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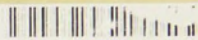
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INTERGOVERNMENTAL GROUP ON SUPPLEMENTARY FINANCING:
 REPORT ON ITS FIRST SESSION

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Introduction

1. In pursuance of a decision by the Committee on Invisibles and Financing related to Trade taken at its resumed first session (Geneva, 13-20 April 1966),^{1/} as approved by the Trade and Development Board at its fourth session (Geneva, 30 August - 24 September 1966),^{2/} the Intergovernmental Group on Supplementary Financing was established and met in Geneva between 10 and 14 October 1966.
2. The terms of reference of the Intergovernmental Group are set forth in the annex to decision A (i) of the Committee on Invisibles and Financing at its resumed session referred to above, and are further reproduced as Annex A to this record. A summary of the Group's discussion is contained in Chapter I of the present report. A list of studies requested by the Group is given in Chapter II.
3. During the discussions, two papers were submitted to the Group by participants: a list of questions by the delegation of France and a note by the delegation of the United Kingdom. These papers are reproduced as Annex B and C respectively. At the request of the Group, the secretariat prepared a comparison of the IMF Scheme for Compensatory Finance and the World Bank staff proposals on Supplementary Financial Measures: this is reproduced as Annex D.

^{1/} TD/B/73-TD/B/C.3/22, paragraphs 31-35, and Annex A (i).

^{2/} A/6315, Part Two, paragraph 147.

CHAPTER I
SUMMARY OF DISCUSSION OF ITEMS 1-7 OF THE
TERMS OF REFERENCE OF THE GROUP

1. Questions affecting the scope of the scheme, including the treatment of overages and the regard to be paid to import prices

General scope of the scheme

(a) As described in the study by the staff of the World Bank^{1/} the objective of the scheme "is that of preventing the disruption of sound development programme or policies by unexpected shortfalls in export earnings which are of a 'nature or duration which cannot adequately be dealt with by short-term balance of payments support'" (p.2).

(b) Export receipts are defined by the Bank staff study "to include merchandise and, where appropriate, invisible items" (pp. 8-9). The question was raised whether receipts from exports of manufactures should be included, and whether the statistics on invisible earnings were sufficiently reliable to be included in total export receipts. It was pointed out that exports of merchandise include those of manufactures which should therefore come within the scope of the Scheme.

(c) It was suggested that the scheme may be formulated so as to take into account the effects on a development programme of a situation in which, although the value of exports did not fall short of reasonable expectations, this occurred only because of a rise in export volume offsetting a fall in export prices. It was pointed out that such an increase in export volume involved the use of real resources possibly at the expense of resources needed for other development purposes. It should be considered whether in such a situation a country would qualify for supplementary financial assistance.

(d) Two views were expressed regarding the causes of disruption to be taken into account. On one view, the scheme should include only those causes of disruption specified in UNCTAD recommendation A.IV.18. A broader interpretation, however, would provide for the inclusion of other, though related, causes of disruption, such as crop failures or other unforeseen circumstances leading to

^{1/} IBRD, Supplementary Financial Measures, December 1965, TD/B/43. Page references in parenthesis refer to this study.

increases in import expenditures. More information concerning the causes of shortfalls in export receipts, other causes of disruption and the mechanism of disruption may be provided by further study and consideration should be given as to which ones should qualify for assistance under the scheme.

(e) It was, however, suggested that interpretations such as those expressed in (c) and (d) would go beyond UNCTAD recommendation A.IV.18.

Import prices

(a) Disruptive effects on a development programme of significant rises in import prices, particularly the import prices of capital goods, may be taken into account in calculating shortfalls and in determining the amount of supplementary finance to be provided by the Agency.^{1/}

(b) Solutions to the statistical problems in obtaining reliable information about import prices should be explored. Some amplification of the views expressed in the Bank study, that satisfactory import statistics were not available, was suggested. The Bank's views as to the character, country-availability and reliability of import price figures would be welcome.

(c) Assuming such statistical problems could be overcome, one way of taking import prices into account would be to compare expected export earnings adjusted for expected import prices with actual export earnings adjusted for actual import prices. This is, in effect, a particular way of calculating the gross shortfall. It has the virtue of measuring the import purchasing power of exports, a matter of relevance to development plans. But the "expected" values must be calculated ex ante, which may prove too complex. If that were the case, an alternative which might be adopted would be to consider import prices ex post, when a country was applying for supplementary finance in the event of a shortfall already experienced.

(d) A rise in import prices may lead to an increase in the cost of the import content of a given value of exports, thus reducing the net foreign exchange value of exports. The purchasing power of net foreign exchange receipts would also be reduced by a rise in import prices.

Overages

(a) The scheme requires that member countries use overages and other sources of finance before receiving supplementary finance (p.41). This is necessary not only to reduce the total cost of the scheme but also to ensure symmetry between the responsibilities of all participants in the scheme.

^{1/} See Proceedings of the United Nations Conference on Trade and Development, Vol. I, Final Act and Report, Annex A. IV.18, part A, II and Note 3.

(b) Overages would therefore have to be secured or accounted for in some manner which would make it possible for them to be offset against shortfalls in accordance with the criteria of the scheme.

(c) Statistical problems in the estimation of overages, including problems of export valuation should be considered.

(d) Deliberate withholding of commodity exports during a period of unfavourable market conditions followed by enlarged sales subsequently at better prices could result in overages in particular years. It was suggested that overages resulting from marketing strategy of this type should not necessarily limit a country's potential access to supplementary finance.

(e) While the offsetting of overages against shortfalls may be necessary to reduce the cost of the scheme, the question arises whether there are other legitimate uses of overages, such as reconstitution of reserves, maintenance of essential imports and servicing of foreign debt. In particular, the question was raised whether, if overages occurred in the early years of a planning period they may not be legitimately used for the financing of imports consistent with the agreed development programme. One view was that it might be hard for a country to forego the use of overages in early years if it had experienced in those years difficulties other than export shortfalls disruptive of development programmes. Use of overages should form part of the prior agreement between the Agency and the participating Government. It was also suggested that since overages - like the shortfalls, in fact - are calculated in relation to projections they are statistical in nature and not accounting data, and would not necessarily become available foreign exchange resources whose use could be supervised by the administrating Agency.

(f) The Bank staff study recommends that overages should "not be transferred from the accounts of one projection period to the next" (p.42). The question was raised whether such a transfer might be effected in whole or in part. It was pointed out that the recommendations of the Bank staff study was meant to be a stimulus to increased exports from participating members.

2. The forms, terms and conditions for the provision of financial assistance to countries participating in the scheme

Terms and conditions of assistance

(a) The scheme lays down that the terms and conditions of assistance from the Agency would be similar to those for basic development finance. This implies that they would be tailored to the conditions prevailing in each country. It would be necessary to arrive at a judgment on the terms appropriate for each country. The view was

expressed that the consultative groups and the experience of the World Bank Group might provide a guide. Although the terms would vary from case to case, the Agency would be prepared to extend funds on concessional terms in many countries (p.60). If it were not possible to devise a system of tailor-made terms, some system of grouping might be used (based, for example, on income per head and balance of payments prospects), or the "DAC norm" (twenty-five years maturity, seven years grace period, 3 per cent interest) might be adopted.

(b) A suggestion was made that the average terms of basic development finance should not be taken to mean the average terms of the existing outstanding debt since these terms may be heavily influenced by the past, rather than the present economic situation of the country. It was, therefore, suggested that the terms and conditions of assistance under the scheme should approximate those applicable to current basic finance.

(c) An opposite view was that the objective and nature of the scheme were such as to justify shorter repayment periods than those applying to long-term development finance in cases of improving exports or indebtedness of the country. It was, however, pointed out that this would be inconsistent with UNCTAD recommendation A.IV.18, which specifically called for longer-term assistance.

(d) Under the scheme, the Agency would have the right to request repayment earlier than originally stipulated, in the event that the resource and foreign exchange position of the debtor country improved so substantially over time that it could afford to repay its debt to the Agency before maturity, without affecting the previously agreed target rate of growth. It was suggested that the above provision was unduly stringent, especially if it were intended to use the occasion of export improvement in one planning period to repay loans obtained to offset shortfalls in a previous period. Since recourse to supplementary finance would be sought under conditions of a threat of disruption of a development plan through the creation of a gap in a country's resources, such finance would be of a marginal character and should, therefore, be on soft terms to avoid an aggravation of the debt-servicing obligations of the country.

Adjustment

(a) It was recognized that receipt of supplementary finance would not eliminate the need for adjustments to a shortfall in export earnings. While it would be difficult to foresee every situation that might arise, it was agreed that adjustments undertaken should be consistent with the over-all objectives of the development programme in question.

(b) Where a shortfall in export earnings reflects a major structural change in the market prospects of an export product, the measures of adjustment should facilitate adaptation to that change. Such adaptation might in suitable circumstances include provision for diversification. The view was expressed that depending on the seriousness of the change, it might or might not be desirable to revise the development plan itself. Whether a shortfall requires a relatively minor modification of current economic and financial policies or a revision in the development plan, the previously agreed level of foreign exchange receipts needed to carry out the development plan (in its original agreed form or as subsequently revised by agreement between the country and the Agency) should be maintained. Resources would not, of course, continue to be channelled to export activities affected by structural shifts in demand, but would become available for diversification.

(c) It was suggested by some members that the nature of adjustments which might be required as a condition for receipt of supplementary finance should be the subject of prior agreement and should be centred on trade policies and related fields.

(d) The proposed scheme foresees a need for consultation between the Agency and a member country when an unexpected export shortfall results in a need for finance from the Agency (p.10). Although consultation would be necessary to determine that other available sources of finance were being used, and that feasible adjustments not endangering the development programme were being made, it was agreed that this would not prejudice the certainty or speed of availability of needed assistance, particularly since regular periodic consultations between the Agency and its members would be taking place in the normal course of events. The point was also made that what constituted "feasible" adjustments could not be determined in advance of the experience which made them necessary; the satisfactory determination of feasible adjustments would depend on confidence being established between the Agency and member countries.

(e) It was further suggested that revisions of development programmes should not be imposed as a condition for receiving supplementary finance. It was pointed out that the regular consultations envisaged in the scheme would provide timely and adequate opportunities for any necessary modifications of development programmes and policies.

(f) The IMF is the responsible agency in matters of adjustment arising from balance of payments difficulties. Close co-operation between the Fund and the Agency would therefore be necessary in providing for measures of adjustment to be adopted in connexion with the utilization of supplementary finance.

3. Measures for establishing a relationship between the resources available and the resources required; in this connexion the Group should examine the implications for the scheme of the hypothesis that resources on the scale suggested in the Bank staff study (taking account of any modification which the Group may suggest) would be available

(a) It is clear that Governments and parliaments of donor countries cannot be expected to support a scheme with no maximum limit. It was pointed out, however, that just as a maximum limit was a condition for support of the scheme by donor countries, so would a minimum level of finance be necessary to ensure that the objectives of the scheme would be achieved. At the same time, a fully reliable estimate of the resources required to operate the proposed scheme is probably not attainable due to the complexity of factors influencing possible needs for supplementary finance, and the fact that only limited guidance for the future can be obtained from the analysis of past fluctuations.

(b) The World Bank staff study estimates the annual requirements of the scheme at \$300 - 400 million. The estimate was derived from estimates of unexpected annual gross shortfalls for the period 1959-1963 of about \$1.6 billion for all developing countries (p.70) adjusted for a number of factors tending to reduce the need for recourse to the scheme. Among these were improvements in export projections; the emphasis on policy performance; the fact that not all developing countries would qualify for assistance; the offsetting of overages against shortfalls; the use of the Fund's compensatory financing facility; the use of other available foreign exchange resources; and feasible internal adjustments that would not disrupt development programmes (pp.70-71).

(c) It was considered indispensable that more precise information be made available concerning the manner in which the annual requirements of the scheme were estimated, including the weight given to the use of overages and additional estimates of the incidence of the enlarged IMF compensatory financing facility.

(d) It was suggested that the resources available from particular donor countries might be affected by their balance of payments positions, and that the need for supplementary financing might well be greatest at times when donor countries were themselves in difficulties. The latter consideration might apply with particular force to primary producing donor countries.

(e) It was pointed out that possible changes in the requirements of the scheme might occur as total exports of participating countries increased, making it likely that unexpected shortfalls would increase in magnitude. Some factors which would counter such a tendency were cited: experience gained by the Agency and participating Governments in estimating expected export earnings; changes in the composition of exports of developing countries, particularly the likelihood that exports of manufactures and earnings from invisible items would rise as a proportion of total receipts and thus increase their stability. The conclusion of commodity agreements would also contribute to increased stability of export earnings.

(f) It was considered that the requirements of the scheme would build up only gradually due to the time needed to get the scheme going, and to provide for the necessary prior agreements between the Agency and participating members.

(g) The goal of 100 per cent financing of unexpected export shortfalls of a disruptive nature was felt to be desirable. It was pointed out, however, that such coverage would not be possible if available resources were less than eligible claims. It would therefore be prudent to provide against the possible need to ration the Agency's disbursements. It was suggested, however, that although rationing might be considered as an emergency measure, its possible use should not enter into calculations of the resources required for the scheme.

(h) Rationing might take one of the following three forms:

(i) a pro rata system whereby a country's share in total eligible shortfalls would determine its share in total disbursements by the Agency. It was recognized that this system might encounter difficulties in ascertaining, at a given moment, all the actual and potential shortfalls of a given period;

- (ii) rationing on the basis of needs, as reflected, say, in per capita income; and
- (iii) rationing according to the ability of countries to withstand the disruptive effects of shortfalls, taking account of their reserve positions. It was suggested that any system of rationing should be as automatic in its application as possible. It was also pointed out that there were sufficient elements of flexibility in the scheme to permit the adjustment of eligible claims to available resources so that the second and third forms of rationing would appear to be less appropriate.

(i) A point was made about the "insurance" character of the scheme. If \$300-400 million were to be made available in addition to other aid, it would be for donors and recipients alike to consider whether it should be distributed in the same manner as other aid - in which case the share of each recipient country would be relatively small - or in the manner set out in the scheme, in which case countries experiencing poor exports could receive relatively large amounts.

4. The need to establish a boundary between problems of an economic nature and those which fall within the political sphere in the administration of any scheme

(a) The World Bank scheme provides that before the beginning of the plan period during which a member would have assurance in case of an export shortfall, the Agency and the member Government would agree on a development programme and policies and related issues: that is, there would be agreement on a "policy package" through which the targets on resource mobilization and utilization would be implemented (p.9).

(b) The need to avoid infringing upon the national sovereignty of member countries is fully recognized. At the same time it was noted that the modern world economy is highly interdependent and freedom of action in the economic field is not absolute. Countries desiring external finance, whether basic or supplementary, would therefore expect to reach agreement on certain aspects of their development programmes with those undertaking to provide such finance. Where existing practice already provides for agreements in connexion with the provision of basic finance, the task of the Agency would be facilitated since the Agency's requirements would be fully consistent with these agreements.

(c) It was suggested that the basic objectives of a development plan lie outside the responsibility of the Agency. There was therefore a need to delimit the area of responsibility of the Agency to the export sector and factors affecting the performance of that sector. A different view was also put forward, namely that the

Agency, without prejudice to the political and social objectives of a development plan, could properly seek to reach agreement by consultation with the developing country on the economic feasibility of its proposed plan; and that, although interest would be concentrated on export performance, other questions of economic policy might be relevant to this.

