

FILE COPY

**CIRCULATING COPY
TO BE RETURNED TO REPORTS DESK**

DOCUMENT OF INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Not For Public Use

**CIRCULATING COPY
TO BE RETURNED TO REPORTS DESK**

Report No. P-1626-IS

REPORT AND RECOMMENDATION
OF THE
PRESIDENT
TO THE
EXECUTIVE DIRECTORS
ON A
PROPOSED LOAN
TO
ISRAEL
FOR AN
INDUSTRIAL DEVELOPMENT PROJECT

May 7, 1975

This report was prepared for official use only by the Bank Group. It may not be published, quoted or cited without Bank Group authorization. The Bank Group does not accept responsibility for the accuracy or completeness of the report.

Currency Unit = Israel Pound (IL)

US\$1 = IL 6

IL 1 = US\$0.17

IL 1,000 = US\$166.67

IL 1,000,000 = US\$166,666.67

Fiscal Year - April 1 to March 31

Abbreviations

IDBI - Industrial Development Bank of Israel Ltd

L.A. - Loan Agreement

OCS - Office of the Chief Scientist

P.A. - Project Agreement

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATION OF THE PRESIDENT
TO THE EXECUTIVE DIRECTORS ON A
PROPOSED LOAN TO ISRAEL
FOR AN INDUSTRIAL DEVELOPMENT PROJECT

1. I submit the following report and recommendation on a proposed loan to Israel for the equivalent of US\$35 million at the Bank's standard lending rate to help finance a project for industrial development. The Government would on-lend \$25 million at the same interest rate to the Industrial Development Bank of Israel Limited (IDBI) with repayments by IDBI to the Government and by the Government to the Bank conforming substantially to the aggregate amortization schedule of IDBI's subloans. The remaining \$10 million would finance industrial research and development and vocational/technical training and be repaid in 15 years, including 5 years grace.

PART I - THE ECONOMY

2. A report entitled "Current Economic Position and Prospects of Israel" will be distributed to the Executive Directors shortly. Its principal findings are reflected below. Country Data sheets (Annex I) are attached.

3. Israel has few natural resources. Its economic growth has been based largely on the imported or acquired skills of its people, technological sophistication and a large capital inflow from abroad. Although the domestic market has expanded considerably as incomes have risen, exports remain more than ever crucial for continued growth and economic viability.

4. From 1970 to September 1973, Israel enjoyed a period of prosperity, with rapidly increasing levels of consumption. GNP per capita is estimated to have reached \$2,860 (Atlas basis) in 1973. GDP at factor cost grew by 10 percent per annum in real terms in 1971 and 1972, and at an annual rate of 7 percent up to September 1973, with industry growing at 12 percent, agriculture at 5 percent and services at 4 percent over the period. Labor force growth over the same period was a rapid 5 percent per annum, and productivity growth 4 percent per annum under the impact of high investment and the introduction of capital-intensive technologies. Private consumption grew at an accelerating rate; private savings also grew rapidly with rising incomes. Public consumption was held constant in real terms for three years and real defense expenditures declined. The investment rate increased from 27 to 29 percent of GDP between 1970 and 1972. Gross savings, normally low, rose sharply in those years from 4 to 14 percent of GDP. The current account deficit narrowed from \$600 million in 1970 to almost zero in 1972 as a result of a rapid growth of unilateral transfers. The resource gap was equivalent to 72 percent of investment in 1970, but only 41 percent in 1972. The pressures generated by rapid growth led to some scarcity of labor, while Government deficits and large capital inflows raised liquidity and money incomes, raising

prices and finally generating an import boom. Unemployment dropped to a record low of 2.5 percent in the first nine months of 1973. Prices rose by about 13 percent in 1971 and 1972 and by 20 percent in 1973; the largest part of the increase occurred before the October 1973 war. Until then, the Government focused more on controlling rising prices than on the underlying weakening of the balance of payments, attempting to control its deficits and employ more orthodox methods of financing them.

5. The October 1973 war caused major economic dislocations. Some 30 percent of the labor force was mobilized. Output fell initially in all sectors except agriculture, but most reached prewar levels again by the second quarter of 1974. Public consumption and imports rose sharply, as the war led to a tremendous upsurge in defense expenditures, which doubled to reach IL 12.5 billion (\$3 billion), equivalent to 31 percent of GNP in 1973. This came at a time when the civilian economy was already overheated and price rises accelerating.

6. Real GDP growth in 1973 was 8 percent. This reflects national accounting conventions under which defense expenditures contribute to output; non-defense output fell by 4 percent during the year. In 1974, however, GDP growth slowed to about 6 percent. The Government introduced a series of fiscal measures involving large cuts in aggregate demand. Attempts to reduce real private consumption failed because of trade union strength, particularly under full employment conditions, the payment of automatic cost-of-living allowances on basic wages, and possibly some fall in private savings rates. The continuing high level of defense expenditures (IL 16 billion in 1974) led to a continuing Government deficit. Sharply rising prices of fuel and other imports compounded Israel's economic difficulties. The rate of inflation doubled in 1974 to an unprecedented figure of 40 percent.

7. The deficit on goods and services was about \$1.2 billion in 1971 and 1972. Exports increased in value by 24 percent in 1973, but imports rose 60 percent, under the impact of booming consumption, world price rises and defense purchases, so that the deficit on goods and services widened rapidly to reach \$2.6 billion. It was almost matched by unilateral transfers, consisting of restitution payments by Germany, personal cash transfers and institutional transfers. The transfers were exceptionally high following the October 1973 war, and reached \$2.2 billion in 1973, with the current account deficit at \$400 million. Gross loan inflow before the war was at a rate of \$1 billion per annum and net inflow \$600 million, and consisted of U.S. Government credits, German capital aid and commercial loans. The inflows permitted a continual increase in foreign exchange reserves, to a peak of \$1.8 billion (gross) at the end of 1973, equivalent to four months' imports of goods and services.

8. Imports increased by some 29 percent in value in 1974 to \$6.7 billion, nearly all from price increases for a few key commodities, particularly oil. Even though Israel was partly shielded from the worldwide oil price increase because it used oil extracted from the Sinai oil fields, the increase in the oil import bill was \$450 million, equivalent to 4.6 percent of 1973 GNP and nearly 9 percent of 1973 imports. In February 1975, Israel drew \$78

million under the 1974 IMF oil facility. In 1974, exports increased by 24 percent in value to \$3.3 billion, with little volume increase. The deficit on goods and services widened further to \$3.4 billion in 1974 (about 23 percent of GNP). The increase in the deficit in 1973 and 1974 originated mainly in the deterioration of Israel's terms of trade, and resulted in a considerable real resource loss because of the high ratio of exports and imports to GNP. The exceptional capital inflows of the war year 1973 could not be repeated. Foreign exchange reserves halved to \$0.9 billion by November 1974.

9. The Government is taking strong measures to reduce demand. The proposed 1975/76 budget of IL 56.3 billion is expected to involve no increase, and perhaps a small decline, in real expenditures. Significant reductions have been made in subsidies on basic food items, public utilities and petroleum products. The development budget (other than for housing) will be reduced by 15 percent in real terms in 1975/76, with the cuts concentrated in lower-priority sectors. Government industrial investment will be expanded and export-oriented private industrial investment stimulated as much as possible. In November, the Israel pound was devalued from IL 4.2 to IL 6 to the US dollar. An import surcharge (more than halved to 15 percent) and corresponding export rebates were retained. The Government expects GDP growth to slow to 3 percent in 1975. Inflation is expected to slow steadily from its record level in 1974. The success of this program depends on a stagnation in per capita private consumption, which requires moderation in wage settlements. In support of its program, Israel made a drawing from the IMF in November 1974, and a second in February 1975, under standby arrangements.

