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## INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

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REPORT AND RECOMMENDATION

OF THE

PRESIDENT

TO THE

EXECUTIVE DIRECTORS

ON A

PROPOSED LOAN

TO THE

NATIONAL ELECTRICITY BOARD

OF THE

STATES OF MALAYA

WITH THE

GUARANTEE OF MALAYSIA

June 24, 1970

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATION OF THE PRESIDENT  
TO THE EXECUTIVE DIRECTORS ON A  
PROPOSED LOAN TO THE NATIONAL ELECTRICITY BOARD  
OF THE STATES OF MALAYA FOR A FIFTH POWER PROJECT

1. I submit the following report and recommendation on a proposed loan in an amount in various currencies equivalent to US\$20.0 million to the National Electricity Board of the States of Malaya (NEB) for a fifth power project to be guaranteed by Malaysia.

PART I - HISTORICAL

2. The Bank has made four loans to the NEB totalling US\$136.0 million, of which US\$13.3 million has been cancelled. In September 1958 the Bank made its first loan (210-MA), amounting to the equivalent of US\$28.6 million, to the Central Electricity Board (now renamed National Electricity Board of the States of Malaya) to finance the foreign exchange cost of the first stage of the Cameron Highlands hydroelectric scheme. A second loan (350-MA), equivalent to US\$51.1 million, was made in July 1963 for the second stage of that scheme, the first stage of the Prai Thermal Station, and the expansion of transmission facilities. In July 1966 a third loan (458-MA) equivalent to US\$31.5 million was made for the first stage of the Port Dickson Thermal Station, the second stage of the Johore Bahru Thermal Station, and a further extension of the Cameron Highlands scheme. A fourth loan (579-MA) equivalent to US\$11.5 million was made in January 1969 for the second stage of the Port Dickson and Prai Thermal Stations and for expansion of transmission facilities. Projects covered by the first two loans have been completed and are operating satisfactorily. Of the project financed under the third loan, the first stage of the Port Dickson Station and the units at the Cameron Highlands scheme have been completed and are in operation; the second stage of Johore Bahru is expected to be in service by early 1971. Construction of the project financed under the fourth loan is on schedule and the second stage of the Prai Station is expected to be operating early in 1971 and that of Port Dickson by mid-1972.

3. In January 1970, Malaysia applied to the Bank for a loan for the third stage of the Port Dickson Thermal Station and transmission lines and associated substations to deliver the power to the load centers. The project was appraised in February 1970. Negotiations took place between June 4 and 8, 1970. The NEB was represented by Dato Osman bin Talib (Chairman), Raja Zainal (Deputy Chairman), Chan Khee Pok (Acting General Manager) and L.H. Tan (Financial Controller). The Government of Malaysia was represented by Messrs. Sulaiman bin Abdullah (Deputy Undersecretary, Economic Planning Unit), and Zakaria Yatim (Attorney General's Office).

4. The proposed loan is the Bank's fourteenth in Malaysia. The Bank also made a loan of US\$6.8 million in February 1965 to the Public Utilities Board of Singapore with the guarantee of Malaysia, of which Singapore was then a part. Malaysia remains the Guarantor of this loan until action has been completed for Singapore to assume this obligation. The following is a summary statement of Bank loans to Malaysia, excluding the loan to Singapore, as of May 31, 1970:

Loan No.	Year	Borrower	Purpose	Amount	
				Bank (US\$ million)	Undisbursed (US\$ million)
210-MA	1958	Central Electricity Board	Electric Power	28.6	-
348-MA	1963	Malaysian Industrial Development Finance Berhad (MIDF)	Industrial Finance	7.9	-
350-MA	1963	Central Electricity Board	Electric Power	51.1	-
434-MA	1965	Government of Malaysia	Irrigation	45.0	19.9
458-MA	1966	National Electricity Board	Electric Power	31.5	7.4
500-MA	1967	Government of Malaysia	Irrigation	10.0	7.6
523-MA	1968	Government of Malaysia	Land Settlement	14.0	11.9
560-MA	1968	Government of Malaysia	Telecommunications	4.4	4.4
561-MA	1968	Government of Malaysia	Water Supply	3.6	3.5
579-MA	1969	National Electricity Board	Electric Power	11.5	11.1
599-MA	1969	Government of Malaysia	Education	8.8	8.7
672-MA*	1970	Government of Malaysia	Land Settlement	13.0	13.0
673-MA	1970	Government of Malaysia	Forestry	8.5	8.5
Total (less cancellations) of which has been repaid to Bank and others				237.9	
				<u>12.5</u>	
Total now outstanding				225.4	
Amount sold of which has been repaid				9.0 <u>5.5</u>	
				<u>3.5</u>	
Total now held by Bank				<u>221.9</u>	
Total undisbursed					<u>96.0</u>

\*Not yet effective.

