

# LOAN COMMITTEE

LC/M/86/-15

May 12, 1986

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Minutes of Loan Committee Meeting to Consider  
CHILE - Second Structural Adjustment Loan  
held on April 23, 1986 in Conference Room E-1208

## A. Present

### Committee:

Messrs./ E. Stern (Chairman)  
 Mmes. S. Husain (OPSVP)  
 A. Krueger (VPERS)  
 I. Shihata (LEGVP)  
 M. Qureshi (SVPFI)  
 D. Knox (LCNVP)  
 A. Golan (INDDR)

### Others:

Messrs./ A. Choksi (CPDTA)  
 Mmes. L. Fox (CPD)  
 N. McMullen (PBDCP)  
 E. Kopp (SVPOP)  
 R. Clements (SVPOP)  
 P. Donovan (SVPOP)  
 R. B. Steckhan (LC1DR)  
 P. Meo (LC1DR)  
 G. Schultz (LCPI2)  
 L. E. Derbez (LC1PA)  
 C. Jones-Carroll (LC1PA)  
 N. de Souza (LEGLC)  
 E. Abbott (LEGLC)

## B. Issues

1. The meeting was called to discuss issues arising from the Initiating Memorandum (IM) seeking approval to appraise a US\$300 million Second Structural Adjustment Loan to the Republic of Chile, under cover of a memorandum from Mr. Knox dated April 16, 1986. Issues dealt with included:

- (a) the specific measures intended to support rehabilitation of the financial/banking sector, and the extent to which the public sector should share in the cost of this;

## DISTRIBUTION

### COMMITTEE

Senior Vice President, Operations (Chairman)  
 Senior Vice President, Finance  
 Vice President & General Counsel  
 Vice President, Operations Policy  
 Regional Vice President concerned\*  
 Vice President, Energy & Industry (for lending in these sectors and SALs)  
 Vice President, Economics and Research (for non-project lending)

### OTHERS

Standard (see OMS 9.25 page 7)

\*Copy to all other Regional Vice Presidents

- (b) the respective roles of public and private sectors in promoting economic recovery and how the public sector would finance its contributions; and
- (c) the size of the SAL and role of commercial banks.

### **C. Discussion**

2. **Financial Rehabilitation:** In response to queries, the Region described the Chilean Central Bank's four programs to salvage the financial/banking sector--at significant initial cost to the Central Bank--and current plans to phase the Central Bank out of this role. These plans should reduce the annual costs of the program to the Central Bank from 4.5 percent of GDP in 1985 to 1.6 percent this year and less next year. These cash losses, once ended, must thus be added to the net stock loss; the net amount of bad debts in the banking system. Since much of this latter involves case-by-case workouts--and much of the workout costs could be borne by the private sector--precise costing--and burden sharing--is difficult and SAL II targets would thus focus on the institutional mechanisms. The Chairman nevertheless summarized that we should reach agreement on a time-bound program for the rehabilitation of the financial sector, incorporating a specific target on how much of the cost would be absorbed by the public sector. The Region further agreed that proposed actions to rationalize the banking sector would take into account the need to remove those incentives in the credit system that might be leading banks to overextend their operations.

3. **Public Sector and Finance:** The Region clarified that while the Government holding company, CORFO, will, as a policy measure, be divesting at market rates many of the enterprises it holds, others, because of their size and profitability (e.g. CODELCO, the Copper Company) will be retained by the State. Beyond that, public sector involvement will be chiefly in provision of necessary infrastructure to facilitate private production. The Region also noted that, as the IM stated, should public sector savings fall short of the targets, a variety of corrective measures might be urged, including more public expenditure cuts or more taxes. Similarly, if non-copper exports fall short of their targets, this would trigger further action, including adjustments in the foreign exchange rate policy. The Chairman also cautioned the Region to ensure the private sector was encouraged to assume responsibilities in export promotion (e.g. of small farmers) rather than depend on state institutions.

4. **Loan Size:** While some participants favored taking advantage of this year's potentially smaller financing gap resulting from oil price and interest rate drops to make SAL II smaller (saving our leverage perhaps for next year), the Chairman pointed out the need to avoid overstating such potential savings since the IM's projections show that Chile faces a very difficult situation, with little breathing space. He also noted that the Bank's role now was more aggressive than in the past, and per capita lending levels thus may have to be reconsidered. Loan Committee members were, in general, impressed with Chile's performance to date, supportive of the Bank doing as much as it could after the private banks had maximized their



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support, and cognizant of the considerable effort Chile would have to make just to keep its adjustment program on track. Indeed, this effort must be continued since Chile still had little margin for error in its economic program.

5. After the meeting, the Region decided, in view of the discussion, to initiate the SAL II appraisal discussions based on a proposed loan of \$250 million.

**D. Recommendation**

6. The Loan Committee gave approval to the Region to appraise the proposed Second SAL to Chile.

Cleared with and cc: Loan Committee

CJones-Carroll:ab