10. The deficit on goods and services in the balance of payments is expected to stabilize at \$3.3 billion in 1975. Israel's exports have become more competitive as a result of the November 1974 devaluation. Domestic demand pressures should slacken and cost rises slow under the impact of the Government's stabilization policies. However, defense imports are expected to rise again and debt servicing payments are also increasing rapidly. Projections of foreign inflows depend heavily on developments abroad. Unilateral transfers are expected to grow very little. The Government projects a \$1.4 billion net medium- and long-term capital inflow, about half associated with the increased defense imports. Even so, reserves are not expected to increase during 1975. The Government hopes to achieve balance of payments equilibrium again in 1976, by restraining consumption and preventing domestic cost rises from threatening the price advantage brought about by the November 1974 devaluation. Favorable developments in world market conditions will also be needed to permit a considerable improvement in the current account. In addition, the Government has approached the U.S. for a large special aid allocation for fiscal year 1976.

11. In addition to its three traditional goals of defense, absorption of immigrants and rapid economic growth, Israel has in recent years given more emphasis to social equalization, financial stabilization and the strengthening of the balance of payments. It is experiencing intense competition for resources between high consumption and Government expenditures (especially subsidies, defense needs, and the costs of absorption of immigrants), exports,

and investment for future growth. The balance of payments has now become the overriding economic problem, with the critical position in late 1974 and difficult short-term prospects dictating higher priority for exports and export-oriented investment, particularly in industrial products and minerals. Growth depends closely on import capacity and hence on foreign exchange receipts; however, the current recession and uncertain timing of renewed growth of Western economies, which are Israel's major markets and sources of capital inflows, suggest cautious predictions for the short-term growth of Israel's economy. Thereafter, the presently projected medium-term prospects for the OECD member countries should permit Israel to achieve faster growth.

12. As of December 31, 1973, Israel's reported public external debt (including undisbursed) stood at \$4,783 million, made up of \$1,339 million in conventional debt, \$1,697 million in military debt and \$1,747 million in Israel Bonds. There has in recent years been some increase in private non-guaranteed debt. Debt service in 1973 was \$520 million and was equivalent to 22 percent of 1973 exports of goods and non-factor services. If military debt is excluded from the figures - which may be desirable for inter-country comparisons - the debt service ratio drops to 15 percent. In addition, many holders of Israel bonds have rolled them over as they mature and it may be reasonable to expect them to do so in future if Israel's economic situation required this. Finally, the regularity of a large part of unilateral transfers to Israel should also be taken into account in judging Israel's debt service burden. The debt service ratio is tentatively estimated to have risen in 1974, and is projected to peak at just under 30 percent of exports in 1975, or some 22 percent excluding military debt. It would then decline, slowly at first and then more rapidly, on the assumption of rapid but feasible export growth.

13. Economic management may be expected to remain prudent and efficient, although the task has been greatly complicated by the increase in consumption and defense expenditures, and the room for manoeuvre reduced by the high debt service ratio and the fall in reserves which has already taken place. The Bank's share in total debt outstanding in December 1974 and debt service during 1974 was 3 percent in each case; with the growth of the total debt, it is expected to fall steadily. Provided the debt situation and particularly further recourse to short-term credit is carefully monitored, and provided export incentives are maintained and produce rapid export growth, Israel can support additional long- and medium-term debt on conventional terms.

PART II - BANK GROUP OPERATIONS IN ISRAEL

14. The Bank has to date made ten loans to Israel; the amount held by the Bank as of March 1975 totalled \$181.5 million. Three loans have been made to IDBI for financing of industry (\$60 million), two to the Israel Bank of Agriculture for agricultural credit projects (\$55 million), one for the expansion of a potash plant (\$25 million), one for the port of Ashdod (\$27.4 million), two for highways (\$52 million), and one for a national sewerage project (\$30 million). Annex II contains a summary statement of Bank loans and IFC investments as of March 31, 1975, and notes on the execution of ongoing projects.

15. Foreign exchange earnings and employment opportunities are being increased through the three IDBI loans, which helped finance investment in export industries, and through the two agricultural credit projects, which helped finance the production of flowers, fruit and vegetables for the European market, as well as water-saving investments. The two highway projects and the port project contributed to basic infrastructure improvements needed to service the growing economy; the sewerage project will help avoid increasing pollution and health hazards while making water available for reuse in irrigation. Project implementation has on the whole been satisfactory. The second highway and the sewerage projects, however, have experienced significant cost increases, due to rapid inflation in Israel and delay consequent to the October 1973 war.

16. IFC made an equity investment in, and a convertible loan to, Makhteshim Chemical Works Limited, a producer of pesticides, in June 1974. It has under preliminary consideration a second investment in Makhteshim to expand pesticide production, besides an investment in Haifa Chemicals Limited to expand production of potassium nitrate.

17. Israel's relatively high per capita income and its access to substantial external sources of capital make it a marginal claimant on Bank resources. Its persistently high capital requirements resulting from a need to increase productivity and exports in order to improve its balance of payments have, however, warranted continued Bank assistance up to now. No additional operations are presently being prepared or contemplated.

PART III - INDUSTRIAL ACTIVITIES IN ISRAEL

18. Industry in Israel is mainly privately owned, but subject to considerable Government influence through a pervasive incentives system and Government predominance in providing finance for industrial investment. Industrial output has grown by 12 percent annually since 1970, with employment growing by 4 percent and productivity by 8 percent. Industry accounted for 24 percent of net domestic product at factor cost in 1973. Clothing, rubber and plastics products, chemicals, petroleum products, metal products and diamonds have increased their shares of value added in industry.

19. Industrial exports grew by 27 percent per annum in value (18 percent in volume) between 1970 and 1973 to reach \$1,188 million and accounted for 87 percent of commodity exports and 45 percent of total foreign exchange earnings. Polished diamonds remained the largest single item, at \$557 million in 1973; Israel already has a significant share of this market. With industrial exports growing rapidly, there has been some diversification, with chemicals and electrical and electronic goods the fastest-growing items, but further efforts are essential.

20. Government policy is to promote exports, giving priority to industries taking advantage of the highly-qualified labor force in Israel, processing local raw materials, or locating in less-developed regions. It provides

a comprehensive package of incentives which are essential to sustain past high growth of industrial investment and exports. They include development loans, investment grants in exchange for export commitments, and tax incentives, including rebates on the imported component of exports. Since investment proposals are subjected to careful economic analysis before approval of incentives, interest rates play only a limited allocative role in industry. The rates on development loans are currently 8, 10 and 12 percent, with the highest rate for the most developed central region of Israel. For this region, the Government is in the process of implementing its decision to apply a partial indexing to the loans; if the cost of living in a particular year rises more than 20 percent, the excess will be added to the outstanding principal. Since 1970, an import surcharge has provided protection against imports, even though tariffs have been steadily reduced. The Government is currently considering refining the incentives to increase their emphasis on exports. Their cost is tentatively estimated at 20 percent of the volume of industrial investment.

21. The Government's 1974-78 industrial plan, published in May 1974, envisages annual expansion of industrial investment at 16 percent and output at 10 percent in real terms, and exports at between 15 and 18 percent in volume. Mineral development and processing are expected to account for a large share of industrial investment in the next few years and provide a major part of export growth. A very large investment program has been drawn up for phosphates, salts such as potash extracted from the Dead Sea, and petrochemical and other chemical products. Exports of metal products and electronics may be expected to expand rapidly. Import substitution will focus on fertilizers, other intermediates, and capital goods for the chemical industry and power generation. While all the plan targets are optimistic, industrial investment is expected to grow rapidly, since industry must provide the main source of increased exports. The export targets are feasible, if Israel's main markets in Western Europe and the US resume growth, and if the price advantage given by the November 1974 devaluation is not quickly lost through domestic wage and other cost increases.

