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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATION

OF THE

PRESIDENT

TO THE

EXECUTIVE DIRECTORS

ON A

PROPOSED LOAN

TO THE

REPUBLIC OF FINLAND

FOR A

THIRD HIGHWAY PROJECT

January 28, 1971

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATION OF THE PRESIDENT
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1. I submit the following report and recommendation on a proposed loan in an amount in various currencies equivalent to US \$13.0 million to the Republic of Finland.

PART I - HISTORICAL

2. The Bank has made fifteen loans to, or guaranteed by, the Republic of Finland. The projects for which these loans were made have been, or are being, carried out satisfactorily.

3. There have been two previous loans for highway projects totalling \$48.5 million. Both are fully disbursed. Through these loans the Bank has assisted the Government in its efforts to improve the planning and construction of highways and modernize the responsible organization, the National Board of Public Roads and Waterways (NBR). A mission to appraise the third highway project visited Finland in May 1969. Construction was originally planned to start in 1970 at the beginning of Finland's short summer construction season, but unexpected delays in completing detailed engineering and bidding documents caused the Government to postpone construction until 1971 in order to take advantage of a full construction season. As a result, the Bank was asked to defer consideration of the project, and a reappraisal mission visited Finland in September/October 1970.

4. Negotiations were held in Washington in December 1970. The delegation from Finland consisted of Mr. Vaino Suonio, Director in Chief of NBR; Mr. Jorma Aranko, a Director of the Bank of Finland; and Mr. Niilo Pusa, Counselor of the Embassy of Finland.

5. The following is a summary statement of Bank loans to Finland as at December 31, 1970:

<u>Loan Number</u>	<u>Year</u>	<u>Borrower</u>	<u>Purpose</u>	<u>Amount</u> <u>(US \$ million)</u>	<u>Undisbursed</u>
	1949- 1966	Fully disbursed loans (less cancellations)		221.5	
582-FI	1969	Teollistamisrahasto Oy (IFF)	Industrial Credit	22.0	5.9
708-FI	1970	Teollistamisrahasto Oy (IFF)	Industrial Credit	20.0	20.0
		Total (less cancellations) of which has been repaid to the Bank and others		263.5	
		Total now outstanding		153.1	
		Amount sold	62.6		
		of which has been repaid	<u>56.5</u>	<u>6.1</u>	
		Total now held by Bank		<u>147.0</u>	
		Total undisbursed			<u>25.9</u>

6. No other loan proposal for Finland is expected to be submitted to the Executive Directors for approval within this fiscal year.

7. The present amount of IFC investment in Finland is \$230,122. This includes a shareholding of \$159,279 in Teollistamisrahasto Oy (IFF), which is the only privately owned and managed financial institution in Finland to provide long-term financing to private industrial enterprises. (IFF has received four Bank loans totalling \$63.0 million.) IFC has also invested \$70,843 in shares of Huhtamaki-Yhtymä Oy, a company manufacturing pharmaceuticals. IFC's total investment in this company included a loan of approximately \$700,000 (now fully repaid) and equity participation of about \$100,000 original cost. This investment was a joint operation with IFF. IFC currently has no projects under consideration in Finland.

PART II - DESCRIPTION OF THE PROPOSED LOAN

8. Borrower: Republic of Finland
- Amount: The equivalent in various currencies of US \$13 million
- Purpose: To assist in financing the construction of a 22 km expressway section between Tattariharju and Jarvenpaa and the paving of about 910 km of roads
- Amortization: In fifteen years, including a three-year period of grace, through semi-annual installments beginning August 1, 1974 and ending February 1, 1986
- Interest Rate: 7-1/4 percent
- Commitment Charge: 3/4 of 1 percent
- Rate of Return: The economic rate of return is estimated at 17 percent for the expressway and 30 percent for the paving works

PART III - THE PROJECT

9. An appraisal report entitled "Appraisal of a Third Highway Project in Finland" (PTR-37b), dated January 28, 1971, is attached (No. 1).

