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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATIONS
of the
PRESIDENT
to the
EXECUTIVE DIRECTORS
on the
CASSA PER IL MEZZOGIORNO LOAN APPLICATION
guaranteed
by the
REPUBLIC OF ITALY

September 28, 1953

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

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

1. I submit the following report and recommendations with regard to a proposed second loan of \$10 million to the Cassa per Opere Straordinarie di Pubblico Interesse nell'Italia Meridionale (Cassa per il Mezzogiorno).

PART I - HISTORICAL

2. On October 10, 1951, the Bank made a loan of \$10 million to the Cassa per il Mezzogiorno to assist in promoting the economic and social development of Southern Italy.

3. The depressed condition of Southern Italy was a national problem which had endured for generations, and only an attack of major proportions could be expected to make any real improvement. Possible Bank participation in a proposed 10-year development plan for Southern Italy had been discussed since the spring of 1949. The law providing for the plan was passed on August 10, 1950. At that time, the Bank indicated its interest in the plan, and its willingness to assist, probably on a continuing basis, the massive investment program established by that law.

4. Although it was clear that the investment of Lit. 100 billion per year would have some direct impact on Italy's dollar balance of payments, it was realized that the major impact would be indirect, resulting from the rising demand for imports of consumption goods stimulated by the additional investment expenditures of the Cassa. The Bank agreed, therefore, to lend \$10 million to assist in meeting the dollar impact of the plan in its initial stages. No list of goods could be drawn up, and the Bank and the Borrower therefore agreed that disbursement in dollars would be made to the Banca d'Italia, based on lire expenditures of the Cassa on its over-all program, and would be in the proportion of \$10 million to Lit. 100 billion. The lire equivalent of the withdrawals would be transferred to the credit of the Borrower, thus adding to the Cassa's resources. This counterpart would be used by the Borrower for re-lending for an agreed list of Supplementary Projects which would still further contribute to the development of the South.

5. The loan did not become effective until September 4, 1952, almost a year after signing. The Cassa program, however, was by that time well under way, and its effects on the economic life of the South were already beginning to be felt.

6. During the Bank's Annual Meeting in Mexico City in September 1952, Dr. Pella, then Italian Minister of the Treasury, requested that a Bank mission be sent to Italy to discuss future relations between Italy and the Bank, and to consider the question of Supplementary Projects under the existing loan.

7. Accordingly, a mission visited Italy during October and November 1952. The mission made a general survey of the operations of the Cassa and reached the conclusion that after two years its accomplishments had been considerable;

that it had proceeded with care and efficiency in launching its program; and that its staff was competent. The mission also worked with the Cassa in establishing an amended list of supplementary projects, four of which are now well begun and the fifth of which is being commenced.

8. When the report of the mission had been considered, the Bank wrote to the Government of Italy on March 16, 1953, stating it was prepared to enter into negotiations for a second loan in an amount of \$10 million and that it would be willing to send a representative of the Bank to Italy to pave the way for negotiations and to discuss with the Italian Government the use of the counterpart funds which would be created by the loan. The Bank representatives visited Italy in April and May of this year.

9. Final negotiations commenced in Washington on September 9, 1953, the Cassa and the Government of Italy being represented by Dr. Attilio Jaschi, Director General of the Foreign Exchange Division of the Italian Ministry of Foreign Trade.

PART II - DESCRIPTION OF PROPOSED LOAN

Borrower

10. The Borrower would be the Cassa per Opere Straordinarie di Pubblico Interesse nell'Italia Meridionale.

Guarantor

11. The Guarantor would be the Republic of Italy.

Amount

12. The loan would be in the amount of \$10 million in dollars.

Purpose

13. 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 by supplying part of the foreign exchange requirements resulting directly and indirectly from the carrying out of the plan of the Borrower and Guarantor for the development of Southern Italy. The loan would also result in making available the lire equivalent of \$10 million to be used for a supplementary project or supplementary projects which would contribute to the development of the South.

14. Agreement has not yet been reached with the Cassa and the Government of Italy concerning the use to be made of the lire counterpart of the dollar loan. Because, however, the over-all program of the Cassa is of a continuing nature and the "impact" on the dollar balance of payments of the development program is therefore continuous, the Bank and the Government of Italy have agreed that disbursements under the second loan should follow with as small a break as possible the final drawdown under the first loan. For this reason it is proposed to make a second loan now and leave for later agreement between the Bank and the Cassa the use to which the counterpart shall be put.