(d) The scheme provides that a member would qualify for assistance as long as its agreement with the Agency on development policies was being carried out, and it could be shown that the export shortfall was beyond the country's control. It was agreed that on the basis of this criterion, a country would be eligible for supplementary finance as long as it followed agreed policies, even if the targets of the plan were not actually achieved.

(e) The question was raised whether the Agency and participating countries might not encounter some difficulties in reaching agreement concerning commitments to implement development programmes and the assessment of good performance.

(f) There were questions about the number of countries whose development planning, comprehensive or partial, would be sufficiently advanced to make them eligible for membership in the scheme.

5. Questions relating to the methodology to be applied in the formulation of the projections and the technical assessment of the policies on which the development plans of individual countries are based, the circumstances which may give rise to a claim on the scheme, and the circumstances which the Agency should take into account in dealing with such a claim

The need for export projections

(a) The drawing up of any development plan necessarily involves taking a view of export prospects, especially since projected expenditures under a plan imply the need for a certain level of imports which can be financed out of the foreign exchange that is expected to become available. Unexpected export shortfalls are therefore apt to prejudice the achievement of the plan. Since the scheme is designed to deal with "shortfalls from reasonable expectations" (p.28), some quantification of "reasonable expectations" is indispensable.

(b) The fear was expressed that because of the inherent uncertainty of the future and unreliability of data, projections of exports may be wide of the mark. Therefore, it was suggested that export projections be used solely as a certain guidance for development planning but not as an agreed basis for the calculation

of export shortfalls for the purpose of the scheme. Instead, it should be possible to identify export shortfalls at the time when they materialize, taking into account export performance in the current year and in the preceding periods.

(c) It was suggested on the other hand that while the fact of uncertainty about the future and its effects on the accuracy of projections must be recognized, that very uncertainty was the cause of unexpected export shortfalls and hence a major justification for the scheme. Moreover, some projection errors may tend to cancel out over a period of time.

Methodology of projections

(a) The scheme proposes that export projections would be based on an analysis of market conditions for major export commodities. Apart from an analysis of factors influencing the evolution of demand and supply, account should be taken of the probable effects on exports of any new policies that a country might adopt to alter the existing export trend.

(b) In the administration of its compensatory financing scheme, the IMF measures short-term export shortfalls from the estimated medium-term trend value of exports for the year for which the shortfall is calculated. The medium-term trend value is defined as the annual average of the five years beginning two years before, and ending two years after, the year for which the trend value is calculated. Since exports for the last two years of this five-year period are unknown at the time of the calculation, the Fund estimates the trend value partly by direct forecast of the two years in question and partly by using a weighted average of actual exports of the first three years of the five-year period, the weights being chosen for their predictive power as shown by regression analysis.

(c) In so far as direct forecasting is employed by the Fund, the methods used are not basically different from those employed by the Bank for its longer-term projections. The average level of exports predicted by the Fund for the two years following the shortfall year is, however, subject to certain predetermined limits, in that it is assumed not to exceed by more than 10 per cent the average level of exports experienced in the two years preceding the shortfall year and not to fall below the level of exports experienced in the shortfall year itself.

(d) It was considered advisable for the World Bank and the IMF to pool their experience in forecasting exports. It was also pointed out that the World Bank has had extensive experience over many years in making export projections directly based

on commodity studies. Both institutions are, therefore, now utilizing the same approach and it is expected that the Supplementary Financing Agency would take full advantage of the work of the two institutions in this field.

6. The appropriate period of time for which the relevant projections of exports should be established and for which the concomitant obligations of the Agency and the developing country concerned respectively should be assumed

(a) The question was raised whether projections over an extended period could be relied upon for determining financial obligations under the scheme, particularly since the financial resources available were likely to be limited.

(b) On the other hand, it was pointed out that if the scheme were to succeed in its stated objective, export projections would have to be made for a period coinciding with the time-horizons of development plans, which were usually drawn up for periods of four to six years.

(c) There was some discussion of the possibility of a radical change in demand conditions for a given export commodity arising, for example, from the development of a new synthetic. The view was expressed that even if export expectations had been agreed with the Agency, a radical change might call for revision, but this view was criticized on the grounds that this was the kind of risk against which the scheme was designed to insure. It was also pointed out that the long-term prospects for commodities do not alter radically with great speed; development of a synthetic may gradually erode, but will not suddenly remove, the market for a commodity.

7. The relationship between supplementary financial measures and other types of economic assistance both multilateral and bilateral with particular regard to the need to ensure compatibility between them as regards the terms, conditions and criteria on which they are to be provided

(a) Both the compensatory financing facility of the Fund and the proposed Supplementary Financing Scheme are designed to deal with shortfalls in export proceeds. However, while the Fund's compensatory financing facility is designed to compensate for fluctuations about a medium-term trend, the Supplementary Financing Scheme would compensate for shortfalls from reasonable expectations of export proceeds so as to avoid disruption of development programmes. Since the two types of shortfall may be closely interrelated, intimate co-operation between the Fund and the Agency would clearly be required.

(b) Where there is uncertainty as to the nature of a shortfall at the time of its occurrence, it would be natural to have recourse to the Fund's compensatory financing facility in the first instance. The view was expressed that this would be the normal case. It was also suggested that persistence of the shortfall would then indicate the need for supplementary financing in addition. Where, however, it is clear from the outset that the shortfall is of a persistent nature, immediate access to supplementary financing would be appropriate.

(c) In some instances, it might be appropriate for a country to draw upon its ordinary credit facilities in the Fund or upon its reserves before obtaining assistance from the Supplementary Financing Scheme. In such a case, however, it was considered that the Fund's views on the reserve needs of the country concerned should prevail. Moreover, the supplementary financing could not necessarily be regarded as the residual element. Where a country draws on Fund resources as well as on the Supplementary Financing Agency, residual financing would be a joint function of the two institutions.

(d) It was suggested that under UNCTAD recommendation A.IV.18 a country should not have to go beyond the utilization of the compensatory financing facility of the Fund before qualifying for supplementary financing.^{1/}

(e) Attention was drawn to the fact that it was normally considered appropriate to use the compensatory financing facility and other facilities of the Fund only for short-term purposes. Under the Bank staff proposal, however, it may turn out that the IMF facilities are in effect utilized to deal with export shortfalls of a persistent character which should more appropriately be financed by long-term funds. It was doubtful whether a country should be called upon to borrow short for long-term purposes. On the other hand, it was suggested that at the time an export shortfall occurred, it would often be impossible to tell whether the cause was of a short-term or of a persistent character.

^{1/} Paragraph II.4 of Annex A.IV.18 of the Final Act of the United Nations Conference on Trade and Development reads as follows: "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."

(f) The question was raised as to whether the scheme could be used to refinance short-term borrowings, notably drawings from the Fund. It was agreed that this matter should be given further consideration. It was however, pointed out that where a country entered a planning period with Fund borrowings outstanding from the previous periods, the finance plan would reflect that fact, and the provision of basic finance would be adjusted accordingly.

(g) The World Bank study implies that resources provided for the scheme would be additional to those available for basic development finance. Indeed, the scheme rests on the assumption that there would be a prior indication of the level of basic finance available to support a development plan, stretching usually over a period of four to six years. The view was expressed that close collaboration between the Agency and, for example, consortia or consultative groups would therefore be desirable.

(h) Concern was expressed that, considering the existing trend of external assistance, resources allocated to supplementary finance may be at the expense of the normal flow of basic finance. It was also indicated that Governments would wish to give priority to the replenishment of IDA and would be able to consider resources for supplementary finance only in the light of the scale, terms and conditions of IDA replenishment.

(i) Doubts were expressed whether firm prior assurances would be forthcoming not only with regard to the overall volume of finance for the developing countries as a whole, but also for individual countries for periods as long as four to six years. It was suggested, however, that this situation already existed, that developing countries had to adapt their plans to it and that the scheme was not designed to deal with it.

(j) The scheme suggests that in granting assistance to a member, the Agency would also take into account the possibilities of using other sources for offsetting shortfalls, for example, the emergency foreign trade loans of the United States Export-Import Bank, the programme loans and the Food for Peace Programme of the United States Agency for International Development, the World Food Programme, etc.

(p.8). The authors of the scheme did not, however, intend that the Agency would insist on recourse to particular bilateral sources of help before granting assistance. The intention was that agreement on other possible sources of help to be tapped in the event of an export shortfall would emerge in the course of periodic consultations between the member and the Agency.

(k) The question was raised as to what would be the attitude of the Agency toward help from other sources if such credit was available only at higher interest rates or had a shorter maturity period. It was suggested that the Agency, following existing World Bank practice under its Charter, should provide assistance if help from other sources was not forthcoming at reasonable terms and conditions.

8. The comparative effects on economic development of the scheme proposed and of other possible methods which might be employed for the same purpose but with due regard to the primary task laid down in the fifth and sixth paragraphs of the resolution to which the terms of reference of the proposed Group are annexed.

(a) Various types of financial and non-financial schemes could be devised to deal with the problem of unexpected export shortfalls. There was a fear that the scheme, valuable as it might be, might prejudice action on the more basic remedy of organization of markets. Concern was also expressed that the adoption of the scheme should not reduce the incentive to negotiate commodity agreements.

(b) It was agreed that while supplementary financing was not a substitute for a fundamental solution of the commodity problem, it has a useful contribution to make, and the Group should concentrate its attention in this direction.

9. The status, membership and function of the Agency and its relationship with other international bodies, having regard to paragraphs 7 and 8 of Part A of recommendation A.18.

(a) According to one view, UNCTAD recommendation A.IV.18 precludes the establishment of any new Agency. On the other hand, it was suggested that the UNCTAD recommendation on this point was flexible.

(b) Nevertheless, it was considered premature at the present stage to undertake a detailed consideration of the status of the Agency and its precise relations with other international bodies since this presupposed agreement on the basic nature of the scheme which the Agency would be required to administer. However, it was agreed that regardless of the precise legal status of the Agency, an effective implementation of the scheme would imply the closest possible co-operation with the World Bank and the IMF.

CHAPTER II

STUDIES REQUESTED BY THE GROUP DURING ITS FIRST SESSION

1. The relative importance of export shortfalls and other causes of instability in the external financing of development and to the extent possible, estimates of the effects of these causes on selected countries.
2. The Group invited the Bank and the Fund to communicate to the Group any views they may feel able to express on how supplementary finance would fit into the existing international financial system.
3. A revision (to include data as recent as possible) of Table I, "Adequacy of external liquidity to finance fluctuations in exports of some Fund members", on page 19 of the study produced in 1963 by the International Monetary Fund, Compensatory Financing of Export Fluctuations.
4. A study of the differences between and the respective merits of the methods used for the determination of export shortfalls.
5. A presentation of the methods used by the Bank staff in arriving at its estimates of the annual cost of the scheme (in quantitative terms).
6. An estimate of the effects of recent changes in the Fund's compensatory financing facility on the annual cost of the scheme.

Chapter III

ORGANIZATIONAL MATTERS

Opening of the session

1. The session was opened by Mr. J. Everts (Netherlands), Chairman of the Committee on Invisibles and Financing related to Trade.

Adoption of the agenda

2. The provisional agenda issued before the session (TD/B/C.3/AC.3/1) was adopted unchanged, and is reproduced below:

1. Opening of the session
2. Adoption of the agenda
3. Election of officers
4. Organization of work
5. Study of the proposed scheme for supplementary financing
6. Other business
7. Adoption of the report of the Intergovernmental Group on Supplementary Financing to the Committee on Invisibles and Financing related to Trade.

Election of officers

3. The Group decided to postpone the election of a Chairman and elected Mr. Jo W. Saxe (United States) as Vice-Chairman-cum-Rapporteur. Mr. Saxe served as Acting Chairman throughout the first session.

Credentials and attendance

4. Credentials were received on behalf of experts from the following countries: Argentina, Brazil, Ceylon, Federal Republic of Germany, France, Ghana, India, Japan, Poland, Sweden, United Arab Republic, United Kingdom of Great Britain and Northern Ireland, United States of America, Yugoslavia. The following countries designated observers to attend the session: Australia, Austria, Belgium, Bulgaria, Canada, Chile, China, Denmark, Finland, Honduras, Iran, Italy, Netherlands, New Zealand, Pakistan, Philippines, Republic of Korea, Republic of Viet-Nam, South Africa, Spain, Switzerland, Tunisia, Turkey. Representatives of the International Bank for Reconstruction and Development, the International Monetary Fund, the Organisation for Economic Co-operation and Development and the International Chamber of Commerce attended the session. The list of participants is reproduced in Annex E.

Organization of work

5. The Intergovernmental Group had before it the following documents:
Study on supplementary financial measures by the staff of the International Bank for Reconstruction and Development (TD/B/43). Report of the Committee on Invisibles and Financing related to Trade on its resumed first session (TD/B/73-TD/B/C.3/22). Consideration of the scheme for supplementary financial measures contained in the report of the International Bank for Reconstruction and Development - Note by the Secretary-General of UNCTAD (TD/B/C.3/25).
Compensatory financing of export fluctuations, a second report by the International Monetary Fund (Washington, 28 September 1966).
6. The Group decided to hold its second session in Geneva, starting on 6 February 1967, for a period of three weeks.

ANNEX A

Terms of reference of the Intergovernmental Group

1. The Group should examine the study presented to the Secretary-General by the staff of the Bank, in the light of the discussion of it in the Committee. The Group should submit a report on the study (with such modifications to the scheme as it may consider appropriate) as a means of achieving the objective set out in part A of Recommendation A.IV.18 of the first Conference. Having regard to the time-table for the next Conference, the Group should endeavour to submit the report in good time for consideration by the Committee at its second session, in November 1966.
2. The Group should pay special attention to the following points:
 - (i) Questions affecting the scope of the scheme, including the treatment of overages and the regard to be paid to import prices.
 - (ii) The form, terms and conditions for the provision of financial assistance to countries participating in the scheme.
 - (iii) Measures for establishing a relationship between the resources available and the resources required; in this connexion the Group should examine the implications for the scheme of the hypothesis that resources on the scale suggested in the Bank staff study (taking account of any modifications which the Group may suggest) would be available.
 - (iv) The need to establish a boundary between problems of an economic nature and those which fall within the political sphere in the administration of any scheme.
 - (v) Questions relating to the methodology to be applied in the formulation of the projections and the technical assessment of the policies on which the development plans of individual countries are based, the circumstances which may give rise to a claim on the scheme, and the considerations which the Agency should take into account in dealing with such a claim.
 - (vi) The appropriate period of time for which the relevant projections of exports should be established and the concomitant obligations of the Agency and the developing country concerned respectively should be assumed.

- (vii) The relationship between supplementary financial measures and other types of economic assistance, both multilateral and bilateral, with particular regard to the need to ensure compatibility between them as regards the terms, conditions and criteria on which they are to be provided.
 - (viii) The comparative effects on economic development of the scheme proposed and of other possible methods which might be employed for the same purpose but with due regard to the primary task laid down in the fifth and sixth paragraphs of the resolution to which these terms of reference are annexed.
 - (ix) The status, membership and function of the Agency and its relations with other international bodies, having regard to paragraphs 7 and 8 of part A of Recommendation A.IV.18.
3. The Group may also put forward suggestions, for further consideration by Governments, of ways in which the scheme might be financed.

