

THE WORLD BANK GROUP ARCHIVES

PUBLIC DISCLOSURE AUTHORIZED

Folder: Irving Friedman UNCTAD Files: Board Seminar on Supplementary Finance, April 17, 1969 - Correspondence

Folder ID: 1787634

ISAD(G) Reference Code: WB IBRD/IDA 03 EXC-10-4481S

Series: Records of Economic Advisor Irving Friedman

Sub-Fonds: Records of President Robert S. McNamara

Fonds: Records of the Office of the President

Digitized: June 14, 2013

To cite materials from this archival folder, please follow the following format:

[Descriptive name of item], [Folder Title], Folder ID [Folder ID], ISAD(G) Reference Code [Reference Code], [Each Level Label as applicable], World Bank Group Archives, Washington, D.C., United States.

The records in this folder were created or received by The World Bank in the course of its business.

The records that were created by the staff of The World Bank are subject to the Bank's copyright.

Please refer to <http://www.worldbank.org/terms-of-use-earchives> for full copyright terms of use and disclaimers.



THE WORLD BANK
Washington, D.C.

© 2012 International Bank for Reconstruction and Development / International Development Association or
The World Bank
1818 H Street NW
Washington DC 20433
Telephone: 202-473-1000
Internet: www.worldbank.org

PUBLIC DISCLOSURE AUTHORIZED

Friedman UNCTAD Files - Board Seminar on
Suppl. Finance

Apr. 17, 1969

DECLASSIFIED
WBG Archives

The World Bank Group
Archives



1787634

A1992-017 Other # 6

167585B

Inving Friedman UNCTAD Files Board Seminar on Supplementary Finance, April 17, 1969
- Correspondence

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT
ASSOCIATION

INTERNATIONAL FINANCE
CORPORATION

April 7, 1969

Mr. Sarma is sending copies to
Mr. Sundrum and Prof Frank for comment.

*
Mr. Jalan and Mr. Gulhati are in town
if you decide to send copies to them.

Copies sent for comment 4/8

OFFICE MEMORANDUM

TO: Mr. Irving S. Friedman

DATE: April 3, 1969

FROM: N. A. Sarma

N. A. Sarma

APR 3 1969

*2 p.m.*SUBJECT: Board Seminar on Supplementary Finance*- to be distributed April 17/69*

Please see this revised (draft) paper, rather than the one I sent you on January 15.

Would you like me to circulate this to the Commodity Group staff members?

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

STABILIZATION OF PRICES OF PRIMARY PRODUCTS

ACTION EVALUATION PAPER NO. 9

SUPPLEMENTARY FINANCE

I. Introduction

1. The Bank Staff Study on Supplementary Financial Measures was forwarded to the U.N. Secretary-General in December 1965 as forming "the basis for a feasible solution to a problem of major importance", in response to a Recommendation of UNCTAD I which requested the Bank to study the feasibility of a scheme which "should aim to deal with problems arising from adverse movements in export proceeds which prove to be of a nature and duration which cannot adequately be dealt with by short-term balance of payments support" and, if appropriate, to work out a scheme. This paper gives a resume of the discussions that have taken place so far in UNCTAD I and UNCTAD II, and in the Inter-governmental Group set up by UNCTAD on Supplementary Finance, describes the main elements of the scheme proposed by the Bank Staff, as well as the critical comments made, and points out the relationship of Supplementary Finance to Commodity Arrangements.

2. The next session of the Inter-governmental Group, to be held during June 23 - July 4, 1969, is expected to finalize its Report, which would then be considered by the Trade and Development Board of UNCTAD at its session during August 26 - September 12, 1969.

3. This paper suggests a possible course of action that the Bank might take on supplementary finance in connection with the commodity study pursuant to the Rio Resolution.

II. Recommendation of UNCTAD I

4. In his statement at UNCTAD I on April 6, 1964, the Head of the United Kingdom delegation, the Rt. Hon. Edward Heath, commended the stabilization of commodity prices and supplementary financial assistance as among the key points before the Conference. On supplementary financial assistance he had this to say: "We recognize that balance-of-payments problems may arise in developing countries which call for special measures of assistance. Sharp falls in the export earnings of less developed countries, such as have occurred from time to time in commodity trade, can be disruptive of development. The International Monetary Fund offers certain facilities to meet the short-term effect of such falls. ...However, there is a risk that development may be disrupted as a result of longer term adverse movements in export receipts. In the distribution of the aid which we in the developed countries make available, whether bilateral or multilateral, we should perhaps take more account of these risks."

5. Recommendation A.IV.18 of the Conference on Supplementary Financial Measures (Annex A), the result of the initiative taken by the U.K. and Swedish delegations, was adopted by 106 votes to none, with ten abstentions (USSR and other Socialist Countries). The Recommendation requested the World

Bank to study the feasibility of a scheme which "should aim to deal with problems arising from adverse movements in export proceeds which prove to be of a nature or duration which cannot adequately be dealt with by short-term balance of payments support", and, if appropriate, to work out such a scheme. An adverse movement was defined as a 'shortfall from reasonable expectations". The purpose was "to provide longer-term assistance to developing countries which would help them to avoid disruption to their development programs". The recommendation was made recognizing that "adverse movements in the export proceeds of developing countries can be disruptive of development", and noting that "the IMF can make available balance of payments support to help meet the short-term effects of shortfalls in export proceeds". Australia while voting in favor of the proposal for studies as to the feasibility of supplementary finance, expressed reservations about the desirability of financial measures as a means to dealing with long-term shortfalls in export receipts. France, while voting in favor of the Recommendation, did not accept the principle of what they termed long-term compensation of fluctuations in export earnings; in its view, the real solution was in the organization of primary produce markets, permitting the maintenance of stable and remunerative prices.

6. The Recommendation represented a consensus to which both developed market economy countries and developing countries subscribed. There was another draft resolution sponsored by fourteen developing country delegations. Recommendation A.IV.18 incorporates both, as separate parts. It is in response to the first part of the Recommendation that the World Bank Staff proposed a Scheme for Supplementary Finance, to meet the problem of unexpected short-falls that are potentially disruptive of a developing country's development efforts. The basic approach of the World Bank Staff proposal is outlined in paragraphs 7-8 below. The Staff proposal was circulated to the Board in November 1965,^{1/} and was forwarded to the U.N. in December 1965 as forming "the basis for a feasible solution to a problem of major importance". Since then, discussion has been focused on this in UNCTAD bodies and outside.

7. The Bank Staff Study proceeds on the premise that it is desirable to provide countries, already short of foreign exchange because of their efforts to speed up the process of development, with a ready source of long-term assistance to enable them to maintain agreed development programs in the face of unforeseen adverse export movements that are beyond their control. It is important under the Bank Staff Scheme that the development programs and policies be internationally discussed and agreed. Thus, the Scheme seeks to assure prompt assistance - assistance that would be supplementary to and not a substitute for already existing forms of aid. While there is no implication that there should be binding commitments with respect to basic development assistance over a period, it is to be expected that the careful examination of development programs internationally would facilitate the flows of development capital.

8. In order to avail itself of this facility, a country would have to enter into an initial understanding with the administering agency as to

^{1/} R/65/174: November 15, 1965.

what might be regarded as reasonable expectations for exports during a period covered by the country's development program and as to certain key aspects of its development program and policies. (The need for and feasibility of export projections are considered later.) The designated international agency would be reviewing the performance of the country periodically, to judge whether the country's performance is satisfactory enough for it to be eligible for assistance from the Scheme. A shortfall from reasonable expectations of export earnings (as specified in an agreed export projection) occurring in a country which has been following the agreed policy understandings can be assumed to be beyond its control. This obviates a time-consuming study of the causes and consequences of such shortfall at the time it occurs. The Scheme would be a means of providing speedy assistance at the time of need, without being an automatic one, because it provides for judgments by the Agency. Thus, the Scheme does deal with the problem of uncertainty but makes a clear distinction between certainty and automaticity.

III. Report of the Inter-governmental Group to UNCTAD II

9. An Inter-governmental Group on Supplementary Financing ^{1/} was established by the Trade and Development Board in September 1966, to examine the Bank Staff Scheme and to submit a report (with such modifications to the Scheme as it might consider appropriate) as a means of achieving the objective set out in Part A of Recommendation A.IV.18 of the first Conference. Bank staff members participated in these deliberations as technical experts. At its third session held from October 30 to November 13, 1967, the Group adopted its Report which was forwarded direct to UNCTAD II. The general assessment of the Group given in this Report was as follows: "A few members have stated that, in view of unresolved questions of some importance (and without prejudging the question whether the objectives set out in Recommendation A.IV.18 should be achieved by a scheme with the characteristics of that of the IBRD staff or in other ways), they are not as yet prepared to take a position. One member expressed the view that the Scheme would not be either a timely or a genuine solution to the basic problem - the instability and inadequacy of the export proceeds of developing countries - which in its opinion could only be dealt with efficaciously by a system of organization of markets for primary products. All other members of the Group believe that, although a number of questions, some of them important, require further consideration, the objective set out in Part A of the Recommendation can be achieved by a scheme with the essential characteristics of the IBRD Staff Scheme." The developing countries' members of the Group prepared a joint statement of their views, strongly endorsing all the essential elements of the Bank Staff Scheme, which was also circulated as a document of UNCTAD II.

IV. Some Other Suggestions

10. Certain other proposals for avoiding the disruption of development programs made in the course of the Group's deliberations are noted in the

^{1/} The members of the Group were: Argentina, Brazil, Ceylon, Federal Republic of Germany, France, Ghana, India, Japan, Poland, Sweden, U.A.R., U.K., U.S.A., and Yugoslavia. There was provision for two Eastern Group countries; one remained vacant.

Report referred to above. Each of these proposals is followed by extensive comments representing the views of most members of the Group who thought that none of these suggestions would adequately meet the objectives of UNCTAD Recommendation A.IV.18 on supplementary financing.

(a) Under one alternative the scheme would be operated on an ad hoc basis without the need for export projections and any prior understanding on policy matters. Under this suggestion also, however, a country wishing to avail itself of the scheme is expected to undertake to consult fairly regularly with the Agency administering supplementary finance about its development and economic policies. As for determining whether a decline in exports constituted a shortfall from reasonable expectations, this would be done by the administering agency ex post on the basis of certain established guidelines. When a country suffers a serious shortfall in export proceeds, the causes of the shortfall are to be examined in a speedy manner, and the amount and conditions of financial assistance are to be decided, taking into account the need of the country (possible disruption of the development program), its general performance and all relevant circumstances, as well as the availability of resources for the Agency. There would be close cooperation between the Agency and the Fund, possibly through a Joint Committee. The Joint Committee would receive and consider applications for both Compensatory financing and Supplementary financing.

(b) Another suggested essentially the refinancing of IMF drawings. According to one suggestion, the Agency would examine, at the request of the countries, the economic situation and performance of countries that had drawn from the Fund under Compensatory Financing Facility or had made ordinary Fund drawings to offset shortfalls of the same general character, so as to ascertain whether the country in question was making a reasonably effective effort to promote its own economic development. The purpose of assistance under this suggestion would be in effect to extend the period of repurchase of Fund drawings if the Agency took the view that the obligation to repurchase threatened disruption of its development program. A variant of the suggestion was that the Agency would also be empowered to provide assistance should a country's entitlement to draw from the Fund prove smaller than the amount of the shortfall.

(c) The third is the proposal for organization of markets. One representative argued that a purely financial solution to problems arising from poor organization of trade relations between industrialized and developing countries would fail. In his view, an initiative with respect to Supplementary Finance would delay the work in the Fund and Bank in response to the Rio Resolution on Commodity Price Stabilization.

V. Resolution of UNCTAD II on the Subject

11. In March 1968, UNCTAD II adopted the Resolution on Supplementary Financial Measures by 70 votes to none, with 8 abstentions (Socialist Countries) (Annex B). As recorded in the Report of the Second Conference, all representatives of LDC's who participated in discussions in Committee III (the Committee of the Conference that considered questions relating to finance) on this subject emphasized the need for a Supplementary Finance

scheme, and many called for early establishment of a scheme on the lines of the Bank Staff Study. The representatives of some developed market economy countries also supported the majority assessment of the Inter-governmental Group. Representatives of a number of other developed market economy countries, however, had reservations about the Bank Staff proposal; one of them felt that implementation of supplementary finance might detract from efforts to establish commodity stabilization agreements. Several references were made to the Bank and Fund studies in progress pursuant to the Resolution by the Boards of Governors of these institutions on stabilization of primary commodity prices.

12. The Resolution on Supplementary Financial Measures adopted at UNCTAD II reaffirms the objective of the proposal for Supplementary Financial Measures set out in A.IV.18 of the First Conference; it states that any scheme devised to meet this need should "provide reasonable assurance of help to protect a country's development plan or program against the effects of export shortfalls ..." It was decided to continue the Inter-governmental Group, suitably expanded, and the Group is requested to attempt to resolve certain outstanding issues enumerated in the Resolution. These are: (a) definition and method of assessment of reasonable expectations; (b) the scope of policy understandings; (c) measures to be taken by beneficiary countries; (d) relationship between Supplementary Finance and the Fund's Compensatory Financing Facility. This paper covers each of these issues, among others. Denmark, speaking on behalf of the Nordic countries, recalled that they had come to the Conference with the hope that the principles elaborated in the Bank Staff Scheme and the Inter-governmental Group Report would be accepted; they would do everything possible in the future work of the Inter-governmental Group to make this a reality. The "deep disappointment" of the developing countries at lack of definitive progress with respect to Supplementary Finance at the Conference was expressed by Brazil and Ceylon speaking for the developing countries.

VI. Present Status of Discussions

13. The expanded Inter-governmental Group has 26 members.^{1/} The fourth session - first one of the expanded group - was held in Geneva from October 21 - 25, 1968, and was intended to be preparatory for the next session to be held during June 23 - July 4, 1969. According to the Resolution adopted by UNCTAD II, the next session is to conclude the work of the Group, and the final Report of the Group would be considered by the Trade and Development Board at its ninth session during August 26 - September 12, 1969. The Group has requested the UNCTAD Secretariat, the Bank Staff, and the Fund Staff to furnish additional material and advice.

^{1/} Afghanistan, Argentina, Australia, Brazil, Canada, Ceylon, Chad, Chile, Federal Republic of Germany, France, Ghana, India, Italy (Spain in 1969), Japan, Nigeria, Pakistan, Poland, Sweden, Switzerland, Tunisia, United Arab Republic, United Kingdom of Great Britain and Northern Ireland, United States of America, Uruguay, Venezuela, Yugoslavia.

14. In the discussions in the Inter-governmental Group, and at UNCTAD II, critical comments were made by some of the main donor countries on certain aspects of the Scheme put forward by the Bank Staff. In brief, it was argued that the policy understandings were likely to involve duplication with the work of other agencies and might raise difficulties for recipient countries of a political kind; that export projections for as long as 4 to 6 years could not be made with reliability and could not form the basis for financial claims; that the cost estimates were not precise and seemed to envisage open-ended commitments for contributing countries; that there was no provision for adequate coordination with the Fund's Compensatory Financing Facility. There is also the important question of how Supplementary Finance fits into an overall or integrated approach with respect to the commodity problem, and the overlap, if any, between commodity price stabilization efforts and supplementary finance. These matters are dealt with in the following paragraphs.

VII. Policy Understanding

15. With respect to the scope of policy understandings, and the frequency of consultations, it was noted in the Bank Staff Study: "The precise nature and degree of detail of such an understanding would vary considerably as among countries. Continuing contact would be maintained, moreover, between the administering agency and the country throughout the plan period in order to provide the basis for an assessment of the extent to which the agreed criteria of performance were currently being fulfilled or needed adjustment in the light of changing circumstances". The "policy package" would have to be in broad macro-economic terms, including understandings in particular about export earnings, public and private investment and domestic savings; implementation would be left to continuous working relations between a country and the Agency, made necessary in any case by the needs of nearly all developing countries for external assistance, including assistance from international financial institutions. The policy understanding would not be confined to the export sector only, because the factors and policies affecting exports arise in all sectors of the economy. It was emphasized by the Bank staff in the various meetings on the proposal that, in general, the policy understanding represents what a country discusses with donor countries and international institutions about its development program when it seeks basic development finance and that understandings on these matters were becoming more common. Available data, experience and assessments arising from consortia and consultative group discussions, the work in the World Bank Group and in the Fund, were to be fully utilized. In evaluating the development programs of countries for purposes of supplementary finance, the Agency, if separate, could avail itself especially of the experience of the World Bank Group. Similarly, the Agency could avail itself of the advice of the Fund on matters falling within the field of the Fund's responsibilities.

16. A multilateral institution, like the World Bank Group, while concerned with the obtaining and allocation of its resources, has a wider perspective, i.e. the improved performance of a developing country in the mobilization and effective use of its resources, domestic and external. Given this broad framework of approach, however, there cannot be uniformity for all countries. One or another aspect may have to be considered in depth

depending on the situation of a particular country. It may be fiscal matters in one case; in another, the working of public enterprises. In a third, it may be the foreign exchange mechanism. In considering and evaluating performance, flexibility is essential, seeking the crucial or key elements for a given country, in a certain situation. No one will argue, for example, that monetary or fiscal policies can be fixed over time. In any case, not all eventualities can be visualized at this stage; procedures would have to evolve in the light of actual experience. Above all, policy understandings would be predicated on and involve mutual cooperation and contacts between a member country and the administering agency. A certain confidence in international agencies, created and run by governments, is needed by both developed and developing countries to enable them to function effectively, especially in assessing economic performance.

17. After extensive discussions within the framework of UNCTAD and otherwise, the developing countries have come to accept by and large the underlying purposes of policy understandings and the manner they would be arrived at and implemented, whatever their initial misgivings may have been. Thus, for the first time, the need for performance evaluation and commitments thereon on the basis of international consultations, so important in the field of development finance and urged so long by the donor countries, came to be discussed openly, and a certain approach was formulated to which the LDC's have indicated willingness in principle to subscribe. The conclusion of the Inter-governmental Group on policy understanding in its Report of November 1967, expresses general agreement "that a policy understanding should be part of the Scheme", and "it was generally agreed that consultations might be broadly along the lines of those conducted by international financial institutions".

VIII. Export Projections

18. A feature of the Scheme proposed by the Bank Staff is an understanding between the administering agency and the country on an export projection for a period over which the country has formulated a development program. The export projection indicates the amount of foreign exchange which the country may reasonably assume will be available from its exports in each year of this period. The projections are based on informed assumptions regarding world trade developments, and on the understanding that certain domestic policies would be followed. An export projection is a way of utilizing available information combined with the most plausible assumptions about the future circumstances in order to estimate future export earnings on which to base a development program. It is important to distinguish such projections from predictions of what will in fact occur in the future. Hence, it is not a valid criticism to point out that projections turn out to be 'wrong' in any particular case. In fact, if every projection were to prove 'right', i.e. if it were an accurate prediction, a scheme to handle unforeseen short-falls would not be needed. The essential point relates to the defense of a development program from deviations in earnings from anticipated exports on the basis of which the program had been formulated -- a viewpoint fully in accord with the original UNCTAD Resolution.

19. Such projections, together with other items affecting foreign exchange availability, would be required by developing countries, irrespective of supplementary finance, in order to judge the feasibility of their development programs. Export projections are built into development programs in two ways: the development program contains commitments to certain policy actions on which the projections are based, especially in export policies; the development program in turn is based on the export projection and is tested for financial feasibility on the basis of anticipated export earnings and other sources of development finance.

20. In suggesting a five-year projection period, to coincide with the normal length of a development plan, limitations of available techniques of projection over that long a period were recognized. However, today most developing countries are accustomed to making export projections to provide a basis on which investment programs can be built. The Bank Staff's considerable experience in this field suggests that such five-year projections are practical. The quality of projections can, of course, be improved by sharpening analytical tools and strengthening the basis for technical judgments, and this is being attempted in the World Bank in any case. However, whatever the improvement in projection techniques, this would not eliminate the problem of unexpected shortfalls because unpredictable changes in a country's export situation and in the world economy will continue to take place.

21. The question has been raised relating to the desirability of periodic revisions, say, every year or every two years. The viewpoint in the Bank Staff Study is that during the operation of a development plan, the underlying export projection should not be subject to revision except when changed conditions justify a major readjustment of the investment pattern and of the development strategy, because investment calculations must be based on export projections. Whether or not such a major readjustment is required would be determined in consultations between the Agency and the country concerned. Revisions in export projections would be made when the development program itself has to be reformulated due to circumstances other than an export shortfall such as a fundamental change in export prospects, major change in development aid, etc. During discussions, a consensus has been emerging that a rough mid-term review of the development program might be appropriate; this would also make it possible to review export projections as well as increase their reliability. This can be reconciled with the Bank Staff view in that such a review would help to defend development programs in an 'orderly' way; one can see then what can be done to raise more resources -- domestic and external -- and also evaluate the changes in export outlook more precisely, and act accordingly.

IX. Cost Estimates

22. Given an agreed projection of export proceeds on which the country's development program is based, the financial assistance which a country can expect from the Scheme in the event of an export shortfall may be determined by comparing the actual exports with the projected exports. The idea is put forward in the Scheme that such financial assistance should be related to the amount of shortfalls -- the amounts by which actual exports fall short of projected exports in particular years -- net of "overages", i.e.

the amounts by which actual exports exceed projected exports in other years within the same planning period.

23. In the Bank Staff Study, a simulation exercise was carried out, comparing merchandise export projections for individual countries made by the Bank Staff for various periods with the actual export earnings of the same countries in the corresponding years. 'Global' gross shortfalls were derived from this. Overages and drawings under the IMF's Compensatory Financing Facility were allowed for. Then, several other adjustments were made to arrive at an estimate that would indicate the financing requirements of the Agency. They were the number of developing countries likely to utilize the Scheme in the initial years, the likely improvement in the methodology and use of export projections as compared to the periods of the simulation exercise, the extent to which the developing countries would be expected to meet shortfalls on their own and, finally, the possible contribution to meet export shortfalls from sources of finance other than the IMF Compensatory Facility. Under the Supplementary Finance Scheme, a developing country is expected to meet the problem of an unexpected export shortfall to some extent with its own means, which include the use of some part of its foreign exchange reserves and internal adjustments involving a reduction in demand for foreign exchange. It is understood that these measures could be undertaken in a number of cases without disrupting the development effort in which the country was engaged. Although the extent to which each individual country could do so would vary from case to case, an attempt was made to assess the probable order of magnitude of the effort which might be considered reasonable when all developing countries are grouped together.