22. Investment in industrial research and development (R&D) is vital for industrial expansion and export promotion. R&D expenditures in product design and process engineering are necessary to utilize Israel's limited natural resources more intensively, make effective use of the high educational levels and technological skills of its manpower, and develop an indigenous technology. Although industrial and university expenditures on R&D in Israel currently amount to some 1.4 percent of GNP, only 22 percent is applied **research** done by industry. To orient research more towards commercial application, the Government has since 1966 encouraged private sector R&D through 50-50 matching grants for firms lacking the capital necessary to develop new products or processes. During 1971-73, these grants totalled \$10.4 million. The Government now proposes to provide grants of up to 80 percent of the cost of selected "projects of national importance", i.e. projects with significant potential payoff. Private enterprises are presently unable to undertake these because they are new and small by international standards, the required R&D outlays are substantial in relation to their resources, the risks with new sophisticated products are high, and the supply of private venture capital is relatively insufficient.

23. Because of large-scale immigration from developed countries, the labor force in Israel has an unusually high proportion of highly-qualified people. At the same time, there are shortages of middle- and high-level technicians, skilled workers, and artisans. To match employment opportunities to the labor force, the Government encourages science-based industries such as electrical goods and electronics, scientific instruments, engineering, chemicals and plastics. It has also undertaken a comprehensive program of technical training, involving expansion of vocational and of post-secondary technical education, retraining and refresher programs, on-the-job-training, apprenticeship programs, youth centers, and rehabilitation programs.

24. Since the mid-1960s, the capital market has been a relatively unimportant source of funds for industry. Between 1968 and 1973, enterprises raised only IL 47.5 million in the form of share capital, due to a steady decline in stock prices. Institutional investors, the main source of funds, must invest 85-90 percent of them in Government bonds or Government-approved securities. In addition, the Government absorbs considerable sums through compulsory loans. Because of the market situation, new issues need to be indexed. Between 1968 and 1973, industrial bond issues amounted to only IL 30 million. Given this situation, the Government's grants and development loans have become major sources of long-term financing for industry, accounting for 7 and 51 percent respectively of total fixed investment financing between 1968 and 1973. This enables the Government to exercise wide influence over the allocation of funds of the financial institutions engaging in term financing, notably the industrial development banks (including IDBI), and the public sector companies.

PART IV - THE PROJECT

Project History

25. The proposed project was identified in 1973 and 1974. The Government and IDBI prepared it with assistance from Bank missions in May and July 1974, and appraisal took place in October-November 1974. Negotiations were held in April 1975 with an Israeli delegation headed by Mr. H. Stoessel, Accountant-General in the Ministry of Finance; IDBI was represented by Mr. D. Friedmann, Joint General Manager.

The Project

26. The project consists of three complementary components supporting the Government's industrial development strategy: (i) industrial financing through IDBI, of projects producing for exports or which are located in less-developed regions of Israel; (ii) industrial research and development (R&D), administered by the Office of the Chief Scientist (OCS) in the Ministry of Commerce and Industry, and involving strengthening of the Government's capacity to appraise and supervise R&D programs and support for six identified and prepared R&D activities; and (iii) vocational/technical training, administered by the Ministry of Labor, designed to increase Israel's output

of middle and high-level technicians and skilled workers to meet projected manpower shortages. All project activities would be carried out within Israel's borders as of January 1, 1967. The project is expected to be completed in five years. In view of its composite nature, the Bank loan would be made to the Government, with on-lending to IDBI for the industrial financing component. The details are provided hereunder and in the Loan and Project Summary in Annex III. A report entitled "Appraisal of an Industrial Development Project -- Israel" (No. 656a-IS) dated May 7, 1975 is being distributed separately to the Executive Directors.

IDBI Component

27. Industrial financing under the project, for which \$25 million of the Bank loan is allocated, would be carried out through IDBI. The Bank has so far provided three loans to IDBI totalling \$60 million, all of which have been satisfactorily implemented. The Government would onlend \$25 million from the proposed Bank loan to IDBI, with amortization substantially in conformity with the aggregate amortization schedule of IDBI's subloans financed out of the proposed Bank loan, interest at the Bank's lending rate and a commitment charge of three-quarters of one percent (L.A. 3.02(a)). Signing of an on-lending agreement satisfactory to the Bank would be a condition of effectiveness of the proposed Bank loan (L.A. 8.01(b)). The funds onlent to IDBI would support only private sector projects located in the less-developed regions of the country, and export-oriented projects wherever located, in line with the Government's development objectives (L.A. Schedule 2). A good part of these projects would be in industries employing sophisticated technologies, which the Government is eager to promote. The Bank funds are expected to be committed by June 30, 1977. About half of IDBI's recent lending has been for terms of 6-8 years, and about one-third for 9-13 years and occasionally more; however, its pipeline contains a number of large projects with long gestation periods which will require an increasing proportion of loans with the longer maturities. Sub-loans to be financed from the Bank loan would have a maximum maturity of 13 years. IDBI's lending rates are set in accordance with Government policy on development loans (see para. 20) and are expected to average between 10 and 11 percent on Bank-funded sub-loans; IDBI's spread will average 1-3/4 percent. IDBI makes its loans in Israeli currency. The Government will bear the foreign exchange risk, in accordance with arrangements to which the Bank agreed under the third loan to IDBI, and with the prevailing practice regarding private companies. In view of IDBI's capacity and past performance, the free limit on sub-loans would be raised from \$750,000 to \$1,000,000, with an aggregate free limit of \$12,500,000 (L.A. 3.01(b) and (c)).

28. IDBI has an experienced management team and competent staff and is efficiently run. It has a notable record of performance since its creation in 1957, in terms of both financial assistance to industry and development impact. It continues to be the most important development finance institution in Israel, with assets of IL 2.4 billion as of September 30, 1974, and loan approvals which have increased in amount by 30 percent per annum since 1968. It provided 30 percent of total financing for industrial investment between 1969 and 1974. IDBI is also an important instrument of Government industrial policy. Its portfolio is diversified and sound. Arrears are well

within acceptable limits and provisions for losses are adequate. Administrative expenses are low. Earnings have shown steady growth and have represented a return of 15-16 percent on non-Government held share capital in recent years. IDBI's project appraisal methods pay suitable regard to economic criteria, and its follow-up work will be strengthened by the recruitment of additional staff.

29. IDBI has been reasonably successful in mobilizing resources abroad. Between July 1970 and June 1974, it raised \$155 million equivalent in foreign loans and debentures, including loans from a dozen new sources in the US and Western Europe. This represented about one-half of its total resource requirements. At home, the Government's policies have restricted IDBI's access to the capital market. However, the Government has willingly provided a large part of IDBI's local currency needs, as part of its program of development loans, and plans to remain its major source of such funds. IDBI forecasts commitments of IL 2.8 billion (some \$470 million) over the period July 1975 - June 1977, based on its pipeline and realistic projected growth rates of industrial investment. About half will be in local currency and will be covered by internally generated funds, debentures, and loans or other receipts from Government, which will cover any shortfall. About half of the foreign currency requirements totalling IL 1.4 billion, or some \$240 million equivalent, will be covered from existing lines of credit or new loans at various stages of negotiation. The rest will be covered by as yet unidentified sources, and by the proposed Bank funding of \$25 million, equivalent to 10 percent of requirements. IDBI will have to further intensify its resource mobilization effort abroad, and is expected to continue its past success.