ANNEX B

Questions raised by the French delegation

I. Evaluation of export projections and measurement of shortfalls

Could the Bank and the Fund agree to apply a single method of calculating shortfalls in order to avoid costly duplication and contradictions in diagnosis and solutions ?

Could the Bank work out a method of calculation that would permit deduction from the measured shortfalls of surpluses recorded under the headings of manufactures and invisibles, the word "surplus" to be taken to mean any growth beyond the level attained when the supplementary financial measures are introduced ?

Could the Bank specify the nature of the controls that the Agency might apply to statistics of real exports to ensure that donor countries do not compensate participating countries for fictitious export shortfalls ?

II. Provisions for financial stabilization of development programmes

What data does the Bank think the executive agency should have available - particularly in regard to external financial assistance - in order to reach agreement, with a developing country desirous of participating in the supplementary financial scheme, on its development programme and policy for a period of three to five years ?

III. Concept of surplus and compensation of shortfalls

Since surplus is a statistical concept and supplementary financing is an accounting or financial concept, might the Agency not in fact be constrained to replace the principle of deduction of surpluses by a detailed supervision of the management of foreign exchange reserves by recipient countries and of their import policies ?

IV. Effect of shortfalls on development plans

Since a shortfall will not necessarily affect the financing of a country's development plan, especially where the basic finance is provided from other sources, through foreign loans or domestic public or private savings, could the Bank specify the methods of calculation that the Agency would use to determine the amount of supplementary financing to be granted ?

When the Agency observes that the development plan is held up both by an export shortfall and by a lack of basic finance from domestic or external sources, or by some other political or technical problem, how will it be able to determine what part of the delay is due to the shortfall, and hence calculate the amount of supplementary financing to be granted ?

As the Bank advocates a system that includes developing countries whose plans are incomplete, how does it propose in these cases to measure what degree of disorganization of a plan which is by definition incomplete is attributable to an export shortfall ?

V. Probable cost of the machinery

Can the Bank explain how it has reduced the annual cost from \$1,600 billion to \$400 million, and in particular specify whether the figure of \$400 million represents a "cruising" or a "take-off" rate of expenditure ?

VI. Terms of lending

What criteria will the Agency adopt in establishing the terms governing the loans granted under the heading of supplementary financing ?

ANNEX C

Note by the delegation of the United Kingdom

Discussion of the problems connected with Supplementary Financial Measures in the Committee on Invisibles and Financing related to Trade and the Intergovernmental Group has so far been in general terms. The United Kingdom representatives believe that it may be helpful to show how those problems might arise, and have therefore produced a brief account of how in their view the scheme might work in practice. These notes may of course require modification in the light of discussions presently taking place, and of further material being prepared by the Bank.

How the scheme might work

1. A country would submit to the Agency its proposed development programme covering a period of, say, five years. The plan would set out inter alia target rates of growth for GNP and for exports, the latter based on given assumptions about the market for its main products, together with at least the elements set out on page 48 of the Bank Study.
2. The development plan would be discussed with the Agency, simultaneously perhaps with discussions in other multilateral meetings with donor countries which would be concerned with the total need for aid.
3. The export assumptions would be discussed with the Agency and, if necessary adjusted in the light of an agreed evaluation of world market prospects. The agreed projections would then be adopted as the reasonable expectation for the five-year period.
4. The development plan should now be consistent not only with the agreed export projections, but also with realistic expectations about the availability of domestic and external resources in general, and of foreign aid in particular. The plan should be devised with sufficient flexibility to meet the contingency that some of these latter expectations may not be fulfilled.
5. The country would achieve an understanding with the Agency as to how much of its other possible sources of finance (reserves, IMF compensatory finance, etc.) it would use annually in the event of a subsequent export shortfall or other balance of payments difficulties. It would indicate the measures to economize foreign exchange it might adopt in these circumstances. The country would also agree in general as to the measures required to ensure the success of its plan.

6. (a) If in the first year of the plan the value of its exports were greater than the projected value, it would be noted that the country had experienced an overage and it would neither receive anything from the scheme nor pay anything to it. The Government would have to ensure that the overage became available to it through, for example, some form of taxation or, at any rate, take account of the fact that compensation for future shortfalls might be diminished as a result of the overage.
(b) If its exports were less than the projected value, a "gross shortfall" would be recorded and it would be entitled to supplementary finance from the scheme after having used the previously agreed amount of alternative finance, and put into effect the agreed measures to economize foreign exchange.
7. The Agency, satisfied that the conditions of the scheme had been met (and assuming its own financial resources to be adequate) would disburse to the country an amount equal to the "net shortfall" - the gross shortfall minus alternative finance and the result of the agreed economies in foreign exchange.
8. In any subsequent year, the net shortfall would be calculated in relation to the gross shortfall, if any, minus alternative finance and accumulated overages, if any. The accounts would be adjusted as necessary, to ensure that the country's total receipts from the scheme over the whole period were no more than the sum of all its gross shortfalls, minus all alternative finance, all the economies of foreign exchange and all overages. (This might be adjusted by any refinancing of short-term credits that the Agency would be empowered to undertake.) On the other hand, if total overages exceeded total gross shortfalls minus total alternative finance, the country should on balance receive and pay nothing. It would have to bear in mind that the overages experienced during the period would be taken into account as an offset to the shortfalls occurring later during the period.
9. At the end of the period the books would be closed and the process would begin again with the country's next plan.

ANNEX D

A comparison of the IMF Scheme for Compensatory Finance and World Bank staff proposals on Supplementary Financial Measures 1/

IMF scheme

World Bank staff proposals

Objective of the scheme

1. The IMF scheme seeks to offset the adverse effects on balance of payments of "members, particularly primary exporters" brought about by temporary export shortfalls which are "largely attributable to circumstances beyond the control of the member" (p. 41).
1. The IBRD scheme is expected to provide long-term assistance to developing countries in the event of unexpected export shortfalls from reasonable expectations. The scheme is designed to help developing countries overcome the problems of unexpected export shortfalls that "result in disruption of sound development programmes" (p. 1).

Measurement of shortfall

2. To measure temporary shortfalls in exports, the IMF in conjunction with the member concerned, will seek "to establish reasonable estimates regarding the medium-term trend of the member's exports based partly on statistical calculations and partly on appraisal of export prospects" (p. 41). The medium-term trend value for any given year is defined as "the average of actual exports for five years beginning two years before and ending two years after the year for which the trend value was calculated" (p. 5) "In order to give members some assurance that estimates of the trend value of exports will remain within a certain predictable range", in calculating the trend, "the average level of exports predicted for the two years following the shortfall year will not be assumed to exceed by more than ten per cent the average level experienced in the two years preceding the shortfall year and will not be assumed to be less than the level of exports experienced in the shortfall year itself." (p. 8).
2. In the IBRD proposals, the Agency's initial understanding with the member will include an agreement on export expectations spelled out in the form of a precise projection which is an integral part of a development programme. Export projections will be based "on the analysis of major export commodities" (p. 30) and projections will cover both merchandise exports as well as, where appropriate, invisible items (p. 8). Reasonable expectations are thus established prior to the shortfall rather than ex post. No judgement regarding the short-term character or persistency of shortfall is required. The duration of the export forecast would be "synchronized with the appropriate time-horizon of planning in the member country - normally within a range of four to six years" (p. 9). Since the forecast is an essential part of the development programme it should be subject to revision only as part of a total recasting of the programme. A shortfall which is eligible for financing under the scheme emerges if

1/ Reference to the text in the case of IMF Scheme are to the Second IMF Report on Compensatory Financing of Export Fluctuations; those in the case of the World Bank Staff Proposals are to the study Supplementary Financial Measures (TD/B/43).

actual exports in a given period are less than the projected exports while the member has been effectively implementing the policy package which it initially agreed with the Agency.

Conditionality

3. Under the compensatory finance scheme, the IMF will finance an export shortfall measured as stated above only if it "is largely attributable to circumstances beyond the control of the member" (p. 30) and also that "the member will co-operate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties" (p. 30). The Fund states that in interpreting the last condition in the past, it "has not attempted to reach agreement with the member on what the nature of these solutions would have to be. This has been left to subsequent discussions, and has not stood in the way of prompt action on requests for compensatory drawings" (p. 16). Of course, the Fund scheme is intended to finance only short-term export shortfalls. However, the definition of the medium-term trend itself tends to ensure that any departures from it are of temporary duration so that every shortfall so determined is of temporary duration.
3. The IBRD scheme assumes that the export shortfall as determined above would be considered to be due to factors beyond control only if the member was effectively implementing the understanding with regard to development policies and programmes initially arrived at in agreement with the Agency. As long as the country is following these agreed policies all unexpected shortfalls would be interpreted as being beyond the country's control and the Agency would be under the obligation to provide adequate financing in order to save an agreed development programme from disruption.

Relation of financing to shortfalls

4. Export shortfalls which are considered to be of a temporary duration and are due to factors beyond a member's control can be fully financed by the IMF scheme subject to the following provisions:

"Drawings outstanding ... may amount to 50 per cent of the member's quota provided that (i) except in the case of shortfalls resulting from disasters or major emergencies, such drawings will not be increased by a net amount of more than 25 per cent of the member's quota in any 12-month period, and (ii) requests for drawings which would
4. The amount of financing provided under the scheme would be in most cases "less than the amount of export shortfall in accordance with prior understanding between the member and the Agency, by deducting (a) accumulated overages; (b) other drawings on a member's own reserves, where feasible; (c) use of the IMF compensatory financing facility, or other credit or grant facilities, if available, and (d) that portion of the shortfall that could be absorbed by the country without disruption of the development effort" (p. 66).

increase the drawings outstanding ... beyond 25 per cent of the member's quota will be met only if the Fund is satisfied that the member has been co-operating with the Fund in an effort to find, where required, appropriate solutions for its balance of payment difficulties" (p. 30).

Terms of lending

5. The assistance from the IMF is in the nature of short- and medium-term help to be repayable in 3 to 5 years. In addition, the Fund now recommends that "as soon as possible after the end of each of the four years following a drawing ... the member repurchase an amount of the Fund's holdings of the member's currency approximately equal to one half of the amount by which the member's exports exceed the medium-term trend of its exports" (p. 31). Refinancing of Fund loans under the scheme is possible in that "whenever the Fund's holdings of a member's currency resulting from an outstanding compensatory drawing ... are reduced, by the member's repurchase or otherwise, this will restore pro tanto the member's facility to make a further compensatory drawing ... should the need arise" (p. 31).
5. Assistance from the scheme, in a given projection period, will be in the nature of a long-term debt. However, the scheme also provides that to the extent that shortfalls materializing in the initial phase of the projection were offset by the scheme, the member would have to reimburse the Agency if initial shortfalls were followed by overages during the same projection period (p. 41). It is proposed that "the Agency should base the terms of its finance - the rate of interest as well as maturity - on the overall financial and economic position of the member. "The scheme allows for the possibility that the terms of finance should be geared to the debt servicing capacity of the member country as well as other relevant factors" (p. 59). "Although the terms would vary from case to case, the scheme should be prepared to extend funds on concessional terms in many countries" (p. 60). "By and large, it may prove reasonable to extend assistance under the scheme on about the same terms at which the country is obtaining development finance for other purposes" (p. 60).

ANNEX E

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Union des Industries de Métaux Non Ferreux

File - SFS

WESTERN UNION
TELEGRAM

SIA031 (P CDU554) 21 PD INTL FR CD GENEVE VIA
WUI 17 17 10 (DUPLICATE OF TELEPHONED TELEGRAM)
MR FRIEDMAN

6620 FIRM WOOD COURT BETHESDA (MD)

CHAIRMAN IN CONCLUDING REMARKS NOTED SUPPORT OF ALL LESS DE VELOPED
COUNTRIES FO SCHEME

ADAMS. (350P EST).

IN UNION
GRAM

INCOMING CABLE

DATE AND TIME OF CABLE: FEBRUARY 16, 1967 1407

LOG NO.: RC 3/17
TO: INTBAFRAD
FROM: GENEVE

ROUTING	
ACTION COPY:	MR. FRIEDMAN'S OFFICE
INFORMATION COPY:	
DECODED BY:	

TEXT:

FRIEDMAN ARRIVING DULLES PA 107 1715 HRS FRIDAY 17
PLEASE ADVISE FAMILY

CORDERY

FAMILY NOTIFICATION BEING MADE.

Deftre:

*Advised Mr. Ferguson of arrival
and he is arranging for Mr. Friedman to
be met - Joe is out sick today!*

MP

IRVING FRIEDMAN
CARE BERGUESHOTEL
GENEVA

FEBRUARY 9, 1967

LT

(SWITZERLAND)

PARA ONE RE ROLLING PLANS FOR QUICK BACKGROUND SEE PAGE 43 OUR STUDY AND PAGES
139 TO 141 WATERSTONS BOOK QUOTE DEVELOPMENT PLANNING UNQUOTE UNDOUBTEDLY
AVAILABLE UN LIBRARY STOP MACONE SURVEY RECENT EXPERIENCE REVEALS NOTHING
SIGNIFICANT TO ADD WATERSTON STUDY RE COUNTRIES CITED THEREIN OR GENERAL FINDING
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EACH PLAN AFTER TWO YEARS OPERATION RESULTED IN SUCCESSIVE NEW FOUR YEAR PLANS
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INCLUDED YOUR BACKGROUND MATERIAL

KAMARCK

ANDREW M. KAMARCK
ECONOMICS

Cleared: Mr. C. H. Thompson

AJMacone/hl

INCOMING CABLE

DATE AND TIME OF CABLE: FEBRUARY 6, 1967 1744

LOG NO.: ITT TELEX/6

TO: FRIEDMAN INTBAFRAD

FROM: BASEL

ROUTING	
ACTION COPY:	MR. FRIEDMAN
INFORMATION COPY:	
DECODED BY:	

TEXT:

WOULD BE HAPPY IF YOU COULD JOIN SMALL DINNER PARTY
 I AM GIVING IN HONOUR OF GOVERNOR COOMBS OF RESERVE
 BANK OF AUSTRALIA ON SATURDAY, 11TH REGARDS

FERRAS

MT

INCOMING CABLE

DATE AND TIME OF CABLE: FEBRUARY 7, 1967 1723

LOG NO.: ITT TELEX/7

TO: FRIEDMAN INTBAFRAD

FROM: BASEL

ROUTING	
ACTION COPY:	MR. FRIEDMAN
INFORMATION COPY:	
DECODED BY:	

TEXT:

ON BEHALF OF THE PRESIDENT WOULD LIKE TO INVITE YOU TO LUNCHEON
WITH MEMBERS OF THE BOARD IN HONOUR OF GOVERNOR COOMBS ON SUNDAY,
12TH REGARDS

FERRAS

MT

FERRAS
INTERBANK
BASLE

JANUARY 24, 1967

LT

SWITZERLAND

AM PLANNING TO BE IN EUROPE ABOUT TIME OF FEBRUARY BIS MEETING STOP
WOULD BE HAPPY TO ATTEND YOUR MEETING IF AGREEABLE TO YOU REGARDS

FRIEDMAN
INTBAPRAD

Irving S. Friedman
Office of the President

Distr.
RESTRICTED

TD/B/C.3/AC.3/Conf.Room Paper 39
16 February 1967

Original: ENGLISH

Trade and Development Board
Committee on Invisibles and Financing
related to Trade
Intergovernmental Group on
Supplementary Financing
Geneva, 6 February 1967

Summary of the Remarks made by Mr. Friedman (International Bank) during further
discussion of the policy package on 15 February 1967

1. General remarks

The following attempts to summarize the remarks made during the further discussion on the Policy Package on Wednesday, February 15, 1967, it does ~~not~~ however ^{avoid} attempt to ~~summarize~~ remarks which were already made in the previous discussions and have been circulated to the Group.