24. Given the nature of the problem, it was not possible to quantify these factors in any exact way. On the other hand, to estimate even the rough order of magnitude of the amount of resources needed to run the Agency during an initial period, it was necessary to attribute some orders of magnitude to the different factors mentioned above. On this basis, it was estimated that an annual average of \$300 - \$400 million for the initial five years would have to be covered by the Agency administering Supplementary Finance. It was emphasized in the Study that the quantification of financial requirements and of the various factors involved was rough; no precise calculations were possible because the Scheme was novel and historical data were only useful in helping to judge magnitudes but were by no means certain indicators. The intent was to arrive at an estimate of finance for the Scheme with which the Scheme might reasonably be expected to operate successfully in the initial period, for the purposes set out in the Recommendation.

25. In the course of discussions in the Inter-governmental Group, the cost estimates furnished in the Bank Staff Study were questioned on the grounds that the underlying data did not take into account experience in more recent years; that the difference between estimated export shortfalls and the cost estimate was large; and that the Scheme seemed to be an open-ended one, and claims might prove to be larger than the cost estimates provided for.

26. However, the conclusion of the Inter-governmental Group on costs reads: "It was widely agreed that the estimate of \$300-\$400 million per

year of the World Bank Staff provided the basis for arriving at a figure with which the Scheme might reasonably be expected to operate successfully in the initial period." During the discussions in the Group, it clearly emerged that a scheme of this kind could, however, not be open-ended. It had to envisage a fixed fund that was considered adequate and reasonable, and, therefore, the possibility of rationing had to be kept in mind. The Bank Staff agreed with this view.

27. The Bank Staff had now examined the cost estimates again, taking into account also available data for more recent years, i.e. up to 1967, as requested by the Inter-governmental Group. There is now a much longer period (11 years) for which data are available. Using the method described above in para. 23, the Bank Staff now estimate the financial requirements at \$250 mn.- \$300 mn. per annum for five years. As recommended by the Inter-governmental Group, a fixed fund could be set up (partly in cash contributions and the rest as a readily available line of credit as was indicated in the original study by the Bank Staff and referred to during discussions in the Inter-governmental Group), and the Agency entrusted with the Scheme be asked to manage it within that total for five years. All discussions on the subject have explicitly assumed that the funds for such a Scheme would be additional to other available development resources.

X. Administering Agency

28. The Resolution of UNCTAD I on Supplementary Finance envisaged administration of the Scheme under the IDA, with resources contributed by the major Part I member countries of the Association in the form of additional commitments, prescribed in advance. The 1965 Bank Staff Study did not address itself to the question of Administering Agency; throughout, the reference was only to the Agency. It was believed that it was desirable first to discuss the substance of the proposal made by the Staff. The Report of the Inter-governmental Group of November 1967 expressed the general agreement that the IBRD Group would be the most appropriate for the administration of the Scheme. In fact, the Inter-governmental Group at its fourth session (October 1968) asked the Bank: to what extent can the Bank Staff Scheme be implemented by the Bank and IDA within their existing Articles of Agreement, if the Executive Directors so agreed and if the necessary funds were made available.

XI. Supplementary Finance and Compensatory Financing Facility of the Fund

29. An important question that has come up frequently in the course of discussions relates to the relationship of the proposal for Supplementary Finance to the Compensatory Financing Facility of the Fund. The Compensatory Financing Facility helps to even out the availability of exchange earnings from exports for a member country and thus assists a country in meeting temporary, reversible, balance of payments deficits, on the understanding that the drawings would be repaid by the country within 3-5 years; the Fund recommends earlier repayment by a country when its export earnings exceed the trend value. The Supplementary Finance Scheme, on the other hand, has developmental objectives: it is intended to assist a developing country to maintain its development program which might otherwise be dis-

rupted by a shortfall of export earnings from reasonable expectations on which the development program was based. The proposal for Supplementary Finance has been made because countries cannot undertake development programs with a longer term perspective unless there is some assurance that their export earnings would correspond to reasonable expectations. In brief, it may be said that Compensatory Financing Facility has to do with instability or short-term fluctuations in export earnings, and Supplementary Finance with uncertainty of export earnings. Another difference is that in Compensatory Finance the emphasis is on the simple fact of a downward fluctuation; in Supplementary Finance it is on the causes of the change and its impact on the development process.

30. The different purposes of the two are reflected in the method of calculating export shortfalls. Under the Supplementary Finance Scheme, export prospects are considered in the context of a development program and take account not only of various objective factors, domestic and external, but also the impact of new policy measures. Attempt is made to estimate future export eventualities over a planning period of, say, five years, on which a developing country can rely in formulating and implementing its development program. The shortfall in export earnings is measured from a prior export projection for a future period. Under the Compensatory Financing Facility, the Fund meets requests for drawings by members whose export proceeds over the latest twelve-month period have fallen short of the estimated medium-term trend value of exports. The shortfall in export earnings is measured from a norm representing the medium-term trend value, estimated from a statistical formula as well as a qualitative judgment. The statistical formula attaches a weight of .50 to exports in the shortfall year and .25 to each of the two preceding years; the qualitative estimate involves a direct forecast of exports for two years ahead. Formerly, the statistical and qualitative estimates were given about equal weight in determining trend value of exports; currently a somewhat greater weight is given to qualitative estimates. But, "the average level of exports for the two years following the shortfall year will not be assumed to exceed by more than 10 percent the average level experienced in the preceding two years ..."^{1/} It is precisely because the trend or norm is a moving average for five years centered on the current shortfall year as the middle year that a rough balancing of shortfalls and surpluses of actual exports with respect to trend is expected over a relatively short period of time.

31. It was noted earlier that during the deliberations of the Intergovernmental Group, a view of Supplementary Finance was put forward in terms of possible refinancing of drawings under the Fund Compensatory Financing Facility: the different purposes of the two facilities would indicate that any refinancing of Compensatory Financing Facility could not be an alternative or substitute way of dealing with the problem for which Supplementary Finance has been proposed. Both at UNCTAD I and UNCTAD II, there were distinct recommendations on Compensatory Financing, and refinancing of Compensatory Finance drawings forms part of the content of these resolutions. The Recommendations on Supplementary Finance are separate, and are intended to deal with another problem.

^{1/} II Report by the IMF on Compensatory Financing and Export Fluctuations, p. 8.

32. If the resources of the Fund were available to meet export shortfalls as defined in the Supplementary Finance Scheme, it would help to avoid the disruption of an agreed development program; then, the amounts drawn in the Fund would likely be much larger and the ability of the country to repurchase in 3-5 years much less, as the country would not be expected to cut back, if necessary, its development effort to a level making possible the fulfillment of a medium-term repurchase obligation to the Fund. Thus, it is the mode of determining the shortfall and the length of time for which financing is available that are critical -- it is not a question of techniques, but one of purpose.

XII. Commodity Agreements: Elements of:

33. The Commodity Problem is described briefly thus in the joint study "The Problem of Stabilization of Prices of Primary Products", Part I, by the Staffs of the Fund and the Bank: "The developing countries are heavily dependent on primary products for most of their exports: currently, 88 percent of their export earnings are derived from primary product sales. Furthermore, these exports are concentrated on a narrow range of products: almost one-half of these countries depend on one commodity for more than 50 percent of their total exports and as many as three-quarters derive more than 60 percent of their total exports from three primary commodities. As a result, the export earnings of the developing countries, with their crucial influence on import capacity and development potential, are heavily dependent on the prices and trading opportunities prevailing in world commodity markets. With limited but important exceptions, these markets have shown two major unfavorable characteristics. First, their absorptive capacity has grown only slowly, so that increased sales have often been possible only at falling prices. Second, these markets have been subject to particularly wide price fluctuations, which have themselves sometimes contributed to adverse longer-term price trends. Demand for most primary products is growing relatively slowly as a result of both technological developments and changes in consumer spending patterns. Moreover, world trade in primary products, and particularly in agricultural products, has been held back by the protection given by industrial countries to their own primary producers."

34. The stabilization of prices of commodities through commodity arrangements and increased access to the markets of industrial countries represent the trade approach for influencing the foreign exchange receipts of developing countries. By reducing the amplitude of price fluctuations and by seeking to deal with the slow growth of demand for primary commodities, they help to improve the level and trend of export earnings. For years the need for commodity agreements has been recognized; their aims and essential features have been discussed extensively. However, it has been possible to conclude only a few agreements. Access to markets has proved no more rapid to improve.

XIII. Fund and Bank Group Action in Financing of Stocks (Proposals)

35. The extensive study of the commodity problem in pursuance of the Rio Resolution by the Bank Staff and consideration by the Board in a series of Seminars have led to the recognition that:

- (1) The sound economic development of member countries can, under certain conditions, be effectively assisted by suitable international commodity agreements providing, among other things, for the holding of commodity stocks in national or international hands;
- (2) that this would be among the guidelines for the World Bank Group in appraising economic performance and the needs of member countries for development financing; and
- (3) international buffer stocks may, under certain conditions, make a useful contribution to a reduction of the amplitude of short-term fluctuations in export earnings and thus help to promote the sound economic development of member countries.

While the Fund would (as proposed) use its Compensatory Financing Facility to provide short-term credit to member countries to facilitate their participation in international buffer stocks under suitable international commodity agreements, it would appear that member countries may also need to commit resources over a longer period for this purpose. The Bank Group, in considering its loans or credits to member countries, would (as proposed) take into account additional long-term capital requirements arising from countries' participation in such buffer stock schemes, while maintaining its customary lending standards, and as part of its normal lending operations.

36. It is also recognized that the holding of reserve stocks by members to prevent abnormal price increases of primary commodities may in some cases help improve the longer-term export earnings of developing countries; and, similarly, the holding of stocks of certain primary products by member countries over medium-to-long term periods, while production is being adjusted to demand, may support export earnings of developing countries from such products. According to the proposal under consideration, the Bank Group would take into account the additional need of countries for external borrowing resulting from participation in international commodity agreements serving these purposes, in considering applications of member countries for development loans or credits.

37. Thus, the complexity of the commodity problem, as well as the limitations and framework under which international financial institutions function, require that a positive and realistic approach be adopted. We may now, appropriately, proceed to consider the relevance of this to Supplementary Finance.

XIV. Commodity Agreements and Supplementary Finance

38. As for the relationship between Commodity Agreements and Supplementary Finance, progress in negotiating commodity agreements is likely to enable countries to have more accurate expectations of their export prices and hence, in part, of their earnings, on the basis of which to formulate their development programs. It has been observed in past periods that large export shortfalls occur when commodity prices fall. Buffer and other stock arrangements help to maintain better price stability. When a developing country depends on one or two commodity exports, and a degree of price

stability is secured, this reduces a main factor of uncertainty in export earnings. Thus, effective commodity arrangements make for better export projections and reduce the cost of Supplementary Finance. This effect would depend on the number of commodities subject to agreements and the operative features of such agreements, especially in regard to export volume. However, even where a commodity agreement is effective, with stock management and other features, it is only a price range -- not a fixed price -- that is sought to be maintained. And, the other elements of uncertainty also remain. More important, however, is that insofar as commodity agreements take considerable time to negotiate and conclude, this effect of creating greater certainty of export earnings would be postponed. Other important elements are that a large number of successful commodity agreements cannot be expected to be concluded in the foreseeable future, for reasons fully explained in the Commodity Seminars; thus, at most, they would not cover a large part of the earnings of many countries from all their exports, so that there would still remain the problem for which Supplementary Finance Scheme was designed.

39. the fact that there is some overlap between the area that may be covered by commodity agreements and the area covered by supplementary financial measures might be interpreted to imply that the adoption of supplementary financial measures might inhibit efforts to conclude commodity agreements. This is not justified for a number of reasons. One reason is that primary product exporting LDC's have an advantage in earning foreign exchange from their own exports, subject to commodity agreements, rather than by obtaining foreign exchange from Supplementary Finance Scheme as a loan, even if these loans were to be provided on concessional terms. Secondly, supplementary financial measures are only concerned with the extent to which actual export earnings are close to their expected values, and not with whether the expected earnings are stable or unstable. Finally, while commodity arrangements have a certain impact described above on Supplementary Finance, they have other, important, objectives: viz. to improve the trend of the export earnings of countries, especially by regulating international trade in particular commodities.

40. Thus, Compensatory Finance Facility and Supplementary Finance Scheme, the former to meet the volatility aspect of export earnings, and involving essentially short-term assistance, and the latter to meet the uncertainty aspect and involving essentially long-term assistance, would also be needed, however optimistic assumptions are made about the future of international commodity agreements. These financial arrangements and commodity agreements become complementary to one another and reinforce their effectiveness mutually, so that development programs of countries can go forward uninterrupted by export shortfalls resulting from causes beyond their control and to which they cannot adapt by taking domestic measures only without major setbacks to their development efforts. It is only for those very few countries that depended to a very large proportion (say, two-thirds or more) of their foreign exchange earnings on one or two commodities, if those commodities were covered by effective international commodity agreements, that the need for supplementary finance would become of minor importance.

XV. Conclusions and Recommendation

41. It is not suggested that the World Bank Group at this time give its views on all aspects of the proposals made with respect to Supplementary Finance. What might be done is for the World Bank Group to indicate its attitude on the relation between the commodity problem and Supplementary Finance; more particularly, after its review of the commodity problem, whether there still remains a need for supplementary finance. The various papers prepared for the Commodity Seminar and the discussions held would indicate that the problem of uncertainty to which the Supplementary Finance Scheme and suggested amendments thereof are addressed will still remain, however optimistic the assumptions which may be made about the future of international commodity arrangements. It is assumed that the Bank staff would continue to collaborate as it has in the past with the deliberations being held under the auspices of UNCTAD, including providing the requested information and analysis. In light of this there is appended hereto a proposed action which might be taken by the Bank as part of the Commodity Study now being done.

A P P E N D I X

DRAFT OF DECISIONS BY EXECUTIVE DIRECTORS TO BE REPORTED TO GOVERNORS ON SUPPLEMENTARY FINANCIAL MEASURES

The Executive Directors have approved the following statement of policy regarding supplementary financial measures:

Having considered the question whether there continues to be a need for supplementary finance to meet unexpected shortfalls in export earnings as part of their review of the commodity stabilization problem, the Executive Directors conclude that different approaches to the problem are desirable and can be mutually reinforcing.

The Executive Directors note that the United Nations Trade and Development Board is considering a scheme proposed by the World Bank staff and certain other suggestions for dealing with the problem of providing supplementary finance to meet unexpected shortfalls in export earnings of developing countries.

The Executive Directors consider that the Bank should continue to collaborate with the United Nations Trade and Development Board in its deliberations to formulate measures for supplementary finance.

Annex A

UNCTAD I: Recommendation A.IV.18: Supplementary Financial Measures

A

The Conference,

Recognizing that adverse movements in the export proceeds of developing countries can be disruptive of development, and noting that the International Monetary Fund (IMF) can make available balance-of-payments support to help meet the short-term effects of shortfalls in export proceeds,

Recommends that the International Bank for Reconstruction and Development be invited to study the feasibility of a scheme with the objective set forth in section I below and based on the principles set forth in section II below, and, if appropriate, to work out such a scheme.

I. Objective

1. The new scheme should aim to deal with problems arising from adverse movements in export proceeds which prove to be of a nature or duration which cannot adequately be dealt with by short-term balance-of-payments support. Its purpose should be to provide longer term assistance to developing countries which would help them to avoid disruption of their development programmes.

II. Principles

2. The scheme should be provided with resources by contributions from participating countries, shared between them on an equitable basis.

3. Developing countries only should be eligible for assistance from the scheme; such assistance should be on concessional and flexible terms.

4. The scheme should normally be applicable after a developing country had had recourse to the International Monetary Fund, under its compensatory financing facility, and it had been possible to make a full assessment of the nature, duration and implication of any adverse movement in the export proceeds of the developing country concerned.

5. An adverse movement for the purposes of the scheme should be regarded as a shortfall from reasonable expectations (see Note 1 below) of the level of export proceeds (including, in appropriate cases, invisible exports).

6. A prima facie case for assistance from the scheme should be established by reference to shortfalls from reasonable expectations and to their nature and duration (see Note 2).

7. Once a prima facie case has been established there should be an examination, under the International Development Association, of all relevant economic circumstances (see Note 3) in order to assess how far assistance from the scheme would be required and justified in order to help avoid disruption of development programmes. Subject to these points, assistance could cover a substantial proportion of a shortfall from reasonable expectations.

8. Resources for the scheme, which would be administered under the International Development Association, should be in the form of additional commitments, prescribed in advance, for contributions to the Association; all the major Part I member countries of the Association should contribute.

NOTES

Note 1. To the extent that these could be prescribed in advance they could be taken account of by developing countries for planning purposes.

Note 2. The following are offered as illustrative circumstances which might constitute a prima facie case for assistance from the scheme to a developing country:

- (i) If, following an IMF drawing in one year under its special compensatory financing facility, exports fall significantly below reasonable expectations in the second or third year.
- (ii) If, when the IMF drawings were due to be repaid, exports had not recovered sufficiently for this to be possible without disruption of development.
- (iii) If there were a significant shortfall in exports which the IMF adjudged at the outset to be other than of a short-term nature and the IMF had decided that it would be inappropriate for it to provide temporary balance-of-payments support.

Note 3. Among other matters, these would include adverse effects from significant rises in import prices.

Annex B

UNCTAD II: Resolution 30: Supplementary Financial Measures

1. The Conference reaffirms the objective of the proposal for Supplementary Financial Measures set out in Annex A.IV.18 to the Final Act of the first session of the Conference. This states that "the new scheme should aim to deal with problems arising from adverse movement in export proceeds which prove to be of a nature or duration which cannot adequately be dealt with by short-term balance-of-payments support. Its purpose should be to provide longer terms assistance to developing countries which would help them to avoid disruption of their development programmes".
2. Any measures devised to meet this need should, on the basis of appropriate criteria, which should, to the extent possible, be objective, provide reasonable assurance of help to protect a country's development plan or programme against the effects of export shortfalls, to the extent that they cannot be met by short-term balance-of-payments support.
3. The Conference expresses its appreciation of the report prepared by the staff of the International Bank for Reconstruction and Development; and of the reports of the Inter-governmental Group on Supplementary Financing. These reports have defined the issues involved and clarified many of them. The Conference agrees that further work is required to resolve some outstanding issues. The principal issues are:
 - (a) The definition and method of assessment of reasonable expectations;
 - (b) The scope, nature and acceptability of the understandings between the administering agency and individual participant countries on their development programmes and the policies to be adopted in order to carry them out;
 - (c) The measures to be taken by countries applying for assistance;
 - (d) The relationship between supplementary finance and the IMF Compensatory Financing Facility.
4. A matter requiring additional attention is how to determine in quantitative terms the disruption which has resulted from export shortfalls and consequently, what are the financial implications of proposals to meet the objectives of part A of recommendation A.IV.18.
5. Some of the issues set forth in paragraphs 3 and 4 above would arise not only from consideration of the IBRD staff Scheme but from consideration of other measures to meet the objectives of part A of recommendation A.IV.18, including those submitted to the Inter-governmental Group. Any additional proposals clearly responsive to the recommendation should receive due attention, with the aim of working out the most effective measures possible.

6. The Conference decides:

- (a) To continue in existence the Inter-governmental Group suitably expanded;
- (b) To request the Inter-governmental Group to consider and attempt to resolve the issues set forth in paragraphs 2 to 5 above;
- (c) In the light of the foregoing considerations to instruct the Inter-governmental Group to work out measures for supplementary finance;
- (d) To instruct the Inter-governmental Group to report thereon to the Trade Development Board as early as possible, and no later than its ninth session;
- (e) To direct the Trade and Development Board to study and take early action on the findings of the Inter-governmental Group, taking account of any proposals for action in the field of international commodity policy which may be submitted to the Board of Governors of the IBRD and the IMF on the basis of the studies which they have requested to be presented to them at their next annual meeting;
- (f) To instruct the Chairman of the Inter-governmental Group to report on its progress to the seventh session of the Trade and Development Board.

OFFICE MEMORANDUM

TO: Mr. Irving S. Friedman

FROM: N. A. Sarma

SUBJECT: Seminar on S.F.

DATE: April 14, 1969

APR 14 1969

/s/ N.A. Sarma

Attached hereto is (draft) Action Paper, and a draft
decision.

Attachment

W 1241

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

STABILIZATION OF PRICES OF PRIMARY PRODUCTS

ACTION EVALUATION PAPER NO. 9

SUPPLEMENTARY FINANCE

I. Introduction

1. The Bank Staff Study on Supplementary Financial Measures was forwarded to the U.N. Secretary-General in December 1965 as forming "the basis for a feasible solution to a problem of major importance", in response to a Recommendation of UNCTAD I which requested the Bank to study the feasibility of a scheme which "should aim to deal with problems arising from adverse movements in export proceeds which prove to be of a nature and duration which cannot adequately be dealt with by short-term balance of payments support" and, if appropriate, to work out a scheme. The background paper attached hereto gives a resume of the discussions that have taken place so far in UNCTAD I and UNCTAD II, and in the Inter-governmental Group set up by UNCTAD on Supplementary Finance, describes the main elements of the scheme proposed by the Bank Staff, as well as the critical comments made, and points out the relationship of Supplementary Finance to Commodity Arrangements.

2. The next session of the Inter-governmental Group, to be held during June 23 - July 4, 1969, is expected to finalize its Report, which would then be considered by the Trade and Development Board of UNCTAD at its session during August 26 - September 12, 1969.