30. IDBI has reached and, as a direct result of the November 1974 devaluation, possibly exceeded the limit of 3:1 on its overall debt-equity ratio agreed under the previous Bank loan. This ratio is conservative for an institution as financially strong as IDBI, and it would be raised to 5:1 under the proposed loan (P.A. 3.03(a)). IDBI's ratio of secured debt to equity would also be raised, from 2:1 to 5:1 (P.A. 5.01). Even so, IDBI is expected to experience some pressure to increase its equity base. IDBI has agreed that its loans and advances to, or investments in, subsidiaries in which it has a majority shareholding would not exceed 20 percent of its own unimpaired paid-up capital, surplus and free reserves (P.A. 3.02). IDBI has operated over the years with a current ratio less than one, keeping its resources fully committed and relying for short-term needs on its long-standing arrangements with the Bank of Israel. It will continue to have its accounts audited by independent external auditors acceptable to the Bank (P.A. 3.01 (b)).

31. Between 1974 and 1979 IDBI's loan portfolio is expected to grow by 28 percent per annum. Net earnings would grow by 13 percent per annum to provide an increasing rate of return on share capital, even though the equity base is likely to be expanded. Debt service coverage is projected to be satisfactory. IDBI's liquidity, provisions against losses, and build-up of other reserves, are projected to be sufficient. Overall, IDBI's financial position is sound.

Industrial Research and Development Component

32. The industrial research and development (R&D) component, for which \$5 million of the Bank loan is allocated, is the first of its kind to be financed by the Bank. It would assist OCS to make technological, financial and commercial appraisals of R&D proposals and supervise their implementation. The Bank loan would also help finance six identified and prepared R&D activities with industrial and commercial application, which have been closely defined (L.A. Schedule 2, Annex B). The first is the expansion of facilities of the Negev Research and Development Authority, which is associated with the Ben-Gurion University of the Negev and provides R&D and technical services to industrial enterprises and university laboratories, by the provision of a unit process laboratory and a testing service facility. Of the other five R&D activities, two are subprojects at the stage of pre-commercial development (ponds to collect and store solar energy, liquid wax from jojoba beans), while three involve the development of commercial prototypes (rural telephone system, a range of prime movers (engines), improved tomographic scanner (for X-ray diagnosis)).

33. The six activities proposed for Bank funding were selected after appraisal of nine "projects of national importance" submitted by the Government. All nine were reviewed for their commercial and technological feasibility and potential spin-offs; potential benefit to Israel's economy; usefulness of the prospective technology to other developing countries; and overall capability of the undertaking entity. Those projects involving private firms were also reviewed for possibility of market success; inability of the sponsoring firm to borrow for R&D or self-finance; and the experience, ability to commercialize technology, and financial strength of the firms. The ability of the Negev R&D Authority to render R&D services not generally available to the industrial community was considered in the appraisal of this subproject. OCS will launch these projects along with a similar group not funded by the Bank, together selected as the most promising so far prepared.

34. Since its creation four years ago, OCS has administered the relatively small matching grant program for R&D. To handle much larger and more important R&D projects, it needs to develop not only the technological appraisal capability typical of a scientific research granting agency, but also financial and commercial expertise sufficient for it to review competently proposals for R&D on a timetable leading to prototypes and products with specifications and selling prices dictated by a market. To do this, OCS is expected to strengthen and double its professional staff to a total of 25 by March 1976, and to continue a rapid expansion thereafter. The Government would provide the funds needed for this build-up (L.A. 5.01(a)). To help determine future priorities for the R&D activities it finances, OCS would establish a Policy Advisory Committee with representatives from industry, Government and the academic technological community (L.A. 5.03(a)).

35. Appraisal of R&D activities will be continuous. OCS will establish standing review committees, organized by technological sector, each to handle up to four projects of national importance. Each will include at least two OCS staff members, one designated as monitor for the project being reviewed,

or as an assistant monitor, to provide continuity within OCS and work and be trained under the supervision of an outside monitor, in cases where OCS does not yet have qualified staff. Committee members would have technological, financial, marketing and business planning expertise (L.A. 5.03(b)). So far, committees covering electronics, machines, and industrial crops have been created, and will supervise four of the six project activities. Others will be set up for the Negev R&D Authority and solar ponds. Initial appraisal will establish the project activities, a timetable, and outline plans for the production stage (including indications of the sources of finance) for commercial projects. As the project progresses, the monitor will prepare quarterly and comprehensive annual reports to the Chief Scientist, based on the sponsor's reports, reviewing progress against the agreed timetable, technological and market developments affecting ultimate success, and the revised market studies presented by sponsors. The committee will review these, recommending assistance to resolve difficulties or termination of support, as appropriate.

36. No disbursements from the loan would be permitted for any of the activities proposed for Bank financing until a review committee has been established to supervise it, and until OCS and the sponsor have entered into an agreement satisfactory to the Bank (L.A. Schedule 1, para 4 (b)(i)). The reports covering Bank-funded activities would be submitted, with the review committee's and the Chief Scientist's recommendations, to the Bank (L.A. 5.05 (b)(i)). Material changes would be made only with Bank approval; an understanding was reached that if financing of any of the subprojects were terminated, the Bank would permit one substitution, provided initial appraisal proved feasible and the new subproject justified.

37. OCS would enter into arrangements with the sponsors of Bank-funded commercial subprojects providing, inter alia, that if successful products are developed, they would be licensed for use in other developing countries on reasonable conditions; that sponsors would contribute between one and four percent of sales of such products for ten years to a special Government fund to finance other R&D "projects of national importance", thus permitting flexibility in the light of experience and the financial structure and performance of the firm; and that no reference would be made to the Bank in product advertising or promotional literature (L.A. Schedule 6). Ownership of the technology will, as is normal in Israel, rest with the sponsors. An understanding was reached that OCS would report to the Bank annually on the Negev R&D Authority's degree of autonomy, activities, emphasis on contract applied research, budget, staffing, work program, methods of project selection, and internal financial controls, as well as furnish regularly updated assessments of the likely demand by industry for R&D infrastructure facilities.

38. In supervising this project component, the Bank would draw on the work of the monitors and review committees. OCS has already hired consulting accountants and would set up an accounting system designed to ensure full accountability on Bank-funded subprojects (L.A. 5.05 and 5.06). The Government would provide the Bank with that part of the Accountant-General's annual financial report to the State Comptroller dealing with OCS operations, as well

as any evaluation reports on OCS operations produced by the State Comptroller. Finally, OCS has agreed to hire monitors (when no qualified OCS staff are available) and consultants to assist in reviewing Bank-funded subprojects if the Bank deems it necessary. In addition, OCS might in consultation with the Bank hire consultants to assist OCS in developing its system of R&D management and in handling other R&D projects of national importance (L.A. 5.02). A sum of \$150,000 would be allocated out of the proposed Bank loan to meet the foreign exchange costs involved (L.A. Schedule 1). Two years after completion of each subproject, OCS would prepare and submit to the Bank a completion report, covering inter alia the further development and commercial history of, and the benefit to Israel and other developing countries from, the product. One year after completion of the whole R&D component, OCS would submit to the Bank a comprehensive report assessing its overall impact (L.A. 5.05(b)(iii) and (iv)).

Vocational/Technical Training Component

39. The project includes an allocation of \$5 million from the Bank loan to help finance the expansion of training facilities and programs sufficient to meet about 35 and 30 percent respectively of the shortages of skilled workers and technicians projected for 1985. It comprises construction and equipping of the expansion of one technician/practical engineering institute (Beersheva); equipment only for two more (Haifa and Jerusalem); construction and equipping of the expansion of three vocational training centers (Haifa, Jerusalem, and Holon - near Tel Aviv); and equipment for a fourth one (Tel Aviv). These expansions would increase the number of student places in project institutions, by 760 (54 percent) at technician/practical engineering institutes and by 850 (167 percent) at vocational training centers. The project would also provide the additional equipment needed to meet new program requirements or replace obsolete equipment.