2. It is very difficult to predict in advance the future working of an international financial mechanism. It should be noted that the Group was considering and trying to answer how the Scheme might work including future policies and procedures rather than what might be included in an international understanding on the Scheme. Procedures and policies of international financial organizations were adapted in the light of experience and changing circumstances. In this respect a number of questions which were raised on the Policy Package could not be answered definitively at this time. The Scheme was not expected to even begin until 1969 or 1970. One cannot possibly predict with any precision what the Policy Package will be like five or ten years from now. However, it seems safe to say that whatever policy packages prevail at the time for basic finance will also be suitable for Supplementary Finance.

repetition
of

3. As to the influence of international institutions, there is no question of changing the authority of existing international organizations, particularly there is no question of the Scheme exercising authority which has been entrusted by international agreements to existing international organizations. It has been suggested that the choice of policy alternatives in the adjustment process should be left to the countries. There is no objection to such a procedure as long as it conforms with obligations under international agreements and that it is recognized that a country cannot unilaterally decide that it is fulfilling the policy programmes and still be entitled to assistance from the international community. It should be emphasized that no international organization wants to run the economy of a particular country. All countries live with the problem of reconciliation of development objectives with the need for day to day short-term policies. Moreover, for a great many countries and for all of the developing countries, short term policies had normally to operate within the framework of development objectives because of their overwhelming importance for these countries. In certain circumstances changes in the development plans cannot be avoided.

4. Specific questions

(i) How comprehensive should a Policy Package be?

On the basis of present practices, in certain cases it may be fairly comprehensive and in other cases only embody the critical points such as, for example, fiscal policy or management of public utilities. Thus sometimes you may go deeply into a particular question, but the coverage may not be wide. There will, of course, be no need to look in detail into elements which are satisfactory from the development viewpoint.

(ii) Formality

Here again, the attitude will be dictated by the circumstances; at present, these problems are dealt with privately and on a country by country basis. The Ceylon Representative had made a useful distinction between what might be publicized and what should be kept private. What is needed is that the mandate to the Agency should be clear. The additional workload involved will not be too heavy as most of the Policy Package elements are already covered by existing activities. Completely new procedures will only have to be set up for those occasional countries which had no previous arrangements with existing institutions. Most probably, there will be more formality in the future not only because of Supplementary Finance, but as a general trend. Due to the special circumstances of each country, there cannot be a unique type of Policy Package. It would be possible, if requested, to describe some of the different policy packages now in use, eliminating, of course, names of countries involved.

(iii) Criteria

In this respect one cannot have very simple ones, such as growth rates. Others like investment pattern, domestic savings, export effort, need to be considered. The real question is whether a country is making satisfactory efforts for its economic development. A blend of targets and policies could be worked out.

(iv) The nature of the claim

It should be stressed again that the Scheme elaborated by the IBRD Staff is not an automatic one. The Agency will have to make judgements and decisions and the performance of the country will be checked at the time of the unexpected shortfall. However, the Scheme does aim to deal with the serious problem of uncertainty arising out of unexpected export shortfalls. One should make a clear distinction between greater **certainty** and automaticity.

(v) Will Supplementary Finance be an addition to basic finance or a substitute for the latter?

Supplementary Finance should be considered as additional.

(vi) Is there a danger that the very poor countries who badly need additional resources will not be eligible for participation in this Scheme?

The vast majority of countries now have some form of development programme, including the poorest countries. One cannot expect the same behaviour in every country, but what is being sought is determination by each country to give economic development primary emphasis, and clear evidence of this. The Scheme itself is designed to serve needs of several categories of countries.

(vii) Does it underwrite basic aid?

The procedures suggested in the Scheme would lead to a greater degree of comprehension by creditors and donors of the external aid requirements of countries. There would, however, be no legal commitments for the projection periods. It is hoped that the careful examination of development programmes internationally might facilitate the required flows of development capital.

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10 February 1967

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Trade and Development Board
Committee on Invisibles and Financing
Related to Trade
Intergovernmental Group on
Supplementary Financing
Geneva, 6 February 1967

A Comparison of the proposals of the World Bank Staff
as analyzed by the delegation of the United Kingdom
and the proposals of the delegation of the Federal
Republic of Germany 1/

World Bank staff proposals as
analyzed by the delegation of
the United Kingdom

1. A country would submit to the Agency its proposed development programme covering a period of, say, five years. The plan would set out inter alia target rates of growth for GNP and for exports, the latter based on given assumptions about the market for its main products, together with at least the elements set out on page 48 of the Bank Study.
2. The development plan would be discussed with the Agency, simultaneously perhaps with discussions in other multilateral meetings with donor countries which would be concerned with the total need for aid.

Procedures suggested in the
note of the delegation of the
Federal Republic of Germany

1. A country wishing to avail itself of the scheme undertakes to consult fairly regularly with the Agency about its development and economic policy.
2. There would be consultation between the country concerned and the Agency in order to make the necessary adjustments, to encourage diversification, and to facilitate the decision of the Agency to be taken at the time of the shortfall. These consultations could be largely based on the ones already conducted by IBRD/IDA.

1/ This comparison has been compiled on the basis of documents TD/B/C.3/41 (TD/B/C.3/AC.3/16) (Annex C) and TD/B/C.3/AC.3/Conf. Room Paper 16.

3. The export assumptions would be discussed with the Agency and, if necessary, adjusted in the light of an agreed evaluation of world market prospects. The agreed projections would then be adopted as the reasonable expectation for the five-year period.
4. The development plan should now be consistent not only with the agreed export projections, but also with realistic expectations about the availability of domestic and external resources in general, and of foreign aid in particular. The plan should be devised with sufficient flexibility to meet the contingency that some of these latter expectations may not be fulfilled.
- 5 (former 6(b)). If its exports were less than the projected value, a "gross shortfall" would be recorded and it would be entitled to supplementary finance from the scheme after having used the previously agreed amount of alternative finance, and put into effect the agreed measures to economize foreign exchange.
- 6 (former 7). The Agency, satisfied that the conditions of the scheme had been met (and assuming its own financial resources to be adequate) would disburse to the country an amount equal to the "net shortfall" - the gross
- 3 and 4. In the view of the delegation of the Federal Republic of Germany recommendation A.IV.18 does not imply that its purpose is to establish a system of insurance against the uncertainties of projections. After a country has suffered a shortfall in exports by reasons beyond its control and has presented its case, the Agency must examine all relevant circumstances, and will surely be able to recognize and determine shortfalls as such - taking into account the development of export proceeds in the current and in the preceding years.
- 5 and 6. The Joint Committee will examine the cause of the shortfall and in doing so analyse past export developments and their probable development in the future, as well as the economic performance of the country in general. This examination should be speedy in order not to delay financial assistance; a reasonably fast procedure could be assured since conditions in the country are known to the Agency from previous consultations. If the Joint Committee determines that there is an export shortfall of short duration and that the presuppositions of compensatory financing are met it will then

- 6 (former 7) (contd) shortfall minus alternative finance and the result of the agreed economies in foreign exchange.
- 5 and 6. (contd) normally refer the application to the IMF for compensatory financing. However, if the Joint Committee comes to the conclusion that the shortfall is definitely of a long-term nature (e.g. destruction of plantations by natural disaster, or significant change of the market situation due to the appearance of substitutes), it would refer the application to the Agency for supplementary financing. The Agency would then decide upon amount and conditions of supplementary financing, taking into account the need of the country (possible disruption of development programmes), its general performance and all relevant circumstances as well as the availability of the Agency's resources.
- 7 (former 6(a)). If in the first year of the plan the value of its exports were greater than the projected value, it would be noted that the country had experienced an overage and it would neither receive anything from the scheme nor pay anything to it. The Government would have to ensure that the overage became available to it through, for example, some form of taxation or, at any rate, take account of the fact that compensation for future shortfalls might be diminished as a result of the overage.
7. Since the proposal of the delegation of the Federal Republic of Germany does not rely on expectations of export earnings, but rather on an ex post determination of a shortfall, it is presumed that there will be no accounting for overages under their proposed scheme.

- 8 (former 5). The country would achieve an understanding with the Agency as to how much of its other possible sources of finance (reserves, IMF compensatory finance, etc.) it would use annually in the event of a subsequent export shortfall or other balance of payments difficulties. It would indicate the measures to economize foreign exchange it might adopt in these circumstances. The country would also agree in general as to the measures required to ensure the success of its plan.
8. There would be adequate co-ordination between the compensatory financing facility of the IMF and the supplementary financing so that the latter truly "supplements" the existing facilities in cases where this is required. This means that normally supplementary financing should be used only after recourse to compensatory financing in the IMF. There would have to be a body co-ordinating the two institutions, the IMF and the Agency administering supplementary financing. It might be called the "Joint Committee". The Joint Committee would receive and consider applications both for compensatory and supplementary financing. In addition, the IBRD and IMF country studies and reports might conceivably be co-ordinated for the purposes of the scheme within that Committee.
- 9 (former 7) The Agency, satisfied that the conditions of the scheme had been met (and assuming its own financial resources to be adequate) would disburse to the country an amount equal to the "net shortfall" - the gross shortfall minus alternative finance and the result of the agreed economies in foreign exchange.
9. The amount and terms of assistance would be determined according to the merits of each case. A limited fund would be established on the basis of contributions by donor countries and, if possible, other resources. Administration would be by the Agency. This should be one of the existing institutions with wide experience and authority, preferably IBRD/IDA. If the Joint Committee comes to the conclusion that the shortfall is definitely of a long-term nature

9.
(contd) (e.g. destruction of plantations by natural disaster, or significant change of the market situation due to the appearance of substitutes), it would refer the application to the Agency for supplementary financing. The Agency would then decide upon amount and conditions of supplementary financing, taking into account the need of the country (possible disruption of development programmes), its general performance and all relevant circumstances as well as the availability of the Agency's resources.

10 (former 8) In any subsequent year, the net shortfall would be calculated in relation to the gross shortfall, if any, minus alternative finance and accumulated overages, if any. The accounts would be adjusted as necessary, to ensure that the country's total receipts from the scheme over the whole period were no more than the sum of all its gross shortfalls, minus all alternative finance, all the economies of foreign exchange and all overages. (This might be adjusted by any refinancing of short-term credits that the Agency would be empowered to

11. Supplementary financing could also be provided if, after a drawing on the Fund's compensatory financing facility, it were to turn out that the shortfall was not of a short-term nature. This would be the case if e.g. also in the years following a drawing export receipts remain below expectations and if, as a consequence thereof, the danger of an interruption of the development process persists. Another example would be if, at the time of the repurchase falling due, the country were unable to effect repayment or could only do so by sacrificing investments important to development as a result of a persistent shortfall in export proceeds beyond the country's control.

- 10 (former 8).
(contd) undertake). On the other hand, if total overages exceeded total gross shortfalls minus total alternative finance, the country should on balance receive and pay nothing. It would have to bear in mind that the overages experienced during the period would be taken into account as an offset to the shortfalls occurring later during the period.
- 11 (former 9). At the end of the period the books would be closed and the process would begin again with the country's next plan.
12. The form and terms of supplementary financing would be determined in the manner described in the World Bank Study and document TD/B/C.3/AC.3/8.
12. The terms of supplementary financing should be flexible and correspond to the stage of development of the country concerned as well as to its particular situation. Normally, supplementary financing would be extended in a form not tied to particular projects. However, if the Agency were to determine that, e.g. for purposes of diversification or for earning foreign exchange, it is essential and urgent to promote specific projects it could tie its assistance to such projects and thereby assure maximum effectiveness.

ENGLISH ONLY

TRADE AND DEVELOPMENT BOARD
Committee on Invisibles and Financing
related to Trade
Intergovernmental Group on Supplementary
Financing
Second session
Geneva, 6 February 1967

DAILY PROGRAMME

Saturday, 11 February

Salle XI

10:00 a.m.

Twentieth meeting

1. Procedural matters on organization of work for the remainder of the session.
2. Item 4 (continued).

TD/B/C.3/AC.3/PROG.6
GE.67-1988

INTRODUCTION: THE INTERNATIONAL
FINANCING OF ECONOMIC DEVELOPMENT

This is a sketch of those institutions and policies which are intended to provide capital and other assistance for the two-thirds of the population of the free world whose incomes are dismally low, and who must be able to invest more than they save at home if they are to increase them. Almost nothing is said herein about their own efforts. Clearly, these are essential; but so is external assistance. Cooperative arrangements for moving capital from the Western industrialized countries to the LDCs on appropriately easy terms for many years to come is the principal subject of this introduction.

In 1960, the United States invited a number of other countries which were exporting capital or providing development assistance to LDCs to meet regularly in order to concert and increase their efforts in this field. Flows of public funds to LDCs had been small in the early 1950's--only about \$1.9 billion per year on average, net of amortization on existing debt. In the second half of the decade, they doubled. There was a further large increase to about \$6 billion in 1961. From then until now, this amount has not increased significantly.*

The principal reason for this is the very rapid increase in amortization payments which are offsets to gross aid. But now, gross aid is not increasing while amortization payments will rise as grace periods come to an end. Total debt of the LDCs is approaching \$40 billion. The IBRD has recently warned its members that it will be virtually impossible to avoid refinancing or rescheduling in some cases. Widespread use of short-term suppliers' credits, uncontrolled by borrowers and lenders, adds to the acuity of this problem.

One purpose of the United States in taking this initiative was to work out a common, coordinated approach to the problems of raising and productively spending public money for this purpose. Another was to share the burden of development assistance with other Western countries by inducing them to increase and improve their part of the common aid effort.

* For details and a discussion of aid "targets", see Annex 1.

The ad hoc Development Assistance Group which emerged from this first meeting became the Development Assistance Committee (DAC), of the Organization for Economic Cooperation and Development (OECD), which was successor to the Organization for European Economic Cooperation (OEEC). * Its membership changed with its name. The United States, Canada, and somewhat later Japan, became members of the OECD. Later still, Australia became associated with it. Thus constituted, the OECD has among its members all of the major economic powers of the free world, ** and it has within the scope of its activities almost all of the major economic problems likely to arise among them and between them and the under-developed "third world".