3. This paper suggests a possible course of action that the Bank might take on supplementary finance in connection with the commodity study pursuant to the Rio Resolution.

watch paragraph numbering

DRAFT
N. A. Sarna
April 15, 1969

SUPPLEMENTARY FINANCIAL MEASURES

+ Introduction
→ A
I. Recommendations of UNCTAD I and UNCTAD II -
Discussions and Proposals in the Inter-governmental
Group

II Recommendation of UNCTAD I

4. In his statement at UNCTAD I on April 6, 1964, the Head of the United Kingdom delegation, the Rt. Hon. Edward Heath, commended the stabilization of commodity prices and supplementary financial assistance as among the key points before the Conference. On supplementary financial assistance he had this to say: "We recognize that balance-of-payments problems may arise in developing countries which call for special measures of assistance. Sharp falls in the export earnings of less developed countries, such as have occurred from time to time in commodity trade, can be disruptive of development. The International Monetary Fund offers certain facilities to meet the short-term effect of such falls. ... However, there is a risk that development may be disrupted as a result of longer term adverse movements in export receipts. In the distribution of the aid which we in the developed countries make available, whether bilateral or multilateral, we should perhaps take more account of these risks."

5. Recommendation A.IV.18 of the Conference on Supplementary Financial Measures (Annex A), the result of the initiative taken by the U.K. and Swedish delegations, was adopted by 106 votes to none, with ten abstentions (USSR and other Socialist Countries). The Recommendation requested the World Bank to

study the feasibility of a scheme which "should aim to deal with problems arising from adverse movements in export proceeds which prove to be of a nature ^{or} ~~and~~ duration which cannot adequately be dealt with by short-term balance of payments support", and, if appropriate, to work out such a scheme. An adverse movement was defined as a 'shortfall from reasonable expectations'. The purpose was "to provide longer-term assistance to developing countries which would help them to avoid disruption to their development programs". The recommendation was made recognizing that "adverse movements in the export proceeds of developing countries can be disruptive of development", and noting that "the IMF can make available balance of payments support to help meet the short-term effects of shortfalls in export proceeds". Australia, while voting in favor of the proposal for studies as to the feasibility of supplementary finance, expressed reservations about the desirability of financial measures as a means to dealing with long-term shortfalls in export receipts. France, while voting in favor of the Recommendation, did not accept the principle of what they termed long-term compensation of fluctuations in export earnings; in its view, the real solution was in the organization of primary produce markets, permitting the maintenance of stable and remunerative prices.

6 The Recommendation represented a consensus to which both developed market economy countries and developing countries subscribed. There was another draft resolution sponsored by fourteen developing country delegations. Recommendation A.IV.18 incorporates both, as separate parts. It is in response

to the first part of the Recommendation that the World Bank Staff proposed a Scheme for Supplementary Finance, to meet the problem of unexpected short-falls that are potentially disruptive of a developing country's development efforts. The basic approach of the World Bank Staff proposal is outlined in paragraphs 4-5 below. The Staff proposal was circulated to the Board in November 1965, and was forwarded to the U.N. in December 1965 as forming "the basis for a feasible solution to a problem of major importance". Since then, discussion has been focused on this in UNCTAD bodies and outside.

give reference in footnote

7. The Bank Staff Study proceeds on the premise that it is ^{desirable} necessary to provide countries, already short of foreign exchange because of their efforts to speed up the process of development, with a ready source of long-term assistance to enable them to maintain agreed development programs in the face of unforeseen adverse export movements that are beyond their control. It is important under the Bank Staff Scheme that the development programs and policies be internationally discussed and ^{agreed} supported. Thus, the Scheme seeks to assure prompt assistance - assistance that would be supplementary to and not a substitute for already existing forms of aid. While there is no implication that there should be binding commitments with respect to basic development assistance over a period, it is to be expected that the careful examination of development programs internationally would facilitate the flows of development capital.

8. In order to avail itself of this facility, a country would have to enter into an initial understanding with the administering agency as to what might be regarded as reasonable expectations for exports during a period

U R/65/174: November 15, 1965

covered by the country's development program and as to certain key aspects of its development program and policies. (The need for and feasibility of export projections are considered later, ^{designated international} The Agency would be reviewing the performance of the country periodically, to judge whether the country's performance is satisfactory enough for it to be eligible for assistance from the Scheme. A shortfall from reasonable expectations of export earnings, (as specified in an agreed export projection) occurring in a country which has been following the ^{agreed} policy understanding can be assumed to be beyond its control. This obviates a time-consuming study of the causes and consequences of such shortfall at the time it occurs. The Scheme would be a means of providing speedy assistance at the time of need, without being an automatic one. Thus, the Scheme does deal with the problem of uncertainty arising out of unexpected export shortfalls, but makes a clear distinction between certainty and automaticity.

111 Report of the Inter-governmental Group to UNCTAD II

9. An Inter-governmental Group on Supplementary Financing ^{1/-} was established by the Trade and Development Board in September 1966, to examine the Bank Staff Scheme and to submit a report (with such modifications to the Scheme as it might consider appropriate) as a means of achieving the objective set out in Part A of Recommendation A.IV.18 of the first Conference. ^{Bank staff members participated in these deliberations} At its third session held from October 30 to November 13, 1967, the Group adopted its Report which was forwarded direct to UNCTAD II. → →

1/ The members of the Group were: Argentina, Brazil, Ceylon, Federal Republic of Germany, France, Ghana, India, Japan, Poland, Sweden, U.A.R., U.K., U.S.A., and Yugoslavia. There was provision for two Eastern Group countries; one remained vacant.

as technical experts.

The general assessment of the Group given in this Report was as follows:

"A few members have stated that, in view of unresolved questions of some importance (and without prejudging the question whether the objectives set out in Recommendation A.IV.18 should be achieved by a scheme with the characteristics of that of the IBRD staff or in other ways), they are not as yet prepared to take a position. One member expressed the view that the Scheme would not be either a timely or a genuine solution to the basic problem - the instability and inadequacy of the export proceeds of developing countries - which in its opinion could only be dealt with efficaciously by a system of organization of markets for primary products. All other members of the Group believe that, although a number of questions, some of them important, require further consideration, the objective set out in Part A of the Recommendation can be achieved by a scheme with the essential characteristics of the IBRD Staff Scheme." The developing countries' members of the Group prepared a joint statement of their views, strongly endorsing all the essential elements of the Bank Staff Scheme, which was also circulated as a document of UNCTAD II.

IV Some Other Suggestions

10 Certain other proposals for avoiding the disruption of development programs made in the course of the Group's deliberations are noted in the ~~Report~~ *referred to above.* ~~Report, prepared by the Group in November 1967 and sent to UNCTAD II.~~ Each of these proposals is followed by extensive comments representing the views of most members of the Group who thought that none of these suggestions would adequately meet the objectives of UNCTAD Recommendation A.IV.18 on supplementary financing.

8. (a) Under one alternative the scheme would be operated on an ad hoc basis without the need for export projections and any prior understanding on policy matters. Under this suggestion also, however, a country wishing to avail itself of the scheme is expected to undertake to consult fairly regularly with the Agency administering supplementary finance about its development and economic policies. As for determining whether a decline in exports constituted a shortfall from reasonable expectations, this would be done by the administering agency ex post on the basis of certain established guidelines. When a country suffers a serious shortfall in export proceeds, the causes of the shortfall are to be examined in a speedy manner, and the amount and conditions of financial assistance are to be decided, taking into account the need of the country (possible disruption of the development program), its general performance and all relevant circumstances, as well as the availability of resources for the Agency. There would be close cooperation between the Agency and the Fund, possibly through a Joint Committee. The Joint Committee would receive and consider applications for both Compensatory financing and Supplementary financing.

9. (b) ^{*Suggested essentially the*} Another ~~is in terms of~~ refinancing ~~the~~ IMF drawings. According to one suggestion, the Agency would examine, at the request of the countries, the economic situation and performance of countries that had drawn from the Fund under Compensatory Financing Facility or had made ordinary Fund drawings to offset shortfalls of the same general character, so as to ascertain whether the country in question was making a reasonably effective effort to promote its own

in effect
economic development. The purpose of assistance under this suggestion would be to extend the period of repurchase of Fund drawings if the Agency took the view that the obligation to repurchase threatened disruption of its development program. *A variant of the suggestion was that* The Agency would also be empowered to provide assistance should a country's entitlement to draw from the Fund prove smaller than the amount of the shortfall.

Da. (C) The third is the proposal for organization of markets. One representative argued that a purely financial solution to problems arising from poor organization of trade relations between industrialized and developing countries would fail. In his view, an initiative with respect to Supplementary Finance would delay the work in the Fund and Bank in response to the Rio Resolution on Commodity Price Stabilization.

V Resolution of UNCTAD II on the Subject

11. In March 1968, UNCTAD II adopted the Resolution on Supplementary Financial Measures by 70 votes to none, with 8 abstentions (Socialist Countries) (Annex B). As recorded in the Report of the Second Conference, all representatives of LDC's who participated in discussions in Committee III (the Committee of the Conference that considered questions relating to finance) on this subject emphasized the need for a Supplementary Finance scheme, and many called for early establishment of a scheme on the lines of the Bank Staff Study. The representatives of some developed market economy countries also supported the majority assessment of the Inter-governmental Group. Representatives of a number of other developed market economy countries, however, had reservations

about the Bank Staff proposal; one of them felt that implementation of supplementary finance might detract from efforts to establish commodity stabilization agreements. Several references were made to the Bank and Fund studies in progress pursuant to the Resolution by the Boards of Governors of these institutions on stabilization of primary commodity prices.

12. The Resolution on Supplementary Financial Measures adopted at UNCTAD II reaffirms the objective of the proposal for Supplementary Financial Measures set out in A.IV.18 of the First Conference; it states that any scheme devised to meet this need should "provide reasonable assurance of help to protect a country's development plan or program against the effects of export shortfalls ..." It was decided to continue the Inter-governmental Group, suitably expanded, and the Group is requested to attempt to resolve certain outstanding issues enumerated in the Resolution. These are:

- (a) definition and method of assessment of reasonable expectations;
- (b) the scope of policy understandings; (c) measures to be taken by beneficiary countries; (d) relationship between Supplementary Finance and the Fund's Compensatory Financing Facility. This paper covers each of these issues, *among others!*

Denmark, speaking on behalf of the Nordic countries, recalled that they had come to the Conference with the hope that the principles elaborated in the Bank Staff Scheme and the Inter-governmental Group Report would be accepted; they would do everything possible in the future work of the Inter-governmental Group to make this a reality. The "deep disappointment" of the developing

Supplementary Finance

countries at lack of definitive progress with respect to ~~S.F.~~ at the Conference was expressed by Brazil and Ceylon speaking for the developing countries.

VI Present Status of Discussions

13. The expanded Inter-governmental Group has 26 members.^{1/} The fourth session - first one of the expanded group - was held in Geneva from October 21 - 25, 1968, and was intended to be preparatory for the next session to be held during June 23 - July 4, 1969. According to the Resolution adopted by UNCTAD II, the next session is to conclude the work of the Group, and the final Report of the Group would be considered by the Trade and Development Board at its ninth session during August 26 - September 12, 1969. The Group has requested the UNCTAD Secretariat, the Bank Staff, and the Fund Staff to furnish additional material and advice.

14. In the discussions in the Inter-governmental Group, and at UNCTAD II, critical comments were made by some of the main donor countries on certain aspects of the Scheme put forward by the Bank Staff. In brief, it was argued that the policy understandings were likely to involve duplication with the work of other agencies and might raise difficulties for recipient countries of a political kind; that export projections for as long as 4 to 6 years could not be made with reliability and could not form the basis for financial

^{1/} Afghanistan, Argentina, Australia, Brazil, Canada, Ceylon, Chad, Chile, Federal Republic of Germany, France, Ghana, India, Italy (Spain in 1969), Japan, Nigeria, Pakistan, Poland, Sweden, Switzerland, Tunisia, United Arab Republic, United Kingdom of Great Britain and Northern Ireland, United States of America, Uruguay, Venezuela, Yugoslavia.

claims; that the cost estimates were not precise and seemed to envisage open-ended commitments for contributing countries; that there was no provision for adequate coordination with the Fund's Compensatory Financing Facility. There is also the important question of how Supplementary Finance fits into an overall or integrated approach with respect to the commodity problem, and the overlap, if any, between commodity price stabilization efforts and supplementary finance. These matters are dealt with in the following paragraphs.

II. Discussion of Main Elements of Bank Staff Proposal

Vii) Policy Understanding

15. With respect to the scope of policy understandings, and the frequency of consultations, it was noted in the ^{Bank Staff} Study: "The precise nature and degree of detail of such an understanding would vary considerably as among countries. Continuing contact would be maintained, moreover, between the administering agency and the country throughout the plan period in order to provide the basis for an assessment of the extent to which the agreed criteria of performance were currently being fulfilled or needed adjustment in the light of changing circumstances". The "policy package" would have to be in broad macro-economic terms, including understandings in particular about export earnings, public and private investment and domestic savings; implementation would be left to continuous working relations between a country and the Agency, made necessary in any case by the needs of nearly all developing countries for external assistance, including assistance from international financial institutions. The policy understanding would not be confined to the export sector only, because the factors and policies

becoming more common

affecting exports arise in all sectors of the economy. It was emphasized by the Bank Staff *in the several meetings on the proposal* that, in general, the policy understanding represents what a country discusses ~~and agrees upon~~ with donor countries and international institutions about its development program when it seeks basic development finance. *but that understanding on these matters were,* Available data, experience and assessments arising from consortia and consultative group discussions, the work in the World Bank Group and in the Fund, were to be fully utilized. In evaluating the development programs of countries for purposes of supplementary finance, the Agency, if separate, could avail itself especially of the experience of the World Bank Group. Similarly, the Agency could avail itself of the advice of the Fund on matters falling within the field of the Fund's responsibilities.

16. A multilateral institution, like the World Bank Group, while concerned with the obtaining and allocation of its resources, has a wider perspective, i.e. the improved performance of a developing country in the mobilization and effective use of its resources, domestic and external. Given this broad framework of approach, however, there cannot be uniformity for all countries. One or another aspect may have to be considered in depth depending on the situation of a particular country. It may be fiscal matters in one case; in another, the working of public enterprises. In a third, it may be the foreign exchange mechanism. In considering and evaluating performance, flexibility is essential, seeking the crucial or key elements for a given country, in a certain situation. No one will argue, for example, that monetary or fiscal policies can be fixed over time. In any case, not all eventualities can be visualized at this stage; procedures would have to evolve in the light of actual experience. Above all, policy understandings

within the framework of UNCTAD and otherwise

would be predicated on and involve mutual cooperation and contacts between a member country and the administering agency. A certain confidence in international agencies, created and run by governments, is needed by both developed and developing countries to enable them to function effectively, especially in assessing economic performance.

17. After ~~an~~ extensive ^{discussions} exchange of views, the developing countries have come to accept by and large the underlying purposes of policy understandings and the manner they would be arrived at and implemented, whatever their initial misgivings ^{may have been}. Thus, for the first time, the need for performance evaluation ^{and commitments thereon} on the basis of international consultations, so important in the field of development finance and urged so long by the donor countries, came to be discussed openly, and a certain approach was formulated to which the LDC's have indicated willingness in principle to subscribe. The conclusion of the Inter-governmental Group on Policy Understanding in its Report of November 1967, expresses general agreement "that a policy understanding should be part of the Scheme", and "it was generally agreed that consultations might be broadly along the lines of those conducted by international financial institutions".

VIII

Export Projections

18. A feature of the Scheme proposed by the Bank Staff is an understanding between the administering agency and the country on an export projection for a period over which the country has formulated a development program. The export projection indicates the amounts of foreign exchange which the country may reasonably ^{assume will be available from} ~~anticipate earning from~~ its exports in each year of this period. The projections are based on informed assumptions regarding world trade developments, and on the understanding that certain ^{domestic} policies would be followed.



*To handle unforeseen
short falls*



An export projection is a way of utilizing available information combined with the most plausible assumptions about the future circumstances in order to estimate future export earnings on which to base a development program. It is important to distinguish such projections from predictions of what will in fact occur in the future. Hence, it is not a valid criticism to point out that projections turn out to be 'wrong' in any particular case. In fact, if every projection were to prove 'right', i.e. if it were an accurate prediction, a scheme like ~~this~~ would not be needed. The essential point relates to the defense of a development program from deviations in earnings from anticipated exports on the basis of which the program had been formulated -- a viewpoint fully in accord with the original UNCTAD.

*Resolution as well as private and public practice in investment
decision making in all parts of the world.*

19. Such projections, together with other items affecting foreign exchange availability, would be required by developing countries, irrespective of supplementary finance, in order to judge the feasibility of their development programs. Export projections are built into development programs in two ways: the development program contains commitments to certain policy actions on which the projections are based, especially in export policies; the development program in turn is based on the export projection and is tested for financial feasibility on the basis of anticipated export earnings and other sources of development finance.

20. In suggesting a five-year projection period, to coincide with the normal length of a development plan, limitations of available techniques of projection over that long a period were recognized. However, *most developed* today countries are accustomed to making export projections to provide a basis on which investment programs can be built. The Bank Staff's considerable experience in this field suggests that such five-year projections are feasible.

The quality of projections can, of course, be improved by sharpening analytical tools and strengthening the basis for technical judgments, and this is being attempted in the World Bank in any case. However, whatever the improvement in projection techniques, this would not eliminate the problem of unexpected shortfalls because unpredictable changes in a country's export situation and in the world economy will continue to take place.

21. ^{desirability of periodic} The question has been raised relating to the revision of export ^{say every year or every two years,} projections. The viewpoint in the Bank Staff Study is that during the operation of a development plan, the underlying export projection should not be subject to revision except when changed conditions justify a major readjustment of the investment pattern and of the development strategy, because investment calculations must be based on export projections.

Whether or not such a major readjustment is required would be determined in consultations between the Agency and the country concerned. Revisions in export projections would be made when the development program itself has to be reformulated due to circumstances other than an export shortfall, ^{such as} ~~such as~~ ^{major change} a serious gap in development aid, fundamental change in export prospects, etc. During discussions, a consensus has been emerging that a rough mid-term review of the development program might be appropriate; this would also make it possible to review export projections as well as increase their reliability. This can be reconciled with the Bank Staff view in that such a review would help to defend development programs in an 'orderly' way; one can see then what can be done to raise more resources -- domestic and external -- and also evaluate the changes in export outlook more precisely, and act accordingly.

IX Cost Estimates

22. Given an agreed projection of export proceeds on which the country's development program is based, the financial assistance which a country can expect from the Scheme in the event of an export shortfall may be determined by comparing the actual exports with the projected exports. The idea is put forward in the Scheme that such financial assistance should be related to the amount of shortfalls -- the amounts by which actual exports fall short of projected exports in particular years -- net of "overages", i.e. the amounts by which actual exports exceed projected exports in other years within the same planning period.

23. In the Bank Staff Study, a simulation exercise was carried out, comparing merchandise export projections for individual countries made by the Bank Staff for various periods with the actual export earnings of the same countries in the corresponding years. 'Global' gross shortfalls were derived from this. Overages and drawings under the IMF's Compensatory Financing Facility were allowed for. Then, several other adjustments were made to arrive at an estimate that would indicate the financing requirements of the Agency. They were the number of developing countries likely to utilize the Scheme in the initial years, the likely improvement in the methodology and use of export projections as compared to the periods of the simulation exercise, the extent to which the developing countries would be expected to meet shortfalls on their own and, finally, the possible contribution to meet export shortfalls from sources of finance other than the IMF Compensatory Facility. Under the Supplementary Finance Scheme, a developing country is expected to meet the problem of an unexpected export shortfall to some extent with its own means, which include the use of some

part of its foreign exchange reserves and internal adjustments involving a reduction in demand for foreign exchange. It is understood that these measures could be undertaken in a number of cases without disrupting the development effort in which the country was engaged. Although the extent to which each individual country could do so would vary from case to case, an attempt was made to assess the probable order of magnitude of the effort which might be considered reasonable when all developing countries are grouped together.

24. Given the nature of the problem, it was not possible to quantify these factors in any exact way. On the other hand, to estimate even the rough order of magnitude of the amount of resources needed to run the Agency during an initial period, it was necessary to attribute some orders of magnitude to the different factors mentioned above. On this basis, it was estimated that an annual average of \$300 - \$400 million for the initial five years,

would have to be covered by the Agency administering Supplementary Finance. It was emphasized in the Study that the quantification of financial requirements and of the various factors involved was rough; no precise calculations were possible because the Scheme was novel and historical data were only useful in helping to judge magnitudes but were by no means certain indicators. The intent was to arrive at an estimate of finance for the Scheme with which the Scheme might reasonably be expected to operate successfully in the initial period, for the purposes set out in the Recommendation.

25. In the course of discussions in the Inter-governmental Group, the cost estimates furnished in the Bank Staff Study were questioned on

~~several~~ ^{the} grounds; that →

- (1) Long-term ~~export~~ projections cannot provide a basis for financial claims and obligations;
- 2) (2) the underlying data did not take into account experience in more recent years; *larger*
- (3) (the difference between estimated export shortfalls and the cost estimate was large; *and larger*)
- (4) (the Scheme seemed to be an open-ended one, and claims might prove to be larger than the cost estimates provided for.)

26. However, the conclusion of the Inter-governmental Group on costs reads: "It was widely agreed that the estimate of \$300-\$400 million per year of the World Bank Staff provided the basis for arriving at a figure with which the Scheme might reasonably be expected to operate successfully in the initial period." During the discussions in the Group, it clearly emerged that a scheme of this kind could, however, not be open-ended. It had to envisage a fixed fund that was considered adequate and reasonable, and, therefore, the possibility of rationing *had to* should be kept in mind. The Bank Staff agreed with this view.

