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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATIONS

OF THE

PRESIDENT

TO THE

EXECUTIVE DIRECTORS

ON A

PROPOSED LOAN

TO

MALTA

August 5, 1963

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATIONS OF THE PRESIDENT
TO THE EXECUTIVE DIRECTORS ON A
PROPOSED LOAN TO MALTA

1. I submit the following report and recommendations on a proposed loan of \$7.5 million to Malta for a combined electric power and sea water distillation project.

PART I - HISTORICAL

2. The Bank was asked in September, 1961 by the United Kingdom Government and the Government of Malta about the possibility of a loan to Malta to assist in financing a new thermal electric power and sea water distillation project. The proposed installations would be owned and operated by a new statutory corporation, the Malta Electricity Board (MEB) to which the proceeds of the loan would be relent. A mission from the Bank visited Malta in January and February, 1962 to examine the economy and the proposed project. The negotiations, which were deferred pending the new Malta Government's approval of a revised draft Electricity Act, were conducted in Washington in November. The Electricity Act was enacted by the Malta Legislative Assembly in June, 1963.

3. The proposed lending would be the Bank's first loan in Malta. The Bank has already made the following loans with the guarantee of the United Kingdom:

<u>Year</u>	<u>Borrower</u>	<u>Purpose</u>	Amount as of June 30, 1963 <u>(in U.S. \$m. equivalent)</u>
1952	Colony of Southern Rhodesia	Power	28.0
1953	Territory of Northern Rhodesia	Railways	14.0
1955	East Africa High Commission	Railways & harbours	24.0
1956	Federal Power Board (Federation of Rhodesia & Nyasaland)	Power	80.0
1958	Federation of Nigeria	Railways	28.0
1958	Federation of Rhodesia and Nyasaland	Railways	19.0
1960	Federation of Rhodesia and Nyasaland	Agriculture	5.6
1960	Colony and Protectorate of Kenya	Agriculture & roads	5.6
1961	Protectorate of Uganda	Power	8.4
1961	Colony of British Guiana	Agriculture	1.3
1961	Trinidad and Tobago	Electric power	23.5
1961	Colony and Protectorate of Kenya	Agriculture	8.4
1963	State of Singapore	Power	15.0
1963	Swaziland	Power	<u>4.2</u>
Total:			265.0
of which has been repaid:			<u>25.0</u>
Total now outstanding:			240.0
Amount sold or agreed to be sold:		136.1	
of which has been repaid:		<u>24.5</u>	<u>111.6</u>
Net amount held by the Bank			128.4

The total outstanding includes \$48.9 million not yet disbursed. In addition to the foregoing loans, IDA made a credit of \$2.8 million to Swaziland in 1962 for roads.

PART II - DESCRIPTION OF THE PROPOSED LOAN

4. The main characteristics of the loan are as follows:

<u>Borrower:</u>	State of Malta.
<u>Guarantor:</u>	United Kingdom.
<u>Amount:</u>	The equivalent in various currencies of \$7.5 million.

<u>Purpose:</u>	To assist in financing a combined thermal power and sea water distillation station to be owned and operated by MEB.
<u>Amortization:</u>	In 35 semi-annual installments, beginning on April 15, 1966 and ending on April 15, 1983.
<u>Interest rate:</u>	5 $\frac{1}{2}$ % per annum, including 1% commission.
<u>Commitment charge:</u>	3/4 of 1%.
<u>Payment dates:</u>	April 15 and October 15.
<u>Subsidiary Borrower:</u>	Malta Electricity Board. The Borrower will relend, at the same terms, to MEB the proceeds of the loan.

PART III - LEGAL INSTRUMENTS AND LEGAL AUTHORITY

5. Attached are drafts of the Loan Agreement between the State of Malta and the Bank (No. 1), the Guarantee Agreement between the United Kingdom and the Bank (No. 2) and a Subsidiary Loan Agreement between the Borrower and MEB (No. 3).

