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INTERNATIONAL DEVELOPMENT ASSOCIATION

REPORT AND RECOMMENDATIONS OF THE PRESIDENT TO THE EXECUTIVE DIRECTORS ON A PROPOSED DEVELOPMENT CREDIT TO THE REPUBLIC OF TURKEY FOR AN ELECTRIC POWER PROJECT

January 23, 1963

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REPORT AND RECOMMENDATIONS OF THE PRESIDENT TO THE EXECUTIVE DIRECTORS ON A PROPOSED DEVELOPMENT CREDIT TO THE REPUBLIC OF TURKEY FOR AN ELECTRIC POWER PROJECT

1. I present the following report and recommendations on a proposed development credit to the Republic of Turkey in an amount in various currencies equivalent to $1.7 million to assist in financing the expansion of the plant of the Çukurova Electric Company and the preparation of engineering studies for future power projects in the Çukurova area.

PART I - HISTORICAL BACKGROUND

2. In June 1952 the Bank made a loan of $25 million (Loan 63 TU) to the Government of Turkey for the Seyhan multi-purpose project near Adana in southern Turkey. The Seyhan project was designed for flood control, irrigation and hydro-electric power. It was agreed at the time that a private company, to be known as the Çukurova Electric Company (CEC), would be established and that on completion of the project, the Turkish Government would hand over the power installations to the new company. Accordingly, CEC was founded in 1953, the Government granted it a 49-year concession and it began operations in 1956.

3. In May 1961 IDA informed the Turkish Government that it was prepared to consider credits for suitable projects in an amount of about $20 million. The Government then put forward a number of projects one of which was for power development in the Çukurova area. A mission visited Turkey in June 1962 to make an appraisal of the project and negotiations for the proposed credit were completed in Washington in November.

4. This credit would be the second IDA credit for a project in Turkey. The first was a credit of $5 million for the Industrial Development Bank of Turkey which was signed on November 23, 1962. IDA has also informed the Turkish Government that it is prepared to enter negotiations for a credit of $20 million for the development of irrigation in connection with the Seyhan project.

PART II - DESCRIPTION OF THE PROPOSED CREDIT

5. The main characteristics of the credit would be as follows:

Purpose:	To finance the foreign exchange cost of a third 18 MW generator for the existing 36 MW power plant of the Çukurova Electric Company and of engineering studies by independent consultants for two new power plants to be built in the near future.
Borrower:	The Republic of Turkey.
Amount:	The equivalent in various currencies of $1.7 million.
Term and Amortization:	50 years with no amortization for the first ten years. Repayment to be in 80 installments; 1/2 of 1% of the principal amount to be repaid semi-annually beginning May 15, 1973 and ending November 15, 1982 and 1-1/2% semi-annually thereafter to 2012.
Service Charge:	Three quarters of 1% per year on the principal amount of the credit withdrawn and outstanding.
Payment Dates:	May 15 and November 15.
Subsidiary Borrower:	Çukurova Electrik A.S.
Amount of Subsidiary Loan:	$1,620,000
Terms of Subsidiary Loan:	CEC would pay interest at 5-1/2% per year to the Turkish Government. Principal would be repayable to the Government in 36 semi-annual installments beginning May 15, 1965 and ending November 15, 1982. Each payment of principal and interest taken together would be approximately equal.

6. The engineering studies would be arranged and paid for by the Electrical Studies Investigation Agency, an agency of the Turkish Government. Hence, the portion of the loan to be used for this purpose ($80,000) would not be re-lent to the CEC but would be withdrawn by the Government and used for these studies.

PART III - APPRAISAL OF THE PROPOSED CREDIT

7. A detailed appraisal of the Project (TO 346b) is attached (No. 1).

Introduction

8. The Cukurova Electric Company is the only private power company in Turkey. The remainder of the power industry is owned either by municipalities or by the Government or Government agencies. Although consumption of electric power per capita is lower in Turkey than in any other country in Europe, it is increasing rapidly and the expansion of the industry is lagging behind the demand. There is, in particular, a large pent-up demand for power for use in industry. The Government has prepared a five-year program to expand power capacity by 12.5% per year which is about in line with the expected increase in demand. The program requires capital expenditure of some $560 million. Unfortunately the low rates charged for power reduce the amount which the industry can contribute to its own investment requirements and thus constitute an obstacle to the proper expansion of the industry.

The Project

9. The CEC serves what is called the Cukurova area near Adana, in southern Turkey. It now operates two 18 MW hydro-units at the Seyhan dam together with transmission lines, sub-stations and distribution lines to large industrial consumers. Distribution to other consumers is the responsibility of the local municipalities. CEC power is supplemented by 15 MW of high cost diesel power owned by municipalities and private industries, which is mainly used to meet the peak load. In the recent past, sales of power have increased by 8% per year and are conservatively estimated to grow by 12% per year over the next three years. The present capacity of CEC is already insufficient to meet the peak demand. To avoid serious power shortages, the company must install an additional 18 MW unit by the fall of 1964. Even with this addition, the full capacity of the plant will be reached in 1965 and CEC is already obliged to defer applications from potential consumers until firm plans for its further expansion can be agreed upon.