This said, the OECD is a consultative body dealing with some, but not all international economic questions. Certain very important questions, notably the Kennedy Round of tariff negotiations, are outside its ken, and much of the business of the United States with other members is political and military. This business, even though it has important economic implications and effects, is through alliance organizations or directly with the countries concerned. Consequently, the OECD and the other arrangements for dealing with international economic problems are parts of a crude, somewhat disjointed, and fragile approximation of an international economic order. Development assistance has only gradually become a part of this approximate order as individual aid-giving countries organized their own efforts and undertook to do some things in common. ***

* For an account of these and other arrangements for coordinating aid, see Annex 2

** The full membership of the DAC is Australia, Austria, Belgium, Canada, Denmark, France, Germany, Italy, Japan, Netherlands, Norway, Portugal, Sweden, U. K., and the U. S. All of the DAC members except Australia are members of the OECD; the other OECD members are Greece, Iceland, Ireland, Luxemborg, Spain, Switzerland, and Turkey. In addition, Yugoslavia and Finland are associated with the OECD in an observer status.

*** For an account of the aid policies and programs of other major aid-giving countries, see Annex 3.

Two major, central international institutions are particularly relevant to the financing of economic development, both of which have close relations with the OECD and the DAC. These are the International Bank for Reconstruction and Development (IBRD) and the International Monetary Fund (IMF). Both were established, as was the OEEC, after the shaky international economic system of the twenties had been destroyed by the events of the thirties and the Second World War. They were a reaction against disorder and disruption, a step toward a system of permanent institutions upon and around which a secure and efficient international economic order could be constructed. They are more specialized than the OECD and are empowered to act directly in providing assistance.

The IBRD lends long-term capital for economic development (now that its loans for reconstruction have been made and largely repaid). The IMF provides short-term money to enable countries which encounter temporary balance of payments difficulties to avoid unduly abrupt domestic or external measures damaging to themselves or their neighbors.

The IBRD administers the International Development Association. Its members have committed themselves to provide it with significant amounts of money so that it may make long-term low-interest loans to the poorer countries of the world. The IBRD also has an important role in the coordination of development assistance as manager of consortia and consultative groups.*

The IMF is able to help with crises, to smooth out sharp fluctuations, and to advise. But it can do no more than fill the temporary gaps in financing development.

There are now regional development banks for Latin America, Africa and Asia.** The first of them, the Inter-American Development Bank, has been active for more than six years and is one of a number of closely related inter-American institutions. The other two, the African and Asian Development Banks, have been created very recently. Taken together, they are a promising addition to the community of international institutions in this field.

* See Annex 2.

**For a description of each, see Annex 4.

The OECD "area" is largely inhabited by relatively wealthy countries. Within it, people, goods, and capital--short and long-term--now move about rather freely. This freedom was gradually achieved during the forties and fifties, largely within the framework of the OEEC and the GATT.

A consequence of this freedom is that what happens in almost any member country is likely to affect others. U.S. regulations of automobile construction in the interest of safety alarm European automobile exporters. When money is tight in New York, and the U.S. balance of payments problem requires measures to restrain exports of capital, U.S. corporations borrow large sums in European money markets and may greatly affect supply and interest rates there.

The record of international economic cooperation among these countries has been reasonably good during recent years. The problems of other countries enter into (but, of course, do not determine) national decisions about interest rates, taxes, wages, and investment. Periodic examination and confrontation in the OECD, discussion with the IMF, as well as direct discussion or negotiation between governments, all play a part in defining the interests of the international economic community of industrialized countries which has grown up so rapidly and with so surprisingly little controversy or disruption since Western Europe recovered from the Second World War. National governments have at least on occasion been willing to take the general interest into account.

To an increasing extent, development assistance has become a part of economic policy, national and international. But the resources available for financing development are still relatively small in amount and poor, but improving (by financial standards at least) in quality. Nowhere is development assistance a central feature of national economic policy. In almost every industrialized country, there are claims which receive a higher priority on the budget and the balance of payments.* This is easy enough to explain but not so easy to justify to those concerned with economic development. The relations of the industrialized countries with one another are closer and more important than are their relations with the LDCs. The rupee can be devalued without a chain reaction; the

* See Annex 3.

currency of major industrial countries cannot. Tariff concessions in the United States are important to Western Europe and vice-versa. The amount of trade between the U.S. and India doesn't justify the same degree of concern. Needs for capital at home are almost inevitably met first. Almost every government schedules access for itself to its own capital market before the IBRD is allowed into it.

The central problem which emerges from the foregoing can be simply stated: How can the richer countries of the world establish a stable system for promoting the economic development of the poorer?

An afterword is in order. Significant amounts of goods are supplied by Eastern Europe and the Soviet Union to LDCs. Credit arrangements make some of these exports a form of aid. This aid is almost wholly outside the arrangements described above. It could be argued that changing times would make it desirable to bring eastern aid within these arrangements.

January 9, 1967

SUPPLEMENTARY FINANCIAL MEASURES
COMMENTS BY THE U.K. DELEGATION ON THE NOTE BY THE
DELEGATION OF THE FEDERAL REPUBLIC OF GERMANY
(CONFERENCE ROOM PAPER 16) AND ON ITS IMPLICATIONS
FOR THE SCHEME.

I have already said that my Delegation welcomes the German paper as a contribution to our discussion. It offers a valuable critique of the study by the Bank which forms the basis of that discussion. We need such frank criticism if we are to bring out the points which need clarification. It is, moreover, an honest and thoughtful attempt to express certain serious doubts about some fundamental aspects of the Scheme. These also must be brought into the open, and we must see whether they can be resolved or whether the Scheme needs amendment in order to remove them. The paper is put forward, as I hope that we all recognise, in a constructive spirit. Our German colleague has made this clear by stating that his Government is prepared to support a Scheme for S.F.M., provided that one can be worked out which they can regard as practicable. I hope that we shall all approach this discussion of the paper in an equally constructive manner.

2. I said in my earlier comments on the paper, when we were dealing with matters of procedure, that I would wish to offer my Delegation's views on the substance of the paper later on. That is the purpose of this present intervention. In general, my Delegation considers that, although the paper contains a number of telling points, many of its criticisms of the Bank's study are based on misunderstandings, some of which have been cleared up in our recent discussions; While we consider that many features of the alternative Scheme suggested in the paper are open to criticism.

3. I shall refer to individual paragraphs of the German paper, but I think it important to group the criticisms which I shall offer on behalf of my Delegation to the concerns which, we think, have prompted them. It is these doubts and concerns, above all, which we have to bring out into the open; in doing so we shall be able to identify the central points on which our further discussion would probably be based. We think that there are six ~~xxxxxxxx~~ points which cause concern to the German Delegation:

- (i) the first is that it would be difficult to refuse entry into the Scheme to any country which could meet a ^{leave} ~~bare~~ minimum of requirements, and that this would much increase the demands which the Scheme would involve (II, 5);
- (ii) the arrangements for prior consultation on all the matters included in the policy package are unrealistically complicated (II, 5);
- (iii) in particular, the export projection included in the package would be insufficiently reliable (II,1);
- (iv) in comparison with the complex trial arrangements, the payment of compensation when a claim was made would be quasi-automatic (I, 2b; II, 3);
- (v) this would give rise to an unlimited commitment by contributing governments (I, 2c and d; II, 5);
- (vi) this commitment would include basic aid (II, 2).

4. I do not propose to comment in detail on the observations about the relationship between S.F.M. and the Fund's Compensatory Financing Facilities. I think that the Bank has made it clear that the S.F.M. Scheme does involve prior drawings under the C.F.F. Scheme where the country is eligible. In the long run, of course, C.F.F. would not contribute additional net resources, since the drawings are short-term and we must assume that after, say five or six years, repayments would balance new drawings and these repayments might well have to be refinanced by S.F.M.

5. I will comment one by one on these six concerns, as I have called them.

6. The first is a valid point. My Delegation agrees that it might be politically difficult to refuse entry to countries which wish to join. Moreover, the Bank has told us that nearly all developing countries have a development programme of some sort. But we note that in the cost estimates which the Bank has now circulated, the reduction in total gross short-falls which is made to allow for countries which do not join the Scheme is relatively small.

7. The second (the complexity of the policy package) is a point on which a great deal of misunderstanding can arise and has arisen. This is perhaps due, paradoxically, to the very quality of the Bank's study; to the comprehensiveness and thoroughness with which these questions are discussed in it. But the Bank has explained that, in fact, the existing work done on individual countries would provide the basic data. I think that we ought to expect little more than some enlargement of the existing processes of consultation. Certainly the Scheme should not depend upon a large increase in the number of consultative groups, for which the Bank has only limited plans. The Agency will certainly wish to discuss beforehand the matters referred to on page 48 of the study; and, if a short-fall should arise, the adjustments for which it would wish to ask (set out on page 50 of the study). But we all realise the probable limitations on the information available and on the ability of an international agency to influence the policies of an individual country, though this is not to underrate the value of the influence exercised by these agencies. We should not expect any revolutionary change, though, as the distinguished delegate for Ceylon has pointed out, existing arrangements would probably become more formalised (CRP 21).

8. As regards the third concern, it is true that export projections are, of necessity, unreliable. It is precisely the uncertainty of these projections which the Scheme is designed to meet. But the evidence in the study suggests to my Delegation that the uncertainty should not be overestimated, and we note that the Bank hopes to improve the technique of forecasting. The real problem is whether this uncertainty might give rise to an unlimited commitment. This raises the next two problems.

9. The fourth, we think, is mistaken. There can be no question of ^{quasi-}quasi-automatic operation as the Bank has explained. Some phrases in the study (e.g. pp. 65-66) may be unintentionally misleading here, but the Bank has explained (and my Delegation would certainly envisage) that any request for assistance would necessitate a complex act of judgement, which would have to take into account such matters as available overages, and possible adjustments to the economy in general and the plan in particular.

10. On the fifth concern, the commitment will be limited because the countries concerned will only contribute limited funds. We should not regard this as unduly restrictive; it is a characteristic of all international financial arrangements and ~~which~~ we should not expect S.F.M. (whatever form the Scheme may take) to be any different. We shall make the best estimate we can, with the advice of the Agency, of the Funds needed to operate a worthwhile Scheme; we may hope that these funds will be provided and that they will be adequate. But the Agency will have to operate with them and within whatever limits they may enclose. It was no doubt for this reason that the Recommendation expressed the hope that "assistance could cover a substantial proportion of a short-fall from reasonable expectations". It did not provide for full cover, and the Group has already discussed the possible need for rationing.

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The Scheme proposed in the German paper would be equally exposed to this possibility once the size of the Fund which it envisages had been determined. We need not, however, be too pessimistic about the probable adequacy of resources (once allowance has been made for off setting factors and policy adjustments) especially if, as my Delegation hopes, progress is made with agreements for individual commodities.

11. Finally, on the sixth concern, the Recommendation does not state or imply that the Scheme will guarantee the basic aid needed to fulfil a development programme; nor, in the judgement of my Delegation, does the Bank study. The Scheme is designed to help to meet short-falls arising from one specific cause. Here, I am afraid, I must differ from the views expressed by the distinguished delegate from Ceylon in his statement circulated as CRP 21 (page 4). I do not find this intention in the study, nor would my Delegation endorse it. All that the Scheme does imply is that, in the initial understanding between the Agency and the country, it should be clear that the country's expectations of aid to finance its development programme are realistic.

12. Turning now to the alternative Scheme outlined in Part III of the German paper, I am afraid that my Delegation feels that it contains some serious weaknesses. I will mention four.

13. It is intended to be simple, compared with the Bank study. But in fact it involves a new Committee, superimposed on existing institutions to coordinate them. We think that the normal process of informal consultation is more appropriate and simpler. Moreover, most of the need for any such machinery surely disappears if it is clear that C.F.F. will in all cases be drawn on first of all when available (III, 2b).

/14.

14. Secondly, it appears that examination of a claim to assistance will take place ab initio when the claim is made, though there is provision (III, 2a) for general prior consultation on development and economic activity. This ex post examination will surely involve delay.

15. Thirdly, the Scheme rejects export projections. But what is the basis on which a claim to assistance can be judged if there is no prior projection with which to compare what has actually happened?

16. Fourthly, the prospects for the recipient countries would be very uncertain. All that they could count upon would be some unspecified amount of aid, derived from judgements, the basis of which would only be indicated in advance in the most general terms.

17. My Delegation considers the German paper most valuable, as I have said, in drawing attention to criticisms of the Bank's Scheme and in expressing concerns which must be satisfied. Our comments may have seemed critical, but we hope that they have responded to the challenge, and thereby furthered our discussion. I should like in conclusion to draw together the main views which emerge from our own comments.

18. What are we to hope for from a Scheme of this kind? Not, as donor countries might fear, a comprehensive underwriting of the total need of developing countries for aid, deriving from a Scheme which, once set up, will automatically involve them in unforeseeable commitments. The Scheme is to be set up to meet one specific need - the prevention of the disruption of development programmes which arises from an unexpected short-fall in export earnings. Its funds will be limited by whatever agreement is made ^{to be financed} through financing; and its operations will constantly require acts of judgement by the Agency under the general ~~xxxx~~ authority of its Board of Governors or Directors. Nor, as the recipient /countries

Agency

countries might fear, shall we have an authority with comprehensive powers, interfering in every aspect of their economic life and dictating their economic policies and the political decisions which these involve. The Agency will have neither the status nor the resources to do this,, even if it wished for or were given the authority to do so. Nor, thirdly, shall we have a new and complicated organisation to supervise international aid or a vast extension of existing arrangements for consultation.

19. What we shall have, in the view of my Delegation, is a Scheme with specific but, we may hope, adequate resources, set up to meet a specific need and doing this as well as it can. It should do a great deal to remove or substantially to diminish one main problem which confronts developing countries in planning their development. It should supplement the commodity agreements which my Government hopes will be negotiated in increasing numbers. It should develop further the dialogue between these countries, the international agencies and the developed countries. Moreover, since the Agency will need to specify the terms on which it will lend to individual countries, it will thereby provide a much-needed standard by which donor countries can judge the terms of appropriate for aid loans to these individual countries.

20. These are substantial aims, though much more modest than those for which some may hope and which some may fear. These are the aims which my Government had in mind when it put forward the original proposal, in company with the Swedish Government. These are the aims which we should wish to see embodied in whatever Scheme this Group may recommend.

Meeting of the Informal Working Group

At the meeting of the informal working group, it was decided to consider the items of the agenda in the following order:

1. Procedural questions.
2. Discussion on studies requested by the Group at its first session but not yet prepared.
3. Items not yet completed (Item 9: the status, membership and function of the Agency and its relationship with other international bodies, having regard to paragraphs 7 and 8 of Part A of recommendation A.IV.18).
4. Item 8: the comparative effects on economic development of the scheme proposed and of other possible methods which might be employed for the same purpose but with due regard to the primary task laid down in the fifth and sixth paragraphs of the resolution to which the terms of reference of the proposed Group are annexed (including Intergovernmental Group on Supplementary Financing: Interim Record of Discussions at its Final Session, Annex B, Note by the delegation of the United Kingdom, TD/B/C.3/AC.3/3/Add.1; and Supplementary financial measures, Note by the delegation of the Federal Republic of Germany, TD/B/C.3/AC.3/Conf. Room Paper 16).
5. Remaining items.