40. The technician/practical engineering institutes provide post-secondary courses lasting one year (for technicians) or two years (for senior technicians or practical engineers), with an additional six to twelve months devoted to preparation of a research project in their respective fields of specialization. The proposed project institutions will concentrate on training programs in electrical/electronics fields and mechanical, instrumentation and controls, and automation technology. The vocational training centers admit trainees after 9-10 years of full-time schooling for courses varying in length from three to thirteen months. The proposed project institutions offer courses focusing on metalwork, mechanics, electricity/electronics, carpentry, needle trades and drafting.

41. To implement and coordinate all aspects of this project component, a Project Unit would be established within the Ministry of Labor's Department of Vocational Training. The appointment of a qualified and experienced project director, equipment procurement coordinator and accountant, would be conditions of effectiveness of the proposed Bank loan (L.A. 4.01 and 8.01 (c)).

42. Due to the urgent need for the extensions to facilities included in the project items, qualified consultant architects have been selected to prepare preliminary designs in accordance with criteria acceptable to the Bank. They would also supervise construction, along with participating institutions and the Ministry of Labor (L.A. 4.02). Space standards are based on detailed schedules consistent with accommodation requirements. Equipment and furniture needs have been appraised and detailed lists will be submitted for Bank approval prior to procurement. All project institutions will be cost-effective, with double-shift working.

Project Cost and Financing

43. The proposed loan would provide \$35 million to finance these three components. Out of this amount, \$25 million would be lent to IDBI to meet a part of the foreign cost component of IDBI's expected total commitments of IL 2.8 billion (some \$470 million) over the two-year period July 1975 to June 1977.

44. \$5 million would be used to cover 60 percent of the foreign exchange cost of industrial R&D expenditures under the project. The total cost of this component is estimated at \$22.3 million, and \$5.6 million would come from sponsors' own funds, \$6.1 million in medium-term loans from banks (possibly including IDBI) for equipment purchase and construction, and \$5.6 million from the Government. The proceeds of the Bank loan would be passed to sponsors as a grant. The Government's contribution would provide \$3.4 million to complete the foreign exchange requirements, and \$2.2 million to cover local expenditures. The Government's proposed financing arrangements will ensure that each R&D sponsor has an important interest in the success of his subproject.

45. Vocational/technical training expenditures under the project are expected to total \$15.8 million, with a foreign cost component of \$5.2 million. These expenditures would be financed by \$5.0 million from the proposed Bank loan, virtually covering the foreign cost component, and \$10.8 million from the Government. The Government would also provide the annual running costs of project institutions, estimated at \$5.7 million.

Procurement

46. Procurement in the case of industrial lending through IDBI would take place through normal commercial channels. IDBI usually asks its clients for quotations from more than one supplier and satisfies itself that the quality and price are the best obtainable. For the industrial R&D component, civil works contracts would be let by sponsors following normal local competitive procedures. Bank funds would not be used to finance these works, which amount to only US\$1.4 million and involve three subprojects in different locations. R&D equipment is to a considerable extent specialized and proprietary. The individual items are of relatively small value and procurement

is spread over a period of up to five years; bulking is not feasible. Furthermore, there is adequate representation of foreign suppliers locally to ensure competition. As at present, OCS would satisfy itself about the need for the equipment, the actual purchase and use, and its cost. However, OCS would require the sponsor to request quotations from at least three suppliers if the value of each item is over US\$20,000. For vocational/technical training expenditures, civil works and equipment supply contracts, except for residual equipment, would be awarded following international competitive bidding in accordance with the Guidelines for Procurement under World Bank Loans; furniture would be locally procured and would not be financed out of the proposed loan. Local manufacturers of equipment would be allowed a preferential margin of 15 percent of the CIF costs of competing imports or the existing rate of customs duty, whichever is the lower. Bid comparisons would be made in accordance with the Bank's guidelines on the application of domestic preferences in bid evaluation. Items would be grouped to the extent practicable to form sizeable bid packages and to permit bulk procurement. Up to 20 percent of equipment contracts may be won by local bidders, including 10 percent (\$300,000) in residual items. The Project Unit would be responsible for all aspects of bidding on equipment and would coordinate with the Department of Public Works with respect to bidding on civil works. No foreign firms are expected to submit bids on civil works, given the relatively small size and widespread locations of project items and the well developed construction industry in Israel (L.A. Schedule 5).

Disbursement

47. The part of the proposed Bank loan relant to IDBI would finance the foreign exchange component of IDBI's subloans, which is the c.i.f. cost of equipment procured directly from abroad and is estimated at 50 percent of the cost of goods produced outside Israel and purchased from local suppliers, and 20 percent of the cost of goods produced in Israel (L.A. 3.01(a)). For the industrial R&D component, the proposed Bank funding would finance 60 percent of the CIF cost of imported equipment and materials, and the foreign exchange cost of consultant services obtained from outside Israel, up to the specified limit of Bank funding for each activity and for technical assistance to OCS. For the vocational/technical training component, disbursement for equipment would be on the basis of 100 percent of the CIF cost or ex-factory price, and 18 percent of the estimated total cost of civil works, including professional services (L.A. Schedule 1). This latter percentage would be adjusted as necessary, to distribute disbursements over the period of implementation.

Project Justification

48. The IDBI component would directly help to improve Israel's difficult balance of payments situation through expansion of industrial exports, the Government's main policy aim. IDBI has a notable record of support of economically viable projects as well as mobilization of external resources. Both can be expected to be maintained. The project would further another important Government policy objective, that of spreading industry to less-developed regions.

49. The industrial R&D component is complementary to lending through IDBI. It would assist Israel to develop institutional mechanisms to appraise and supervise R&D projects and link them to production and marketing, both at the enterprise level and within the Government's supervisory apparatus. The Bank would participate in the institution-building process, gaining new insights which might be applied as appropriate in other developing countries. The component would also assist Israel in making more effective use of its large body of scientists and technologists in expanding exports of science-based industries. The products to be developed could lead to substantial exports for Israel and also benefits for other developing countries to which the technology developed might be licensed.

50. Estimates of the financial rates of return, if successful, for the three R&D sub-projects where these are amenable to quantification are high; the economic rates of return are acceptable to high. However, they are necessarily based on tentative estimates of sales and costs and will need to be recalculated regularly as development progresses. R&D activities involve technological, financial and commercial risks which are greater than for developments involving known technologies. These risks have been minimized, in the case of the proposed activities, by careful initial appraisal and by the institution of a review process which will continuously monitor their progress and developments which could affect their ultimate success. The risks involved are acceptable.

51. The vocational/technical training component would complement the other two. It would support the Government's soundly conceived manpower strategy by meeting about one-third of the projected shortages of skilled workers and middle and high-level technicians, particularly in industry, through a substantial increase in the number of training places and greater efficiency and qualitative improvement in their use. It would particularly assist early leavers from the formal school system and adult workers requiring retraining for productive employment in a changing labor market.

PART V - LEGAL INSTRUMENTS AND AUTHORITY

52. The draft Loan Agreement between the State of Israel and the Bank, the draft Project Agreement between the Bank and Industrial Development Bank of Israel Limited, the Report of the Committee provided for in Article III, Section 4(iii) of the Articles of Agreement and the text of a draft resolution approving the proposed loan are being distributed to the Executive Directors separately.

53. Features of the Loan Agreement of special interest are referred to in paragraphs 32 to 38 of this Report.

54. Additional conditions of effectiveness are:

- (i) signing of a satisfactory relending agreement between the Government and IDBI (para 27);
- (ii) appointment of a project director, equipment procurement coordinator, and accountant for the project unit to carry out the vocational/technical training component (para 41).