27. The Bank Staff have now examined the cost estimates again, taking into account also available data for more recent years, i.e. up to 1967, as requested by the Inter-governmental Group. There is now a much longer period (11 years) for which data are available. Using the method described above in para. 23, the Bank Staff now estimate the financial requirements at \$250 mn.- \$300 mn. per annum for five years. As recommended by the Inter-governmental Group, *a fixed fund* ~~a fixed fund of about \$1,200 mn. to \$1,500 mn.~~ could be set up (partly in cash contributions and the rest as a readily available line of credit as was indicated in the original study by the Bank Staff

and referred to during discussions in the Inter-governmental Group), and the Agency entrusted with the Scheme be asked to manage it within that total for five years. All discussions on the subject have explicitly assumed that the funds for such a Scheme would be additional to other available development resources.

XI

Administering Agency

28. The Resolution of UNCTAD I on Supplementary Finance envisaged administration of the Scheme under the IDA, with resources contributed by the major Part I member countries of the Association in the form of additional commitments, prescribed in advance. The 1965 Bank Staff Study did not address itself to the question of Administering Agency; throughout, the reference was only to the Agency. It was believed that it was desirable first to discuss the substance of the proposal made by the Staff. *The Report of the Inter-Governmental Group of November 1967 proposed the general agreement in the Inter-governmental Group that the IBRD Group would be the most appropriate for the administration of the Scheme. In fact, the Inter-governmental Group at its fourth session (October 1968) asked the Bank: to what extent can the Bank Staff Scheme be implemented by the Bank and IDA within their existing Articles of Agreement, if the Executive Directors so agreed and if the necessary funds were made available.*

*anywhere
has
purpose
referred*

The Report of the

Inter-Governmental Group of November 1967 proposed the general agreement in the Inter-governmental Group that the IBRD Group would

III. Relationship between Supplementary Finance and Compensatory Financing Facility of the Fund

XI Supplementary Finance and Compensatory Financing Facility of the Fund
~~Purpose and Method~~

29. An important question that has come up frequently in the course of discussions relates to the relationship of the proposal for Supplementary Finance to the Compensatory Financing Facility of the Fund. The Compensatory Financing Facility helps to even out the availability of exchange earnings

from exports for a member country and thus assists a country in meeting temporary, reversible, balance of payments deficits, on the understanding that the drawings would be repaid by the country within ~~an outer limit of~~ 3-5 years; the Fund recommends earlier repayment by a country when its export earnings exceed the trend value. The Supplementary Finance Scheme, on the other hand, has developmental objectives: it is intended to assist a developing country to maintain its development program which might otherwise be disrupted by a shortfall of export earnings from reasonable expectations on which the development program was based. The proposal for Supplementary Finance has been made because countries cannot undertake development programs with a longer term perspective unless there is some assurance that their export earnings would correspond to reasonable expectations. In brief, it may be said that Compensatory Financing Facility has to do with instability or short-term fluctuations in export earnings, and Supplementary Finance with uncertainty of export earnings, ~~i.e. losses in export earnings~~ ~~which are not the result of temporary, reversible, factors.~~ Another difference is that in Compensatory Finance the emphasis is on the simple fact of a downward fluctuation; in Supplementary Finance it is on the causes of the change and its impact on the development process.

30. The different purposes of the two are reflected in the method of calculating export shortfalls. Under the Supplementary Finance Scheme, export prospects are considered in the context of a development program and take account not only of various objective factors, domestic and external, but also the impact of new policy measures. Attempt is made to estimate future export eventualities over a planning period of, say, five years, on which a developing country can rely in formulating and implementing its

development program. The shortfall in export earnings is measured from a prior export projection for a future period. Under the Compensatory Financing Facility, the Fund meets requests for drawings by members whose export proceeds over the latest twelve-month period have fallen short of the estimated medium-term trend value of exports. The shortfall in export earnings is measured from a norm representing the medium-term trend value, ^{estimate} ~~derived~~ from a statistical formula as well as a qualitative judgment. The statistical formula attaches a weight of .50 to exports in the shortfall year and .25 to each of the two preceding years; the qualitative estimate involves a direct forecast of exports for two years ahead. Formerly, the statistical and qualitative estimates were given about equal weight in determining trend value of exports; currently a somewhat greater weight is given to qualitative estimates. But, "the average level of exports for the two years following the shortfall year will not be assumed to exceed by more than 10 percent the average level experienced in the preceding two years ..."^{1/} It is precisely because the trend or norm is a moving average for five years centered on the current shortfall year as the middle year that a rough balancing of shortfalls and surpluses of actual exports with respect to trend is expected over a relatively short period of time.

Refinancing of Compensatory Financing Facility

31. It was noted earlier that during the deliberations of the Intergovernmental Group, a view of Supplementary Finance was put forward in terms of possible refinancing of drawings under the Fund Compensatory Financing Facility: The different purposes of the two facilities would indicate that

^{1/} II Report by the IMF on Compensatory Financing and Export Fluctuations, p. 8.

any refinancing of Compensatory Financing Facility, while it may be deemed desirable in certain instances, could not be an alternative or substitute way of dealing with the problem for which Supplementary Finance has been proposed. Both at UNCTAD I and UNCTAD II, there were distinct recommendations on Compensatory Financing, and refinancing of Compensatory Finance drawings forms part of the content of these resolutions. The Recommendations on Supplementary Finance are separate, and are intended to deal with another problem. ~~The fulfillment of the repurchase obligation under Compensatory Financing may result in disruption of a country's development program. In some such cases refinancing may be desirable, but would involve very limited amounts.~~

32. If the resources of the Fund were available to meet export shortfalls as defined in the Supplementary Finance Scheme, it would help to avoid the disruption of an agreed development program; then, the amounts drawn in the Fund would likely be much larger and the ability of the country to repurchase in 3-5 years much less, as the country would not be expected to cut back, if necessary, its development effort to a level making possible the fulfillment of a medium-term repurchase obligation to the Fund. Thus, it is the mode of determining the shortfall that is critical -- it is not a question of techniques, but one of purpose.

IV. Commodity Arrangements and Supplementary Finance

X II Commodity Agreements: Elements of:

33. The Commodity Problem is described briefly thus in the joint study "The Problem of Stabilization of Prices of Primary Products", Part I, by the Staffs of the Fund and the Bank: "The developing countries are

heavily dependent on primary products for most of their exports: currently, 88 percent of their export earnings are derived from primary product sales. Furthermore, these exports are concentrated on a narrow range of products: almost one-half of these countries depend on one commodity for more than 50 percent of their total exports and as many as three-quarters derive more than 60 percent of their total exports from three primary commodities. As a result, the export earnings of the developing countries, with their crucial influence on import capacity and development potential, are heavily dependent on the prices and trading opportunities prevailing in world commodity markets. With limited but important exceptions, these markets have shown two major unfavorable characteristics. First, their absorptive capacity has grown only slowly, so that increased sales have often been possible only at falling prices. Second, these markets have been subject to particularly wide price fluctuations, which have themselves sometimes contributed to adverse longer-term price trends. Demand for most primary products is growing relatively slowly as a result of both technological developments and changes in consumer spending patterns. Moreover, world trade in primary products, and particularly in agricultural products, has been held back by the protection given by industrial countries to their own primary producers."

34. The stabilization of prices of commodities through commodity arrangements and increased access to the markets of industrial countries represent the trade approach for influencing the foreign exchange receipts of developing countries. By reducing the amplitude of price fluctuations and by seeking to deal with the slow growth of demand for primary commodities, they help to improve the level and trend of export earnings. For years the need for commodity agreements has been recognized; their aims and essential features have been discussed extensively. However, it has been possible

to conclude only a few agreements. Access to markets has proved no more rapid to improve.

X III Fund and Bank Group Action in Financing of Stocks (Proposals)

35. The extensive study of the commodity problem in pursuance of the Rio Resolution by the Bank Staff and consideration by the Board in a series of Seminars have led to the recognition that:

- (1) The sound economic development of member countries can, under certain conditions, be effectively assisted by ~~feasible~~ *suitable* international commodity agreements providing, among other things, for the holding of commodity stocks in national or international hands;
- (2) that this would be among the guidelines for the World Bank Group in appraising economic performance and the needs of member countries for development financing; and
- (3) ~~(international)~~ buffer stocks may, under certain conditions, make a useful contribution to a reduction of the amplitude of short-term fluctuations in export earnings and thus help to promote the sound economic development of member countries.

While the Fund would (as proposed) use its Compensatory Financing Facility to provide short-term credit to member countries to facilitate their participation in international buffer stocks under suitable international commodity agreements, it would appear that member countries may also need to commit resources over a longer period for this purpose. The Bank Group, in considering its loans or credits to member countries, would (as proposed) take into account additional long-term capital requirements arising from countries' participation in such buffer stock schemes, while maintaining its customary lending standards, and as part of its normal lending operations.

36. It is also recognized that the holding of reserve stocks by members to prevent abnormal price increases of primary commodities may in some cases help improve the longer-term export earnings of developing countries; and, similarly, the holding of stocks of certain primary products by member countries over medium-to-long term periods, while production is being adjusted to demand, may support export earnings of developing countries from such products. According to the proposal under consideration, the Bank Group would take into account the additional need of countries for external borrowing from these purposes, in considering applications of member countries for development loans or credits.

37. Thus, the complexity of the commodity problem, as well as the limitations and framework under which international financial institutions function, require that a positive and realistic approach be adopted. We may now, appropriately, proceed to consider the relevance of this to Supplementary Finance.

XIV Commodity Agreements and Supplementary Finance

38. As for the relationship between Commodity Agreements and Supplementary Finance, progress in negotiating commodity agreements is likely to enable countries to have more accurate expectations of their export prices and hence, in part, of their earnings, on the basis of which to formulate their development programs. It has been observed in past periods that large export shortfalls occur when commodity prices fall. Buffer and other stock arrangements help to maintain better price stability. When a developing country depends on one or two commodity exports, and a degree of price stability is secured, this reduces a main factor of uncertainty in export earnings.

resulting from participation in international commodity agreements
Serving

Thus, effective commodity arrangements make for better export projections and reduce the cost of Supplementary Finance. This effect would depend on the number of commodities subject to agreements and the operative features of such agreements, especially in regard to export volume. However, even where a commodity agreement is effective, with stock management and other features, it is only a price range -- not a fixed price -- that is sought to be maintained. And, the other elements of uncertainty also remain. More important, however, is that insofar as commodity agreements take considerable time to negotiate and conclude, this effect of creating greater certainty of export earnings would be postponed. Other important elements are that a large number of successful commodity agreements cannot be expected to be concluded in the foreseeable future, for reasons fully explained in the Commodity Seminars; thus, at most, they would not cover a large part of the earnings of many countries from all their exports, so that there would still remain the problem for which Supplementary Finance Scheme was designed.

39. The fact that there is some overlap between the area that may be covered by commodity agreements and the area covered by supplementary financial measures ~~has sometimes been~~ ^{might be} interpreted to imply that the adoption of supplementary financial measures might inhibit efforts to conclude commodity agreements. This is not justified for a number of reasons. One reason is that primary product exporting LDC's have an advantage in earning foreign exchange from their own exports, subject to commodity agreements, rather than by obtaining foreign exchange from Supplementary Finance Scheme as a loan, even if these loans were to be provided on concessional terms. Secondly, supplementary financial measures are only concerned with the extent to which actual export earnings are close to their expected values, and not

with whether the expected earnings are stable or unstable. Finally, while commodity arrangements have a certain impact described above on Supplementary Finance, they have other, important, objectives: viz. to improve the trend of the export earnings of countries, especially by regulating international trade in particular commodities.

40. Thus, Compensatory Finance Facility and Supplementary Finance Scheme, the former to meet the volatility aspect of export earnings, and involving essentially short-term assistance, and the latter to meet the uncertainty aspect and involving essentially long-term assistance, would also be needed, however optimistic assumptions are made about the future of international commodity agreements. These financial arrangements and commodity agreements become complementary to one another and reinforce their effectiveness mutually, so that development programs of countries can go forward uninterrupted by export shortfalls resulting from causes beyond their control and to which they cannot adapt by taking domestic measures only without major setbacks to their development efforts.

It is only for those very few countries that depended to a very large proportion (say, two-thirds or more) of their foreign exchange earnings on one or two commodities and those commodities were covered by effective international commodity agreements that the need for supplementary finance would be of minor importance.

XV. Conclusions and Recommendation

41. It is not suggested that the World Bank Group at this time give its views on all aspects of the proposals made with respect to Supplementary Finance. What might be done is for the World Bank Group to indicate its attitude on the relation between the commodity problem and Supplementary Finance; more particularly, after its review of the commodity problem, whether there still remains a need for a Supplementary Finance Scheme. The various papers prepared for the Commodity Seminar and the discussions held would indicate that the problem of uncertainty to which the Supplementary Finance Scheme and suggested amendments thereof are addressed will still remain, however optimistic the assumptions which may be made about the future of international commodity arrangements. It is assumed that the Bank staff would continue to collaborate as it has in the past with the deliberations being held under the auspices of UNCTAD, including providing the requested information and analysis. In light of this there is appended hereto a proposed action which might be taken by the Bank as part of the Commodity Study now being done.

A P P E N D I X

The World Bank Group has considered the question of whether there continues to be a need for Supplementary Finance to meet unexpected shortfalls in export earnings, in the light of its discussions and recommendations on Commodity Stabilization. The World Bank Group believes that the problem of unexpected shortfalls will remain for the foreseeable future. The World Bank Group notes that the United Nations Trade and Development Board is considering a scheme proposed by the World Bank Staff and certain other suggestions for dealing with this problem. The World Bank Group will continue to collaborate with the United Nations Trade and Development Board in its deliberations on this matter.

Annex A

UNCTAD I: Recommendation A.IV.18: Supplementary Financial Measures

A

The Conference,

Recognizing that adverse movements in the export proceeds of developing countries can be disruptive of development, and noting that the International Monetary Fund (IMF) can make available balance-of-payments support to help meet the short-term effects of shortfalls in export proceeds,

Recommends that the International Bank for Reconstruction and Development be invited to study the feasibility of a scheme with the objective set forth in section I below and based on the principles set forth in section II below, and, if appropriate, to work out such a scheme.

I. Objective

1. The new scheme should aim to deal with problems arising from adverse movements in export proceeds which prove to be of a nature or duration which cannot adequately be dealt with by short-term balance-of-payments support. Its purpose should be to provide longer term assistance to developing countries which would help them to avoid disruption of their development programmes.

II. Principles

2. The scheme should be provided with resources by contributions from participating countries, shared between them on an equitable basis.
3. Developing countries only should be eligible for assistance from the scheme; such assistance should be on concessional and flexible terms.

4. The scheme should normally be applicable after a developing country had had recourse to the International Monetary Fund, under its compensatory financing facility, and it had been possible to make a full assessment of the nature, duration and implications of any adverse movement in the export proceeds of the developing country concerned.
5. An adverse movement for the purposes of the scheme should be regarded as a shortfall from reasonable expectations (see Note 1 below) of the level of export proceeds (including, in appropriate cases, invisible exports).
6. A prima facie case for assistance from the scheme should be established by reference to shortfalls from reasonable expectations and to their nature and duration (see Note 2).
7. Once a prima facie case has been established there should be an examination, under the International Development Association, of all relevant economic circumstances (see Note 3) in order to assess how far assistance from the scheme would be required and justified in order to help avoid disruption of development programmes. Subject to these points, assistance could cover a substantial proportion of a shortfall from reasonable expectations.
8. Resources for the scheme, which would be administered under the International Development Association, should be in the form of additional commitments, prescribed in advance, for contributions to the Association; all the major Part I member countries of the Association should contribute.

NOTES

Note 1. To the extent that these could be prescribed in advance they could be taken account of by developing countries for planning purposes.

Note 2. The following are offered as illustrative circumstances which might constitute a prima facie case for assistance from the scheme to a developing country:

- (i) If, following an IMF drawing in one year under its special compensatory financing facility, exports fall significantly below reasonable expectations in the second or third year.
- (ii) If, when the IMF drawings were due to be repaid, exports had not recovered sufficiently for this to be possible without disruption of development.
- (iii) If there were a significant shortfall in exports which the IMF adjudged at the outset to be other than of a short-term nature and the IMF had decided that it would be inappropriate for it to provide temporary balance-of-payments support.

Note 3. Among other matters, these would include adverse effects from significant rises in import prices.

B

The Conference also recommends that the continuing machinery recommended by this Conference be invited to study and organize further discussion of the following concepts and proposals for financing put forward by the delegations of the developing countries at the Conference:

1. That a fund be set up, financed by contributions from developed countries, as required, and administered by an appropriate agency of the United Nations;
2. That only developing countries should be eligible to draw from the Fund;
3. That disbursements should be in the form of non-reimbursable transfers and/or contingent loans on concessional terms;

4. That the criteria used in deciding upon claims should be as objective as possible and should include the following;

(a) The effect of shortfalls in export earnings and the adverse movements in the terms of trade;

(b) The effect on the country's development programme;

5. That to complement this longer term approach, facilities be provided for interim financing, when warranted, to assist the developing countries concerned while the longer term problem is being assessed.

Annex B

UNCTAD II: Resolution 30: Supplementary Financial Measures

1. The Conference reaffirms the objective of the proposal for Supplementary Financial Measures set out in Annex A.IV.16 to the Final Act of the first session of the Conference. This states that "the new scheme should aim to deal with problems arising from adverse movement in export proceeds which prove to be of a nature or duration which cannot adequately be dealt with by short-term balance-of-payments support. Its purpose should be to provide longer term assistance to developing countries which would help them to avoid disruption of their development programmes".

2. Any measures devised to meet this need should, on the basis of appropriate criteria, which should, to the extent possible, be objective, provide reasonable assurance of help to protect a country's development plan or programme against the effects of export shortfalls, to the extent that they cannot be met by short-term balance-of-payments support.

3. The Conference expresses its appreciation of the report prepared by the staff of the International Bank for Reconstruction and Development; and of the reports of the Inter-governmental Group on Supplementary Financing. These reports have defined the issues involved and clarified many of them. The Conference agrees that further work is required to resolve some outstanding issues. The principal issues are:

- (a) The definition and method of assessment of reasonable expectations;
- (b) The scope, nature and acceptability of the understandings between the administering agency and individual participant countries on their development programmes and the policies to be adopted in order to carry them out;
- (c) The measures to be taken by countries applying for assistance;

- (d) The relationship between supplementary finance and the IMF Compensatory Financing Facility.

4. A matter requiring additional attention is how to determine in quantitative terms the disruption which has resulted from export shortfalls and consequently, what are the financial implications of proposals to meet the objectives of part A of recommendation A.IV.18.

5. Some of the issues set forth in paragraphs 3 and 4 above would arise not only from consideration of the IBRD staff Scheme but from consideration of other measures to meet the objectives of part A of recommendation A.IV.18, including those submitted to the Inter-governmental Group. Any additional proposals clearly responsive to the recommendation should receive due attention, with the aim of working out the most effective measures possible.

6. The Conference decides:

- (a) To continue in existence the Inter-governmental Group suitably expanded;
- (b) To request the Inter-governmental Group to consider and attempt to resolve the issues set forth in paragraphs 2 to 5 above;
- (c) In the light of the foregoing considerations to instruct the Inter-governmental Group to work out measures for supplementary finance;
- (d) To instruct the Inter-governmental Group to report thereon to the Trade and Development Board as early as possible, and no later than its ninth session;
- (e) To direct the Trade and Development Board to study and take early action on the findings of the Inter-governmental Group, taking account of any proposals for action in the field of international commodity

policy which may be submitted to the Board of Governors of the IBRD and the IMF on the basis of the studies which they have requested to be presented to them at their next annual meetings;

- (f) To instruct the Chairman of the Inter-governmental Group to report on its progress to the seventh session of the Trade and Development Board.

OFFICE MEMORANDUM

TO: Mr. Irving S. Friedman

DATE: April 15, 1969

FROM: N. A. Sarma

N. A. Sarma

APR 15 1969

*lgm*SUBJECT: Board Seminar on Supplementary Finance

Attached hereto is (revised) draft paper incorporating your suggestions.

cc: Prof. Isaiah Frank
Mr. Sundrum

don't use

*mutuals like S.F. P
C.F.F. etc*

*Back of last page
for action*

SUPPLEMENTARY FINANCIAL MEASURES

Contents

paragraphs

- I. Recommendations of UNCTAD I and UNCTAD II -
Discussions and Proposals in the Inter-governmental
Group

1 - 14

Recommendation of UNCTAD I
Report of the Inter-governmental Group
to UNCTAD II
Some Other Suggestions
Administering Agency
Resolution of UNCTAD II on the Subject
Present Status of Discussions

- II. Main Features of Bank Staff Proposal

15 - 31

Assurance of Prompt Assistance
Policy Understanding
Export Projections
Cost Estimates

- III. Relationship between Supplementary Finance and
Compensatory Financing Facility of the Fund

32 - 35

Purpose and Method
Refinancing of C.F.F.

- IV. Commodity Arrangements, Financing of Buffer Stocks,
and Supplementary Finance

36 - 48

Commodity Agreements: Elements of
Price Stabilization and Buffer Stocks
Commodity Agreements and
Supplementary Finance

*1/ How many countries helped to
2/ What kinds of countries?*

SUPPLEMENTARY FINANCIAL MEASURES

I. Recommendations of UNCTAD I and UNCTAD II -
Discussions and Proposals in the Inter-governmental Group

Recommendation of UNCTAD I

1. In his statement at UNCTAD I on April 6, 1964, the Head of the United Kingdom delegation, the Rt. Hon. Edward Heath commended the stabilization of commodity prices and supplementary financial assistance as among the key points before the Conference. On supplementary financial assistance he had this to say: "We recognize that balance-of-payments problems may arise in developing countries which call for special measures of assistance. Sharp falls in the export earnings of less developed countries, such as have occurred from time to time in commodity trade, can be disruptive of development. The International Monetary Fund offers certain facilities to meet the short-term effect of such falls. However, there is a risk that development may be disrupted as a result of longer term adverse movements in export receipts. In the distribution of the aid which we in the developed countries make available, whether bilateral or multilateral, we should perhaps take more account of these risks."

2. Recommendation A.IV.18 of the Conference on Supplementary Financial Measures (Annex A), the result of the initiative taken by the U.K. and Swedish delegations, was adopted by 106 votes to none, with ten abstentions (USSR and other Socialist Countries).