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Trade and Development Board
Committee on Invisibles and Financing
related to Trade
Intergovernmental Group on
Supplementary Financing
Geneva, 6 February 1967

COST ESTIMATES FOR SUPPLEMENTARY FINANCE SCHEME, FOR INITIAL
FIVE YEARS ; COMPUTATION IN BANK STAFF STUDY

		<u>\$ millions</u>
Gross Overall Shortfall Based on Historical Experience		1600 ¹
<u>Adjustments and Other Sources of Financing</u>		
Internal Measures of Adjustment	75	
Greater reliability of projections (effects of new use for projections, need for international agreement on projection, improvement in techniques and data, effects of better policy adherence, etc.)	350	
Use of Reserves	75	
Fund Facility and Overages	400	
Other Sources of Finance	50	950
Total remaining Shortfalls for S.F.S. (i.e. total cost, assuming all countries can use Scheme)		650
Adjustment for countries which do not use Scheme as they do not meet initial requirements or do not implement performance package		250
Financial requirements for Scheme		400

The working of Commodity Agreements e.g. Coffee Agreements reduces Shortfalls. Moreover, the amount assumed above for bilateral aid programmes may well be low. Thus, even \$300 million a year for five years is believed to be a reasonable amount with which to commence Scheme.

^{1/} See Annex IV of Study.

9 February 1967

ENGLISH/FRENCH/SPANISH

TRADE AND DEVELOPMENT BOARD
Committee on Invisibles and Financing
related to Trade
Intergovernmental Group on Supplementary
Financing
Geneva, 6 February 1967

REVISED PRELIMINARY LIST OF REPRESENTATIVES AND OBSERVERS^{1/}

^{1/} Delegations are requested to give corrections or additions, in writing, to the Secretariat in the Conference Room.

TD/B/C.3/AC.3/Misc.2/Rev.1
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7 February 1967

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Trade and Development Board
Committee on Invisibles and Financing
related to Trade
Intergovernmental Group on
Supplementary Financing
Geneva, 6 February 1967

Supplementary financial measures

Note by the delegation of the Federal Republic of Germany

The Delegation of the Federal Republic of Germany to the Intergovernmental Group on Supplementary Financing followed with great attention the course of the deliberations of this Group at its October meeting last year and expressed, on that occasion, its views on a number of the problems which arise in connexion with the scheme for Supplementary Financial Measures proposed by the staff of the IBRD.

In the meantime, we have studied the problems before us anew in the light of what has been said by the participants in the first meeting of the Group. Since, as is well known to the members of this Group, we have certain doubts with regard to some of the salient aspects of the scheme proposed by the IBRD staff, we have considered the question whether one could not find other and, as we feel, more realistic ways of implementing recommendation A.IV.18. The result of these considerations which, of course, are still of a rather preliminary character, was that an attempt should be made to develop a scheme more closely along the lines already indicated in the recommendation itself and, in doing so, to avoid some of the complexities of the proposal of the staff of the IBRD.

We have tried to set out in this note the starting point of our deliberations, and - in part III - to lay down some thoughts about how a feasible solution could perhaps be found. We would be grateful if our note which we have formulated in a constructive spirit found the attention of members of the Group.

*Paper written before this
discussion -*

I.

1. The present discussion on supplementary financing is based on UNCTAD recommendation A.IV.18. This recommendation sets forth in rather general terms, yet with regard to some aspects in a quite distinct manner, a number of ideas as to how a scheme for supplementary financial measures could be instituted. The International Bank was asked to study the feasibility of a scheme on the basis of the objectives and principles embodied in the recommendation.

The study by the IBRD staff is now before us, and it is our task to discuss it thoroughly from all relevant points of view. The study proposes a highly elaborate and comprehensive scheme with many interesting features. All of us have paid it the tribute it deserves. Nevertheless, the proposed scheme raises many questions which up to now, in our opinion, are not yet answered, and there are serious doubts as to whether it can be carried out in practice.

2. It is important to note that with regard to some essential aspects of supplementary financing the IBRD staff proposes solutions or procedures which are not entirely the same as those which are outlined in recommendation A.IV.18. The authors of the scheme, apparently, thought it advisable to interpret some of the guidelines given in recommendation A.IV.18 rather extensively in order to arrive at a more comprehensive scheme, which was, of course, a legitimate approach. Nevertheless, it is interesting to list the points in which there are distinctions between the IBRD staff study and the guidelines given in the recommendation:

- (a) The recommendation provides that the scheme should normally be applicable after a developing country had had recourse to the International Monetary Fund after its compensatory financing facility.

The IBRD staff scheme contains no such close connexion between supplementary financing and IMF compensatory financing; recourse to the IMF is only a possibility.

- (b) The recommendation envisages, once a prima facie case has been established, an examination of all relevant economic circumstances in order to assess how far assistance from the scheme could be required and justified in order to help avoid disruption of development programmes.

The IBRD staff scheme provides for prior agreement between the country concerned and the Agency on export projections, on development programmes and policies, as well as on feasible adjustments. If the country acts within the framework of such agreement and if actual exports fall behind the agreed projections assistance could be granted quasi-automatically.

- (c) The recommendation sets forth that assistance could cover a substantial portion of any shortfall. This means, in our opinion, that the amount will be fixed according to the merits of each case and in the light of what financial resources are available.

The IBRD staff scheme envisages complete or nearly complete compensation (after adjustments have been taken as agreed upon) inasmuch as other sources of financing are not forthcoming.

- (d) The recommendation envisages that the resources for the scheme are prescribed in advance.

The IBRD staff scheme provides for open-end financial obligations of donor countries. The financial requirements of the scheme are determined by its working criteria and are, therefore, theoretically unlimited.

Certainly, there might be differences of opinion about the respective merits of the various features mentioned above. At any rate, it should be obvious that our comments on certain ideas, that have been introduced by the IBRD staff, do not imply any criticism of the basic concept of or a retreat from recommendation A.IV.18.

II.

The doubts we feel as to the feasibility of the Scheme proposed by the IBRD staff may be summed up as follows:

1. The basis of the scheme is determined by the agreed export projections. In our view, export forecasts for a period of up to six years cannot be made with any satisfactory degree of accuracy. This is due to the impossibility of making dependable forecasts on the situation of supply and demand for a multitude of products in a multitude of countries, as well as to the lack of reliable information and statistics. While it is certainly appropriate to use export forecasts as guidelines for development planning - forecasts which, of course, require continuous adjustment as circumstances change - it is not possible to make them the basis of valid financial claims and commitments. By the way, such rigid projections could, after some years, have lost any economic significance and any connexion with reality. They might, therefore, tend to lead to misallocation of valuable resources of the country concerned.

*Not covered
to
enlighten
reference*

In addition, to base financial assistance upon deviations from export projections made long ago would have the strange consequence that a country whose export development had been forecast in a precise manner would receive nothing at all even if its exports were to fall dramatically, whereas a country whose export development was judged unduly optimistically would receive large amounts even if there were no really adverse movement in export earnings.

*Inherent
in
concept*

The basic idea of recommendation A.IV.18 is to give assistance to countries which experience export setbacks, as in the case of a natural disaster or a sudden deterioration of market conditions. We do not understand the recommendation to imply that its purpose is to establish a system of insurance against the uncertainties of projections. In our view, after a country has suffered a shortfall in exports by reasons beyond its control and has presented its case, the Agency must examine all relevant circumstances, and will surely be able to recognize and determine shortfalls as such - taking into account the development of export proceeds in the current and in the preceding years.

*Merely
made
of projects*

2. Another essential feature of the IBRD staff proposal is the policy package. Its basic concept is sound and constructive. However, the question is whether it is feasible. To conclude agreements of the scope envisaged in the study with perhaps 50 - 70 developing countries in any meaningful way would necessitate a

Meaning of devlop process and programming

Ex. Indian financing of exports -
go to IMF as to co-ordination for
non-project financing -

tremendous amount of work and, therefore, require a gigantic administrative machinery. In addition, it has to be considered by developing countries whether they would be prepared to bind themselves with regard to their economic and development policy to such a degree and for such a long period unless they were assured that supplementary financing would cover the whole or almost the whole of a possible shortfall. However, whether that assurance can be given must appear doubtful (see paragraph 5 below). And even if supplementary finance is forthcoming in a substantial way no guarantee could be given with regard to basic financing on which development financing must rely in the first place as far as external resources are concerned.

3. The degree of automaticity which is embodied in the IBRD staff study is questionable. If a country is assured of full or nearly full compensation its will to adjust - beyond the adjustments agreed upon in the policy package - to changing circumstances could be weakened. Efforts towards diversification might be impaired. In addition, there is a financial problem involved (see paragraph 5 below).

4. The IBRD staff scheme does not expressly provide for co-operation between the Fund facility for compensatory financing and supplementary financing. Admittedly, both schemes are defined in a somewhat different way and their basic purposes are not quite identical. However, it is obvious that they both try to give help to those countries which experience a shortfall in export receipts and therefore a shortfall in foreign exchange availabilities. It is only natural and indeed necessary to connect both schemes and to find a reasonable working arrangement between the two. The Bank representative has already, in the course of the October meeting, indicated a certain readiness to consider such a possibility.

Because of the quasi-automatic features of the scheme its financial requirements are, theoretically, unlimited. The financial estimates presented in the IBRD staff study are very global and based on uncertain assumptions. In particular, it is not known how exactly the authors of the study arrived at an annual figure of \$300 - 400 million, after having established by extrapolation of

all
assume countries don't want to develop -
only helping
we assume countries which want to develop

not automatic

not true

policy
issues

Have
decided

Believe
the spirit
to be true -

Have
done
analysis
in IMF
inwards
Belgium

Large
majority -
please

statistical data that the average annual shortfall would be of the order of \$1.2 billion, after deduction of IMF drawings and overages. It does not appear appropriate to base the cost estimate to a considerable extent on the assumption, as may perhaps have been done, that only a limited number of developing countries would participate in the Scheme. Clearly, it was intended by recommendation A.IV.18 that assistance should be given, in principle, to all developing countries which experience export shortfalls and meet the presuppositions set forth in the recommendation. Therefore, the amount needed would probably be much higher than the figure given in the study. By obvious reasons of sound budgetary principles there would be but few prospective donor countries, if any, able to subscribe to an open-end fund. However, if, on the other hand, the financial resources were limited to a fixed amount it would not be possible to implement a scheme so far-reaching and entailing quasi-automatic features.

Not re-

depends on

"limit"

can start with

magnitudes suggested

300 - 400 million

all will financial institutions by virtue
of its members less room for periodic
review of resources and their possible increases.

Agree, if meant means "announced" - not political criteria - and ~~as far as funds available~~
no or not to over finance -

III.

These difficulties involved in the IBRD staff scheme require careful examination. We doubt that they can be overcome. Therefore, we believe that a possible solution to this dilemma might be to go back to recommendation A.IV.18 and to try to work out a system complying more closely with its wording. Such a system would certainly be less elaborate but it might perhaps have the advantage of being realistic and feasible. The following ideas, which are not entirely new ones but are already embodied largely in the recommendation, are submitted for consideration by the members of this Group.

1. In accordance with what has been said above, a realistic plan ought to be based on the following principles:
 - (a) Adequate co-ordination between the compensatory financing facility of the IMF and the supplementary financing so that the latter truly "supplements" the existing facilities in cases where this is required. This means that normally supplementary financing should be used only after recourse to compensatory financing in the IMF. There would have to be a body co-ordinating the two institutions, the IMF and the Agency administering supplementary financing. It might be called the "Joint Committee". The Joint Committee would receive and consider applications both for compensatory and supplementary financing. In addition, the IBRD and IMF country studies and reports might conceivably be co-ordinated for the purposes of the scheme within that Committee.
 - (b) Careful examination of the shortfalls at the time they arise and of all relevant circumstances including performance of the country. Determination of amount and terms of assistance according to the merits of each case.
 - (c) Establishment of a limited fund on the basis of contributions by donor countries and, if possible, other resources. Administration by the Agency. This should be one of the existing institutions with wide experience and authority, preferably IBRD/IDA.
 - (d) Consultation between the country concerned and the Agency in order to make the necessary adjustments, to encourage diversification, and to facilitate the decision of the Agency to be taken at the time of the shortfall. These consultations could be largely based on the ones already conducted by IBRD/IDA.

Agree
interests
advantage
regarding

Agree

Agree
very
close
to

in practice
Fund but in practice nearly all done in advance
to which worked [see (d) below]

2. The following procedure might be conceivable:

(a) A country wishing to avail itself of the scheme undertakes to consult fairly regularly with the Agency about its development and economic policy.

Agree
at least
weekly
①

(b) If, at some point of time, the country suffers a serious shortfall in its export proceeds it will approach the Joint Committee, of which the Agency and the IMF are members, and will present its case.

(c) The Joint Committee will examine the cause of the shortfall and in doing so analyse past export developments and their probable development in the future, as well as the economic performance of the country in general. This examination should be speedy in order not to delay financial assistance; a reasonably fast procedure could be assured since conditions in the country are known to the Agency from previous consultations.

country
sub SPS
//

(d) If the Joint Committee determines that there is an export shortfall of short duration and that the presuppositions of compensatory financing are met it will then normally refer the application to the IMF for compensatory financing. However, if the Joint Committee comes to the conclusion that the shortfall is definitely of a long-term nature (e.g. destruction of plantations by natural disaster, or significant change of the market situation due to the appearance of substitutes), it would refer the application to the Agency for supplementary financing. The Agency would then decide upon amount and conditions of supplementary financing, taking into account the need of the country (possible disruption of development programmes), its general performance and all relevant circumstances as well as the availability of the Agency's resources.

??
OK -

(e) Supplementary financing could also be provided if, after a drawing on the Fund's compensatory financing facility, it were to turn out that the shortfall was not of a short-term nature. This would be the case if e.g. also in the years following a drawing export receipts remain below expectations and if, as a consequence thereof, the danger of an interruption of the development process persists. Another example would be if, at the time of the repurchase falling due, the country were unable to effect repayment or could only do so by sacrificing investments important to development as a result of a persistent shortfall in export proceeds beyond the country's control.

OK if
enough
OK -
Ankle
Ankle
sample?

How
long
delay?

even if large - or uncertain - change ??

(f) The terms of supplementary financing should be flexible and correspond to the stage of development of the country concerned as well as to its particular situation. Normally, supplementary financing would be extended in a form not tied to particular projects. However, if the Agency were to determine that, e.g. for purposes of diversification or for earning foreign exchange, it is essential and urgent to promote specific projects it could tie its assistance to such projects and thereby assure maximum effectiveness.

Agree

[Handwritten signature]

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Committee on Invisibles and Financing
related to Trade
Intergovernmental Group on
Supplementary Financing
Geneva, 6 February 1967

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I.

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- (a) The recommendation provides that the scheme should normally be applicable after a developing country had had recourse to the International Monetary Fund after its compensatory financing facility.

The IBRD staff scheme contains no such close connexion between supplementary financing and IMF compensatory financing; recourse to the IMF is only a possibility.

- (b) The recommendation envisages, once a prima facie case has been established, an examination of all relevant economic circumstances in order to assess how far assistance from the scheme could be required and justified in order to help avoid disruption of development programmes.

The IBRD staff scheme provides for prior agreement between the country concerned and the Agency on export projections, on development programmes and policies, as well as on feasible adjustments. If the country acts within the framework of such agreement and if actual exports fall behind the agreed projections assistance could be granted quasi-automatically.

