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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PRELIMINARY REPORT OF THE PRESIDENT

TO THE

EXECUTIVE DIRECTORS

ON A

PROPOSED LOAN FOR SOUTHERN ITALY

DEVELOPMENT PROJECTS

March 25, 1959.

PRELIMINARY REPORT OF THE PRESIDENT TO THE EXECUTIVE
DIRECTORS ON A PROPOSED LOAN FOR SOUTHERN ITALY
DEVELOPMENT PROJECTS

1. I submit the following preliminary report with regard to a proposed loan in an amount in various currencies equivalent to \$20 million to the Cassa per Opere Straordinarie di Pubblico Interesse nell'Italia Meridionale (Cassa per il Mezzogiorno) to assist in the financing of three projects in Southern Italy.

PART I - HISTORICAL

2. The Bank has already made loans aggregating the equivalent of \$239.6 million to Italy. The status of the individual loans is as follows:

<u>No.</u>	<u>Borrower</u>	<u>Purpose</u>	<u>Amount (net of cancellations)</u> (equivalent in \$ million)
50 IT	Cassa per il Mezzogiorno	Development of Southern Italy	10.0
88 IT	Cassa per il Mezzogiorno	" "	10.0
117 IT	Cassa per il Mezzogiorno	" "	68.4
150 IT	Cassa per il Mezzogiorno	" "	74.6
189 IT	Cassa per il Mezzogiorno	" "	<u>75.0</u>
	Total, net of cancellations:		238.0
	of which has been repaid :		<u>2.9</u>
	Total now outstanding :		235.1
	Amount sold :	24.1	
	of which has been repaid :	<u>2.5</u>	<u>21.6</u>
	Net amount now held by Bank:		<u><u>213.5</u></u>

3. Following discussions early in 1958, the Bank agreed to consider a further loan to the Cassa which would be made in conjunction with an issue in the New York market. Shortly thereafter it developed that the European Investment Bank (EIB) would be interested in participating in the proposed joint lending. It was agreed in principle that the EIB and the Bank would cooperate in the selection and appraisal of projects and that each institution would provide half the external finance being provided for each project. Both loans would be made simultaneously with a public issue to be arranged by Morgan Stanley and Co.

4. A Bank mission visited Italy in February and March of this year to discuss the general lines of the operation and to appraise the projects. Representatives of the EIB and of Morgan Stanley were in Italy at the same time. Three projects were selected as being most suitable as a basis for lending by both the Bank and the EIB. The proceeds of the public issue would be used for the general development program of the Cassa.

5. In addition to the loan described in this report, discussions are now in progress for a loan of \$40 million equivalent to the Cassa for the SENN nuclear power project.

PART II - DESCRIPTION OF THE PROPOSED FINANCING

6. As now envisaged, the proposed financing would total \$70 million equivalent and would consist of a \$30 million public issue, a \$20 million loan from the Bank and a \$20 million loan from the EIB. The financing would have the following main characteristics:

	<u>The Bank Loan and EIB Loan</u>	<u>The Public Issue</u>
<u>Borrower</u>	Cassa per il Mezzogiorno	Cassa per il Mezzogiorno
<u>Guarantor</u>	The Republic of Italy	The Republic of Italy
<u>Amount</u>	Bank Loan: Equivalent of \$20 million EIB Loan: Equivalent of Lit. 12.5 billion	\$30 million
<u>Purpose</u>	To assist in financing two industrial and one power project in Southern Italy	Cassa program of development in Southern Italy
<u>Interest Rate</u>	Bank Loan: Interest rate to be determined in the normal way; EIB Loan: Interest rate under consideration	To be determined