Wald

The Recommendation requested the Bank to study the feasibility of a scheme which "should aim to deal with problems arising from adverse movements in export proceeds which prove to be of a nature and duration which cannot adequately be dealt with by short-term balance of payments support", and, if appropriate, to work out such a scheme. An adverse movement was defined as a 'shortfall from reasonable expectations'. The purpose was "to provide longer-term assistance to developing countries which would help them to avoid disruption to their development programs". The recommendation was made recognizing that "adverse movements in the export proceeds of developing countries can be disruptive of development", and noting that "the IMF can make available balance of payments support to help meet the short-term effects of shortfalls in export proceeds". Australia, while voting in favor of the proposal for studies as to the feasibility of supplementary finance, expressed reservations about the desirability of financial measures as a means to dealing with long-term shortfalls in export receipts. France, while voting in favor of the Recommendation, did not accept the principle of ~~what they termed~~ long-term compensation of fluctuations in export earnings; in its view, the real solution was in the organization of primary produce markets, permitting the maintenance of stable and remunerative prices.

3. The Recommendation represented a consensus to which both developed market economy countries and developing countries subscribed. There was another draft resolution sponsored by fourteen developing country delegations.

The main elements of the World Bank staff proposal are outlined in paras below.

Recommendation A.IV.18 incorporates both, as separate parts. It is in response to the first part of the Recommendation that the World Bank Staff proposed a Scheme for Supplementary Finance, to meet the problem of unexpected shortfalls that are potentially disruptive of a developing country's development efforts. It was forwarded to the U.N. in December 1965 as forming "the basis for a feasible solution to a problem of major importance". Since then, discussion has been focussed on this in UNCTAD bodies and outside.

note cumulative Part

Report of the Inter-governmental Group to UNCTAD III

4. An Inter-governmental Group on Supplementary Financing^{1/} was established by the Trade and Development Board in September 1966, to examine the Bank Staff Scheme and to submit a report (with such modifications to the Scheme as it might consider appropriate) as a means of achieving the objective set out in Part A of Recommendation A.IV.18 of the first Conference. At its third session held from October 30 to November 13, 1967, the Group adopted its Report which was forwarded direct to UNCTAD II.

should examine Bank Staff proposal members

5. The General assessment of the Group was as follows: "A few members have stated that, in view of unresolved questions of some importance (and without prejudging the question whether the objectives set out in Recommendation A.IV.18 should be achieved by a scheme with the characteristics of that of the IBRD staff

when reported?

whose parenthesis marked

to whom assessment sent

1/ The members of the Group were: Argentina, Brazil, Ceylon, Federal Republic of Germany, France, Ghana, India, Japan, Poland, Sweden, U.A.R., U.K., U.S.A., and Yugoslavia.

? plus one vacancy?

or in other ways), they are not as yet prepared to take a position. One member expressed the view that the Scheme would not be either a timely or a genuine solution to the basic problem -- the instability and inadequacy of the export proceeds of developing countries -- which in its opinion could only be dealt with efficaciously by a system of organization of markets for primary products. All other members of the Group believe that, although a number of questions, some of them important, require further consideration, the objective set out in Part A of the Recommendation can be achieved by a scheme with the essential characteristics of the IBRD Staff Scheme." The developing countries' members of the Group prepared a joint statement of their views, strongly endorsing all the essential elements of the Bank Staff Scheme, which was also circulated as a document of UNCTAD II.

Some Other Suggestions

*When make
storage
after Res?*
6. Certain other proposals for avoiding the disruption of development programs are noted in the Report. *which was sent to UNCTAD II* Each of these proposals is followed by extensive comments representing the views of most members of the Group who thought that none of these suggestions would adequately meet the objectives of UNCTAD Recommendation A.IV.18 on supplementary financing.

7. Under one alternative, *put forward by the representative of the* Federal Republic of Germany, the scheme would be operated on an ad hoc basis without the need for export projections and any prior understanding on policy matters. Under this suggestion also, however, a country wishing to avail itself of the scheme is expected to undertake to consult fairly regularly with the Agency *at monthly supplementary finance* about its development and economic policies. As for determining whether a decline in exports constituted a shortfall from reasonable expectations, this

would be done by the administering agency ex post on the basis of certain established guidelines. When a country suffers a serious shortfall in export proceeds, the causes of the shortfall are to be examined in a speedy manner, and the amount and conditions of financial assistance are to be decided, taking into account the need of the country (possible disruption of the development program), its general performance and all relevant circumstances, as well as the availability of resources for the Agency. There would be close co-operation between the Agency and the Fund, possibly through a Joint Committee. The Joint Committee would receive and consider applications for both Compensatory financing ^(CFF) and Supplementary financing. ^(SP)

8. Another is in terms of refinancing the IMF drawings. ^{The U.S.} ~~representative~~ ^{me} seemed inclined to this viewpoint. According to this suggestion, ^{the Agency would examine}, at ^{their} request, the economic situation and performance of countries that had drawn from the Fund under CFF or had made ordinary ^{Fund} drawings to offset shortfalls of the same general character, so as to ascertain whether the country in question was making a reasonably effective effort to promote its own economic development. The purpose of assistance under this suggestion would be to extend the period of repurchase of Fund drawings if the Agency took the view that the obligation to repurchase threatened disruption of its development program. The Agency would also be empowered to provide assistance should a country's entitlement to draw from the Fund prove smaller than the amount of the shortfall.

9. The third is the proposal for organization of markets. ^{The} ~~The~~ French representative argued that a purely financial solution to problems arising from

stet
what?

reference?

It was believed that it was desirable first to discuss the substance of the proposal made by the Staff.

- 6 -

poor organization of trade relations between industrialized and developing countries would fail. In his view, an initiative with respect to S.F. would delay the work in the Fund and Bank in response to the Rio Resolution on Commodity Price Stabilization.

at least up to Rio?

Administering Agency

10. The Resolution of UNCTAD I on S.F. envisaged administration of the Scheme under the IDA, with resources contributed by the major Part I member countries of the Association in the form of additional commitments, prescribed in advance. The 1965 Bank Staff Study did not address itself to the question of Administering Agency; throughout the reference was only to the Agency. In the proposal put forward by ~~the~~ ^{me} representative of the Federal Republic of Germany, ~~the~~ ^{it set forth in para 3 above} administration was to be entrusted to one of the existing institutions with wide experience and authority, preferably IBRD/IDA. There was general agreement in ICG that the IBRD Group would be the most appropriate for the administration of the Scheme. In fact, a main question addressed by the Group ~~to~~ ^{was} to what extent can the Bank Staff Scheme be implemented by the Bank and IDA within their existing Articles of Agreement, if the Executive Directors so agreed and if the necessary funds were made available.

delete?

?

when? asked

open and

of March 1968

Resolution of UNCTAD II on the Subject

11. UNCTAD II adopted ~~the~~ ^a Resolution on Supplementary Financial Measures by 70 votes to none, with 8 abstentions (Socialist Countries) (Annex B). As recorded in the Report of the Second Conference, all representatives of LDC's

when? when

Describe very brief ^{was} what is Committee III

who participated in discussions in Committee III on this subject emphasized the need for a S.F. scheme, and many called for early establishment of a scheme on the lines of the Bank Staff Study. The representatives of some developed market economy countries also supported the majority assessment of the Inter-governmental Group. Representatives of ^a ~~many~~ ^{number of} other developed market economy countries, however, had reservations about the Bank Staff proposal; some of them felt that implementation of supplementary finance might detract from efforts to establish commodity stabilization agreements. Several references were made to the Bank and Fund studies in progress pursuant to the Resolution by the Boards of Governors of these institutions on stabilization of primary commodity prices.

12. The Resolution on Supplementary Financial Measures adopted at UNCTAD II reaffirms the objective of the proposal for Supplementary Financial Measures set out in A.IV.18 of the First Conference; it states that any scheme devised to meet this need should "provide reasonable assurance of help to protect a country's development plan or program against the effects of export shortfalls" It was decided to continue the Inter-governmental Group, suitably expanded, and the Group is requested to attempt to resolve certain outstanding issues enumerated in the Resolution. Denmark, speaking on behalf of the Nordic countries, recalled that they had come to the Conference with the hope that the principles elaborated in the Bank Staff Scheme and the IGG Report would be accepted; they would do everything possible

at these enumerated anywhere

This paper covers for main issues

in the future work of the Inter-governmental Group to make this a reality.

words used?
copy

The deep disappointment of the developing countries at lack of definitive progress with respect to S.F. at the Conference was expressed by Brazil and Ceylon, on behalf of the Group of '77'.

Present Status of Discussions

13. The expanded Inter-governmental Group has 26 members.^{1/} The fourth session - first one of the expanded group - was held in Geneva from October 21 - 25, 1968, and was intended to be preparatory for the next session to be held during June 23 - July 4, 1969. The next session is likely to conclude the work of the Group, and the final Report of the Group would be considered by the Trade and Development Board at its ninth session during August 26 - September 12, 1969. The Group has requested the UNCTAD Secretariat, the Bank Staff, and the Fund Staff to furnish additional material and advice.

*Ref. UNCTAD
whose
view*

14. In the discussions in the Inter-governmental Group, and at UNCTAD II, critical comments by some of the main donor countries ~~have focussed on the~~ complexity of the Scheme put forward by the Bank Staff. ~~Specifically~~, it was argued that the policy understandings were likely to involve duplication with the work of other agencies and might raise difficulties for recipient countries

come earlier

[Handwritten signature]

^{1/} Afghanistan, Argentina, Australia, Brazil, Canada, Ceylon, Chad, Chile, Federal Republic of Germany, France, Ghana, India, Italy (Spain in 1969), Japan, Nigeria, Pakistan, Poland, Sweden, Switzerland, Tunisia, United Arab Republic, United Kingdom of Great Britain and Northern Ireland, United States of America, Uruguay, Venezuela, Yugoslavia.

of a political kind; that export projections for as long as 4 to 6 years could not be made with reliability and could not form the basis for financial claims; that the cost estimates were not precise and seemed to envisage open-ended commitments for contributing countries; that there was no provision for adequate coordination with the Fund's CFF. There is also the important question of how Supplementary Finance fits into an overall or integrated approach with respect to the commodity problem, and the overlap, if any, between commodity price stabilization efforts and supplementary finance. These matters are dealt with in the following sections of this paper.

II. Main Features of Bank Staff Proposal

Assurance of Prompt Assistance

15. The Bank Staff Study proceeds on the premise that it is necessary to provide countries, already short of foreign exchange because of their efforts to speed up the process of development, with a ready source of long-term assistance to enable them to maintain ^{agreed} their development programs in the face of unforeseen adverse export movements that are beyond their control. It is important under the Bank Staff Scheme that the development programs and policies be internationally discussed and supported. Thus, the Scheme seeks to assure prompt assistance - assistance that would be supplementary to and not a substitute for already existing forms of aid. While there is no implication that there should be binding commitments with respect to basic development assistance over a period, it is to be expected that the careful

** need to explain that "projection" - not a
free prediction - but a basic assumption, possibly
made that is necessary for any develop. or national
programming, whether public or private - certainly*

examination of development programs internationally would facilitate the *flows of development capital.* *flows of development capital*

16. In order to avail itself of such insurance, a country would have to enter into an initial understanding with the administering agency as to what might be regarded as reasonable expectations for exports during a period covered by the country's development program and as to certain key aspects of its development program and policies. The Agency would be reviewing the performance of the country periodically, to judge whether the country's performance is satisfactory enough for it to be eligible for assistance from the Scheme. A shortfall from reasonable expectations of export earnings, as specified in an agreed export projection, occurring in a country which has been following the policy understanding can be assumed to be beyond its control. This obviates a time-consuming study of the causes and consequences of such shortfall at the time it occurs. Thus, the Scheme would be a means of providing speedy assistance at the time of need, without being an automatic one. *thus* However, the Scheme does deal with the problem of uncertainty arising out of unexpected export shortfalls, *but does not make* One should make a clear distinction between greater certainty and automaticity. *of foreign exchange*

Ref to report from 1963

Policy Understanding

17. With respect to the scope of policy understandings, and the frequency of consultations, it was noted in the Study: "The precise nature and degree of detail of such an understanding would vary considerably as among countries. Continuing contact would be maintained, moreover, between the

made necessary in any case by the needs of nearly all developing countries for external assistance

administering agency and the country throughout the plan period in order to provide the basis for an assessment of the extent to which the agreed criteria of performance were currently being fulfilled or needed adjustment in the light of changing circumstances". The policy package would certainly be not easy to operate. It would have to be in broad macro-economic terms, including in particular about export earnings, public and private investment, and domestic savings; ~~and~~ implementation could be left to working relations between a country and the Agency. ~~Nor can~~ the policy understanding be confined to the export sector only; the factors and policies affecting exports arise in all sectors of the economy. It was further clarified by the Bank Staff that, in general, the policy understanding represents what a country discusses and agrees upon with donor countries and international institutions about its development program when it seeks basic development finance. Available data, experience and assessments arising from consortia and consultative group discussions, the work in the World Bank Group and in the Fund, were to be fully utilized. In evaluating the development programs of countries for purposes of supplementary finance, the Agency could avail itself especially of the experience of the World Bank. Similarly, the Agency could avail itself of the advice of the Fund on matters falling within the field of the Fund's responsibilities.

including the of external financial agencies

18. A multilateral institution, like the World Bank Group, while concerned with the allocation of its limited resources, has a wider perspective, i.e. the improved performance of a developing country in the mobilization and

obtaining and

effective use of its resources, domestic and external. Given this broad framework of approach, however, there cannot be uniformity for all countries. One or another aspect may have to be considered in depth depending on the situation of a particular country. It may be fiscal matters in one case; in another, the working of public enterprises. In a third, it may be the foreign exchange mechanism. In considering and evaluating performance, flexibility is essential, seeking the crucial or key elements for a given country, in a certain situation. No one will argue, for example, that monetary or fiscal policies can be fixed over time. In any case, not all eventualities ^{could be} can be visualized at this stage; in the light of actual experience, ^{would} procedures have to evolve. Above all, policy understandings ^{would be} are predicated on and involve mutual cooperation and contacts between a member country and the administering agency. A certain confidence in international agencies, created and run by governments, is needed to enable them to function effectively, especially in assessing economic performance.

19. ^{As a result of such} ~~On the basis of such~~ clarifications during discussions, the developing countries have come to accept by and large the underlying purposes of policy understandings and the manner they would be arrived at and implemented, whatever their initial misgivings. Thus, for the first time, the need for performance evaluation, on the basis of international consultations, so important in the field of development finance and urged so long by the donor countries, ^{came} ~~has come~~ to be discussed openly, and a certain approach ^{was} ~~has been~~ formulated to which the LDC's themselves ^{have indicated} ~~are~~ willing to subscribe. This is a

by both developed and developing countries

in principle

above
major gain from S.F. discussions to the wider area of external development and flows. The conclusion of the Inter-governmental Group on Policy Understanding expresses general agreement "that a policy understanding should be part of the Scheme", and "it was generally agreed that consultations might be broadly along the lines of those conducted by international financial institutions".

Export Projections

20. A feature of the Scheme proposed by the Bank Staff is an understanding between the administering agency and the country on an export projection for a period over which the country has formulated a development program. The export projection indicates the amounts of foreign exchange which the country may reasonably anticipate earning from its exports in each year of this period. The projections are based on informed assumptions regarding world trade developments, and on the understanding that certain policies would be followed.

above (see what they are not)
[In considering the need for export projections, it is useful to go back to Recommendation A.IV.18: that the scheme should aim to deal with problems arising from "adverse movements in export proceeds" so as to avoid the disruption of development programs; an adverse movement should be regarded as a shortfall from reasonable expectations of the level of export proceeds. Note 1 to the Resolution further suggested that "to the extent these (i.e. reasonable expectations) could be prescribed in advance they could be taken account of by developing countries for planning purposes".] *should be earlier*
The essential point is that

the
the UNCTAD Resolution is concerned with defense of a development program from deviations in earnings from anticipated exports on the basis of which the program had been formulated.

a viewpoint completely in accord with the original UNCTAD Resolution

21. Such projections, together with other items affecting foreign exchange availability, would be required by developing countries, irrespective of supplementary finance, in order to judge the feasibility of their development programs. Export projections are built into development programs in two ways: the development program contains commitments to certain policy actions on which the projections are based, especially in export policies; the development program in turn is based on the export projection and is tested for financial feasibility on the basis of anticipated export earnings and other sources of development finance. *Is it* feasible to formulate development programs without export projections - how does one plan without some expectation with regard to resources available?

22. In suggesting a five-year projection period, to coincide with the normal length of a development plan, limitations of available techniques of projection over that long a period were recognized. However, today countries are accustomed to making export projections to provide a basis on which investment programs can be built. The Bank Staff's considerable experience in this field suggests that such five-year projections are feasible. The quality of projections can, of course, be improved by sharpening analytical tools and strengthening the basis for technical judgments, and this is being attempted in the World Bank in any case. However, whatever the improvement in projection

*expand to
shorter
no
any
projection*

*Domestic "misconceptions" - export
projections are "predetermined" - if jobs
would be created - never
right - no basis for them -*

techniques, this would not eliminate the problem of unexpected shortfalls because unpredictable changes in a country's export situation and in the world economy will continue to take place.

*discourage
"planning"
"planning"
not
necessary
or
desirable,
etc*

23. ~~There is~~ ^{has been raised} the question relating to the revision of export projections during the period of the plan. Frequent revisions would reduce the cost of the scheme; but such revision unrelated to a revision of the development program would vitiate the purpose of the scheme. The viewpoint in the Bank Staff Study is that during the operation of a development plan, the underlying export projection should not be subject to revision except when changed conditions justify a major readjustment of the investment pattern and of the development strategy, because investment calculations must be based on export projections. Whether or not such a major readjustment is required would be determined in consultations between the Agency and the country concerned. Revisions in export projections would be made when the development program itself has to be reformulated due to circumstances other than an export shortfall such as a serious gap in development aid, fundamental change in export prospects, etc. Further, in practice, a rough mid-term review of the development program might be appropriate; this would also make it possible to review export projections as well as increase their reliability.

*Explain
what
and
why
suggested*

See whether changes in export outlook likely to be larger than allowed in original program. The latter is possible.

Cost Estimates

24. Given an agreed projection of export proceeds on which the country's development program is based, the financial assistance which a country can expect from the Scheme in the event of an export shortfall may be determined

*at Commission
emphasizing
the
the*

not realistic

Review in substance - help to definet development program in orderly way. See what can be done because more domestic resources, what the amount of external capital available.

by comparing the actual exports with the projected exports. The idea is put forward in the Scheme that such financial assistance should be related to the amount of shortfalls -- the amounts by which actual exports fall short of projected exports in particular years -- net of "overages", i.e. the amounts by which actual exports exceed projected exports in other years within the same planning period.

25. In the Bank Staff Study, a simulation exercise was carried out, comparing merchandise export projections for individual countries made by the Bank Staff for various periods with the actual export earnings of the same countries in the corresponding years. 'Global' gross shortfalls were based on statistics for 14 countries from 1957 to 1963 and for 18 countries from 1959 to 1963. Aggregated average shortfalls from these two groups were expanded, by appropriate factors, so as to approximate average yearly estimates for all developing countries. These estimates indicated that the gross aggregate shortfalls of the developing countries could have amounted to between \$1 billion and \$2 billion per year. For convenience, instead of a wide range of figures, the Study adopted a single estimate, of \$1.6 billion per year, which was approximately at the midpoint of the range and corresponded most nearly to the experience of the larger, eighteen-country sample, in the most recent period (1959-63) for which data were available.

26. After crediting both overages and drawings under the IMF's Compensatory Financing Facility, the global net shortfall was placed at \$1.2 billion per year. (The range was \$900-1500 mn.) From this, several other adjustments were made to arrive at an estimate that would indicate the financing requirements of the

*would
merely
just factors
incident*

Agency. They were the number of developing countries likely to utilize the Scheme in the initial years, the likely improvement in the methodology and use of export projections as compared to the periods of the simulation exercise, the extent to which the developing countries would be expected to meet shortfalls on their own and, finally, the possible contribution to meet export shortfalls from sources of finance other than the IMF Compensatory Facility. Under the Supplementary Finance Scheme, a developing country is expected to meet the problem of an unexpected export shortfall to some extent with its own means, which include the use of some part of its foreign exchange reserves and internal adjustments involving a reduction in demand for foreign exchange. It is understood that these measures could be undertaken in a number of cases without disrupting the development effort in which the country was engaged. Although the extent to which each individual country could do so would vary from case to case, an attempt was made to assess the probable order of magnitude of the effort which might be considered reasonable when all developing countries are grouped together.

27. ~~It was~~ clear that, given the nature of the problem, it ~~was~~ not possible to quantify these factors in any exact way. On the other hand, to estimate even the rough order of magnitude of the amount of resources needed to run the Agency during an initial period, it ~~was~~ necessary to attribute some orders of magnitude to the different factors mentioned above. On this basis, it was estimated that the effect of taking these factors into account would be to reduce the net shortfalls of \$1.2 billion to an annual average of \$300 - \$400 million for the initial five years, which would have to be covered by the ~~Supplementary Finance Agency.~~ administrative supplementary finance

*Use model and the
closest historical data available
were useful in helping to judge
magnitudes but by no means
certain indicators.*

28. ~~It is necessary to emphasize, as was done in the Study, that the quantification of financial requirements and of the various factors involved is rough; no precise calculations are possible because the Scheme deals with the uncertain and the unpredictable. It may happen that, in the event, the actual needs for any year may prove to be either larger or smaller than estimated. Therefore, the estimate given in the Study cannot be taken as referring to the needs in each year, but as the annual average over an initial experimental period of five years, which corresponds to the normal duration of development programs. The cost estimate was only an order of magnitude derived from certain available data for a particular past period with such special features as might have characterized that period. There is no historical basis for making any precise estimate of future costs. The intent was to arrive at an estimate of finance for the Scheme with which the Scheme might reasonably be expected to operate successfully in the initial period, for the purposes set out in the Recommendation.~~

para on challenge of estimates
29. The conclusion of the Inter-governmental Group on costs reads:

"It was widely agreed that the estimate of \$300-\$400 million per year of the World Bank Staff provided the basis for arriving at a figure with which the Scheme might reasonably be expected to operate successfully in the initial period." During the discussions in the Group, it clearly emerged that a scheme of this kind could not be open-ended. It has to envisage a fixed fund that ~~is~~ *was* considered adequate and reasonable, and, therefore, the possibility of rationing has to be kept in mind.

