million) Bank	IDA	Undisbursed on May 31/66
7/29 1960	262	India	Railways V	70.0		-
10/28 1960	269	ICICI	Industry III	20.0		1.14
6/21 1961	3	India	Roads		60.0	4.85
8/9 1961	292	India	Private Coal Mining	35.0		0.78
8/17 1961	294	Calcutta Port	Equipment II	21.0		10.39
9/6 1961	8	India	Tubewell Irrigation		6.0	-
10/13 1961	298	India	Railways VI	50.0		-
11/22 1961	13	India	Shetrunji Irrigation		4.5	1.11
11/22 1961	14	India	Salandi Irrigation		8.0	6.42
11/22 1961	15	India	Punjab Flood Protection		10.0	0.55
12/22 1961	307	IISCO	Coal Mining	19.5		14.15
2/14 1962	19	India	Durgapur Power		18.5	5.78
2/28 1962	312	ICICI	Industry IV	20.0		2.96
6/29 1962	21	India	Sone Irrigation		15.0	3.27
7/18 1962	23	India	Purna Irrigation		13.0	3.57
8/8 1962	24	India	Koyna Power II		17.5	8.41
9/14 1962	27	India	Bombay Port		18.0	12.73
9/14 1962	28	India	Telecommunications I		42.0	6.05
3/22 1963	36	India	Railways VII		67.5	-
5/24 1963	37	India	Kothagudem Power I		20.0	6.49
6/5 1963	340	ICICI	Industry V	30.0		11.50
6/9 1964	52	India	Industrial Imports I		90.0	-
7/6 1964	58	India	Telecommunications II		33.0	10.16
10/26 1964	67	India	Railways VIII		62.0	-
5/28 1965	414	ICICI	Industry VI	50.0		49.08
6/11 1965	416	India	Power Transmission	70.0		70.00
6/11 1965	417	India	Kothagudem Power II	14.0		8.57
8/11 1965	78	India	Industrial Imports II		100.0	71.50

6. The total amount lent by the Bank to the Railways since the first such loan in 1949 is $377.7 million. With the two previous IDA credits of $129.5 million, the proposed credit would increase total Bank and IDA lending to the Railways to $575.3 million. Of the Bank loans for the Railways, $93 million has so far been repaid and a further $18 million will be repaid during the current year, so that the Bank group's net commitment in the Railways after disbursement of the proposed credit would come to about $465 million.

7. Delays in disbursement continue to be a source of concern for a number of Bank and IDA projects in India. About 8 percent of Credit 3-IN (Road Project) made in June 1961 is still to be disbursed, and the Closing Date has been postponed to June 30, 1967; the undisbursed portion relating to the Bassein Creek Bridge ($530,000) was cancelled at the request of the Borrower. The Second Calcutta Port Project (Loan 294-IN), after suffering initially from delays in placing orders for equipment and floating craft, will be completed by March 1967. With respect to the Salandi Irrigation Project (Credit 14-IN) a full report will be presented to the Executive Directors within a few days. The Third IISCO Coal Mining Project (Loan 307-IN) was delayed nearly three years by a change from open pit to shaft mining, and is now scheduled for completion by 1970. The Durgapur Power Project (Credit 19-IN) will be fully disbursed by the middle of 1967 except for a small amount in respect of retention payments that will not fall due until some months later. A project review mission visited the Sone Irrigation Project (Credit 21-IN) in May 1966 and has confirmed that construction will be completed by March 1967. The Purna Irrigation Project (Credit 23-IN) is about two years behind schedule but will be completed by August 1967.

8. The first unit of the Second Koyna Project (Credit 24-IN) is being commissioned on schedule and the rest of the Project is also proceeding satisfactorily. The Bombay Port Project (Credit 27-IN) is about two years behind the original schedule; recently, deadlines have been established with respect to several important aspects of the Credit, and these are being followed up closely. The Closing Date of the Telecommunications Project (Credit 28-IN) had to be extended by fifteen months to March 31, 1967 on account of the time needed initially to make an adequate choice among suppliers competing to provide a new exchange system. The first Kothagudem Power Project (Credit 37-IN) will be completed on schedule early next year. To date no disbursements have been made for the Power Transmission Project (Loan 416-IN) because of the time required by Government in obtaining satisfactory financial undertakings from all participating Boards and Agencies and in awarding procurement contracts.