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

PART VI - RECOMMENDATION

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

Robert S. McNamara
President

Attachments
May 7, 1975

ANNEX I

Page 1 of 3 pages

COUNTRY DATA - ISRAEL

AREA	POPULATION		DENSITY		
	20,700	km ²	3.08 million (mid-1972)		Per km ² of arable land
SOCIAL INDICATORS					
	Israel		Reference Countries		
	1950	1970	Singapore 1970	Greece 1970	Finland* 1970
GNP PER CAPITA US\$ (ATLAS BASIS) /1	1,200 /a	2,610 /b	1,300 /b	1,460 /b	2,810 /b
DEMOGRAPHIC					
Crude birth rate (per thousand)	26.4 /c	26.9 /b	22.1 /d	15.5 /b	12.2 /d
Crude death rate (per thousand)	5.7 /c	7.2 /b	5.5 /d	8.6 /b	9.3 /d
Infant mortality rate (per thousand live births)	31.5 /c	22.1 /b	20.4 /d	27.8 /b	10.1 /d
Life expectancy at birth (years)	70 /c,f	72 /b	70 /k	70	70 /h
Gross reproduction rate /2	1.9	1.5 /k	2.0 /k	1.0	0.9
Population growth rate /3	5.3	3.1 /l	2.2 /i	0.6 /j	0.3 /l
Population growth rate - urban	5.8 /i	4.0 /j,k	2 /i	5 /n	0.9 /l
Age structure (percent)					
0-14	36.1 /k	32.2 /d,e	31 /b	25 /c	23.7 /e
15-64	58.7 /k	59.8 /c,e	59 /b	44 /b	46.7 /d
65 and over	5.2 /k	7.3 /d,e	10 /b	11 /b	9.6 /d
Age dependency ratio /4	6.6 /f	0.7 /d	0.7 /b	0.6 /b	0.5 /d
Economic dependency ratio /1	1.2 /f	1.1	1.2	1.3 /e	0.7
Urban population as percent of total	78 /f,i	80 /d,e	100 /i	53 /p,r	57.1 /d,n
Family planning: No. of acceptors cumulative (thous.)	..	..	..	..	..
No. of users (% of married women)	..	..	..	..	..
EMPLOYMENT					
Total labor force (thousands)	700	1,100 /d,g	730	3,300 /p,s	2,700 /b,l
Percentage employed in agriculture	17	7 /d,g	3	40 /p	18.4 /b
Percentage unemployed	5	3 /d,g,r	10	1 /p,u	2.5 /e
INCOME DISTRIBUTION					
Percent of national income received by highest 5%	13 /v,k	13 /v	..	..	..
Percent of national income received by highest 20%	39 /v,w	38 /v	..	..	..
Percent of national income received by lowest 20%	7 /v,w	8 /v	..	..	..
Percent of national income received by lowest 40%	20 /v,w	20 /v	..	..	..
DISTRIBUTION OF LAND OWNERSHIP					
% owned by top 10% of owners	..	..	..	..	..
% owned by smallest 10% of owners	..	..	..	..	..
HEALTH AND NUTRITION					
Population per physician	410 /x	400 /y	1,520 /y	620	980
Population per nursing person	..	210 /y	160	1,110 /z	180 /aa
Population per hospital bed	150 /x	170	270	160	80
Per capita calorie supply as % of requirements /5	109 /f	116	103 /ab	116	111
Per capita protein supply, total (grams per day) /6	84 /f	92	63 /ab	99	91
Of which, animal and pulse	41 /f	49 /ac	34 /ab	52 /ad	60 /ae
Death rate 1-4 years /7	..	1.0 /p	..	0.9 /p	0.3
EDUCATION					
Adjusted /8 primary school enrollment ratio	100	94 /z	105 /af	109 /z	98
Adjusted /8 secondary school enrollment ratio	48	56 /z	47	60 /z	75
Years of schooling provided, first and second level	12	12 /z	12	12	12
Vocational enrollment as % of sec. school enrollment	29	44 /z	9	20 /z	30
Adult literacy rate %	..	..	74 /ag,ah	82 /ag,ah	99
HOUSING					
Average No. of persons per room (urban)	..	1.4 /p	2.9 /ak,al	0.9 /p,oi	1.0 /al
Percent of occupied units without piped water	..	11 /p,am,an	20 /ak,ar	35 /p,ao	28 /am
Access to electricity (as % of total population)	..	97 /p,an	87 /ak	88 /p	96
Percent of rural population connected to electricity	..	..	..	73 /p	91
CONSUMPTION					
Radio receivers per 1000 population	194	221 /b	150 /b	112 /b	410 /b
Passenger cars per 1000 population	13	65 /b	82 /b	34 /b	163 /b
Electric power consumption (kwh p.c.)	1,165 /f	2,753 /b	1,464 /b	1,353 /b	5,725 /b
Newspaper consumption p.c. kg per year	6.0	10.2 /b	10.4 /b	5.6 /b	18.7 /b

Notes: Figures refer either to the latest periods or to the latest years. Latest periods refer in principle to the years 1956-60 or 1966-70; the latest years in principle to 1960 and 1970.

/1 The Per Capita GNP estimate is at market prices for years other than 1960, calculated by the same conversion technique as the 1972 World Bank Atlas.

/2 Average number of daughters per woman of reproductive age.

/3 Population growth rates are for the decades ending in 1960 and 1970.

/4 Ratio of population under 15 and 65 and over to population of ages 15-64 for age dependency ratio and to labor force of ages 15-64 for economic dependency ratio.

/5 FAO reference standards represent physiological requirements for normal activity and health, taking

account of environmental temperature, body weights, and distribution by age and sex of national populations. Protein standards (requirements) for all countries as established by USDA Economic Research Service provide for a minimum allowance of 60 grams of total protein per day, and 20 grams of animal and pulse protein, of which 10 grams should be animal protein. These standards are somewhat lower than those of 75 grams of total protein and 23 grams of animal protein as an average for the world, proposed by FAO in the Third World Food Survey.

/7 Some studies have suggested that crude death rates of children ages 1 through 4 may be used as a first approximation index of malnutrition.

/8 Percentage enrolled of corresponding population of school age as defined for each country.

/a Computed by applying to the 1970 figure the growth rate of the GNP/cap. in real terms from 1960 to 1970; /b 1972; /c Data tabulated by year of registration rather than occurrence; /d 1973; /e Jewish population; /f 1961; /g 1970-75 estimate; /h 1966-70; /i 1960-72; /j All settlements of more than 2,000 inhabitants, except those where at least one third of the heads of households participating in civilian labor force, earn their living from agriculture; /k 1961 census data; /l City of Singapore; /m Municipalities and communes in which the largest population center has 10,000 or more inhabitants and the population of 12 other urban agglomerations irrespective of their population; /n Urban communes; /o Includes data relating to certain territories under occupation by Israeli military forces since June 1967; /p 1971; /q Including data for East Jerusalem; /r Includes persons who did not work in the country during the previous twelve months; /s Excluding persons in compulsory military service, and persons seeking work for the first time; /t Excluding armed forces; /u Excluding unemployed seamen; /v Jewish wage earners' households; /w 1957-58; /x 1962; /y Number on the register, not all working in the country; /z 1969; /aa Coverage of data unknown; /ab 1964-66; /ac 1969-70; /ad 1967; /ae 1970-71; /af Includes overage students; /ag 15 years and over; /ah Definition unknown; /ai Data refer to households in conventional dwellings; /aj Total, urban and rural; /ak 1966; /al UN estimate; /am Inside or outside; /an Percentage of occupied dwellings; /ao Inside.

* Finland has been selected as an objective country because its per capita income and population are similar to those of Israel.