*Using same criteria and techniques described here in para — ,
- 19 -
the book was structured*

30. The Bank Staff have now examined the cost estimates again, taking into account also available data for more recent years, i.e. up to 1967, as requested by the ICG. The data relate to 13 countries for the periods 1957-61 and 1961-67; 17 countries for the periods 1959-61 and 1961-67; and 24 countries for 1961-67. The range of (global) gross and net shortfalls derived from all these sets of data turns out to be wider than in the Bank Staff Study. The explanation lies mainly in the much longer period (11 years) for which data are available, and the considerable variation in circumstances prevailing during different sub-periods. The weighted average of total gross shortfalls works out to \$900 mn. (weighted average for 1961-67) - \$2200 mn. (weighted average for 1957-61). From this range, we derive an average estimate for the entire period of \$1.4 bn. for gross shortfalls. Adjusting for CFF transactions and overages, total net shortfalls are placed at an average of \$850 mn. for the entire period. Allowing for use of reserves and internal measures of adjustment, other (bilateral aid) sources for this purpose, better projections, and non-participation and non-qualifying on performance considerations of some countries, the financial requirements may be placed at \$250 mn. - 300 mn. on this basis.

31. Looking ahead, say, to the five years 1971-75, the requirements may seem to increase, with rising levels of exports and with fuller participation by developing countries. On the other hand, with greater accuracy of projections and due to the effect of the conclusion and working of commodity arrangements, the requirements would be reduced. For a 5-year period, then, a total of \$1500 mn.

All discussions on this subject have explicitly assumed that the funds for such a scheme would be additional to other available developed finance resources

should be adequate finance for the purpose. As recommended by the IGG, a fixed fund of this magnitude could be set up (partly in cash contributions and the rest as a readily available line of credit), and the Agency entrusted with the Scheme be asked to manage it within that total for five years.

3/6
ultra suggests this with elaborating

III. Relationship between Supplementary Finance and Compensatory Financing Facility of the Fund

Purpose and Method

32. An important question that has come up frequently in the course of discussions relates to the relationship of the proposal for Supplementary Finance to the Compensatory Financing Facility of the Fund. C.F.F. helps to even out the availability of exchange earnings from exports for a member country and thus assists a country in meeting temporary, reversible, balance of payments deficits, on the understanding that the drawings would be repaid by the country within an outer limit of 3-5 years; the Fund recommends earlier repayment by a country when its export earnings exceed the trend value. The burden of adjustment is thrown on the country itself, so as to be able to re-purchase within a short period, like in other regular Fund drawings. The Supplementary Finance Scheme, on the other hand, is intended to assist a developing country to maintain its development program which might otherwise be disrupted by a shortfall of export earnings from reasonable expectations on which the development program was based. The proposal for Supplementary Finance has been made because countries cannot undertake development programs with a longer term perspective unless there is some assurance that their export earnings would correspond to reasonable expectations. In brief, it may be said that CFF has to do with instability, and SFS with uncertainty of export earnings.

bordered mutual objectives: etc

a short-term fluctuation in

permanent losses

non-adj. report covering cannot due to temporary nature

Further differences that emerge from that the emphasis is on the simple fact of fluctuations & downward fluctuations. A supplementary finance scheme in the course of the downward change and its impact on the development process

to para 32

33. The different purposes of the two are reflected in the method of calculating export shortfalls. Under the Supplementary Finance Scheme, export prospects are considered in the context of a development program and take account not only of various objective factors, domestic and external, but also the impact of new policy measures. Attempt is made to estimate future export eventualities over a planning period of, say, five years, on which a developing country can rely in formulating and implementing its development program. The shortfall in export earnings is measured from a prior export projection for a future period. Under the Compensatory Financing Facility, the Fund meets requests for drawings by members whose export proceeds over the latest twelve-month period have fallen short of the estimated medium-term trend value of exports. Therefore, ~~CFF does not need a prior export projection~~; instead, the shortfall in export earnings is measured from a norm representing the medium-term trend value, derived from a statistical formula as well as a qualitative judgment. The statistical formula attaches a weight of .50 to exports in the shortfall year and .25 to each of the two preceding years; the qualitative estimate involves a direct forecast of exports for two years ahead. Formerly, the statistical and qualitative estimates were given about equal weight in determining trend value of exports; currently a somewhat greater weight is given to qualitative estimates. But, "the average level of exports for the two years following the shortfall year will not be assumed to exceed by more than 10 percent the average level experienced in the preceding two years ..."
It is precisely because the trend or norm is a moving average for five years centered on the current shortfall year as the middle year that a rough balancing

what are we getting

*needs substantially increased from which
being decreased*

of shortfalls and surpluses of actual exports with respect to trend is expected over a relatively short period of time.

Refinancing of C.F.F.

34. The different purposes of the two facilities would indicate that any refinancing of C.F.F., while it may be deemed desirable in certain instances, could not be an alternative or substitute way of dealing with the problem for which S.F. has been proposed. Both at UNCTAD I and UNCTAD II, there were distinct recommendations on Compensatory Financing, and refinancing of C.F. forms part of the content of these resolutions. The Recommendations on S.F. are separate, and are intended to deal with another problem.

35. Furthermore, some refinancing on a short-to-medium term basis is possible even under the existing Fund facility, for instance, by an ordinary drawing at the time of (compensatory) repurchase.^{1/} There is also the practical consideration that refinancing of C.F.F. would not be needed to any great extent; the (statistical) formula adopted for calculating the export shortfall for purposes of C.F.F. itself ensures that compensatory drawings are repurchased mostly within the three-to-five year period. Any outstanding balances have to be repurchased in the fifth year. The fulfilment of this obligation in the fifth year may result in disruption of a country's development program. *under Compensatory Financing* *The repurchase obligation* *is not a* *Re-* *financing, at that stage, desirable as it is, would involve very limited amounts -* *about \$20 mn. a year on an average.* *It is when the mode of determining the*

^{1/} II Report by the IMF on Compensatory Financing of Export Fluctuations, page 27.

If the Fund resources were available to meet shortfalls as designed directly by the type supplementary financing (over)

because it was ^{not} ~~was~~ ~~less~~ ~~than~~ ~~the~~ ~~amount~~

to ~~be~~ ~~maintained~~ ~~sufficient~~ ~~for~~ ~~the~~ ~~purpose~~ ~~of~~

an agreed development program,

then the amount drawn

with the Fund would ^{likely} ~~be~~ ~~be~~

much larger and the ability of the

country to repurchase in 3 to 5 years

greatly ~~likely~~ ~~to~~ ~~be~~ ~~much~~ ~~less~~

frequently because the country would
not be expected to cut back, if necessary,

its development effort to a level making

possible the fulfillment of a medium-

term repurchase obligation to the Fund.

it is not a question of technique, but one of purpose.

that is critical - 23 -

shortfall gets altered, especially if no weight were given to the shortfall year itself, and if the fixed term rule for repurchases is dropped in favor of repurchases out of export excesses without any time limit, that the refinancing need may arise to any extent. Again, in the Bank Staff Study itself, this question of refinancing was referred to with reference to any short-term indebtedness that a country may incur to meet part of the unexpected export shortfall; and it was suggested that if the S.F. Agency were to take up this function also, additional resources would be needed.

IV. Commodity Arrangements, Financing of Buffer Stocks, and Supplementary Finance

Commodity Agreements: Elements of:

36. The Commodity Problem is described briefly thus in the joint study "The Problem of Stabilization of Prices of Primary Products", Part I, by the Staffs of the Fund and the Bank: "The developing countries are heavily dependent on primary products for most of their exports: currently, 88 per cent of their export earnings are derived from primary product sales. Furthermore, these exports are concentrated on a narrow range of products: almost one-half of these countries depend on one commodity for more than 50 per cent of their total exports and as many as three-quarters derive more than 60 per cent of their total exports from three primary commodities. As a result, the export earnings of the developing countries, with their crucial influence on import capacity and development potential, are heavily dependent on the prices and trading opportunities prevailing in world commodity markets.

To sustain the development effort on confidence of agreement

as some have seemingly seen it

With limited but important exceptions, these markets have shown two major unfavorable characteristics. First, their absorptive capacity has grown only slowly, so that increased sales have often been possible only at falling prices. Second, these markets have been subject to particularly wide price fluctuations, which have themselves sometimes contributed to adverse longer-term price trends. Demand for most primary products is growing relatively slowly as a result of both technological developments and changes in consumer spending patterns. Moreover, world trade in primary products, and particularly in agricultural products, has been held back by the protection given by industrial countries to their own primary producers."

37. The stabilization of prices of commodities and increased access to the markets of industrial countries through commodity arrangements represent the trade approach for influencing the foreign exchange receipts of developing countries. By reducing the amplitude of price fluctuations and by seeking to deal with the slow growth of demand for primary commodities, they help to improve the level and trend of export earnings. For years the need for commodity agreements has been recognized; their aims and essential features have been discussed extensively. However, it has been possible to conclude only a few agreements. Access to markets has proved no less difficult.

~~Three main elements of commodity agreements may be noted:~~

- ~~(i) The multilateral contract feature under which importers and exporters agree to buy or sell certain agreed quantities; this is the main feature of the International Wheat Agreement;~~
- ~~(ii) The institution of an international buffer stock, that seeks to stabilize prices by buying when the world price falls below a certain minimum and by selling when the price rises above a~~

certain maximum; this is the main feature of the International Tin Agreement;

- (iii) Export restriction which provides for limiting exports, when needed, to maintain prices at a higher level; logically, this requires regulation of production. This is the main feature of the International Coffee Agreement.

The emphasis given to each of these elements differs in different agreements. However, price stabilization is a principal aim of commodity agreements; there is also some effort at stabilizing export volume.

Price Stabilization and Buffer Stocks

38. An international buffer stock is a useful device, in some commodity agreements and under appropriate safeguards, which can reinforce the effectiveness of export quotas and production controls. A buffer stock management attempts to even out fluctuations around a long-term trend; any attempt to improve the trend itself involves the regulation of production. No international buffer stock management and financing can be contemplated to sustain a continuing over-production; it can only help to facilitate the longer term adjustments needed in production by dealing with temporary phases of excess production or market shortages. A buffer stock cannot undertake to absorb all surpluses, but only up to quota limits, i.e. where a country has not been able to sell the quota specified for it.

As buffer stock operations involve absorbing surpluses or selling the commodity for cash, according to where the market price stands in relation

to an agreed price range, the buffer stock must have both the commodity and cash. While purchases have to be initially at floor prices, and sales at maximum prices set, quotas themselves may be variable and purchases and sales may be at declining or rising prices. At the same time, a buffer stock should have resources adequate to take care of normal swings in supply and demand, and to make an impression on buyers and sellers in the market about the management's ability to protect the price range. A buffer stock, as an instrument of a commodity agreement, has to be equipped with adequate funds, which may eventually be raised in various ways such as levies on producers and importers of a commodity. Initially for some period, while these resources are being built up, the buffer stock management requires some adequate finance - what may be termed prefinancing.

39. For various reasons connected with the nature of the primary commodities and their trading patterns, such finance has proved difficult to raise. International financial institutions are, therefore, being approached. What these institutions are called upon to consider, then, are not investments in stocks on a continuing basis, from which profits may be derived or on which losses may be incurred by them, but the provision of loan finance for buffer stock managements that may be set up for particular commodities - loans that would be repaid as their own resources get built up. It seems important that such initial financing has to be contemplated not always for short periods of 3-5 years but sometimes for somewhat longer terms so as to enable the buffer stock to build up its own resources by such means as levies on producers and consumers, and through any profits from sales, and repay the agency in convenient installments.

par. 38.
40.

need para based on literature

A inferring
of rules

- 27 -

40. The extensive study of the commodity problem in pursuance of the Rio Resolution by the Bank Staff and consideration by the Board in a series of Seminars have led to the recognition that:

1) The sound economic development of member countries can, under certain conditions, be effectively promoted by appropriate international commodity agreements providing, among other things, for the holding of commodity stocks in national or international hands; 2) (international) buffer stocks may, under certain conditions, make a useful contribution to a reduction of the of the amplitude of short-term fluctuations and thus help to promote the sound economic development of the member countries. While the Fund is proposing to use its Compensatory Financing Facility to provide short-term credit to member countries to facilitate their participation in international buffer stocks under suitable international commodity agreements, it is not certain yet whether the Bank Group, in considering its own loans or credits to member countries, would take into account additional long-term capital requirements due to countries' participation in such buffer stock schemes.

41. It is also recognized that the holding of reserve stocks by members to prevent abnormal price increases of primary commodities may in some cases help raise the longer-term export earnings of developing countries; and, similarly, holding of stocks of certain primary products by member countries over medium-to-long term periods, while production is being adjusted to demand, may contribute to raising export earnings of developing countries. However, as yet, there is no consensus whether the Bank Group should provide assistance for the holding of reserve or long-term stocks by developing countries.

392.

Thus, the complexity of the commodity problem, as well as the limitations and framework under which international financial institutions function, require that a positive ~~but~~ ^{and} realistic approach be adopted. We may now, appropriately, proceed to consider the relevance of this to Supplementary Finance.

Commodity Agreements and Supplementary Finance

43. As for the relationship between Commodity Agreements and Supplementary Finance, progress in negotiating commodity agreements is likely to enable countries to have more accurate expectations of their export prices and, hence, in part, of their earnings, on the basis of which to formulate their development programs. It has been observed in past periods that large export shortfalls occur when commodity prices fall. Buffer and other stock arrangements help to maintain better price stability. When a developing country depends on one or two commodity exports, and a degree of price stability is secured, this reduces a main factor of uncertainty in export earnings. Thus, effective commodity arrangements make for better export projections and reduce the cost of supplementary finance measures. This effect would depend on the number of commodities subject to agreements and the operative features of such agreements, especially in regard to export volume. ^{However} Even where a commodity agreement is effective, with stock management and other features, it is only a price range - not a fixed price - that is sought to be maintained. ~~and~~ ^{also} ~~the~~ ^{most important however, is that} other elements of uncertainty remain. ~~Also~~ ^{Also}, insofar as commodity agreements take considerable time to negotiate and conclude, this effect would be postponed.

more

of creating greater certainty of export earnings

*the other important elements are that a large number
successful commodity*

- 29 -

Even if a large number of commodity agreements are successfully concluded
in the foreseeable future for reasons fully explored in the Commodity Seminar,
over a period, they would not cover the ~~total~~ *total* earnings of many countries from
a large part of the
all their exports so that there would still be need for the Supplementary
Finance *scheme was designed.* *Remain the problem for which*
approach.

44. The fact that there is some overlap between the area that may be covered by commodity agreements and the area covered by supplementary financial measures has sometimes been interpreted to imply that the adoption of supplementary financial measures might inhibit efforts to conclude commodity agreements. This is not justified for a number of reasons. One reason is that primary product exporting LDC's have an advantage in earning foreign exchange from their own exports, subject to commodity agreements, rather than by obtaining foreign exchange from SFS as a loan, ~~subject to~~ *subject to* various conditions, even if these loans were to be provided on concessional terms. Secondly, supplementary financial measures are only concerned with the extent to which actual export earnings are close to their expected values, and not with whether the expected earnings are stable or unstable, ~~or whether~~ *or whether* ~~these expected earnings are rising fast enough or not.~~ Finally, while commodity arrangements have a certain impact described above on SFS, they have other, important, objectives: viz. to improve the trend of the export earnings of countries, especially by regulating international trade in particular commodities.

*Thus,
at it
has
not*

45. The stabilization of prices and markets for primary commodities could be attempted in a series of commodity agreements covering the main cereals, fibers, beverages, vegetable oils, rubber, minerals and metals. While there has been extensive discussion of the subject since prewar years, and several attempts to conclude agreements have been made, such agreements have proved possible only in a few cases; effective implementation has been even more limited. Through the removal of tariff and non-tariff obstacles to trade in these commodities, the developed countries can enlarge the market opportunities in their economies for exports of these commodities from less developed countries: there has been but limited progress in this direction too. Sustained growth of the economies of industrial countries would itself maintain and increase their demand for primary commodities. Basically, a measure of discipline both in the industrial (consuming) countries in regard to their production of some of these commodities and in producing countries by way of regulation of production and export quotas, is called for if commodity arrangements of one kind or another are to prove a practicable instrument. The building up of stocks and market operations based on them would be helpful. The complexities involved in production control among a number of countries, as well as the several problems pertaining to the financing of stocks, have been brought out in our own studies of the subject.

46. ^{These} Compensatory finance facility and supplementary financial assistance, the former to meet the volatility aspect of export earnings, and involving essentially short-term assistance, and the latter to meet the uncertainty aspect

resilient from causes
beyond their
control

However
even however optimistic
assumptions are
made about the future of
international commodity
agreements.

and involving essentially long-term assistance, would also be needed. These financial arrangements and commodity agreements become complementary to one another and reinforce their effectiveness mutually, so that development programs of countries can go forward uninterrupted by export shortfalls. In fact, in a rather pragmatic framework, over a period, one can visualize commodity agreements for some major commodities in which the developing countries are the chief exporters, and for the rest devise appropriate financial arrangements to take care of the levels of total export earnings of developing countries.

47. The commodity problem essentially reflects the low level of economic development of LDC's and arises from the slow growth (and stagnation) of demand for many primary commodities over the long run. Only sustained economic growth is the real solvent, which results in a gradual diversification and expansion of their export trade and reduces the undue dependence of many of these economies on one or two commodities. The growth and diversification of exports in turn is predicated on correcting the structural imbalances in these economies and promoting productive efficiency. Diversification can only be partly in the agricultural sector itself, especially toward food production, in view of the serious food shortages developing in several less developed areas; where possible, the development of (non-ferrous) minerals and timber resources would help. But, it should certainly be in part through industrialization, so as to secure continued improvement in export earnings from manufactures. Thus, the commodity problem cannot be dealt with apart from or in isolation from the larger, basic, development problem.

skipped

arts which they cannot take domestic
means only without their own efforts
efforts.

48. Thus viewed, commodity agreements and supplementary finance proposals may be seen to be complementary, in pursuance of the same objectives that derive essentially from the requirements of long-term economic growth. S.F. itself is more directly related to development finance, and requires administrative and technical expertise as much in the development field as in the commodity field.

Prinle Bank action -

(see the side)

To facilitate Geneva discussion ~~to~~
~~viewing~~, prinle Bank ^{action} ~~discuss~~
full reform of prinle policy stated by
Board -

possible
centered need for separate Geneva ~~and~~ ~~discuss~~
~~at~~ possible draft discussion

Action

- ① Endorse principal of S.F. ^{Group} ~~in favor~~
UN WBO
 - ② Indicate willingness to manage,
and subject relationship with IMF
 - ③ Need for additional resources -
relief in limit to resources -
 - ④ If WB group could use ~~any~~
established vehicles of lending
 - (5) If countries desire, WB prepared to
consider in detail formulation of S.F.S
repealing Bretton Woods, country
suggestion, more recent experience, ^{Export}
of currency ^{Facility} and ^{the} least
feasible ~~with~~ ~~and~~ ~~deterring~~ for
arrangement to ^{the} ~~its~~ ^{members} ~~the~~
participation is explicit from countries not ^{fully}
and include ^{the} ~~the~~ ^{question} of ~~the~~ ^{members}
Bret
- (Relationships Capacity Training of IMF)

OFFICE MEMORANDUM

TO: Mr. Irving S. Friedman

DATE: January 15, 1969

FROM: N. A. Sarma

*N. A. Sarma*SUBJECT: Supplementary Financial Measures:A Paper for Board Seminars on Commodity Problems

Attached hereto is a (draft) paper on S.F., as desired.

Section I gives the background, and the current stage of discussions. Section II deals with the main elements of the Bank Staff Scheme. The relationships of S.F. to C.F.F. and to Commodity arrangements are discussed in Sections III and IV.

You may please indicate if this should be circulated to any others.

SUPPLEMENTARY FINANCIAL MEASURES

	<u>Paragraphs</u>
I. <u>Recommendations of UNCTAD I and UNCTAD II -</u> <u>Discussions in the Inter-governmental Group</u>	1-11
Recommendation of UNCTAD I Report of the Inter-governmental Group Resolution of UNCTAD II on the Subject Present Status of Discussions	
II. <u>Major Features of Bank Staff Proposal -</u> <u>Objectives and Methods</u>	12-26
Assurance of Prompt Assistance Policy Understanding Export Projections and Shortfalls Cost Estimates	
III. <u>Relationship Between Supplementary Finance and</u> <u>Compensatory Financing Facility of the Fund</u>	27-30
Purpose and Method Refinancing of C.F.F.	
IV. <u>Commodity Arrangements, Financing of Buffer Stocks,</u> <u>and Supplementary Finance</u>	31-42
Commodity Agreements: Elements of Price Stabilization and Buffer Stocks Commodity Agreements and Supplementary Finance A Coordinated Approach: a Common Agency	

SUPPLEMENTARY FINANCIAL MEASURES

I. Recommendations of UNCTAD I and UNCTAD II - Discussions in the Inter-governmental Group

Recommendation of UNCTAD I

1. In his statement at UNCTAD I on April 6, 1964, the Head of the United Kingdom delegation, the Rt. Hon. Edward Heath commended ten key points to the Conference: the stabilization of commodity prices and supplementary financial assistance were two among the ten. On supplementary financial assistance he had this to say: "We recognize that balance-of-payments problems may arise in developing countries which call for special measures of assistance. Sharp falls in the export earnings of less developed countries, such as have occurred from time to time in commodity trade, can be disruptive of development. The International Monetary Fund offers certain facilities to meet the short-term effect of such falls. However, there is a risk that development may be disrupted as a result of longer term adverse movements in export receipts. In the distribution of the aid which we in the developed countries make available, whether bilateral or multilateral, we should perhaps take more account of these risks."