10. Finland's public highway network in 1969 totalled about 72,000 km of which about 22,000 km were paved. The main roads generally radiate from Helsinki and those closest to the capital have the highest traffic densities.

11. Although the length and general location of the present road network are satisfactory, the design and construction standards of a large part are not appropriate to traffic needs. The relatively high growth rate of passenger and freight traffic in the 1960's (about 11 and 8 percent per annum respectively) has produced increasing congestion, and road maintenance and vehicle operating costs have been high. The Government recognized these problems in the early 1960's. Over the last seven years, it has concentrated on the upgrading and improvement of road surfaces and alignments to meet traffic needs. This is consistent with the long-term recommendations of the transportation study, financed by the Bank under the first road loan made in 1964, and is to be continued in the Government's future highway investment programs.

12. The project consists of:

- (a) The construction of a 22 km section of four-lane divided expressway between Tattariharju and Jarvenpaa, including the construction of five interchanges and the construction or improvement of about 36 km of approach roads. This is part of a planned 138 km expressway between Helsinki and Lusi, a town 40 km north of Lahti. The rapid development of the area between Helsinki and Lahti and the expected increase in traffic indicate a need to extend the expressway to Lusi, where traffic then fans out to the north and northeast; and
- (b) The paving of about 910 km of roads included in the Government's 1971 paving program which comprises about 2,530 km of roads.

13. The project is estimated to cost a total of US \$33.8 million equivalent, of which the expressway works account for \$20.1 million, paving works for \$10.4 million and contingencies for \$3.3 million. The foreign currency component is estimated at \$13.0 million equivalent and would be financed by the proposed loan. The project cost estimate excludes the cost of land acquisition (\$2.8 million equivalent), construction supervision (\$1.2 million equivalent) and project preparation (\$1.2 million equivalent), which have been or will be borne by the Government.

14. Loan funds would be disbursed on the basis of the estimated foreign exchange component as follows:

- (a) 35 percent of actual payments to contractors for highway construction works; and
- (b) 45 percent of actual payments to contractors for paving works.

Any surplus funds remaining in the loan account would be cancelled. Procurement will be carried out under full international competitive bidding in accordance with the Bank's Guidelines. With the Bank's concurrence, pre-qualification was completed in December 1970. The experience of the first and second road projects together with the interest shown by foreign contractors in the proposed project suggest that about one-half of the contract sections will be awarded to foreign firms. This forms the basis for the estimates of the foreign exchange component.

16. The proposed project is economically justified and will expand the existing expressway system in an area of serious traffic congestion and continue the planned upgrading of the highway network, all of which is part of the Government's long-range roads investment program aimed at reducing road transport costs. The economic rate of return for the expressway investment would be about 17 percent based upon estimated savings in vehicle operating costs and time; for the paving program the rate of return would be about 30 percent, based upon estimated savings in road maintenance and vehicle operating costs.

PART IV - LEGAL INSTRUMENTS AND AUTHORITY

17. The draft Loan Agreement between the Republic of Finland and the Bank, the Report of the Committee provided for in Article III, Section 4(iii) of the Articles of Agreement and the text of a Resolution approving the proposed Loan are being distributed to the Executive Directors separately. The draft Loan Agreement conforms substantially to previous loan agreements for projects of this type.

PART V - ECONOMY

18. A report entitled "Current Economic Position and Prospects of Finland" (EMA-31a) is being distributed to the Executive Directors separately. A basic data sheet is annexed.

19. Government policy has been to meet as much of the external capital needs as possible through long-term bond issues in international capital markets. About 25 percent of the gross capital inflow during 1967-69 has been provided by public and private bond issues. Finland's special geographical and political situation and the stringency in capital markets still severely limit the prospects for raising long-term capital abroad. The relatively small size of Finnish companies and a shortage of internationally known names are further obstacles. Total external medium- and long-term public debt outstanding was \$787.6 million on December 31, 1969, of which \$52 million was undisbursed. Debt service payments are moderate. They will amount to only about 3.7 percent of foreign exchange earnings in 1970, and the debt service ratio is not expected to increase appreciably in the next few years. Finland's debt servicing record is very good, its borrowing capacity is substantial, and it is credit-worthy for the proposed lending.