Terms

15. The loan would be amortized by semi-annual payments commencing November 1, 1958, in the amounts set forth in Schedule 1 to the draft Loan Agreement attached as Annex III. These payments would retire the loan by maturity on November 1, 1978.
16. The loan would bear interest (including 1% commission) at the rate of 5%.
17. The commitment charge would be at $3/4$ of 1% per annum and would accrue from the effective date of the loan.

Legal Instruments and Legal Authority

18. The draft of the proposed Loan Agreement between the Cassa per Opere Straordinarie di Pubblico Interesse nell'Italia and the International Bank is attached as Annex III. It is substantially the same as the first loan agreement between the Bank and the Cassa. Sections 7.02 and 8.02 of the draft Loan Agreement make a default under the first loan agreement a default under the second loan agreement and vice versa.
19. Disbursement will be made only in dollars and repayment of principal and interest will be made in dollars except to the extent that dollars for disbursement are purchased with Swiss francs.
20. The draft of the proposed Guarantee Agreement between the Republic of Italy and the International Bank is attached as Annex IV. It is substantially the same as the guarantee agreement between the Republic of Italy and the International Bank guaranteeing the first loan to the Cassa.

PART III - APPRAISAL OF THE PROPOSED LOAN

Justification of the Loan

21. At the time the first loan agreement was signed, it was agreed that the Bank would participate in the financing of the dollar impact of the 10-year plan for the development of Southern Italy, "the extent of such participation to be determined from time to time by agreement between the Bank, the Borrower and the Government of Italy in the light of all relevant considerations including progress made in carrying out the plan and the Italian economic situation."
22. The progress made in carrying out the plan has not until now been as rapid as was forecast at the time the first loan agreement was signed. Progress has, however, been substantial and an account is contained in the progress report attached as Annex II. As is stated in the Annex, it is too early to measure the extent to which the plan has achieved some of its principal objectives, such as an increase of agricultural production or permanent employment. These must, in any case, be regarded as long-term objectives. However, the Cassa's construction activities have already made a notable impact on the unemployment figures in the South of Italy, and their effect on the standard of living in the South is noticeable statistically.

23. The first loan agreement provided that withdrawals from the loan account would be proportional to the Cassa's expenditures on the over-all plan exclusive of the supplementary projects. The proportion which was established was \$10 million to Lit. 100 billion. It was originally expected that the Cassa's rate of expenditure would be about Lit. 100 billion per year. Due to difficulties inherent in launching a program of this size, expenditures in the initial stages of the plan proceeded somewhat slowly and it was only in September 1953 that the final withdrawal was made from the loan account. The Cassa's estimated rate of expenditure for the 12 months commencing July 1, 1953, is Lit. 108 billion and thereafter at the rate of approximately Lit. 27 billion per quarter. If this anticipated rate of expenditure is achieved, the present loan should be wholly utilized by September 1954 or earlier if certain accounting lags can be eliminated or reduced.

24. The principal justification of the loan is the impact on Italy's dollar balance of payments of the Cassa's over-all expenditures. Calculations have been made which demonstrate that the impact on Italy's dollar balance of payments of an additional expenditure of Lit. 100 billion is at least \$10 million.

25. In the first Cassa loan the counterpart is being used by the Cassa for relending for an agreed list of supplementary industrial projects. Since the first loan was signed, certain changes have taken place in Italy with respect to the availability of industrial credits. A law of April 11, 1953, reorganized Isveimer and two similar institutes operating in Sardinia and Sicily, the credit institutions through which the Cassa operates in extending loans to private industry. These institutes have been allocated Cassa funds amounting to Lit. 15 billion (approximately \$25 million) for the continuation of this program. In addition, the Cassa will have at its disposal funds accruing from repayments of loans made from ECA-MSA counterpart funds to private enterprises, the amount of which cannot yet be determined but is likely to be more than Lit. 5 billion. Moreover, the resources of the credit institutes have recently been substantially extended by authorization to issue their own bonds and by the creation of the "Istituto Centrale per il Credito a Medio Termine a Favore delle Medie e Piccole Industrie (Medio Credito)" which can rediscount the early maturities of Isveimer loans to small industries, presently defined as industries whose capital does not exceed \$2½ million. Medio Credito disposes of funds of more than Lit. 60 billion (about \$95 million) for use throughout Italy.

26. In view of the availability to the credit institutions of these new and relatively large credit resources for the financing of supplementary industrial projects in the South, the lack of credit facilities which the Bank helped meet by the use of the counterpart of the first loan to the Cassa now appears to have been met. Therefore, the Cassa has proposed for financing from the counterpart of the proposed second loan the hydroelectric portion of a multi-purpose project in the South of Italy, and the Bank is considering its technical, economic and financial aspects. Since agreement on the use of the lira counterpart is independent from the financing of the dollar effects of the over-all Cassa program and can be determined subsequently, it is proposed that the loan be concluded immediately with the counterpart utilization to be agreed later.