PART II - DESCRIPTION OF THE PROPOSED CREDIT

9. The main features of the proposed credit are as follows:

Borrower:	India, acting by its President.
Amount:	Various currencies equivalent to $68 million.
Purpose:	To finance part of the foreign exchange expenditure of the Railways' investment program during the period from December 1, 1965 to December 31, 1966.

Amortization: The term of the credit would be 50 years with a grace period of 10 years. One-half of 1 per cent of the principal amount would be repayable semi-annually for 10 years beginning August 15, 1976 and 1-1/2 per cent of such principal amount would be repayable semi-annually beginning August 15, 1986 and ending February 15, 2016.

Service Charge: 3/4 of 1 per cent annually.

PART III - THE PROJECT

10. An appraisal report entitled "Appraisal of the Ninth Indian Railways Project" (TO-526a) on the proposed Project is attached (No. 1). The appraisal was completed before the Indian Government announced the devaluation of the rupee on June 5, 1966, and the financial data and forecasts contained therein have not been changed to reflect estimated possible effects of devaluation. The financial viability of the Indian Railways will not be affected by the devaluation since there is every indication that the Government will continue its policy of offsetting increases in expenditures by corresponding increases in rates and fares, as is required in previous Loan and Credit Agreements as well as in Section 4.01 (a) of the proposed Credit Agreement and the supplementary letter on Traffic Costing and Rates. Moreover, any attempt to forecast fully the effects of devaluation on the cost of future investment programs and on operating expenditure would be somewhat speculative at this stage and would not produce a more meaningful assessment of the Railways' financial future than the present appraisal report.

11. As the Fourth Five-Year Plan has not been finalized, Railways have prepared and the Government has approved an interim investment program for the period from December 1, 1965 to December 31, 1966 involving an estimated cost of Rs 4,070 million ($690 million equivalent).1/ This program, which constitutes the Project, will by and large complete investments begun during the Third Five-Year Plan.

12. As has been the case with previous lendings, the proposed credit would finance, jointly with other sources of foreign exchange, the cost of imports required for the Project, estimated to cost the equivalent of $116 million. Credits amounting to $45 million have already been obtained from members of the Indian consortium (including Austria, Belgium, Canada, France, Germany, Japan, Netherlands, Switzerland, and the United States) and the balance of $3 million is expected to be financed by the United States.

13. The proposed Project will primarily increase the railways' capacity to carry bulk commodities, whose share of overall traffic, as in other countries, has steadily increased over the last decade and is expected to account for 97 per cent of the total traffic increase on the Indian railways during the next five years. The mission is satisfied that the assumptions made regarding economic growth and particular production targets for bulk

1/ Expenditures made before June 6, 1966, converted at Rs. 4.76 = $1.00, subsequent expenditures converted at Rs 7.5 = $1.00.

commodities are reasonable. Moreover, the Railways have in the past shown considerable flexibility in adapting their investment programs to traffic needs as these develop. About 40 per cent of total expenditure will be on line capacity works, track renewal and on the completion of new lines taken up under the Third Five-Year Plan. Rolling stock will account for a further 37 per cent.

14. The appraisal confirms the conclusion reached in previous reports that the Indian railways are well managed and efficiently operated. The under-investment in earlier plans which led to critical shortages in rail transport in 1961/62 has been fully made up during the Third Plan. In 1965/66 the Railways were able to handle with ease 206 million originating tons, 40 million more than in 1960/61, and to have in addition enough spare capacity to cope with seasonal fluctuations. The share of electric and diesel electric traction in goods movements has increased from 10 per cent in 1960/61 to 43 per cent in 1964/65. New automatic coupling and braking systems are being tested; their adoption will permit substantial increases in the weight of trains carrying iron ore, coal, and other bulk commodities.