5. The execution of projects financed under Bank loans has been satisfactory and the rate of disbursement of these loans has been roughly in line with expectations except for Loan 560-MA, because of changes in equipment specifications, and for Loan 434-MA, because of delays in completing the internal reticulation system and the water control scheme. Orders for almost half the amount of Loan 560-MA have now been placed and

the Government has been urged to expedite procurement and withdrawals. Loan 434-MA is expected to be fully disbursed by the new Closing Date of December 31, 1971. Loans for electric power, telecommunications, ports, railways and highways, education, agricultural credit and land settlement are expected to be presented to the Executive Directors for their consideration during the Fiscal Years 1971 and 1972.

6. In 1963 IFC invested US\$818,000 in Malaysian Industrial Development Finance Berhad (MIDF) in conjunction with Loan 348-MA and in addition has taken part in three financing operations with MIDF: in March 1966 IFC made a loan of US\$1,275,000 to, and an equity investment of US\$284,000 in, Tasek Cement, Ltd.; in May 1967 it made a loan of US\$2,451,000 to, and an equity investment of US\$1,016,000 in, Malayawata Steel Ltd. and in December 1969 it made a loan of US\$1,250,000 to, and an equity investment of US\$250,000 in, India-Malaysia Textiles Berhad.

#### PART II - DESCRIPTION OF LOAN

7. Borrower: National Electricity Board of the States of Malaya.
- Guarantor: Malaysia.
- Purpose: To cover part of the foreign exchange cost of a project to construct the third stage of the Tuanku Ja'afar (Port Dickson) Thermal Station and Transmission lines and associated substations.
- Amount: Various currencies equivalent to US\$20.0 million.
- Amortization: In 20 years, including a 4½ year period of grace, through semi-annual installments beginning February 1, 1975 and ending February 1, 1990.
- Interest Rate: 7% per annum.
- Commitment Charge: 3/4 of 1% per annum.

#### PART III - THE PROJECT

8. An appraisal report on the proposed project is attached entitled "Malaysia - Appraisal of the National Electricity Board of the States of Malaya Fifth Power Project" (PU-43a) dated June 19, 1970.

9. Electric power in West Malaysia is provided principally by the NEB which serves the whole peninsula of Malaya except (i) Penang Island which is supplied by a municipally-owned plant, and (ii) part of the State of Perak which is supplied by the Perak River Hydroelectric Plant Company (PRHE). The installed capacity of NEB is 664MW, made up of 265MW of hydroelectric plant, 360MW of steam plant, and 39MW of diesel plant. NEB is constructing an additional 180MW of steam plant under Loans 458-MA and 579-MA scheduled for service between 1970 and 1972. Nearly all of NEB's generating capacity supplies the Interconnected System which covers most of the western side of the peninsula and the Southern System around Johore Bahru. The Interconnected System is also connected to the PRHE and the Penang City Council systems. NEB has a long-term contract to sell an increasing bulk power load to PRHE; total sales would be 110MW by 1972 and would increase by 10MW per year thereafter.

10. The project consists of the third stage at Tuanku Ja'afar (Port Dickson) Thermal Station and transmission lines and associated substations to deliver the power to the load centers. The third stage at Port Dickson comprises three new units (Units 5 to 7) each of 120MW and will bring the station to its final total capacity of 600MW.

11. The civil works for all three units would be carried out together and two of the three 120MW units (Units 5 and 6) would be in operation in 1974 to meet the conservatively estimated increase in power demand by that time. The third unit would be installed within two years thereafter to meet growth in power demand as it develops. NEB intends to order all three units at once, retaining the option to cancel the third unit should future demand projections show that it will not be needed as soon as presently planned. A new order would then be placed for a third unit to be installed in time to meet the revised load forecast.