ECONOMIC INDICATORS

GROSS NATIONAL PRODUCT IN 1973

ANNUAL RATE OF GROWTH (% , 1970 constant prices)

	US\$ Mln.	%	ANNUAL RATE OF GROWTH (% , 1970 constant prices)		
			1962 -67	1967 -72	1973
GNP at Market Prices	9.709	100.0	7.5	10.6	7.5
Gross Domestic Investment	3.092	31.8	1.3	16.8	12.5
Gross National Saving	743	7.6	.	.	.
Current Account Balance	2.349	24.2	.	.	.
Exports of Goods, NPS	2.583	26.6	11.7	12.7	0.6
Imports of Goods, NPS	4.931	50.8	8.7	13.6	33.2

OUTPUT, LABOR FORCE AND PRODUCTIVITY IN 1973

	Value Added		Labor Force		V. A. Per Worker	
	US\$ Mln.	%	'000	%	US \$	%
Agriculture	498	5.8	93	7.9	5,355	74.1
Industry	3,120	36.7	418	35.5	7,464	103.2
Services	4,893	57.5	637	54.1	7,681	106.2
Unallocated	.	.	29	2.5	.	.
	<u>8,511</u>	<u>100.0</u>	<u>1,177</u>	<u>100.0</u>	<u>7,231</u>	<u>100.0</u>

GOVERNMENT FINANCE

	General Government			Central Government		
	(I£ Mln.)	% of GDP		(I£ Mln.)	% of GDP	
	1972	1972	1969-71	1972	1972	1969-71
Current Receipts	12,304	39.7	37.1	11,479	37.0	34.2
Current Expenditure	14,921	48.2	49.5	14,325	46.2	47.1
Current Surplus	- 2,617	6.5	12.4	- 2,846	9.2	12.9
Capital Expenditures	2,877	9.3	9.9	2,365	7.6	8.6
External Assistance (net)	2,950	9.5	9.7	2,950	9.5	9.7

MONEY, CREDIT and PRICES

	1969	1972	1973	September 1974
	(Million I£ outstanding end period)			
Money and Quasi Money	8,051	16,401	20,539	23,263
Bank credit to Public Sector	2,858	4,900	4,725	7,498
Bank Credit to Private Sector	4,550	8,302	11,635	15,459

(Percentages or Index Numbers)

Money and Quasi Money as % of GDP	48.2	51.6	49.3	.. 1/
General Price Index (1963 = 100)	130.1	174.5	209.2	292.4 1/
Annual percentage changes in:				1/
General Price Index	2.5	12.9	20.0	39.8
Bank credit to Public Sector	86.2	- 5.6	- 3.6	78.3
Bank credit to Private Sector	21.6	24.6	40.1	43.8

NOTE: All conversions to dollars in this table are at the average exchange rate prevailing during the period covered.

1/ Annual average for 1974.

.. not available
. not applicable

TRADE PAYMENTS AND CAPITAL FLOWS

BALANCE OF PAYMENTS

	<u>1968</u>	<u>1972</u>	<u>1973</u>
	(Millions US \$)		
Exports of Goods, NFS	1,029	2,002	2,393
Imports of Goods, NFS	- 1,699	2,923	4,771
Resource Gap (deficit = -)	- 670	- 921	- 2,378
Interest Payments (net)	-80	-136	-164
Workers' Remittances	16	21	24
Other Factor Payments (net)	16	- 65	- 79
Net Transfers	435	1,053	2,188
Current Account Balance	- 283	- 48	- 409
Direct Foreign Investment	39	108	136
Net MLT Borrowing			
Disbursements	480	1,012	1,232
Amortization	229/1	432 /1	420 /1
Subtotal	251	580	812
Capital Grants	-	-	-
Other Capital (net)	- 5	- 35	31
Other items n.e.i	-61	- 6	8
Increase in Reserves (+) ³	-82	669	578
Gross Reserves (end year)	894	2,503	3,510
Net Reserves (end year)	601	991	1,517
Fuel and Related Materials			
Imports	63	97	210
Exports	..	..	..

MERCHANDISE EXPORTS (AVERAGE 1971-73)

	<u>US \$ Mln</u>	<u>%</u>
Polished diamonds	404	33
Textiles and clothing	130	10
Citrus	111	9
Chemicals, rubber and plastics	100	8
Food, beverages and tobacco	95	8
Machinery & other metal products	71	6
All other commodities	325	26
Total	1,236	100

EXTERNAL DEBT, DECEMBER 31, 1973

	<u>US \$ Mln</u>
Public Debt, incl. guaranteed	4,520
Non-Guaranteed Private Debt (1972)	332

DEBT SERVICE RATIO for 1973^{1/2} 28.2%

	<u>%</u>
Public Debt, incl. guaranteed	21.7
Non-Guaranteed Private Debt and other	6.5
Total outstanding & Disbursed	28.2

IBRD/IDA LENDING (March 31, 1975)(Million US \$):

RATE OF EXCHANGE

<u>Through 11/9/1974</u>	<u>Since 11/10/1974</u>
US \$ 1.00 = I£ 4.20	US \$ 1.00 = I£ 6.00
I£ 1.00 = US \$ 0.24	I£ 1.00 = US \$ 0.17

	<u>IBRD</u>	<u>IDA</u>
Outstanding & Disbursed	104.0	.
Undisbursed	77.5	.
Outstanding incl. Undisbursed	181.5	.

- ^{1/} Amortization figures include some prepayments on bonds and some payments in local currency.
^{2/} Ratio of debt service to exports of goods and non-factor services.
^{3/} Does not match change in net reserves because of valuation adjustments.

.. not available

.. not applicable

May 7, 1975

THE STATUS OF BANK GROUP OPERATIONS IN ISRAEL

A. STATEMENT OF BANK LOANS (as at March 31, 1975)

<u>Loan Number</u>	<u>Year</u>	<u>Borrower</u>	<u>Purpose</u>	<u>US\$ Million</u>	
				<u>Amount (less cancellations)</u>	<u>Undisbursed</u>
Seven loans fully disbursed				129.4	-
689	1970	IDBI III	Development Finance	25.0	2.6
781	1971	State of Israel	Roads II	30.0	25.2
869	1972	State of Israel	Sewerage	30.0	28.6
972	1974	Israel Bank of Agriculture Ltd.	Agricultural Credit II	35.0	21.1
Total of which has been repaid				249.4	
Total now outstanding				<u>67.9</u>	
Amount sold				5.1	
of which has been repaid				<u>5.1</u>	
Total now held by Bank ^{1/}				181.5	—
Total undisbursed					77.5

B. STATEMENT OF IFC INVESTMENTS (as at March 31, 1975)

<u>Year</u>	<u>Obligor</u>	<u>Type of Business</u>	<u>Amount in US\$ million</u>		
			<u>Loan</u>	<u>Equity</u>	<u>Total</u>
1974	Makhteshim Chemical Works Ltd.	Pesticides	1.75	1.75	3.50
Total gross commitments			1.75	1.75	3.50
less cancellations, terminations, repayments and sales			-	-	-
Total commitments now held by IFC			<u>1.75</u>	<u>1.75</u>	<u>3.50</u>
Total undisbursed			-	-	-

^{1/} Prior to exchange adjustments

C. PROJECTS IN EXECUTION 1/

Ln. No. 689: Third Industrial Finance Project; \$25.0 Million Loan of June 15, 1970; Closing Date: (Original) June 30, 1973, (current) June 30, 1975.

IDBI was granted extensions of the terminal dates for submission of projects and for disbursements. The delay in utilizing the loan is attributable mainly to the need for IDBI to reappraise several large projects following the 1971 devaluation, and to IDBI's efforts to use existing lines of credit tied to sources of procurement wherever possible. IDBI successfully mobilized large foreign resources during the period of the loan. It also improved its analysis of the economic justification of subprojects. The loan is fully committed and IDBI expects to disburse it completely before the current closing date.