15. In important fields, such as the building of freight cars, passenger coaches, the rolling of steel rails, manufacturing capacity in India is adequate not only to meet internal requirements but also to provide for some exports. Recently orders in the equivalent of $8 million have been secured for the export of wagons and coaches to East Africa, Hungary and Burma. In addition, track material such as rails, fish plates and bearing plates and miscellaneous items of railway equipment such as wagon parts, fans, and signalling equipment are being exported.

16. Good progress is being made in the implementation of undertakings and assurances given in connection with the previous Credit. A more refined traffic costing system has been introduced and is being used in revising the freight tariff structure to reflect costs more closely. Passenger fares have been increased to cover the cost of the service provided.

17. The Railways are earning at present a return of 7 per cent on net assets in operation. With effect from April 1, 1966 the dividend payable to Government on the capital-at-charge has again been raised further to 5-1/2 per cent on all capital provided before April 1, 1964 and to 6 per cent for all capital provided thereafter. As with the previous Bank loans and IDA credits, the proceeds of the proposed credit would be made available to the Railways as capital-at-charge.

18. The appraisal mission also reviewed the methods used by the Railways for the evaluation of planned investments and agreement was reached on the need to supplement present methods with economic analyses that would, inter alia, measure and compare economic costs and benefits over the life of each major investment proposal. Encouraging progress has already been made in this type of analysis on ports and roads, and comparable economic data for the railways are needed to arrive at balanced investment programs for transport. As a first step, an economic section in the railways will be set up as part of the Project.

19. The Bank has long been concerned with the problem of achieving better coordination among the various modes of transport in India. The Committee on Transport Policy and Coordination, constituted by the Government in 1959, published its final report in February 1966. The Association discussed the major recommendations of the report with representatives of India at the time of negotiations, and it has been agreed to continue the dialogue between the Association and the Government. In anticipation of possible future lending for rail and road transport, the Association attaches considerable importance to implementation of such further measures as may be required to ensure balanced development and effective coordination of transport in India.

PART IV - THE ECONOMY

20. A report on the economic position and prospects of India is being circulated to the Executive Directors on June 20, 1966 (R66-80). India's credit-worthiness for additional Bank lending at this time is limited, considering her present debt service burden. The country's development program would justify substantially increased IDA financing. As one of a series of steps designed to relax administrative controls and bring a more realistic structure of prices into the economy, India on June 5 announced a change in the par value of the rupee (Rs 7.5 = U.S. $1.00). Other major developments in the economy are outlined in the following paragraphs.

21. The level of Indian income and product showed only a modest increase over the first three years (1961/62 - 1963/64) of the Third Plan. This period was characterized by relatively poor performance in the agricultural sector. As a consequence, growth in total income and product during that period averaged about 3.2 percent. In per capita terms, income rose by less than 1 percent a year.

22. The economic picture brightened considerably in the fourth year of the Plan (1964/65), in large measure due to a favorable monsoon and a consequent recovery of agricultural production to levels more consistent with the longer-term trend of growth in that sector. Foodgrain production expanded by over 8 million metric tons in that year, an increase of almost 10 percent. Industrial production continued to show fairly vigorous expansion during 1964/65. In that year, real income increased by about 7.7 percent in total and by 5.3 percent per capita, raising average annual total and per capita growth rates for the first four years of the Third Plan period to 4.3 percent and 2.0 percent, respectively.

23. The recovery of agriculture was, unfortunately, short-lived. Widespread absence of rainfall in the summer and fall of 1965 brought in its wake the worst drought in half a century. Crop failures of unprecedented magnitudes occurred over much of the Indian sub-continent, and production of foodgrains appears to have fallen by some 13 million tons. This failure of agriculture, combined with a concurrent slowing of industrial production, is likely to mean that Indian income and product levels have declined in the final year (1965/66) of the Third Plan period, although the magnitude involved cannot yet be determined.

24. A direct consequence of the drought has been the necessity for India to import large quantities of foodgrains on an emergency basis. Fortunately, most of these imports have been provided by external assistance, predominantly under the U.S. PL 480 program which is supplying some ten million tons of foodgrains. Australia, Canada, the U.K. and other aid donors have also provided grants of food or financing for shipment of such imports. An upward movement in food prices, following the first indications of crop failure in 1965/66, was moderated somewhat by the arrival of aid-provided foodgrains, but inflationary pressures persist throughout the economy.