(Cont'd)	<u>The Bank Loan and EIB Loan</u>	<u>The Public Issue</u>
<u>Maturity</u>	Twenty years. Amortization would be in semi-annual instalments commencing in 1963 and ending in 1978; (for further details, see paragraph 18 below).	It is expected that \$15 million of the issue would be fifteen year sinking fund bonds and that \$15 million would be 3, 4 and 5 year bonds
<u>Currency of Repayment</u>	Bank Loan: The usual provisions will be used. The currencies to be disbursed will be decided at the time of disbursement; EIB Loan: As in the case of the Bank loan, the borrower will be obligated to repay in the same currencies as are disbursed by EIB. The actual currencies to be used are still to be determined.	Repayment will be in dollars only.
<u>Commitment Charge</u>	3/4 of 1%	

PART III - APPRAISAL OF THE PROPOSED BANK LOAN

7. The Bank loan would be similar in form to previous loans to the Cassa for the development of Southern Italy. The Bank loan and the EIB loan would together provide financing for three projects; \$18 million for the Mercure power project, \$14 million for the Sincat petrochemical project and \$8 million for the Celene polyethylene project. Half of these amounts would be provided by the Bank and half by the EIB. A study of these projects is contained in the attached Appraisal Report (TO-202).

The Industrial Projects

8. The Sincat project is the third stage in the development of an integrated chemical manufacturing complex at Priolo, Sicily. The first stage was the construction of a plant for the annual production of 100,000 tons of complex fertilizer. The cost of this stage was \$14.1 million equivalent of which \$5.8 million was financed from Loan No. 117-IT. It was completed in April 1958, eight months ahead of schedule, and is now producing at near rated capacity. The second stage included expansion of the complex fertilizer production to 300,000 tons per year; the addition of facilities for production of ammonia and ammonium salts, caustic soda, chlorine and chlorine derivatives and potash salts; and the opening of a mine at Sta. Catarina for the extraction of potassium-bearing minerals. The cost of this stage, which is nearing completion, is estimated at \$27.4 million equivalent, of which \$12.8 million is being financed from Loan No. 189-IT.

9. The third stage would mark Sincat's entry into the petrochemical field with the production of ethylene and ethylene derivatives. It also includes an increase in capacity for the production of complex fertilizers and related chemicals. The total cost of this third stage is estimated at \$33.6 million equivalent. However, the project proposed for financing would cover only the petrochemical facilities; the expansion of fertilizer production would be financed from other sources. For the petrochemical project, it is proposed that the Bank and EIB jointly finance \$14 million equivalent out of an estimated cost of \$28.5 million equivalent.

10. The Celene Company would purchase ethylene from Sincat for the production of polyethylene (10,000 tons per year), ethylene oxide and ethylene oxide derivatives at a plant to be built next to the Sincat property. The total cost is estimated at \$21.6 million equivalent and it is proposed that \$8 million be financed equally from Bank and EIB funds.

11. These two projects taken together would form one of the most complete industrial chemical complexes in Europe. They are to be located in an area possessing the natural advantage of locally available raw materials in the form of sulphur, potash minerals, rock salt and crude oil. Phosphate rock, the only other necessary material, can be imported from North Africa, and a nearby refinery produces light oil fractions. The development of these two plants should greatly benefit Sicily.

Power Project

12. The Mercure power project, which is estimated to cost \$40 million equivalent, is a 210 MW thermal project forming part of the expansion program of the group of companies controlled by the Societa Meridionale di Elettricita (SME). It is located on the Mercure river about 190 kilometers South-East of Naples. The plant will be equipped with three turbo-generator units, each with a maximum continuous output of 70 MW.

13. Fuel for the plant will be obtained from brown coal deposits at the site. Exploration has shown proven reserves of 42 million tons, of which 22 million tons can be worked by open pit stripping and the rest by underground mining. Comparative studies have shown that the cost of the power produced by the project would be competitive with that produced by an alternative thermal plant using imported fuel oil.

14. The demand for power as measured by sales of energy in the area served by SME has been increasing since 1952 at an average annual rate of 9% and is expected to continue to increase at about the same rate

over the next five years. The Mercure project is part of a construction program planned by SME to meet this future demand. The whole program will provide 1,192 MW of new capacity and is justified by the expected needs of the system.