12. The total cost of the project is estimated at US\$58.9 million equivalent, of which US\$46.7 million would be the foreign exchange component. The present financing plan for the project includes: (i) bilateral or suppliers' credits (estimated at US\$26.7 million) for the boilers and turbo-alternators for the thermal station, (ii) the proposed Bank loan (US\$20.0 million) for the foreign exchange cost of civil works, auxiliary equipment for the thermal station, materials and equipment for transmission lines and substation extensions, and consulting services, and (iii) NEB's cash generation for local currency expenditures (US\$12.2 million). Under Loan 579-MA (Fourth Power) NEB obtained bilateral credits for major equipment requirements without difficulty; and if such credits should prove not to be available on reasonable terms, the Government would undertake in the Guarantee Agreement to fill any financial gap. As a further precaution, it is provided in paragraph 2(d) of Schedule 1 of the Loan Agreement that no disbursements of the Bank loan may be made for the items required for the Port Dickson Station until financing has been arranged for the boilers and turbo-alternators.

13. The items financed under the Bank loan would be procured after international competitive bidding in accordance with the Bank's guidelines for procurement. As far as the boilers and turbo-alternators are concerned, NEB would follow its usual practice of awarding all contracts for equipment and civil works after inviting international tenders. No tenders for the project have yet been invited.

14. The NEB was established in 1949 by the Government under the provisions of the Electricity Ordinance enacted that year. It is a well-organized and well-operated utility and has a great degree of autonomy. The Board of Directors of the NEB at present consists of a Chairman, a Deputy Chairman and nine other members, all of whom are appointed by the Minister of Commerce and Industry. By the end of 1967 all key positions in the NEB were held by Malaysians.

15. The financial record of NEB is good and its present position is sound. During the construction period of the project (1970-1976) a substantial part of the Temengor hydroelectric project, expected to be in operation in 1978, will probably also be constructed. NEB's financing plan therefore covers the nine-year period ending August 31, 1978 in which all payments for both projects would be made. During this period net internal cash generation is expected to finance 55% of NEB's capital requirements. In addition, the use of other resources, including Government contributions towards rural electrification, drawdown of accumulated cash reserves and sales of fixed assets, would increase the proportion of construction costs which would be financed from non-borrowed funds to 60%. Debt service payments would be covered satisfactorily from 1.9 to 2.2 times by internal cash generation. The debt/equity ratio would remain at about 55/45 for about four years and would then improve gradually to 44/56.

16. During the nine years to August 31, 1978 NEB expects to earn an average rate of return above the required 8% per annum on its average net fixed assets in operation. However, because of sizeable additions to plant in some years and the irregular pattern of annual tax payments, the rate of return is expected to vary during this period between 7.5% and 10.4%. The growth of sales is based on a conservative estimate which is in fact expected to be exceeded, and it is therefore considered unnecessary to change the tariffs during the years that temporary shortfalls in the rate of return might occur.

17. The proposed project is the least-cost next step of power system development and forms part of NEB's long-range planning to meet future power demand. The disturbances in May 1969 slowed the growth of power demand in West Malaysia from an average annual rate of 16% between 1963 and 1968 to 9.6% between 1968 and 1969. However, in view of the Government's efforts to stimulate the economy, power demand is expected to resume growth at an accelerated pace. The project would have a unit cost of US\$145 per KW of generating plant installed, which is about average for similar installations in the region. The incremental financial rate of return on the investment would be about 12%.

PART IV - LEGAL INSTRUMENTS AND AUTHORITY

18. The draft Loan Agreement between the Bank and the NEB, the draft Guarantee Agreement between Malaysia 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 and Guarantee Agreements contain provisions usual for this type of project and follow the general pattern adopted for previous loans to the NEB.

PART V - THE ECONOMY

19. A report (EAP-11a) in which the current economic position and prospects of Malaysia are reviewed was distributed to the Executive Directors on March 25, 1970 (R70-44). A basic data sheet is annexed.

20. Malaysia's overall growth performance throughout the 1960's was satisfactory. GDP in real terms grew by a yearly average of about 6½ percent, mainly because of strong investment and production trends in rubber and oil palm, tin mining and timber, as well as development of import substitution industries. However, in the seventies Malaysia faces two difficult economic and social problems which have emerged in recent years despite the growth in output and income, namely increasing unemployment and rural/urban income disparity. They were important underlying causes of the disturbances in Kuala Lumpur in May 1969.