6. The draft Loan Agreement follows the usual form of the Bank's loan agreements for electric power projects carried out by bodies other than the Borrower. Under Section 5.01, the Government of Malta will relend the proceeds of the proposed loan to MEB under a Subsidiary Loan Agreement containing substantially the same terms and conditions as the Loan Agreement. Section 5.05 contains a covenant on MEB's rates for the sale of electricity and water which reflects the statutory provisions of the Electricity Act under which MEB will operate; this covenant would be amplified in a letter (No. 4). Section 5.06 of the draft Loan Agreement provides for a limitation on the incurrence of new long-term debt by MEB, requiring a coverage of its maximum debt service in any future year by at least 1.6 times of past net revenues for a recent twelve-month period. As a condition for its effectiveness, the draft Loan Agreement requires that the Subsidiary Loan Agreement between the Borrower and MEB, in form and substance satisfactory to the Bank, be executed and delivered (Section 7.01 (a)).

7. The attached draft Guarantee Agreement is in substantially the same form as previous guarantee agreements covering loans to dependent territories of the United Kingdom. The United Kingdom will, as usual, give the Bank a letter confirming the interpretation to be given to Section 2.02 of the Guarantee Agreement (No. 5).

8. Also attached is a report of the Committee provided for in Article III, Section 4 (iii) of the Articles of Agreement in respect of the proposed loan (No. 6).

PART IV - APPRAISAL OF THE PROPOSED LOAN

The Project

9. An appraisal report (No. TO-320-a) on the electric power and sea water distillation project is attached (No. 7). This report was prepared in May, 1962 and updated at the end of the year, following the completion of the loan negotiations with Malta. Although over six months have since elapsed, recent information obtained from the Government and its consulting engineers shows that the cost estimates and construction schedule for the project have not materially changed and our appraisal of the project still remains valid.

10. The project consists of the construction of a new thermal power and sea-water distillation station and workshop, office and store buildings in the city of Valletta and the laying of water mains to an existing reservoir. It would add 25 MW to Malta's power generating capacity and would have a water production capacity of 1 million imperial gallons per day. The installations would be designed for an ultimate power generating capacity of 100 MW and a water production capacity of 6 million imperial gallons per day. The project is due to be completed by December, 1965.

11. MEB is a statutory body, established under legislation dated June 28, 1963 and will start its operations this month. (At the time of the loan negotiations, MEB was expected to start its operations in April, 1963 and the appraisal report reflects this assumption.) It succeeds the electricity branch of the Government's present Water and Electricity Department and has taken over the Department's electricity installations, including the existing 25 MW steam power station. MEB will be staffed largely by staff transferred from the Water and Electricity Department, with some new recruitment, particularly at top levels. The financial position of MEB is sound. There is no immediate need for an increase in power rates.

12. The project would be operated by MEB as an integral unit. Its electrical output would be fed into MEB's distribution system and it is expected that the new power capacity would enable the Board to satisfy the growing demand for electricity until mid-1967. The distilled water would be sold at cost to the Government's Water Authority, which is responsible for water distribution.

13. The cost of the project, equivalent to about \$10.0 million, would be covered under a financial plan which provides that \$7.5 million, representing the foreign exchange costs, would come from the Bank loan, \$1.4 million from the government, and the remainder from funds generated by MEB itself. The government would treat its capital contribution to

MEB as non-repayable advances, represented by permanent debentures carrying interest at 6% per annum, which would be subordinated to all other debt of MEB.

14. Contracts for all major works for the generating equipment and for the distillation plant are being awarded on the basis of international competitive bidding.

Economic Situation

15. A report (No. EA-134-b) on the economy of Malta is attached (No. 8).

16. Malta is a densely-populated British dependency in the Mediterranean. It has an area of 122 square miles and a population of about 330,000. The natural increase in population (1.4% per annum) is partly offset by emigration, mainly to Australia.