10. The Government has recently prepared a study on the problem of meeting the prospective demand for energy in the Cukurova area. The study included the provinces of Seyhan and Icle, in which most of the Adana plain is situated, and the neighboring province of Hatay which contains the town of Iskenderun, one of Turkey's most important ports. The study concluded that a 50 MW thermal plant should be built at Mersin, adjacent to an oil refinery. It should be completed by 1965. By 1967 additional power would be required and the study proposed the construction of a hydro plant at Kadincik for this purpose. This general program appears sound but further technical studies are required before final decisions on these two plants can be taken. In the meantime, owing to the urgent need for the third unit, it is proposed to make a credit for the foreign exchange cost of this unit and of the engineering studies required to reach firm conclusions regarding the future expansion program.

11. When the CEC was first established the intention was that it would take over the power facilities of the Seyhan project from the Government at an agreed price. However, owing to an increase in the cost of the project and also to a controversy within the Government about the treatment of the Company, no agreement on the terms of the take-over could be reached at the time. It was not until November 1961, after there had been a change of government and a change in the Company's management, that these matters were finally settled and a proper financial basis for the Company established.

12. As a result of the agreement of November, 1961, the CEC had, at the end of 1961, paid-in capital and reserves amounting to $3.98 million equivalent. About 56% of the share capital is owned by private interests. The CEC's long-term indebtedness, all of which is to the Turkish Government, amounted to $9.05 million, so that the ratio of debt to total capitalization was 72%.

13. Since the financial position of CEC was radically altered in November, 1961, its previous earnings record is not very significant for the future. Since 1958 it has paid dividends averaging about 14%. A forecast of future earnings based on present power rates shows that interest would be covered 1.8 times by net income in 1963 but only 1.4 times in 1966. CEC has agreed (Section 2.08 of the Project Agreement) that it will not incur new debt if the prospective interest coverage is less than 1.75 so that a rate increase may be necessary in connection with the financing of the Mersin project. The timing and magnitude of such an increase cannot yet be precisely determined. Present rates are, however, quite adequate to provide satisfactory earnings until the next stage of the expansion program begins. The CEC is now well managed, its financial position is satisfactory and it is fully capable of carrying out and operating the project.

The Economy of Turkey

14. A memorandum of Turkey's current economic position was included in the report and recommendations (IDA/R62-35) of November 13, 1962 on a proposed development credit to Turkey for use by the Industrial Development Bank of Turkey. As explained in that report the severe inflation which Turkey experienced during the mid-fifties has left her with an exceptionally large external debt and with a very difficult balance of payments problem. The service on Turkey's external debt over the next five years will be nearly 30% of expected export earnings. Even without burdensome debt payments, external aid would be necessary to support the balance of payments and a consortium has been established under the aegis of OECD to co-ordinate external aid for Turkey. In these circumstances, it is of the greatest importance that any external aid to Turkey be made on the easiest possible terms.

PART IV - LEGAL INSTRUMENTS AND AUTHORITY

15. Attached are a draft Development Credit Agreement between the Republic of Turkey and the Association (No. 2), a draft Project Agreement between the Association and the CEC (No. 3), and a draft Subsidiary Loan Agreement between the Republic of Turkey and the CEC (No. 4). The provisions of the Development Credit Regulations No. 1 dated June 1, 1961, subject to the modifications thereof set forth in the Development Credit Agreement, would be applicable to it. The execution and delivery of the Project Agreement and the Subsidiary Loan Agreement would be conditions of effectiveness of the Development Credit Agreement.

16. The Development Credit Agreement provides for the credit to be made to the Turkish Government which would thereby receive the benefit of the IDA terms. The Government would then re-lend under the Subsidiary Loan Agreement up to $1,620,000 equivalent to the CEC on conventional terms for the third generating unit. Withdrawals from the Credit Account for this purpose would be made directly by the CEC (Section 2.03 (a) of the Development Credit Agreement). Withdrawals on account of the engineering studies -- which would be carried out by the Government -- would be made directly by the Government (Section 2.03 (b)) and the part of the credit to be used for this purpose would not, of course, be re-lent to the CEC.

17. All the specific covenants concerning the execution and operation of the project by the CEC have been placed in the Project Agreement between the Association and the CEC. In particular, in Section 2.09 the CEC undertakes to take all steps necessary or desirable to obtain and maintain rates for sale of electricity adequate to provide revenues sufficient to cover operating expenses including taxes, adequate maintenance and depreciation and interest, to meet repayments on long-term indebtedness to the extent that such repayments exceed provision for depreciation, to meet payments to the Government on account of exchange losses and to provide a reasonable surplus. In a corresponding provision of the Development Credit Agreement (Section 4.07) the Government undertakes to grant such rates to the CEC. These two sections reflect the provisions on rates contained in the concession arrangements between the Government and the CEC.

18. The draft Subsidiary Loan Agreement between the Government and CEC provides that the proceeds of the Credit to be used for the third generating unit would be re-lent by the Government to the CEC. The exchange risk would be borne by the CEC.

19. Any default under the Project Agreement would entitle the Association to suspend and premature the credit (Development Credit Agreement, Section 5.02 (b)).

20. The report of the committee provided for in Article V, Section 1 (d) of the Articles of Agreement of the Association is attached (No. 5).

PART V - COMPLIANCE WITH ARTICLES OF AGREEMENT

20. I am satisifed that the proposed Development Credit would comply with the Articles of Agreement of the Association.

PART VI - RECOMMENDATIONS

21. I recommend that the Association make available a Development Credit to the Republic of Turkey in an amount in various currencies equivalent to $1.7 million for a total term of 50 years with a service charge of 3/4 of 1% per annum and on such other terms as are specified in the draft Development Credit Agreement, and that the Executive Directors adopt a resolution to that effect in the form attached (No. 6).

Attachments (6)
Washington, D.C.
January 23, 1963

George D. Woods
President