21. In the long run, accelerated economic growth appears to be a prerequisite for a solution to these problems, This in turn calls for more aggressive Government development policies than in the past. It will not be easy to develop and execute such policies since the financial and managerial capacity of the public sector is already being strained by extended Government activities. The Second Malaysia Plan (1971-1975), now under preparation and to be reviewed by the Bank, will have to propose increases in both public and private investments, which have recently stagnated. Malaysia is unlikely to be able to finance the increased investments from internal resources and will therefore probably need a larger inflow of public capital in the next five years than in the past five. The debt-service ratio remains low at 2 percent as of end 1969, and is expected to remain below 5 percent for several years to come. Malaysia is creditworthy for substantial external borrowings on conventional terms.

PART VII - COMPLIANCE WITH ARTICLES OF AGREEMENT

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

PART VIII - RECOMMENDATION

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

Robert S. McNamara  
President

Washington, D.C.  
June 24, 1970

ANNEXMALAYSIA: BASIC DATA

<u>Area:</u>		128,430 sq. miles	
Under cultivation		12,242 sq. miles	
<u>Population:</u> (mid-1969 estimate)		10,660,000	
Rate of growth, 1964 - '69		3.1% p.a.	
<u>Labor Force:</u> (West Malaysia, 1967)		2,964,000	
Unemployed		197,000	
Unemployed as percentage of labor force		6.7%	
<u>Gross National Product:</u> (current market prices)			
Estimate for 1969		M\$11,305 million	
Rate of growth, 1964 - '69		7.3% p.a.	
1968 - '69		8.5% p.a.	
Per capita GNP, 1969		M\$1.060 (US\$346)	
<u>Gross Domestic Product:</u> (current factor cost)			
Estimate for 1967		M\$8,645 million	
Percentage composition			
Agriculture		30.9	
Mining and quarrying		5.6	
Manufacturing		11.1	
Construction		4.7	
Wholesale and retail trade		15.0	
Public Administration and defense		7.8	
Others		24.9	
<u>Savings, Investment and Resource Balance:</u> (as percentage of GNP)			
		1961-67	
		(average)	
	<u>1969</u>	<u>1968</u>	
Gross Savings	22.9	19.8	19.5
Gross Capital Formation	16.1	17.8	18.8
of which: public sector	(5.9)	(5.9)	(6.8)
private sector	(10.2)	(11.9)	(12.0)
Balance	6.8	2.0	0.7
<u>Money and Price:</u> (end of period; M\$ million)			
	<u>1969</u>	<u>1968</u>	Rate of Change
			<u>1964-69</u>
Money	1,911	1,687	6.3% p.a.
Quasi-Money	5,806	1,542	17.9% p.a.
Consumer price index			
(West Malaysia, 1959=100)	107.1	108.2	0.9% p.a.

Federal Government Finance: (M\$ million)

	<u>1969</u>	<u>1968</u>	<u>1964</u>
Current Revenue	2,060	1,890	1,469
Current Expenditure	<u>1,977</u>	<u>1,795</u>	<u>1,386</u>
Current Surplus	+83	+95	+83
Capital Expenditure	668	608	501
Overall Deficit	<u>-585</u>	<u>-513</u>	<u>-418</u>
(Gross Foreign Borrowing)	(181)	(103)	(6)

External Public Debt: (US\$ million)

Total debt (Dec. 31, 1969)	537
Total debt service (1969)	37.4
Debt service as percentage of exports of goods and services (1969)	2.5%

Balance of Payments: (US\$ million)

	<u>1969</u>	<u>1968</u>	<u>1964</u>
Merchandise Exports	1,654	1,332	1,093
Merchandise Imports	<u>1,140</u>	<u>1,115</u>	<u>1,005</u>
Balance	+514	+217	+ 88
Services (net)	-208	-105	-119
Transfers (net)	<u>- 56</u>	<u>- 47</u>	<u>- 24</u>
Balance	+250	+ 65	- 55
Public Long Term Capital (net)	+ 55	+ 37	+ 7

Composition of Merchandise Exports: (percentage of total exports)

	<u>1969</u>	<u>1968</u>	<u>1964</u>
Rubber	37	33	41
Tin	17	20	22
Timber	14	17	9
Palm Oil	3	3	2
Others	29	27	26

Gold and Foreign Exchange Reserves: (end-1969 - US\$ million)

Monetary authorities	682.8
Government and other public authorities	105.4
Commercial banks (net)	21.6
Total	<u>831.4</u>
Month's merchandise imports at 1969 level	8½

Foreign Exchange Rate: US\$1.00 = M\$3.06

June 24, 1970