17. Malta's first Constitution, providing for an elected government, was granted in 1921. Since then, its constitutional history has been marked by a series of crises, arising mainly from Malta's particular position and relations with the United Kingdom as an important British naval base. In 1959, after widespread strikes and riots which followed the British Admiralty's announcement of its plans to close the naval dockyard, the Constitution was suspended. Until March, 1962, the British Governor directly exercised all governmental powers. Following general elections held in February, 1962, a new Constitution, providing for a substantial degree of self-government, came into effect.

18. At the February polls, the Nationalist Party, a moderate center party, won a majority and formed the Government. In subsequent constitutional discussions in London, the new Government has obtained additional powers on administrative matters. The negotiations on the amount of the United Kingdom's financial assistance to Malta, however, broke down over the Admiralty's plans involving a substantial reduction in employment in the Admiralty dockyards. The Malta Government has asked for immediate independence within the Commonwealth. Discussions on this request, which are now being held in London, indicate that Malta may become independent by May, 1964.

19. By Mediterranean standards, Malta has a relatively high per capita income (\$390 equivalent) which has risen in real terms at a rate of about 5% per annum during the past six years. The economy depends heavily on British aid, and to a lesser extent, NATO military expenditures, which are equivalent to about half of Malta's national income and account for about two-thirds of its foreign exchange earnings. The Maltese are thrifty people and some 19% of national income is saved. Partly because of a lack of investment opportunities in Malta, savings are traditionally invested abroad. In 1959 and 1960, the outflow of capital was unusually high, mainly due to political circumstances, but fell sharply in 1961.

20. In the nuclear age, the strategic value of Malta is decreasing, and expenditure on the base will diminish. In 1959, a large Admiralty dockyard was transferred to a private concern

and is being converted for commercial ship-repairing. The Admiralty has recently announced plans for discharging about 5,000 navy dockyard workers by 1967, which will reduce the Admiralty labor force to some 11,000. This reduction is additional to some reductions already made over the past few years, and increases the problem, already acute, of finding employment.

21. The current five year development plan (1959/60-1963/64) envisages expenditure over the period of \$95 million equivalent, of which 86% will come from the United Kingdom, largely as grants. It lays emphasis on industrialization and the encouragement of tourism. Progress so far has been slow. The conversion of the naval dockyard to commercial use started late, and the establishment of new industries and the building of new hotels have lagged. While some encouraging results have been achieved, it is clear that diversification of the economy will prove slow and difficult, and the stabilization of the economy on a viable basis is not yet in sight.

Prospects of Fulfillment of Obligations

22. Under the government's Electricity Act, the Malta Electricity Board has sufficient autonomy to run its own affairs on sound business lines. It should have no difficulty in generating sufficient revenue to provide for the servicing of the proposed loan.

23. Malta's external public debt amounts to about \$3.4 million equivalent; the Government plans to raise about \$18.1 million equivalent in external loans for completion of the present Development Plan and for the proposed electric power and sea water distillation project. The service burden on the present and prospective external public debt - averaging about \$1.9 million a year - would be equivalent to about 2% of Malta's foreign exchange earnings in 1962, but to 32% of its merchandise exports of domestic origin in that year. The latter ratio, however, may decline to about 20% by 1964.

24. The Government of Malta faces a difficult task in trying to adapt the Maltese economy to meet a fundamentally changed situation and success cannot be taken for granted. In lending to Malta for the proposed project, the Bank would have the assurance of the United Kingdom's guarantee.

PART V - COMPLIANCE WITH ARTICLES OF AGREEMENT

25. I am satisfied that the proposed loan will comply with the requirements of the Articles of Agreement of the Bank.

PART VI - RECOMMENDATIONS

26. I recommend that the Bank at this time make a loan to Malta in an amount in various currencies equivalent to \$7.5 million for a total term of twenty years, with interest (including commission) at $5\frac{1}{2}\%$ per annum 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. 9).

J. Burke Knapp
Vice President
for

George D. Woods
President

August 5, 1963
Washington, D.C.

Attachments.