2. Recommendation A.IV.18 of the Conference on Supplementary Financial Measures (Annex A), the result of the initiative taken by the U.K. and Swedish delegations, was adopted by 106 votes to none, with ten abstentions (USSR and other Socialist countries). As Mr. Heath noted with satisfaction in his statement before the Conference on June 16, 1964, ".... all the developed countries with market economies found it possible to

accept it". Australia, while voting in favor of the proposal for studies as to the feasibility of supplementary finance, expressed reservations about the desirability of financial measures as a means to dealing with long-term shortfalls in export receipts. France, while voting in favor of the Recommendation, did not accept the principle of (what they termed) long-term compensation of fluctuations in export earnings; in its view, the real solution was in the organization of primary produce markets, permitting the maintenance of stable and remunerative prices.

3. Intensive discussions took place on the matter in the Committee and informally among individual delegations, and in the Steering Group for the Conference that had been set up to take up major questions at issue. The U.K. - Swedish draft was modified, mainly to take note of import prices, to clarify 'reasonable expectations', and to invite the IBRD first to study the feasibility of the scheme and then, if appropriate, to work out a scheme. This was a concensus to which both developed market economy countries and developing countries subscribed. There was another draft resolution sponsored by fourteen developing country delegations; this was modified, asking the UNCTAD continuing machinery to undertake the study of concepts and proposals contained therein. Recommendation A.IV.18 incorporates these two (revised) drafts, as separate parts. It is in response to the first part of the Recommendation that the World Bank Staff proposed a Scheme for Supplementary Finance, to meet the problem of unexpected shortfalls that are potentially disruptive of a developing country's development efforts. It was forwarded to the U.N. in December 1965 as forming "the basis for a feasible solution to a problem of major importance". Since then, discussion has been focussed on this in UNCTAD bodies and outside; Part B of the Recommendation has received little attention.

4. The Recommendation requested the Bank to study the feasibility of a scheme which "should aim to deal with problems arising from adverse movements in export proceeds which prove to be of a nature and duration which cannot adequately be dealt with by short-term balance of payments support". An adverse movement was defined as a 'shortfall from reasonable expectations'. The purpose was "to provide longer-term assistance to developing countries which would help them to avoid disruption to their development programs". The recommendation was made recognizing that "adverse movements in the export proceeds of developing countries can be disruptive of development", and noting that "the IMF can make available balance of payments support to help meet the short-term effects of short-falls in export proceeds".

Report of the Inter-governmental Group to UNCTAD II

5. An Inter-governmental Group on Supplementary Financing^{1/} was established by the Trade and Development Board in September 1966, to examine the Bank Staff Scheme and to submit a report (with such modifications to the Scheme as it might consider appropriate) as a means of achieving the objective set out in Part A of Recommendation A.IV.18 of the first Conference. At its third session held from October 30 to November 13, 1967, the Group adopted its Report which was forwarded direct to UNCTAD II.

1/ The members of the Group were: Argentina, Brazil, Ceylon, Federal Republic of Germany, France, Ghana, India, Japan, Poland, Sweden, U.A.R., U.K., U.S.A., and Yugoslavia.

6. The general assessment of the Group was as follows: "A few members have stated that, in view of unresolved questions of some importance (and without prejudging the question whether the objectives set out in Recommendation A.IV.18 should be achieved by a scheme with the characteristics of that of the IBRD staff or in other ways), they are not as yet prepared to take a position. One member expressed the view that the Scheme would not be either a timely or a genuine solution to the basic problem--the instability and inadequacy of the export proceeds of developing countries--which in its opinion could only be dealt with efficaciously by a system of organization of markets for primary products. All other members of the Group believe that, although a number of questions, some of them important, require further consideration, the objective set out in part A of the recommendation can be achieved by a scheme with the essential characteristics of the IBRD Staff Scheme." The developing countries' members of the Group prepared a joint statement of their views, strongly endorsing all the essential elements of the Bank Staff Scheme, which was also circulated as a document of UNCTAD II.

7. Certain other proposals for avoiding the disruption of development programs are noted in the Report: under one suggested alternative the scheme would be operated on an ad hoc basis without the need for export projections and any prior understanding on policy matters; another is in terms of refinancing the IMF drawings; and a third is the proposal for organization of markets. Each of these proposals is followed by extensive comments representing the views of most members of the Group who thought that none of these suggestions would adequately meet the objectives of the UNCTAD Recommendation A.IV.18 on supplementary financing.

Resolution of UNCTAD II on the Subject

8. UNCTAD II adopted the Resolution on Supplementary Financial Measures by 70 votes to none, with 8 abstentions (Socialist countries) (Annex B). As recorded in the Report of the Second Conference, all representatives of LDC's who participated in discussions in Committee III on this subject emphasized the need for a S.F. Scheme, and many called for early establishment of a scheme on the lines of the Bank Staff Study. The representatives of some developed market economy countries also supported the majority assessment of the Inter-governmental Group. Representatives of many other developed market economy countries, however, had reservations about the Bank Staff proposal; some of them felt that implementation of supplementary finance might detract from efforts to establish commodity stabilization agreements. Several references were made to the Bank and Fund studies in progress pursuant to the Resolution by the Boards of Governors of these institutions on stabilization of primary commodity prices.

9. The Resolution on Supplementary Financial Measures adopted at UNCTAD II reaffirms the objective of the proposal for Supplementary Financial Measures set out in A.IV.18 of the First Conference; it states that any scheme devised to meet this need should "provide reasonable assurance of help to protect a country's development plan or program against the effects of export shortfalls" It was decided to continue the Inter-governmental Group, suitably expanded, and the Group is requested to attempt to resolve certain outstanding issues enumerated in the Resolution. The Secretary-General of UNCTAD stated at the Conference that, in the high level Contact Group of the Conference, in reply to a

query by a LDC representative, three representatives of developed countries clearly stated that the Bank Staff Scheme was not superseded or set aside by this Resolution. Denmark, speaking on behalf of the Nordic countries, recalled that they had come to the Conference with the hope that the principles elaborated in the World Bank Staff Scheme and the IGG Report would be accepted; they would do everything possible in the future work of the Inter-governmental Group to make this a reality. The deep disappointment of the developing countries at lack of definitive progress with respect to S.F. at the Conference was expressed by Brazil and Ceylon, on behalf of the Group of '77'.

Present Status of Discussions

10. The expanded Inter-governmental Group has 26 members.^{1/} The fourth session - first one of the expanded group - was held in Geneva from October 21 - 25, 1968, and was intended to be preparatory for the next session to be held during June 23 - July 4, 1969. The next session is likely to conclude the work of the Group, and the final Report of the Group would be considered by the Trade and Development Board at its ninth session during August 26 - September 12, 1969. The Group has requested the UNCTAD Secretariat, the Bank Staff, and the Fund Staff to furnish additional material and advice.

11. In the discussions in the Inter-governmental Group, and at UNCTAD II, critical comments by some of the main donor countries have focussed on the complexity of the scheme put forward by the Bank Staff.

1/ Afghanistan, Argentina, Australia, Brazil, Canada, Ceylon, Chad, Chile, Federal Republic of Germany, France, Ghana, India, Italy (Spain in 1969), Japan, Nigeria, Pakistan, Poland, Sweden, Switzerland, Tunisia, United Arab Republic, United Kingdom of Great Britain and Northern Ireland, United States of America, Uruguay, Venezuela, Yugoslavia.

Specifically, it was argued that the policy understandings were likely to involve duplication with the work of other agencies and might raise difficulties for recipient countries of a political kind; that export projections for as long as 4 to 6 years could not be made with reliability and could not be a basis for financial claims; that the cost estimates were not precise and seemed to envisage open-ended commitments for contributing countries; that there was no provision for adequate coordination with the Fund's CFF. There is also the important question of how Supplementary Finance fits into an overall or integrated approach with respect to the commodity problem, and the overlap, if any, between commodity price stabilization efforts and supplementary finance. These matters are dealt with in the following sections of this paper.

II. Major Features of Bank Staff Proposal: Objectives and Methods

Assurance of Prompt Assistance

12. The Bank Staff Study proceeds on the premise that the UNCTAD Recommendation recognizes the need to provide countries, already short of foreign exchange because of their efforts to speed up the process of development, with a ready source of long-term assistance to enable them to maintain their development programs in the face of unforeseen adverse export movements that are beyond their control and beyond their ability to offset from their own reserves or to finance on a short-term repayable basis. It is important under the Bank Staff Scheme that the development programs and policies be internationally discussed and supported. Thus, the scheme set forth in the Bank Staff Study seeks to assure prompt assistance - assistance that would be supplementary to and not a substitute for already existing forms of aid. At the same time, while there is no implication that there should be binding commitments with respect to basic development assistance over a period, it is to be expected that the careful examination of development programs internationally would facilitate the flows of development capital.

13. In order to avail itself of such insurance, a country would have to enter into an initial understanding with the administering agency as to what might be regarded as reasonable expectations for exports during a period covered by the country's development program and as to certain key aspects of its development program and policies. A purpose of drawing up a policy understanding is to have a way of determining whether a short-fall is due to factors beyond the control of a country or not. The Agency would be reviewing the performance of the country periodically, to judge

whether the country's performance is satisfactory enough for it to be eligible for assistance from the Scheme. A shortfall occurring in a country which has been following the policy understanding can be assumed to be beyond its control. If these matters are agreed to between the agency and the country at the beginning of a planning period, and so long as the country adheres to the terms of such an understanding, it can be presumed that any shortfall from reasonable expectations of export earnings, as specified in the agreed export projection, is one for which the country is eligible to receive assistance from the Agency, without a time-consuming study of the causes and consequences of such shortfall at the time it occurs. Thus, the Scheme would be a means of providing speedy assistance at the time of need, without being an automatic one. However, the Scheme does deal with the problem of uncertainty arising out of unexpected export shortfalls. One should make a clear distinction between greater certainty and automaticity.

Policy Understanding

14. With respect to the scope of policy understandings, and the frequency of consultations, the Study itself noted: "The precise nature and degree of detail of such an understanding would vary considerably as among countries. Continuing contact would be maintained, moreover, between the administering agency and the country throughout the plan period in order to provide the basis for an assessment of the extent to which the agreed criteria of performance were currently being fulfilled or needed adjustment in the light of changing circumstances". The policy package would certainly be not easy to operate. The policy understanding could be in broad macro-economic terms, including in particular about export

earnings, public and private investment, and domestic savings; and implementation could be left to working relations between a country and the agency. Nor can the policy understanding be confined to the export sector only; the factors and policies affecting exports arise in all sectors of the economy. It was further clarified by the Bank Staff that, in general the policy understanding represents what a country discusses with and agrees upon with donor countries and international institutions about its development program when it seeks basic development finance. Available data, experience and assessments arising from consortia and consultative group discussions, the work in the World Bank Group and in the Fund, were to be fully utilized. In evaluating the development programs of countries for purposes of supplementary finance, the agency could avail itself especially of the experience of the World Bank. Similarly, the agency could avail itself of the advice of the Fund on matters falling within the field of the Fund's responsibilities.

15. A multilateral institution, while concerned with the allocation of its limited resources, has a wider perspective, i.e. the improved performance of a developing country in the mobilization and effective use of its resources, domestic and external. Given this broad framework of approach, however, there cannot be uniformity for all countries. One or another aspect may have to be considered in depth depending on the situation of a particular country. It may be fiscal matters in one case; in another, the working of public enterprises. In a third, it may be the foreign exchange mechanism. Flexibility is essential, keeping in view the crucial or key elements for a given country, in a certain situation. No one will argue, for example, that monetary or fiscal policies can be fixed

over time. Essentially, policy understandings are predicated on and involve mutual cooperation and contacts between a member country and the administering agency. A certain confidence in international agencies, created and run by governments, is needed to enable them to function effectively, especially in assessing economic performance. The control of the agency by member countries is a safeguard against excessive intervention.

16. On the basis of such clarifications during discussions, the developing countries have come to accept by and large the underlying purposes of policy understandings and the manner they would be arrived at and implemented, whatever their initial misgivings. In any case, not all eventualities can be visualized at this stage; in the light of actual experience, procedures have to evolve. Thus, for the first time, the need for performance evaluation, on the basis of international consultations, so important in the field of development finance and urged so long by the donor countries, has come to be discussed openly, and a certain approach has been formulated to which the LDC's themselves have been willing to subscribe. This is a major gain from the S.F. discussions to the wider area of external development aid flows. The conclusion of the Intergovernmental Group on Policy Understanding expresses general agreement "that a policy understanding should be part of the Scheme" "most members also agreed that it should include export projections and a statement of the country's basic economic policies", and "it was generally agreed that consultations might be broadly along the lines of those conducted by international financial institutions".

Export Projections and Shortfalls

17. An essential feature of the Scheme proposed by the Bank Staff is an understanding between the administering agency and the country on an export projection for a period over which the country has formulated a development program. The export projection indicates the amounts of foreign exchange which the country may reasonably anticipate earning from its exports in each year of this period. The projections are based on informed assumptions regarding world trade developments, and on the understanding that certain policies would be followed. Such projections, together with other items affecting foreign exchange availability, would be required by developing countries irrespective of the existence of supplementary finance, in order to judge the feasibility of their development programs. Export projections are built into development programs in two ways: the development program contains commitments to certain policy actions on which the projections are based, especially in export policies; the development program in turn is based on the export projection and is tested for financial feasibility on the basis of anticipated export earnings and other sources of development finance. Is it feasible to formulate development programs without export projections - how does one plan without some expectation with regard to resources available? Agreement on export projections between the country and the Agency would reflect the financial viability of the development program in terms of internal and external resources, i.e. from the point of view of availability of adequate domestic savings and foreign exchange.

18. In considering why an export projection is essential to the operation of a Supplementary Finance Scheme, it is useful to go back to Recommendation A.IV.18 in response to which the Bank Staff Scheme is proposed. The resolution suggested that the scheme should aim to deal with problems arising from "adverse movements in export proceeds" so as to avoid the disruption of development programs. An adverse movement, it was suggested in the Resolution, should be regarded as a shortfall from reasonable expectations of the level of export proceeds. Note 1 to the Resolution further suggested that "to the extent these (i.e. reasonable expectations) could be prescribed in advance they could be taken account of by developing countries for planning purposes".

19. The essential point is that the UNCTAD Resolution was concerned with defense of a development program from deviations in earnings from anticipated exports on the basis of which the program had been formulated. A key aim of development is often to bring about by deliberate policy measures a change in past trends in export performance; deviations from anticipated earnings, therefore, cannot be measured from extrapolations of past trends but have to be considered in terms of estimates of future expectations. Thus, in keeping with the logic of the resolution, reasonable expectations were defined as estimated future export eventualities incorporated in an objective export projection within the context of a development program.

20. In suggesting a five-year projection period, to coincide with the normal length of a development plan, limitations of available techniques of projection over that long a period were recognized. However, today countries are accustomed to making export projections to provide a basis

on which investment programs can be built. The Bank Staff's considerable experience in this field suggests that such five-year projections are feasible. The quality of projections can, of course, be improved by sharpening analytical tools and strengthening the basis for technical judgments, and this is being attempted in the World Bank in any case. However, whatever the improvement in projection techniques, this would not eliminate the problem of unexpected shortfalls because unpredictable changes in a country's export situation and in the world economy will continue to take place.

21. There is an important question relating to the revision of export projections during the period of the plan. Annual revisions would reduce the cost of the scheme; but such revision unrelated to a revision of the development program would vitiate the purpose of the scheme. The viewpoint in the Bank Staff Study is that during the operation of a development plan, the underlying export projection should not be subject to revision except when changed conditions justify a major readjustment of the investment pattern and of development strategy, because investment calculations must be based on export projections. Whether or not such a major readjustment is required would be determined in consultations between the Agency and the country concerned. However, in practice, a rough mid-term review of the development program might be appropriate; this would also make it possible to review export projections as well as increase their reliability. In any case, revisions in export projections would be made when the development program itself has to be reformulated due to circumstances other than an export shortfall, such as a serious shortfall in development aid, fundamental change in export prospects, etc.

Cost Estimates

22. Given an agreed projection of export proceeds on which the country's development program is based, the financial assistance which a country can expect from the Scheme in the event of an export shortfall may be determined by comparing the actual exports with the projected exports. The idea is put forward in the Scheme that such financial assistance should be related to the amount of shortfalls -- the amounts by which actual exports fall short of projected exports in particular years - net of "overages", i.e. the amounts by which actual exports exceed projected exports in other years within the same planning period.

23. A simulation exercise was carried out, comparing merchandise export projections for individual countries made by the Bank Staff for various periods since 1950 with the actual export earnings of the same countries in the corresponding years. The observed aggregate gross shortfalls for two groups of countries for three different time-periods were extrapolated on the basis of the share of the respective samples in the export trade of all developing countries. These estimates indicated that the gross aggregate shortfalls of the developing countries could have amounted to between \$1 billion and \$2 billion per year. For convenience, instead of a wide range of figures, the Study adopted a single estimate, of \$1.6 billion per year, which is approximately at the midpoint of the range and corresponds most nearly to the experience of the larger, eighteen-country sample, in the most recent period (1959-63) for which data were available.

24. After crediting both overages and drawings under the IMF's Compensatory Financing Facility, the global net shortfall was placed at \$1.2 billion per year. From this, several other adjustments were made to arrive at an estimate that would indicate the financing requirements of the Agency. They were the number of developing countries likely to utilize the Scheme in the initial years, the likely improvement in the preparation and use of export projections as compared to the periods of the simulation exercise, the extent to which the developing countries would be expected to meet shortfalls on their own and, finally, the possible contribution to meet export shortfalls from sources of finance other than the IMF Compensatory Facility. Under the Supplementary Finance Scheme, a developing country is expected to meet the problem of an unexpected export shortfall to some extent with its own means, which include the use of its own reserves and internal adjustments involving a reduction in demand for foreign exchange. It is understood that these measures could be undertaken in a number of cases without disrupting the development effort in which the country was engaged. Although the extent to which each individual country could do so would vary from case to case, an attempt was made to assess the probable order of magnitude of the effort which might be considered reasonable when all developing countries are grouped together. It was clear from the beginning that, given the nature of the problem, it was not possible to quantify these factors in any exact way. On the other hand, to estimate even the rough order of magnitude of the amount of resources needed to run the Agency during an initial period, it was necessary to attribute some orders of magnitude to the different factors mentioned above.

On this basis, it was estimated that the effect of taking these factors into account would be to reduce the net shortfalls of \$1.2 billion to an annual average of \$300 - \$400 million for the initial five years, which would have to be covered by the Supplementary Finance Agency.

25. It is necessary to emphasize, as was done in the Study, that the quantification of financial requirements and of the various factors involved is rough; no precise calculations are possible because the Scheme deals with the uncertain and the unpredictable. It may happen that, in the event, the actual needs for any year may prove to be either larger or smaller than estimated. Therefore, the estimate given in the Study cannot be taken as referring to the needs in each year, but as the annual average over an initial experimental period of five years, which corresponds to the normal duration of development programs. The cost estimate was only an order of magnitude derived from certain available data for a particular past period with such special features as might have characterized that period. There is no historical basis for making any precise estimate of future costs. The intent was to arrive at an estimate of finance for the Scheme with which the Scheme might reasonably be expected to operate successfully in the initial period, for purposes set out in the Recommendation.

26. The conclusion of the Inter-governmental Group on costs reads: "It was widely agreed that the estimate of \$300-\$400 million per year of the World Bank Staff provided the basis for arriving at a figure with which the Scheme might reasonably be expected to operate successfully in the initial period." During the discussions in the Group, it clearly emerged that a scheme of this kind cannot be open-ended. It has to envisage a fixed fund that is considered adequate and reasonable, and therefore, the

possibility of rationing has to be kept in mind. The Bank Staff are currently examining the cost estimates again, taking into account also available data for the more recent years since 1963, and these estimates should become available by March 1969, to be forwarded to the Group.

III. Relationship between Supplementary Finance and
Compensatory Financing Facility of the Fund

Purpose and Method

27. An important question that has come up frequently in the course of discussions relates to the relationship of the proposal for S.F. to the Fund's C.F.F. The Compensatory Financing Facility of the Fund helps to even out the availability of exchange earnings from exports for a country and thus assists a country in meeting temporary, reversible, balance of payments deficits, on the understanding that the drawings would be repaid by the member country within an outer limit of 3-5 years; the Fund recommends earlier repayment by a country when its export earnings exceed the trend value. The burden of adjustment is thrown on the country itself, so as to be able to repurchase within a short period, like in other regular Fund drawings. The Supplementary Finance Scheme, on the other hand, is intended to assist a developing country to maintain its development program which might otherwise be disrupted by a shortfall of export earnings from reasonable expectations on which the development program was based. The proposal for Supplementary Finance has been made because countries cannot undertake development programs with a longer term perspective unless there is some assurance that their export earnings would correspond to reasonable expectations. Accordingly, the S.F. assistance should be on terms (maturity and interest) corresponding to other types of development assistance to a country. In brief, it may be said that CFF has to do with instability, and SFS with uncertainty of export earnings.

28. The different purposes of the two schemes are reflected in the methods of calculating export shortfalls. Under the Supplementary Finance Scheme, export prospects are considered in the context of a development program and take account not only of various objective factors, domestic and external, but also the impact of new policy measures. Attempt is made to estimate future export eventualities over a planning period of, say, five years, on which a developing country can rely in formulating and implementing its development program. For purposes of SFS, the shortfall in export earnings is measured from a prior export projection for a future period. Under the Compensatory Financing Facility, the Fund meets requests for drawings by members whose export proceeds over the latest twelve-month period have fallen short of the estimated medium-term trend value of exports. Therefore, CFF does not need a prior export projection; instead, the shortfall in export earnings is measured from a norm representing the medium-term trend value, derived from a statistical formula as well as a qualitative judgment. The statistical formula attaches a weight of .50 to exports in the shortfall year and .25 to each of the two preceding years; the qualitative estimate involves a direct forecast of exports for two years ahead. Formerly, the statistical and qualitative estimates were given about equal weight in determining trend value of exports; ^{currently} a somewhat greater weight is given to qualitative estimates. But, in the CFF formula as now applied, "the average level of exports for the two years following the shortfall year will not be assumed to exceed by more than 10 percent the average level experienced in the preceding two years" It is precisely because the trend or norm is a moving average for five years centered on the current shortfall year as the middle year that a rough balancing of shortfalls and surpluses of actual exports with respect to trend is expected over a relatively short period of time.