- (c) The recommendation sets forth that assistance could cover a substantial portion of any shortfall. This means, in our opinion, that the amount will be fixed according to the merits of each case and in the light of what financial resources are available.

The IBRD staff scheme envisages complete or nearly complete compensation (after adjustments have been taken as agreed upon) inasmuch as other sources of financing are not forthcoming.

- (d) The recommendation envisages that the resources for the scheme are prescribed in advance.

The IBRD staff scheme provides for open-end financial obligations of donor countries. The financial requirements of the scheme are determined by its working criteria and are, therefore, theoretically unlimited.

Certainly, there might be differences of opinion about the respective merits of the various features mentioned above. At any rate, it should be obvious that our comments on certain ideas, that have been introduced by the IBRD staff, do not imply any criticism of the basic concept of or a retreat from recommendation A.IV.18.

II.

The doubts we feel as to the feasibility of the Scheme proposed by the IBRD staff may be summed up as follows:

1. The basis of the scheme is determined by the agreed export projections. In our view, export forecasts for a period of up to six years cannot be made with any satisfactory degree of accuracy. This is due to the impossibility of making dependable forecasts on the situation of supply and demand for a multitude of products in a multitude of countries, as well as to the lack of reliable information and statistics. While it is certainly appropriate to use export forecasts as guidelines for development planning - forecasts which, of course, require continuous adjustment as circumstances change - it is not possible to make them the basis of valid financial claims and commitments. By the way, such rigid projections could, after some years, have lost any economic significance and any connexion with reality. They might, therefore, tend to lead to misallocation of valuable resources of the country concerned.

In addition, to base financial assistance upon deviations from export projections made long ago would have the strange consequence that a country whose export development had been forecast in a precise manner would receive nothing at all even if its exports were to fall dramatically, whereas a country whose export development was judged unduly optimistically would receive large amounts even if there were no really adverse movement in export earnings.

The basic idea of recommendation A.IV.18 is to give assistance to countries which experience export setbacks, as in the case of a natural disaster or a sudden deterioration of market conditions. We do not understand the recommendation to imply that its purpose is to establish a system of insurance against the uncertainties of projections. In our view, after a country has suffered a shortfall in exports by reasons beyond its control and has presented its case, the Agency must examine all relevant circumstances, and will surely be able to recognize and determine shortfalls as such - taking into account the development of export proceeds in the current and in the preceding years.

2. Another essential feature of the IBRD staff proposal is the policy package. Its basic concept is sound and constructive. However, the question is whether it is feasible. To conclude agreements of the scope envisaged in the study with perhaps 50 - 70 developing countries in any meaningful way would necessitate a

tremendous amount of work and, therefore, require a gigantic administrative machinery. In addition, it has to be considered by developing countries whether they would be prepared to bind themselves with regard to their economic and development policy to such a degree and for such a long period unless they were assured that supplementary financing would cover the whole or almost the whole of a possible shortfall. However, whether that assurance can be given must appear doubtful (see paragraph 5 below). And even if supplementary finance is forthcoming in a substantial way no guarantee could be given with regard to basic financing on which development financing must rely in the first place as far as external resources are concerned.

3. The degree of automaticity which is embodied in the IBRD staff study is questionable. If a country is assured of full or nearly full compensation its will to adjust - beyond the adjustments agreed upon in the policy package - to changing circumstances could be weakened. Efforts towards diversification might be impaired. In addition, there is a financial problem involved (see paragraph 5 below).
4. The IBRD staff scheme does not expressly provide for co-operation between the Fund facility for compensatory financing and supplementary financing. Admittedly, both schemes are defined in a somewhat different way and their basic purposes are not quite identical. However, it is obvious that they both try to give help to those countries which experience a shortfall in export receipts and therefore a shortfall in foreign exchange availabilities. It is only natural and indeed necessary to connect both schemes and to find a reasonable working arrangement between the two. The Bank representative has already, in the course of the October meeting, indicated a certain readiness to consider such a possibility.
5. Because of the quasi-automatic features of the scheme its financial requirements are, theoretically, unlimited. The financial estimates presented in the IBRD staff study are very global and based on uncertain assumptions. In particular, it is not known how exactly the authors of the study arrived at an annual figure of \$300 - 400 million, after having established by extrapolation of

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statistical data that the average annual shortfall would be of the order of \$1.2 billion, after deduction of IMF drawings and overages. It does not appear appropriate to base the cost estimate to a considerable extent on the assumption, as may perhaps have been done, that only a limited number of developing countries would participate in the Scheme. Clearly, it was intended by recommendation A.IV.18 that assistance should be given, in principle, to all developing countries which experience export shortfalls and meet the presuppositions set forth in the recommendation. Therefore, the amount needed would probably be much higher than the figure given in the study. By obvious reasons of sound budgetary principles there would be but few prospective donor countries, if any, able to subscribe to an open-end fund. However, if, on the other hand, the financial resources were limited to a fixed amount it would not be possible to implement a scheme so far-reaching and entailing quasi-automatic features.

III.

These difficulties involved in the IBRD staff scheme require careful examination. We doubt that they can be overcome. Therefore, we believe that a possible solution to this dilemma might be to go back to recommendation A.IV.18 and to try to work out a system complying more closely with its wording. Such a system would certainly be less elaborate but it might perhaps have the advantage of being realistic and feasible. The following ideas, which are not entirely new ones but are already embodied largely in the recommendation, are submitted for consideration by the members of this Group.

1. In accordance with what has been said above, a realistic plan ought to be based on the following principles:
 - (a) Adequate co-ordination between the compensatory financing facility of the IMF and the supplementary financing so that the latter truly "supplements" the existing facilities in cases where this is required. This means that normally supplementary financing should be used only after recourse to compensatory financing in the IMF. There would have to be a body co-ordinating the two institutions, the IMF and the Agency administering supplementary financing. It might be called the "Joint Committee". The Joint Committee would receive and consider applications both for compensatory and supplementary financing. In addition, the IBRD and IMF country studies and reports might conceivably be co-ordinated for the purposes of the scheme within that Committee.
 - (b) Careful examination of the shortfalls at the time they arise and of all relevant circumstances including performance of the country. Determination of amount and terms of assistance according to the merits of each case.
 - (c) Establishment of a limited fund on the basis of contributions by donor countries and, if possible, other resources. Administration by the Agency. This should be one of the existing institutions with wide experience and authority, preferably IBRD/IDA.
 - (d) Consultation between the country concerned and the Agency in order to make the necessary adjustments, to encourage diversification, and to facilitate the decision of the Agency to be taken at the time of the shortfall. These consultations could be largely based on the ones already conducted by IBRD/IDA.

2. The following procedure might be conceivable:
- (a) A country wishing to avail itself of the scheme undertakes to consult fairly regularly with the Agency about its development and economic policy.
 - (b) If, at some point of time, the country suffers a serious shortfall in its export proceeds it will approach the Joint Committee, of which the Agency and the IMF are members, and will present its case.
 - (c) The Joint Committee will examine the cause of the shortfall and in doing so analyse past export developments and their probable development in the future, as well as the economic performance of the country in general. This examination should be speedy in order not to delay financial assistance; a reasonably fast procedure could be assured since conditions in the country are known to the Agency from previous consultations.
 - (d) If the Joint Committee determines that there is an export shortfall of short duration and that the presuppositions of compensatory financing are met it will then normally refer the application to the IMF for compensatory financing. However, if the Joint Committee comes to the conclusion that the shortfall is definitely of a long-term nature (e.g. destruction of plantations by natural disaster, or significant change of the market situation due to the appearance of substitutes), it would refer the application to the Agency for supplementary financing. The Agency would then decide upon amount and conditions of supplementary financing, taking into account the need of the country (possible disruption of development programmes), its general performance and all relevant circumstances as well as the availability of the Agency's resources.
 - (e) Supplementary financing could also be provided if, after a drawing on the Fund's compensatory financing facility, it were to turn out that the shortfall was not of a short-term nature. This would be the case if e.g. also in the years following a drawing export receipts remain below expectations and if, as a consequence thereof, the danger of an interruption of the development process persists. Another example would be if, at the time of the repurchase falling due, the country were unable to effect repayment or could only do so by sacrificing investments important to development as a result of a persistent shortfall in export proceeds beyond the country's control.

- (f) The terms of supplementary financing should be flexible and correspond to the stage of development of the country concerned as well as to its particular situation. Normally, supplementary financing would be extended in a form not tied to particular projects. However, if the Agency were to determine that, e.g. for purposes of diversification or for earning foreign exchange, it is essential and urgent to promote specific projects it could tie its assistance to such projects and thereby assure maximum effectiveness.

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Observations by Mr. Fleming (International Monetary Fund) on 9 February 1967

1. The "policy package" to which countries participating in the Supplementary Financing Scheme are expected to subscribe at the beginning of planning periods includes several matters with which the Fund is closely connected, such as exchange policies, trade policies (in their balance of payments aspect) and domestic financial policies.
2. In section 4 of the Bank staff paper on the policy package (TD/B/C.3/AC.3/6) it is said that "In reaching an understanding with a member country, the Agency could avail itself of the experience and advice of the IMF on matters within the field of the Fund's responsibilities." In discussions during its first session (TD/B/C.3/AC.3/3/Add.1) this Group concluded that "The IMF is the responsible agency in matters of adjustment arising from balance of payments difficulties. Close co-operation between the Fund and the Agency would therefore be necessary in providing measures of adjustment to be adopted in connexion with the utilization of supplementary finance." In any event, I am confident that the Agent of the Supplementary Financing Scheme, if the Bank has anything to do with its management, will in fact consult the Fund about the initial agreement and will try to act on its advice. The Fund for its part, would certainly seek to co-operate to the best of its ability with any scheme that might be set up as a result of the deliberations of this body, though as I pointed out yesterday the success of this co-operation is bound to be influenced to some extent by the nature of the scheme that emerges. However, I will not conceal the point that the Fund staff has some difficulty in envisaging the modalities and content of this co-operation, particularly as regards the "policy package".
3. What is to be the content as far as Fund matters are concerned of the initial agreement regarding the policies to be followed by the country concerned over the five year planning period? In the first place it seems clear that it cannot contain concrete prescriptions as to monetary, fiscal and exchange policies to be adopted in various possible contingencies over the planning period as a whole though it might do

so with respect to the initial year of that period. The Fund, in making stand-by agreements, does not attempt to prescribe policies for more than a year at a time for the simple reason that the balance of payments situations to which these policies have to be adapted cannot be predicted for more than about a year ahead, if as much.

4. Certain broad policy objectives could, no doubt, be laid down, which countries might seek to attain over the five-year period. For example, that there should be no inflation, no balance of payments restriction, realistic exchange rates, etc. etc., but countries could scarcely undertake to succeed in attaining such objectives, where success depends as much on circumstances as on the good intentions of governments.

5. Another possibility that has been suggested is that countries be asked in the initial agreement to bind themselves to follow such recommendations as the Fund might make subsequently during the lifetime of the Plan, provided that these were compatible with the agreed investment programme. However, there are two problems here. In the first place one wonders whether countries would in fact be willing to give the Fund as much of a blank cheque as this solution would require. In the second place, could the Fund on its side accept the proviso that its policy recommendations should always be compatible with the scale and timetable of the investment programme envisaged in the initial agreement. In certain circumstances, for example in the event of a failure of aid on basic financing to materialize on the scale originally expected, the Fund would be bound to recommend some curtailment of aggregate domestic expenditure, including investment expenditure, in order to make room for the improvement in the balance of current payments that would then become necessary. Admittedly, where the only cause of difficulty in financing the investment programme arose from an export shortfall, such a decline in investment expenditure would not in general be appropriate, though, if the shortfall threatened to persist other means of adaptation might be called for. But a pure case of this sort is rather seldom found. In most situations there are multiple causes of difficulty. Another possible case is where an investment programme that looked perfectly reasonable at the time of the initial agreement turns out to be inflationary - perhaps because of a rise in unplanned investment despite the best efforts of the country concerned - and as a result the country becomes less competitive, and its exports fall below expectations. In such a case the Fund might want to recommend some stretching out or slowing down of planned investment expenditure.

6. I would conclude by saying that, while I have no ready solution for these difficulties, they are likely to be more easily overcome if the scheme itself is such as to encourage and reward the maximum flexibility in the development process.

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Summary of the remarks made by Mr. Irving S. Friedman (International Bank)
in the context of the discussions about the "policy package"

1. For the sake of clarity and taking into account the number of questions dealt with, it seems useful and convenient to group the problems in broad categories.

Nature of the policy package

2. The policy package, which can be understood as an agreement between the Agency administering the scheme and a member country about the development programme and policies which are objectively regarded as appropriate by the international community, is a key feature of the scheme. The IBRD proposal rests on this concept, which is essentially based on actual experience. Export projections are related to the policy package. In the setting up of such a policy package it is possible and advisable to make use of procedures already existing in international organizations like IBRD/IDA, IMF, CIAP, etc.

3. Virtually all developing countries have comprehensive or partial development programmes and these contain export projections, frequently of a detailed character. The scheme is intended to be universal, but some countries may not be in a position initially to participate in a few cases, because of the lack of even minimum development programmes, and in others, because of their inability at the time to pursue economic policies appropriate to development. The situation in this respect is bound to improve, among other things because of the advisory assistance of international organizations. The policy package proposal assumes that as economic development will increasingly assume the highest priority for developing countries, the successful implementation of this approach may help remove some of the existing constraints on the flows of development finance into these countries.

Elements to be embodied in the policy package

4. As the representatives of several donor countries pointed out, questions do arise about the availability of foreign assistance in development programmes. The policy package does not involve the enforcement of any contractual commitments for bilateral aid over a number of years, but it is clear that estimates about the foreign exchange needs of the programmes have to be made and that the developing country must also have some reason to believe that the basic development finance requirements are regarded as reasonable by the donor countries. In order to assess that a shortfall is beyond the control of a country, the policy package cannot be restricted to the export sector only. The factors and policies affecting exports arise in all sectors of the economy.

The problems of flexibility and revisions in development programmes

5. Development programmes are set up for a number of years, but some of their implementing policies cannot be rigid. Nobody would, for example, argue that monetary or fiscal policies can be fixed over time. Flexibility is necessary, but it has to be within a certain framework - that of an agreed development programme. "Rolling" plans, whatever be their theoretical merits, have been impracticable thus far. Continuing consultation and discussion may be expected to keep down areas of disagreement; however, when a disagreement arises between a country and the Agency about the revision of a development programme, the Agency's views should prevail in the ultimate, if the country wishes assistance from the Agency. In practice, these problems are solved by consultation and investigation assisted by informed and objective technicians eager to find the best practical solution.

Limits to the Agency's role

6. The policy package requirements under the supplementary finance scheme may constitute an extension of - but do not go significantly beyond what is already in practice presently. However, the forms may be different and it will be applicable to all member countries. The existence of permanent control of the Agency by the representatives of the national governments constitutes a safeguard against excessive intervention. A certain confidence in international agencies, which are created by governments and ultimately run by them, is of course needed in order to provide them with the necessary authority to carry out their task of judging economic performance. Assessment of economic performance has to be according to economic criteria. Political and social aspects are inevitably involved but economic criteria should rule in judging economic performance. The Agency has one prime objective - to assist in the achievement of sound development.