Procurement

15. For the industrial projects procurement of equipment has been, in general, on the basis of active competition from suppliers in Italy and elsewhere. Some of the machinery and equipment are to be obtained under licensing arrangements and some may be manufactured by associated companies.

16. General planning for the Mercure power plant has been completed. Detailed specifications are under preparation and bids for major pieces of equipment are to be invited by the middle of 1959.

Disbursement

17. As expenditures are made on the projects, requests for disbursements will be made to the Cassa. The Cassa will thereupon request disbursement in equal amounts from the Bank and the EIB. The funds so obtained by the Cassa will be lent in lire to SME in respect of the Mercure project and to IRFIS (a regional financing institution) in respect of the Sincat and Celene projects. This procedure is essentially the same as under previous Bank loans to the Cassa, with the modification necessitated by the participation of the EIB.

Amortization

18. The loan from the Cassa to SME will be for a total term of twenty years with repayment taking place over 16 years starting in July 1963. The loans for the industrial projects will be for twelve years, repayment being over eight years starting also in July 1963. The amortization payments under the Bank loan and the EIB loan will be equivalent and will be in such amounts as, taken together, will be equal to the sum of the amounts payable by the three beneficiary companies under their respective loan agreements.

Prospects of Fulfillment of Obligations

a) The Projects

19. Both the industrial companies are financially sound and they should have no difficulty in meeting their obligations under the proposed loans.

The management of Sincat, which has been the beneficiary of previous loans from the Bank, has proved able and energetic, while for the Celene project adequate management can be provided with the assistance of the parent companies, Edison and the Union Carbide and Carbon Corporation of the U.S.A.

20. SME, the company which will construct and operate the power project, is well managed and financially sound. On the basis of present power rates, it should continue to earn enough to maintain reasonable dividends and to service its debt.

b) The Italian Economy

21. The most recent report on the economic position and prospects of Italy was circulated to the Executive Directors on February 18, 1958. (R 58-15) That report pointed out the essential strength of the Italian position, as a result of recent growth, which took place in an environment of relative price stability due to rising savings and a continued sound monetary policy.

22. When the report was written, the Italian economy was already feeling the effects of the slackening of world economic activity. Since the fall of 1957, the rate of growth of industrial production had been declining; only unusually good crops and further growth in the service sector permitted the real gross product to rise in 1958 by 4%, compared to 5.6% in 1957. However, this trend, which continued during most of 1958, now appears to have come to an end. It did not significantly affect employment or consumption, but it did affect private investment. Italy's basic economic conditions and long-run prospects, however, remain unaffected, and the short-run prospects, which a year ago were dim, have brightened.

23. Recent developments in Italy's external accounts have been favorable. A decline in the volume of imports simultaneously with continued high exports, the fall in import prices and rapidly rising receipts from invisibles have resulted in a sharp rise in reserves. Net official reserves increased by \$286 million in 1957 and \$850 million in 1958, and at the end of the year were more than \$2.2 billion.

24. There can be no doubt of Italy's ability to service the additional external debt now contemplated. On December 31, 1958 the external public debt of Italy was estimated at \$849 million. Service payments constitute at present less than 4% of Italy's global foreign exchange earnings at the 1958 rate. The financing described in this report would increase the Bank's investment in Italy to \$233.5 million, and Italy's total external debt to \$919 million.

PART IV - TIMING

25. Before filing a registration statement, Morgan, Stanley and Co. wish to be assured that in the absence of some major adverse development there is no reason to believe that the loan would not be approved by the Executive Directors in time for the public issue. If you concur, I would give them this assurance.

26. In this event, I propose to submit to you at a meeting before the public issue (which at present is planned for April 22, 1959) a supplement to this report setting forth the proposed final terms of the borrowing, attaching the loan documents, a report on the economy of Italy, and containing my recommendations regarding the loan.

27. The Board of the European Investment Bank approved their lending in principle on March 18 and it is expected that their loan would be signed on the same day as the Bank's loan.

Eugene R. Black

Washington, D.C.
March 25, 1959