Ln. No. 781: Second Highway Construction Project; \$30.0 Million Loan of July 14, 1971; Closing Date: June 30, 1976.

Difficulties in obtaining right-of-way, extension of bidding periods, and mobilization of equipment during and after the October 1973 war are expected to result in a delay of up to eighteen months in the original construction program. Because of two devaluations of the Israel pound in August 1971 and November 1974, and rapid inflation in Israel, costs for the original project are expected to rise by 68 percent. The Government has submitted proposals to revise the scope of the project to fit with the financing available.

Ln. No. 869: National Sewerage Project; \$30 Million Loan of December 21, 1972; Closing Date: June 30, 1978.

After a slow start, progress is now improving and is satisfactory. Completion of the original project would now take fifteen months longer than estimated at appraisal. The two devaluations and rapid inflation in Israel have increased cost estimates for the original project by 50 percent. The Government intends to complete the project, but over a longer period than originally foreseen, and is reconsidering construction priorities to extract maximum benefit from the early years of project execution.

1/ These notes are designed to inform the Executive Directors regarding the progress of projects in execution, and in particular to report any problems which are being encountered, and the action being taken to remedy them. They should be read in this sense, and with the understanding that they do not purport to present a balanced evaluation of strengths and weaknesses in project execution.

Ln. No. 972: Second Agricultural Credit Project: \$35 Million Loan of
April 3, 1974; Closing Date: June 30, 1978.

Progress of project activities has been very good. As of March 31, 1975, disbursements were \$13.9 million.

ISRAEL - INDUSTRIAL CREDIT PROJECT

LOAN AND PROJECT SUMMARY

- Borrower: State of Israel
- Beneficiary: Industrial Development Bank of Israel Limited (IDBI)
- Amount: \$35.0 million in various currencies.
- Terms: (i) \$25 million on-lent to IDBI: Amortization substantially in conformity with the aggregate amortization schedule of IDBI's sub-loans, not to exceed 13 years, financed from the proceeds of the loan; (ii) \$5 million for industrial research and development (R&D) and \$5 million for vocational/technical training: Amortization over 15 years including 5 years grace.
- Interest standard.
- Relending Terms: \$25 million onlent to IDBI, repayable substantially in conformity with aggregate amortization schedule of IDBI's sub-loans financed from the proceeds of the loan, with interest at the Bank's lending rate and a commitment charge of 3/4 percent per annum. In turn, IDBI would relend to its sub-borrowers for a maximum period of 13 years and at interest rates of 8, 10 or 12 percent per annum, depending on subproject location.
- Project Description: The project consists of three components:
- (i) Provision of \$25 million to meet part of IDBI's requirements for financing of the import component of specific industrial projects aimed at producing for export or located in less-developed regions;
 - (ii) Provision of \$5 million to help finance imported equipment, materials and consultants' services estimated at 25 man-months required for
 - (a) strengthening the Government's capacity to appraise and supervise industrial R&D projects;
 - (b) establishment of a basic R&D facility for the Negev R&D Authority at Beersheva consisting of a unit process laboratory and a testing service facility; and

- (c) five R&D subprojects to develop a prototype **non-convecting pond** to collect and store solar energy; commercial cultivation of the jojoba bean and a family of commercial waxes derived from it; a telephone system for communities of between 100 and 400 subscribers; a family of engines compatible with a variety of energy sources; and a high-performance tomographic scanner;
- (iii) Provision of \$5 million to help finance expansion of
- (a) three technician/practical engineering institutes, to provide some 760 additional student places, involving construction and equipment at Beersheva and equipment only at Haifa and Jerusalem; and
 - (b) four vocational training centers, to provide some 850 additional student places, involving construction and equipment at Haifa, Jerusalem and Holon and equipment only at Tel Aviv.

Estimated Cost:

	<u>Local</u>	<u>Foreign</u>	<u>Total</u>
	---- (\$ million) ----		----
(i) Industrial finance (IDBI)	..	25.0	
(ii) Industrial R & D	13.9	8.4	22.3
(iii) Vocational/technical training	10.6	5.2	15.8

Financing Plan:

	<u>Govt.</u>	<u>IDBI</u>	<u>Other Banks</u>	<u>R & D Sponsors</u>	<u>Bank</u>	<u>Total</u>
Industrial R & D	5.6	--	6.1	--	5.6	22.3
Vocational/technical training	10.8				5.0	15.8

Estimated Disbursement:

	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
Annual	1.5	7.8	13.1	10.0	2.5	0.1
Cumulative	1.5	9.3	22.4	32.4	34.9	35.0

Procurement
Arrangements:

- (i) For industrial financing (IDBI):
Through normal commercial channels
- (ii) For industrial R & D:
R&D equipment is to a considerable extent specialized and proprietary. The individual items are of relatively small value and procurement is spread over a period of up to five years; bulking is not feasible. Furthermore, there is adequate representation of foreign suppliers locally to ensure competition. As at present, OCS would satisfy itself about the need for the equipment, the actual purchase and use, and its cost. However, OCS would require the applicant to request quotations from at least three suppliers if the value of each item is over US\$20,000.
- (iii) For vocational/technical training:
Civil works and equipment supply contracts, except for residual equipment, would be awarded following international competitive bidding in accordance with the Guidelines for Procurement under World Bank Loans; furniture would be locally procured and financed. Local manufacturers of equipment would be allowed a preferential margin of 15 percent of the CIF costs of competing imports or the existing rate of customs duty, whichever is the lower. Bid comparisons would be made in accordance with the Bank's guidelines on the application of domestic preferences in bid evaluation. Items would be grouped to the extent practicable to form sizeable bid packages and to permit bulk procurement.

Consultants:

For design and supervision of construction of vocational/technical training facilities (about 10 man-years). The firms of Tatzvit Architects Ltd. (Beersheva) and Pascual Broid Architects (Jerusalem) have been selected.

Economic Rate
of Return:

N/A

Appraisal Report:

No. 656a-IS dated May 7, 1975

IDBI - FINANCIAL FORECASTS

(IL Millions)

Projected Total Commitments (July 1975-June 1977) 2,840

Financed by:

Internal cash generation	40
Loan collections	150
Withdrawal of long-term deposits	50
Existing loans	50
Identified new loans	1,600
Bank loan	150
Unidentified new loans	<u>800</u>
	<u>2,840</u>

Projected Balance Sheets

	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>
<u>Assets</u>						
Current assets	38	50	66	81	97	109
Loan portfolio (net of provisions)	2,108	2,733	3,592	4,641	5,879	7,293
Other assets	608	456	363	292	243	209
<u>Total assets</u>	<u>2,754</u>	<u>3,239</u>	<u>4,021</u>	<u>5,014</u>	<u>6,219</u>	<u>7,611</u>
<u>Liabilities & Equity</u>						
current liabilities	187	180	190	205	224	240
long-term borrowings	2,074	2,553	3,307	4,259	5,408	6,736
equity	493	506	524	550	587	635
<u>Total liabilities</u>	<u>2,754</u>	<u>3,239</u>	<u>4,021</u>	<u>5,014</u>	<u>6,219</u>	<u>7,611</u>
 Debt/Equity Ratio as defined in Loan Agreement	 3.3	 4.3	 5.7	 7.1	 8.6	 10.0

Projected Earnings

Total Income	221	286	347	430	533	655
Total Expenses	131	182	227	290	369	462
Provision for taxes	42	51	60	73	86	105
Net Profit	48	53	60	67	78	88
 as percent of year-end share capital	 12.8	 14.3	 16.0	 18.3	 21.3	 24.2
as percent of year-end net worth	9.7	10.6	11.4	12.3	13.3	14.0