25. Tax revenues represented some 14 percent of Indian national income and product in 1965/66. Government expenditure for development grew rapidly over the Third Plan period, but an even more substantial increase was registered in current expenditures, in large part because of larger defense outlays after the Chinese attack in 1962. The Central Government has consistently increased taxes to meet such increased outlays and is now attempting to keep non-developmental outlays in check. The States, however, have frequently had recourse to Reserve Bank overdrafts despite substantial transfers of resources from the Center. Efforts are now being made to limit State borrowing, and many States have recently increased taxes in an effort to balance their 1966/67 budgets.

26. For several years, India's foreign exchange position has been under strain. Exports have remained more or less stationary at Rs 8 billion annually, while imports moved upwards reaching Rs 15 billion in 1965/66. Export incentives adopted in the last two or three years did not produce very substantial results in part because of the active demand offered by a protected domestic market. In spite of grant or quasi-grant assistance, the drought is estimated to have cost India some $200 million in foreign exchange during the last year, of which an estimated $120 million is for freight on food shipments. In view of India's already-tight foreign exchange position, the Government found it necessary in February to approach the International Monetary Fund with respect to interim assistance to help meet the unanticipated exchange costs. In March, the Fund approved a drawing of $187.5 million by India. Interim aid was also indicated with respect to 1966/67 import requirements by several member countries of the Indian consortium.

27. In view of the uncertainties surrounding India's foreign exchange position, it was decided to frame a one-year program covering 1966/67, with the Fourth Plan to be issued when the longer-term external assistance picture is more clear. An Annual Plan for 1966/67 was accordingly announced in March. It is, in effect, an interim program calling for public sector outlays of Rs 2,082 crores in 1966/67, about Rs 215 crores below the corresponding figure expected for 1965/66. The annual program appears to be framed with due emphasis on the reorientation of agriculture announced last fall. Outlays in most sectors are expected to show declines between 1965/66 and 1966/67, in part because emphasis is being given to completing projects already in process rather than to initiating new ones. An increase of some Rs 36 crores is, however, contemplated in agricultural programs and a smaller increase, of Rs 15 crores, is programmed for the industrial and mining sector.

28. On June 5, 1966, the Government of India announced a 36.5 percent devaluation of the rupee. The Government has also indicated that direct administrative controls on imports would be relaxed as soon as the aid picture is clarified. In many industries, substantial capacity is under-utilized because of shortage of imported materials and components and also, to a lesser extent, because of a recent slackening in demand for their products. Therefore, the extent to which non-project aid is made available during the next year or two will largely determine how rapidly production can expand and how far India will be able to dismantle the cumbersome control system. Over the next several years the devaluation move is expected to stimulate exports, to encourage a more rational allocation of imports among alternative uses and to increase the value of "invisible" receipts that flow through official channels.

PART V - LEGAL INSTRUMENTS AND AUTHORITY

29. The draft Development Credit Agreement between India and the Association, a Supplementary Letter on the Establishment of an Economic Section and the Recommendation of the Committee provided for in Article V, Section 1 (d) of the Articles of Agreement of the Association are being distributed to the Executive Directors separately. The draft agreement follows the general pattern of previous IDA railway credits to India.

PART VI - COMPLIANCE WITH ARTICLES OF AGREEMENT

30. I am satisfied that the proposed development credit would comply with the Articles of Agreement of the Association.

PART VII - RECOMMENDATION

31. I recommend that the Executive Directors adopt the following resolution:

RESOLUTION NO.____

Approval of Credit to India (Ninth Railway Project) in an amount equivalent to U.S. $68,000,000

RESOLVED:

THAT the Association shall grant a development credit to India in an amount in various currencies equivalent to sixty-eight million United States dollars (U.S. $68,000,000), to mature on and prior to February 15, 2016, to bear a service charge at the rate of three-fourths of one percent (3/4 of 1%) per annum, and to be upon such other terms and conditions as shall be substantially in accordance with the terms and conditions set forth in the form of the Development Credit Agreement (Ninth Railway Project) between India and the Association which has been presented to this meeting.

George D. Woods
President

Washington, D.C.
June 20, 1966