PART VI - COMPLIANCE WITH THE ARTICLES OF AGREEMENT

20. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Bank.

PART VII - RECOMMENDATION

21. I recommend that the Executive Directors approve the proposed loan.

Robert S. McNamara
President

Attachment

- January 28, 1971

FINLANDANNEXBASIC DATA

Area: 130,000 square miles (337,000 square kilometers)

Population (1969): 4.7 million

Rate of Growth: 0.48%

Density: South Finland - 26.0 per square kilometer
 North Finland 4.3 per square kilometer
 Whole country 15.3 per square kilometer

Gross National Product at Current Factor Cost (1969)

Fmk 34.0 billion (or U.S. \$8.1 billion at the exchange rate of Fmk 4.20 for US \$1)

Per capita Fmk 7229 (US \$ 1720)

Rate of Growth (in real terms) 1960-66 - 4.3%
 1967 - 2.5%
 1968 - 2.8%
 1969 - 8.3%

Industrial Origin of GDP at Current Factor Cost (% share)

	<u>1964</u>	<u>1966</u>	<u>1969</u>
Agriculture, Fishing	9.8	9.1	8.4
Forestry	8.6	7.1	6.3
Manufacturing	25.8	25.6	28.5
Mining	0.5	0.7	0.9
Power	2.8	2.9	2.7
Construction	9.3	9.8	9.2
Transportation	7.3	7.2	7.2
Commerce, Banking and Insurance	12.9	13.3	12.3
Public Administration and Defense	4.0	4.4	4.5
Others	19.0	19.9	20.0

Expenditures on GDP (% share)

Private consumption	58.2	58.4	56.7
Public consumption	14.2	14.6	14.9
Gross Domestic Investment	29.4	29.5	27.0
Net Exports	-2.0	-2.5	1.4

<u>Central Government Account</u> (in billion Fmk)	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>
Current Revenue	6.5	7.2	8.4	9.1
Current Expenditure	5.2	5.7	6.8	7.8
Balance	1.3	1.5	1.6	1.8
Capital Expenditures	1.4	1.5	1.9	1.8
Total deficit	0.1	-	0.3	-

<u>Money and Credit</u> (in Fmk million)	<u>1969</u>	<u>Increase</u> <u>1965 - 1969</u>	<u>Increase</u> <u>1968 - 1969</u>
Money supply	3 139	10.7% p.a.	17.6%
Time and savings deposits	13 760	11.7% p.a.	11.9%
Claims on private sector	16 173	11.5% p.a.	14.1%

Prices (percentage increase over previous year)	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>Jan-July 1970</u>
Cost of living	5.4	8.7	2.4	2.8
Wholesale	2.9	10.9	3.6	4.6

<u>External Public Debt</u> (U.S. \$ million)				
Total debt (December 31, 1969)		787.6		
Total debt service, 1970		89.2		
Debt service ratio 1970		3.7%		

<u>Balance of payments</u> (U.S. \$ million)	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>Jan-June 1970</u>
Exports (f.o.b.)	1524	1627	1975	1071
Imports (c.i.f.)	-1704	-1602	-2031	-1198
Net invisibles	38	39	76	27
Current account balance	-142	64	20	-99

<u>Commodity Concentration</u> <u>of Exports</u> (percentage of total)	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>Jan-June 1970</u>
Manufactured products:	93.8	94.3	94.6	94.3
Paper and Pulps	62.1	60.4	57.2	54.0
Metal and Engineering	20.6	22.7	24.1	25.6

<u>Gross Foreign Exchange Reserves</u> (U.S. \$ Million)	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>Sept. 1970</u>
	184	354	359	424
<u>IMF Position</u> (U.S. \$ million)				
Quota	125	125	125	125
Drawings	93.8	31.2	-10.0	-13.9
<u>Rate of Exchange</u>	U.S. \$1 = 4.20 Finnish markkas			

January 28, 1971