27. Annex V contains the report of the committee provided for in Article III, Section 4, paragraph (iii) of the Articles of Agreement of the Bank.

Prospect of Fulfillment of Obligations

28. Attached as Annex V is an appraisal of Italy's creditworthiness. Its conclusions are summarized in paragraphs 29-33.

29. The national income of Italy has recovered from the low levels to which it fell during and immediately after World War II. The income per head is now slightly higher than prewar in spite of a 10% increase in population. This growth in national income and in income per head has resulted from an increase in agricultural output of about 7%, an increase in industrial production of approximately one-third and from the generally prosperous conditions in the construction and service fields. Italy continues, of course, to be dependent upon imports of basic foodstuffs and raw materials and minerals. However, the recent discovery and exploitation of natural gas has already led to savings of imports of coal, and according to present plans for its development, should provide Italy with the equivalent of about 9 million tons of coal annually by 1956.

30. With the reconstruction phase completed, Italian investment policy is now being directed toward the development of underdeveloped areas and the creation of additional employment opportunities. The economic development prospects of Italy are relatively limited, but under the stimulus of favorable foreign and domestic demand, considerable increases in output appear possible both in agriculture and in industry. However, because of the rapid growth in population, even an intensive investment program and reasonably favorable emigration prospects are not likely to reduce significantly the present level of structural unemployment of 1.3 million. Unemployment and underemployment remain the most unfavorable feature of the Italian economic and social situation.

31. Italy has enjoyed relative price stability ever since the monetary stabilization of 1947 and even the inflationary pressures which arose after the outbreak of hostilities in Korea have been held in check very satisfactorily. The condition of public finances remains difficult and will be further aggravated by the reduction of counterpart availabilities as U.S. aid declines. However, public revenues should continue increasing as national income rises and a more determined effort is made to collect the newly enacted direct taxes. Moreover, the recently rising level of savings should permit the continuation of projected public investment activity without further encroachment on financing availabilities for the private sector.

32. The Italian balance of payments is affected by two basic weaknesses: (a) while her imports consist of essential foodstuffs and raw materials, her exports largely fall in the "soft" categories, such as textiles and luxury foods; and (b) she generally earns a surplus in inconvertible or partially convertible currencies, while she is in deficit with the dollar area. After achieving a small surplus in her balance of payments in 1950, Italy's external accounts deteriorated seriously during 1951 and 1952. This deterioration largely resulted from a decline in Italian exports to the United Kingdom and other sterling area countries and to France, which had to deliberalize, and from an increase in Italian imports because of a stepped up rate of domestic investment. There is, however, no reason to expect a continuation of an Italian deficit with E.P.U. If her major trading partners pursue liberal commercial policies, Italy should be able to balance her accounts with E.P.U. without any great difficulties. It will probably be more difficult to eliminate the dollar deficit, but increasing

availabilities of non-dollar wheat, cotton and fuel (including domestic methane) should make possible a redirection of many basic dollar imports once U.S. aid ends. Moreover, some further increases of Italian exports to the U.S. and increased dollar earnings from tourism and emigrants' remittances is possible provided that the U.S. national income continues to grow and her commercial policies do not become more restrictive.

33. Thus while the balancing of Italian external accounts in general and with the dollar area in particular still remains a serious problem, it does not appear to be insoluble provided that high levels of production, income and trade are maintained by Italy's major trading partners and their commercial policies are further liberalized. Service on the Italian external public debt is relatively light, amounting to between 2 and 3% of Italy's foreign exchange earnings. Its chief burden arises from the fact that most of the Italian debt is in dollars and service payments on this portion account for roughly 10% of her dollar earnings. Because the Italian debt service record has been very satisfactory and in view of the previously mentioned prospects for improving somewhat her dollar earnings and diverting elsewhere some of her basic dollar imports, Italy should be able to manage her present, or an even slightly higher dollar indebtedness. In these circumstances, Italy may be regarded as a reasonably good risk for another \$10 million loan at this time.

PART IV - COMPLIANCE WITH ARTICLES OF AGREEMENT

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

PART V - RECOMMENDATION

35. I recommend that the Bank at this time lend to the Cassa per Opere Straordinarie di Pubblico Interesse nell'Italia Meridionale \$10 million in dollars for a term of 25 years with interest, commission and commitment charges and on such other terms as are specified in the attached draft Loan and Guarantee Agreements.

Eugene R. Black

Washington, D. C.
September 28, 1953