Refinancing of C.F.F.

29. The different purposes of the two facilities would indicate that any refinancing of C.F.F., while it may be deemed desirable in certain instances, could not be an alternative or substitute way of dealing with the problem for which S.F. has been proposed. Both at UNCTAD I and UNCTAD II, there were distinct recommendations on Compensatory Financing, and refinancing of C.F. forms part of the content of these resolutions. The Recommendations on S.F. are separate, and are intended to deal with another problem.

30. Furthermore, some refinancing on a short-to-medium term basis is possible even under the existing Fund facility, for instance, by an ordinary drawing at the time of (compensatory) repurchase.^{1/} There is also the practical consideration that refinancing of C.F.F. would not be needed to any great extent; the (statistical) formula adopted for calculating the export shortfall for purposes of C.F.F. itself ensures that compensatory drawings are repurchased mostly within the three-to-five year period. It is when the mode of determining the shortfall gets altered, especially if no weight were given to the shortfall year itself, and if the fixed term rule for repurchases is dropped in favor of repurchases out of export excesses without any time limit, that the refinancing need may arise to any extent. Again, in the Bank Staff Study itself, this question of refinancing was referred to with reference to any short-term indebtedness that a country may incur to meet part of the unexpected export shortfall; and it was suggested that if the S.F. agency were to take up this function also, additional resources would be needed.

^{1/} II Report by the IMF on Compensatory Financing of Export Fluctuations, page 27.

IV. Commodity Arrangements, Financing of Buffer Stocks,
and Supplementary Finance

Commodity Agreements: Elements of

31. The Commodity Problem is described briefly thus in the joint study "The Problem of Stabilization of Prices of Primary Products", Part I, by the Staffs of the Fund and the Bank: "The developing countries are heavily dependent on primary products for most of their exports: currently, 88 per cent of their export earnings are derived from primary product sales. Furthermore, these exports are concentrated on a narrow range of products: almost one half of these countries depend on one commodity for more than 50 per cent of their total exports and as many as three quarters derive more than 60 per cent of their total exports from three primary commodities. As a result, the export earnings of the developing countries, with their crucial influence on import capacity and development potential, are heavily dependent on the prices and trading opportunities prevailing in world commodity markets. With limited but important exceptions, these markets have shown two major unfavorable characteristics. First, their absorptive capacity has grown only slowly, so that increased sales have often been possible only at falling prices. Second, these markets have been subject to particularly wide price fluctuations, which have themselves sometimes contributed to adverse longer-term price trends. Demand for most primary products is growing relatively slowly as a result of both technological developments and changes in consumer spending patterns. Moreover, world trade in primary products, and particularly in agricultural products, has been held back by the protection given by industrial countries to their own primary producers."

32. The stabilization of prices of commodities and increased access to the markets of industrial countries through commodity arrangements represent the trade approach for influencing the foreign exchange receipts of developing countries. By reducing the amplitude of price fluctuations and by seeking to deal with the slow growth of demand for primary commodities, they help to improve the level and trend of export earnings. For years the need for commodity agreements has been recognized; their aims and essential features have been discussed extensively. However, it has been possible to conclude only a few agreements. Access to markets has proved no less difficult. Three main elements of commodity agreements may be noted:

- (i) The multilateral contract feature under which importers and exporters agree to buy or sell certain agreed quantities; this is the main feature of the International Wheat Agreement;
- (ii) The institution of an international buffer stock, that seeks to stabilize prices by buying when the world price falls below a certain minimum and by selling when the price rises above a certain maximum; this is the main feature of the International Tin Agreement;
- (iii) Export restriction which provides for limiting exports, when needed, to maintain prices at a higher level; logically, this requires regulation of production. This is the main feature of the International Coffee Agreement.

The emphasis given to each of these elements differs in different agreements. However, price stabilization is a principal aim of commodity agreements; there is also some effort at stabilizing export volume.

Price Stabilization and Buffer Stocks

33. An international buffer stock is a useful device, in some commodity agreements and under appropriate safeguards, which can reinforce the effectiveness of sales quotas. Buffer stock management attempts to even out fluctuations around a long-term trend; any attempt to improve the trend itself involves the regulation of production. No international buffer stock management and financing can be contemplated to sustain a continuing over-production; it can only help to facilitate the longer term adjustments needed in production by dealing with temporary phases of excess production or market shortages. A buffer stock cannot undertake to absorb all surpluses, but only up to quota limits, i.e. where a country has not been able to sell the quota specified for it. A buffer stock, as an instrument of a commodity agreement, has to be equipped with adequate funds, which may eventually be raised in various ways such as levies on producers and importers of a commodity. Initially for some period, while these resources are being built up, the buffer stock management requires some adequate finance - what may be termed prefinancing. For various reasons connected with the nature of the primary commodities and their trading patterns, such finance has proved difficult to raise. International financial institutions are, therefore, being approached. What these institutions are called upon to consider, then, are not investments in stocks on a continuing basis, from which profits may be derived or on which losses may be incurred by them, but the provision of loan finance for buffer stock managements that may be set up for particular commodities - loans that would be repaid as their own resources get built up. It seems important that such initial financing has to be contemplated not for short periods of 3-5 years but for somewhat longer terms so as to

enable the buffer stock to build up its own resources by means of levies on producers and consumers, and through any profits from sales, and repay the agency in convenient installments.

34. As buffer stock operations involve absorbing surpluses or selling the commodity for cash, according to where the market price stands in relation to an agreed price range, the buffer stock must have both the commodity and cash. While purchases have to be initially at floor prices, and sales at maximum prices set, quotas themselves may be variable and purchases and sales may be at declining or rising prices. At the same time, a buffer stock should have resources adequate to take care of normal swings in supply and demand, and to make an impression on buyers and sellers in the market about the management's ability to protect the price range. Apart from the more general economic, administrative, and financial questions involved in any stock management, the particular characteristics of production and marketing of each commodity raise specific problems: in some agricultural commodities (e.g. jute, sugar, oil seeds) there are often wide variations in output and corresponding swings in prices, unless countered; in some instances there is a steady diversion of demand to man-made materials that are price competitive (e.g. fibers and rubber); the perishability of a commodity (e.g. bananas) rules out any stock building; the time taken in increasing or reducing supplies in response to market developments (e.g. rubber); the existing preferential market arrangements (e.g. sugar); continuing over-production (e.g. coffee), or relative ease of over-production developing (e.g. cocoa). Then, there are costs of management. Storage costs are likely to be heavy for commodities that have low value per ton. If a buffer stock amounting to, say, 25 percent of annual trade - in some instances or in certain periods even a higher proportion has to be envisaged -

is to be maintained, storage costs can assume sizeable proportions. Further,, many of the commodities, especially agricultural ones, are subject to physical deterioration, which requires the stocks to be turned over periodically, every two years or so; the buffer stock may otherwise suffer more than marginal loss due to sales being of poorer quality materials than purchases. Under the circumstances, if loans even for the prefinancing purpose are not at concessional rates, buffer stock management may prove unduly costly. With respect to certain commodities like tin, where a few producers have the necessary control over production of the commodity in relation to demand, it may be possible to have buffer stock financing at conventional or market rates. Essentially, the appropriate terms depend on the commodity in question and would require study in detail.

35. Taking into account the validity of international buffer stock arrangements as a useful control device in commodity agreements, but the inability of contracting parties to commodity agreements over the years to incorporate this feature except in one or two cases, and the characteristics of individual commodities and the cost factors involved, a positive but realistic approach has to be envisaged toward the question of buffer stock financing. An international agency may stand ready to take care of the buffer stock finance needs of a few commodity agreements, after the producing and consuming countries have agreed on the other essentials of the agreements (especially on questions relating to price range and sales quotas), and after examining the question on merits. As experience is gained, the scope of financing activities may be extended to other commodities.

Commodity Agreements and Supplementary Finance

36. As for the relationship between Commodity Agreements and Supplementary Finance, progress in negotiating commodity agreements is likely to enable countries to have more accurate expectations of their export prices and, hence, in part, of their earnings, on the basis of which to formulate their development programs. When a developing country depends on one or two commodity exports, and a degree of price stability is secured, this reduces a main factor of uncertainty in export earnings. Thus, effective commodity arrangements make for better export projections and reduce the cost of supplementary finance measures. This effect would depend on the number of commodities subject to agreements and the operative features of such agreements, especially in regard to export volume. Also, insofar as commodity agreements take considerable time to negotiate and conclude, this effect would be postponed. Even if a large number of commodity agreements are successfully concluded over a period, they are unlikely to cover the total earnings of a country from all its exportable commodities (including invisibles) so that there would still be need for the approach through SFS.

37. The fact that there is some overlap between the area that may be covered by commodity agreements and the area covered by supplementary financial measures has sometimes been interpreted to imply that the adoption of supplementary financial measures might reduce the efforts to conclude commodity agreements. This is not justified for a number of reasons. One reason is that primary product exporting LDC's have an advantage in earning foreign exchange from their own exports, subject to commodity agreements, rather than by obtaining foreign exchange from SFS as a loan, subject to various conditions, even if these loans were to be provided on concessional terms.

Secondly, supplementary financial measures are only concerned with the extent to which actual export earnings are close to their expected values, and not with whether the expected earnings are stable or unstable, or whether these expected earnings are rising fast enough or not. Finally, while commodity arrangements have a certain impact described above on SFS, they have other, important, objectives: viz. to improve the trend of the export earnings of countries, especially by regulating international trade in particular commodities.

A Coordinated Approach: a Common Agency

38. The volatility and uncertainty of export earnings from their primary commodity trade has been a main problem faced by developing countries, because of the extent to which these countries depend on primary commodities for their exports. This commodity concentration is even more severe for a number of individual countries. The stability and growth of these exports becomes all important to them, and price stability is an essential to this end. The stabilization of prices and markets for primary commodities could be attempted in a series of commodity agreements covering the main cereals, fibers, beverages, vegetable oils, rubber, minerals and metals. While there has been extensive discussion of the subject since prewar years, and several attempts to conclude agreements have been made, such agreements have proved possible only in a few cases; effective implementation has been even more limited. Through the removal of tariff and non-tariff obstacles to trade in these commodities, the developed countries can enlarge the market opportunities in their economies for exports of these commodities from less developed countries: there has been little progress in this direction too. Sustained growth of the economies of industrial countries would itself maintain and increase their demand for primary commodities. Basically, a measure of discipline both in the industrial (consuming) countries in regard to their production of some of these commodities and in producing countries by way of regulation of production and export quotas, is called for if commodity arrangements of one kind or another are to prove a practicable instrument. The building up of stocks and market operations based on them would be effective under such circumstances.

39. Compensatory finance facility and supplementary financial assistance, the former to meet the volatility aspect of export earnings, and involving essentially short-term assistance, and the latter to meet the uncertainty aspect and involving essentially long-term assistance, would also be needed. These financial arrangements and commodity agreements become complementary to one another and reinforce their effectiveness mutually, so that development programs of countries can go forward uninterrupted by export shortfalls. In fact, in a rather pragmatic framework, one can visualize commodity agreements for some major commodities in which the developing countries are the chief exporters, and for the rest devise appropriate financial arrangements to take care of the levels of total export earnings of developing countries.

40. All these above approaches in substance seek to build on established patterns of economic activity; they are needed, but they do not provide the enduring solution to the commodity problem of developing countries, for the commodity problem essentially reflects their own low level of economic development, and arises from the slow growth (and stagnation) of demand for many primary commodities over the long run. Only sustained economic growth is the real solvent, which results in a gradual diversification and expansion of their export trade and reduces the undue dependence of many of these economies on one or two commodities. The growth and diversification of exports in turn is predicated on correcting the structural imbalances in these economies and promoting productive efficiency. This diversification has to be partly in the agricultural sector itself, especially toward food production, in view of the serious food shortages developing in several

less developed areas; where possible, the development of (non-ferrous) minerals and timber resources would help. But, it should certainly be in part through industrialization, so as to secure continued improvement in export earnings from manufactures. Thus, the commodity problem cannot be dealt with apart from or in isolation from the larger, basic, development problem.

41. Thus viewed, commodity agreements and supplementary finance proposals may be seen clearly to be complementary, in pursuance of the same objectives that derive essentially from the requirements of long-term economic growth. The financing of buffer stocks is a related aspect, being a helpful control instrument in commodity agreements. It may be undertaken by a separate agency or by the agency entrusted with supplementary finance; there may be some advantage in entrusting the two to the same agency. In fact, a joint subsidiary of the Fund and the Bank may be set up as the Agency for CFF, SF and buffer stock financing, and be given adequate funds for these various functions.

42. Such an approach, with a common administrative agency for the various facilities, which would be a joint subsidiary of the Fund and Bank Group, working closely with these two international financial institutions, would have several advantages: 1) When an export shortfall occurs, immediate use could be made of CFF, while a view is taken of the need for and extent to which S.F. should be utilized; any necessary refinancing of CFF would become possible whenever it seemed appropriate; 2) By providing for buffer stock financing as a specific function of this Agency, the conclusion of commodity agreements by interested countries would be facilitated, and

there would be no possibility that the existence of the financial facilities would in any way inhibit efforts of countries toward commodity stabilization; to the extent Fund and Bank Group resources are available through the Agency for buffer stock arrangements, both the organizations get directly involved in commodity arrangements and commodity trade of LDC's;

3) In the appraisal of development programs, balance of payments projections, formulation of policy understandings and their implementation, the periodic consultations that the Fund and Bank have with the member countries and the expertise available with these two organizations, could be utilized by the Agency without procedural or other difficulties. Administrative and other duplication of effort in these respects would be avoided;

4) It would enable these organizations to view such facilities as CFF, SF, buffer stock arrangements, in the context of the longer-term needs of LDC's for diversification of their production and exports and sustained economic development; thus, instead of piecemeal, uncoordinated, steps implemented by different bodies, there would emerge an integrated approach to the trade and development problems of LDC's;

5) Finally, such an administrative mechanism would impart greater reality, on a continuing basis, to the cooperative relationships between the Fund and Bank.

N. A. Sarma

January 15, 1969

Annex A

UNCTAD I: Recommendation A.IV.18: Supplementary Financial Measures

A

The Conference,

Recognizing that adverse movements in the export proceeds of developing countries can be disruptive of development, and noting that the International Monetary Fund(IMF) can make available balance-of-payments support to help meet the short-term effects of shortfalls in export proceeds,

Recommends that the International Bank for Reconstruction and Development be invited to study the feasibility of a scheme with the objective set forth in section I below and based on the principles set forth in section II below, and, if appropriate, to work out such a scheme.

I. Objective

1. The new scheme should aim to deal with problems arising from adverse movements in export proceeds which prove to be of a nature or duration which cannot adequately be dealt with by short-term balance-of-payments support. Its purpose should be to provide longer term assistance to developing countries which would help them to avoid disruption of their development programmes.

II. Principles

2. The scheme should be provided with resources by contributions from participating countries, shared between them on an equitable basis.
3. Developing countries only should be eligible for assistance from the scheme; such assistance should be on concessional and flexible terms.

4. The scheme should normally be applicable after a developing country had had recourse to the International Monetary Fund, under its compensatory financing facility, and it had been possible to make a full assessment of the nature, duration and implications of any adverse movement in the export proceeds of the developing country concerned.
5. An adverse movement for the purposes of the scheme should be regarded as a shortfall from reasonable expectations (see Note 1 below) of the level of export proceeds (including, in appropriate cases, invisible exports).
6. A prima facie case for assistance from the scheme should be established by reference to shortfalls from reasonable expectations and to their nature and duration (see Note 2).
7. Once a prima facie case has been established there should be an examination, under the International Development Association, of all relevant economic circumstances (see Note 3) in order to assess how far assistance from the scheme would be required and justified in order to help avoid disruption of development programmes. Subject to these points, assistance could cover a substantial proportion of a shortfall from reasonable expectations.
8. Resources for the scheme, which would be administered under the International Development Association, should be in the form of additional commitments, prescribed in advance, for contributions to the Association; all the major Part I member countries of the Association should contribute.

NOTES

Note 1. To the extent that these could be prescribed in advance they could be taken account of by developing countries for planning purposes.

Note 2. The following are offered as illustrative circumstances which might constitute a prima facie case for assistance from the scheme to a developing country:

- (i) If, following an IMF drawing in one year under its special compensatory financing facility, exports fall significantly below reasonable expectations in the second or third year.
- (ii) If, when the IMF drawings were due to be repaid, exports had not recovered sufficiently for this to be possible without disruption of development.
- (iii) If there were a significant shortfall in exports which the IMF adjudged at the outset to be other than of a short-term nature and the IMF had decided that it would be inappropriate for it to provide temporary balance-of-payments support.

Note 3. Among other matters, these would include adverse effects from significant rises in import prices.

B

The Conference also recommends that the continuing machinery recommended by this Conference be invited to study and organize further discussion of the following concepts and proposals for financing put forward by the delegations of the developing countries at the Conference:

1. That a fund be set up, financed by contributions from developed countries, as required, and administered by an appropriate agency of the United Nations;
2. That only developing countries should be eligible to draw from the Fund;
3. That disbursements should be in the form of non-reimbursable transfers and/or contingent loans on concessional terms;

4. That the criteria used in deciding upon claims should be as objective as possible and should include the following;

(a) The effect of shortfalls in export earnings and the adverse movements in the terms of trade;

(b) The effect on the country's development programme;

5. That to complement this longer term approach, facilities be provided for interim financing, when warranted, to assist the developing countries concerned while the longer term problem is being assessed.

Annex B

UNCTAD II: Resolution 30: Supplementary Financial Measures

1. The Conference reaffirms the objective of the proposal for Supplementary Financial Measures set out in Annex A.IV.18 to the Final Act of the first session of the Conference. This states that "the new scheme should aim to deal with problems arising from adverse movement in export proceeds which prove to be of a nature or duration which cannot adequately be dealt with by short-term balance-of-payments support. Its purpose should be to provide longer term assistance to developing countries which would help them to avoid disruption of their development programmes".

2. Any measures devised to meet this need should, on the basis of appropriate criteria, which should, to the extent possible, be objective, provide reasonable assurance of help to protect a country's development plan or programme against the effects of export shortfalls, to the extent that they cannot be met by short-term balance-of-payments support.

3. The Conference expresses its appreciation of the report prepared by the staff of the International Bank for Reconstruction and Development; and of the reports of the Inter-governmental Group on Supplementary Financing. These reports have defined the issues involved and clarified many of them. The Conference agrees that further work is required to resolve some outstanding issues. The principal issues are:

- (a) The definition and method of assessment of reasonable expectations;
- (b) The scope, nature and acceptability of the understandings between the administering agency and individual participant countries on their development programmes and the policies to be adopted in order to carry them out;
- (c) The measures to be taken by countries applying for assistance;

- (d) The relationship between supplementary finance and the IMF Compensatory Financing Facility.

4. A matter requiring additional attention is how to determine in quantitative terms the disruption which has resulted from export shortfalls and consequently, what are the financial implications of proposals to meet the objectives of part A of recommendation A.IV.18.

5. Some of the issues set forth in paragraphs 3 and 4 above would arise not only from consideration of the IBRD staff Scheme but from consideration of other measures to meet the objectives of part A of recommendation A.IV.18, including those submitted to the Inter-governmental Group. Any additional proposals clearly responsive to the recommendation should receive due attention, with the aim of working out the most effective measures possible.

6. The Conference decides:

- (a) To continue in existence the Inter-governmental Group suitably expanded;
- (b) To request the Inter-governmental Group to consider and attempt to resolve the issues set forth in paragraphs 2 to 5 above;
- (c) In the light of the foregoing considerations to instruct the Inter-governmental Group to work out measures for supplementary finance;
- (d) To instruct the Inter-governmental Group to report thereon to the Trade and Development Board as early as possible, and no later than its ninth session;
- (e) To direct the Trade and Development Board to study and take early action on the findings of the Inter-governmental Group, taking account of any proposals for action in the field of international commodity

policy which may be submitted to the Board of Governors of the IBRD and the IMF on the basis of the studies which they have requested to be presented to them at their next annual meetings;

- (f) To instruct the Chairman of the Inter-governmental Group to report on its progress to the seventh session of the Trade and Development Board.

FEB 18 1969

S.F.S. and Commodities

Fund deals with temporary balance of payment difficulties -- it provides resources to avoid use of undesired measures of balance of payments management in case of difficulties (unwarranted exchange rate charges, _____) -- if Compensatory Finance not enough -- international _____ of IMF resources available.

In Development field any unexpected shortfalls can use IMF resources if balance of payment difficulties ensue, but adjustment mechanism may include cut back of development program. If development involves latter, no problem in using IMF -- not appropriate to use. If does, because of nature of change or extend debt problem, if try to avoid latter, Fund resources. Therefore, need something -- can be regarded as "special circumstances" for IBRD/IDA lending on case by case basis or special fund for purpose.

SFS - Canada
Fund deals with
large buy/sell requests - to
preserve & avoid use
of sensitive measures by
market causing volatility (unwanted
exchange ^{rate} changes, redemptions) - of
Company has strategy - allocation of IMF
resources available -

In Derivatives or unreported
shortfalls, can use IMF reserve

if hd prog difficulties ensue
but expected mechanism may

include at least develop program
of pres, keeping notes of day & date & do that
if try to avoid letter, Fed reserves
not appropriate to use -

if don't make letter, no
problem in using IOP

therefore, need something -
center regarded as "special
circumstances" for IOP/DIA
leading on each case basis
a special fed for purpose -

Richard Davis - Johnson
Montgomery