International and Inter-Agency Coordination

7. Sometimes development programmes of different developing countries may to a certain extent be in conflict with one another. In this case the Agency may well perform a kind of economic arbitration role. To some extent this sort of arbitration is already going on in international financial organizations. The attempt should be made to deal with this problem in collaboration with regional economic organizations and on the basis of economic criteria. As to the co-ordination with the requirements of other organizations, it can be assumed that these requirements fit into a reasonable development programme. So far as monetary and exchange policies are concerned, the views of the IMF would presumably guide the Agency. In general, the policy package represents what a country discusses with and agrees upon with donor countries and international organizations about its development programme when it seeks basic finance. The Agency, in such cases, would not duplicate these efforts or arrive at separate and different understandings. Thus, there is no need for duplication involved in several agencies going over the same ground concurrently.

8. Questions arose about actions of other countries affecting the exports of developing countries. The Agency can only take account of changes in commercial policies that countries have already agreed to in judging the export outlook.

Feasibility

9. The policy package cannot aim at precise enumeration but all the time should seek reconciliation of the sovereignty of a nation with the needs of international co-operation. Therefore, the proposal made by the representative of Ceylon seems a very constructive one, that the public policy understandings would be in broad macro-economic terms, including in particular export earnings, public and private investment, domestic savings etc., while implementation would be left to working relations between the country and Agency. The policy package and the scheme in general would certainly not be "easy" to operate since it was not automatic, but this is true of any non-automatic scheme of international finance. Given the co-operation of member countries, and with the application of objective standards, the administering Agency, with the necessary degree of technical competence, should however be in a position to implement the scheme successfully. Dealing with the more difficult aspects is already part of the going activities in development finance.

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Summary of the Remarks made by Mr. Friedman (International Bank) during further
discussion of the policy package on 15 February 1967

1. General remarks

The following attempts to summarize the remarks made during the further discussion on the Policy Package on Wednesday, February 15, 1967, it does not however attempt to summarize remarks which were already made in the previous discussions and have been circulated to the Group.

2. It is very difficult to predict in advance the future working of an international financial mechanism. It should be noted that the Group was considering and trying to answer how the Scheme might work including future policies and procedures rather than what might be included in an international understanding on the Scheme. Procedures and policies of international financial organizations were adapted in the light of experience and changing circumstances. In this respect a number of questions which were raised on the Policy Package could not be answered definitively at this time. The Scheme was not expected to even begin until 1969 or 1970. One cannot possibly predict with any precision what the Policy Package will be like five or ten years from now. However, it seems safe to say that whatever policy packages prevail at the time for basic finance will also be suitable for Supplementary Finance.

3. As to the influence of international institutions, there is no question of changing the authority of existing international organizations, particularly there is no question of the Scheme exercising authority which has been entrusted by international agreements to existing international organizations. It has been suggested that the choice of policy alternatives in the adjustment process should be left to the countries. There is no objection to such a procedure as long as it conforms with obligations under international agreements and that it is recognized that a country cannot unilaterally decide that it is fulfilling the policy programmes and still be entitled to assistance from the international community. It should be emphasized that no international organization wants to run the economy of a particular country. All countries live with the problem of reconciliation of development objectives with the need for day to day short-term policies. Moreover, for a great many countries and for all of the developing countries, short term policies had normally to operate within the framework of development objectives because of their overwhelming importance for these countries. In certain circumstances changes in the development plans cannot be avoided.

4. Specific questions

(i) How comprehensive should a Policy Package be?

On the basis of present practices, in certain cases it may be fairly comprehensive and in other cases only embody the critical points such as, for example, fiscal policy or management of public utilities. Thus sometimes you may go deeply into a particular question, but the coverage may not be wide. There will, of course, be no need to look in detail into elements which are satisfactory from the development viewpoint.

(ii) Formality

Here again, the attitude will be dictated by the circumstances; at present, these problems are dealt with privately and on a country by country basis. The Ceylon Representative had made a useful distinction between what might be publicized and what should be kept private. What is needed is that the mandate to the Agency should be clear. The additional workload involved will not be too heavy as most of the Policy Package elements are already covered by existing activities. Completely new procedures will only have to be set up for those occasional countries which had no previous arrangements with existing institutions. Most probably, there will be more formality in the future not only because of Supplementary Finance, but as a general trend. Due to the special circumstances of each country, there cannot be a unique type of Policy Package. It would be possible, if requested, to describe some of the different policy packages now in use, eliminating, of course, names of countries involved.

(iii) Criteria

In this respect one cannot have very simple ones, such as growth rates. Others like investment pattern, domestic savings, export effort, need to be considered. The real question is whether a country is making satisfactory efforts for its economic development. A blend of targets and policies could be worked out.

(iv) The nature of the claim

It should be stressed again that the Scheme elaborated by the IBRD Staff is not an automatic one. The Agency will have to make judgements and decisions and the performance of the country will be checked at the time of the unexpected shortfall. However, the Scheme does aim to deal with the serious problem of uncertainty arising out of unexpected export shortfalls. One should make a clear distinction between greater certainty and automaticity.

(v) Will Supplementary Finance be an addition to basic finance or a substitute for the latter?

Supplementary Finance should be considered as additional.

(vi) Is there a danger that the very poor countries who badly need additional resources will not be eligible for participation in this Scheme?

The vast majority of countries now have some form of development programme, including the poorest countries. One cannot expect the same behaviour in every country, but what is being sought is determination by each country to give economic development primary emphasis, and clear evidence of this. The Scheme itself is designed to serve needs of several categories of countries.

(vii) Does it underwrite basic aid?

The procedures suggested in the Scheme would lead to a greater degree of comprehension by creditors and donors of the external aid requirements of countries. There would, however, be no legal commitments for the projection periods. It is hoped that the careful examination of development programmes internationally might facilitate the required flows of development capital.

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Observations of Mr. Fleming, representative of the International Monetary Fund, in the course of the discussions of the Intergovernmental Group on Supplementary Financing on 6 February 1967.

Mr. Chairman, I would like to congratulate the UNCTAD secretariat, if I may, on this paper which very clearly and very succinctly explains the differences between compensatory financing and supplementary financing as proposed.

I think that the exposition is particularly useful in that it should put an end to an idea to which expression has occasionally been given in previous meetings of this body that one scheme is intended to deal with short-term fluctuations and the other with persistent or long-term fluctuations. This is quite clearly not the distinction between the two schemes, as they stand at present.

There is only one sentence of the paper about which I would have some reservations and that is the penultimate sentence which says that the objectives of the two schemes are compatible. Now there is probably a sense in which that statement is, or could be made to be, true, but I do not think it is true in the obvious sense in which it is likely to be taken, namely, that if the two schemes were put into practice, as they are, each of them could achieve its respective objective as described in the paper. By and large the object of a scheme of compensation - or of a scheme of supplementary financing - is to enable the economy of the country affected to be carried on as if it had a level of exports corresponding to the norm from which the shortfall is measured. In the case of the supplementary financing scheme, that norm is an export projection taken at discontinuous intervals, whereas in the case of the Fund scheme, it is a medium-term trend continuously recalculated. Now, since the norms themselves are different, countries cannot possibly behave as if their exports were simultaneously on both norms. I do not think therefore, that in this particular sense, the objectives of the two schemes can be said to be compatible.

My conclusion is that if the broad objectives of smoothing out export availabilities and of obtaining enough export income to maintain development on a desirable scale are to be reconciled, changes might have to be considered in one or other of the schemes.

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Observations by Mr. Flening (International Monetary Fund)
on 8 February 1967

As regards the first passage in my earlier remarks that has been subject to some questioning, I believe that our discussions are in danger of being confused by the rather vague or inconsistent use of terms such as "short-term and long-term fluctuations and shortfalls" and "persistent" and "non-persistent" shortfalls.

In our compensatory financing scheme we have taken short-term fluctuations to mean fluctuations of actual exports round a medium-term trend, or moving average, and we have taken short-term shortfalls to mean negative deviations from such a trend. By analogy medium-term fluctuations would mean fluctuations round a long-term trend and so on. It should be noted that even short-term shortfalls, as we have defined them, though in general they would be short-lived, might on occasion persist for a longer time than would be comfortable, and in this sense, may be persistent, though short-term, shortfalls. In any event, it is clear that the type of shortfall considered in connexion with the supplementary financing scheme does not fall under any of these headings. It is a shortfall not from an export trend but from a five-year export projection.

The difference between a shortfall from a five-year projection and a shortfall from a five-year moving average does not seem to me to be one which can be described as the difference between a long-term and a short-term shortfall.

As regards the second passage which has given rise to difficulty, perhaps I could put my point in a somewhat different way. If the compensatory financing scheme and the supplementary financing scheme as presented in the Bank study were in existence simultaneously, during certain periods it would be only the compensatory financing scheme, and during other periods only the supplementary financing scheme that would be effective. During projection periods for which projections had been pessimistic, the supplementary financing scheme would be out of operation so far as financing is concerned, and the compensatory financing scheme could go ahead doing what it is supposed to do, that is, evening out short-term fluctuations. On the other hand, during projection periods for which projections had been optimistic, the compensatory financing scheme might still be paying out money and taking it back, but it could be serving not its own purposes, but rather those of the supplementary financing scheme for which it would be helping to provide resources.

I will admit that the supplementary financing scheme does contain an element of smoothing out within the projection period. The fact that overages are offset against shortfalls means that, if the projections for the individual years are themselves smoothly distributed over the period, the export availabilities of the country will be smoothed out also, so that one of the objectives of the compensatory financing scheme will, to some degree, be fulfilled though not by the compensatory financing scheme itself. However, the other main objective of the compensatory financing scheme, which is to keep export availabilities from getting too far away from actual exports, will not necessarily be fulfilled. The effects of this will show up at the end of such a projection period, when there may be a rather abrupt transition from a level of export availabilities which is supported by large amounts of supplementary financing back to a level at which projected and actual exports coincide. In other words, there may be an abrupt fall in export availabilities at the end of such a period, the very sort of thing which compensatory financing is supposed to try to smooth out. But the compensatory financing scheme is in no position either to prevent this taking place, or to mitigate it. I would say that in such a situation, the objectives of the supplementary financing scheme would not be implemented.

There is still some reluctance to believe that the distinction between the supplementary finance scheme as contained in the Bank study and the basic financing arrangements does not correspond to a distinction between long-term and short-term shortfalls. To bring out the point more clearly, let us suppose a country has the sort of fluctuations in its exports that everybody would recognize as being long-term fluctuations, say a regular ten-year cycle or something like that. Now, if a cyclical decline were correctly anticipated at the time the export projections were made, there would be no shortfall whatever under the supplementary financing scheme, which seems to show that that scheme, as presented, is not intended to deal with long-term shortfalls in any normal sense.

At this point perhaps, I should make it clear that I have not been discussing the question of compatibility as between the UNCTAD recommendation on supplementary financing and the compensatory financing scheme. Frankly I believe that the recommendation contained two separate and possibly not quite consistent trends of thought; on the one hand, it dealt with persistent shortfalls and seemed to assume that these were the same type of shortfalls as the Fund was dealing with, except that they went on for a long time. On the other hand, it also suggested a new definition of shortfall in terms of reasonable expectation. Now as I understand it, the Bank, in its study, has essentially followed up the second strand of thought rather than the first, and has made it into a consistent system. Therefore, my remarks about problems of reconciliation do not relate to that part of the original resolution which deals with the persistence of shortfalls of the Fund type.

Coming back to what the distinguished representative of the United Kingdom was saying, I would certainly agree that technically the two schemes are completely compatible, but technically you can have a cooling mechanism and a heater operating simultaneously in the same room. That would be technically compatible but it would not make sense. This is an exaggerated analogy, but it brings out the point. The whole question is not whether the two schemes in their present form could run together but whether, if they did so, they would attain their respective objectives. However, I would like to say that there is not the slightest doubt in my mind that the objective of smoothing out export availabilities and the objective of providing for adequate finance for sound development are as such, entirely compatible.

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page 4

I would be inclined to agree with the distinguished representative of Ceylon that the main difficulties are those which arise over the policy package - the difficulties we have been discussing, though important, are not the most important. But the difficulties with regard to policy packages arise more on ordinary Fund drawings, or Fund advice to its members, than on the compensatory financing scheme because that scheme is to a considerable extent automatic in its application; the policy conditions are lighter than those that are normally applied to Fund drawings in the credit tranches. I also agree with him very much that the Bank and Fund have always managed in the past to co-ordinate their activities and I am sure they will do their best to do so under all circumstances, but clearly the closer the principles of the scheme of supplementary financing are to the principles of which the Fund is the guardian internationally the easier such co-ordination will be.

TRADE AND DEVELOPMENT BOARD
Committee on Invisibles and Financing
related to Trade
Intergovernmental Group on Supplementary
Financing
Second session
Geneva, 6 February 1967

DAILY PROGRAMME

Friday, 10 February

Salle XI

10:00 a.m.

Nineteenth meeting^{1/}

Study of the proposed scheme for supplementary financing including consideration of the studies requested by the Group (Item 4) (TD/B/C.3/AC.3/5, TD/B/C.3/AC.3/6, TD/B/C.3/AC.3/7, TD/B/C.3/AC.3/8, TD/B/C.3/AC.3/10, TD/B/C.3/AC.3/11, TD/B/C.3/AC.3/12, TD/B/C.3/AC.3/13 and TD/B/C.3/AC.3/15).

The afternoon meeting will be announced.

Documents

Documents relating to the agenda items of the sessions will be available at UNCTAD documents distribution counter on the second floor of the Assembly Block near Door 13, telephone extension 4206, and a limited number of documents will be available at the documents counter in Salle XI.

^{1/} Since this is the second session of the Intergovernmental Group on Supplementary Financing and for the sake of continuity, the meetings are being renumbered beginning from the last (tenth) meeting of the first session.

LIST OF SUPPLEMENTARY BACKGROUND MATERIAL

13 July, 1965	Mr. G.D. Woods - Proposals for Development Finance.	
21 July, 1965	International Economic Association. Round Table Conference on Capital Movements and Economic Development. Remarks by Irving S. Friedman at Inaugural Meeting, Washington, D.C.	
9 February, 1966	Economic Committee (Confidential Report) IBRD Study on Supplementary Financial Measures.	EC/O/66 -20
April, 1966	Reprinted from 'The World Today' Irving S. Friedman - In Defence of Development.	
9 May, 1966	UNCTAD Meeting on Supplementary Financial Measures.	SEC.M.66 -148
9 May, 1966	Report on the Meeting of the UNCTAD Expert Committee on Expansion of Trade among Developing Countries.	SEC.M.66 -149
26 May, 1966	United Nations Conference on Trade and Development.	SEC.M.66 -185
28 October, 1966	Letter from S. Bell of UNCTAD in New York with revised Summary of Discussion of Item 5 of Terms of Reference of the Intergovernmental Group on Supplementary Finance.	
November, 1966	Report from Mr. J. Saxe, the U.S. Rep: to the Intergovernmental Group. 'The Effect of various Balance of Payments Items on Foreign Exchange Availability'.	
14 November, 1966	Economic Work of the World Bank Group.	SEC.M.66 -358
29 November, 1966	Intergovernmental Group on Supplementary Financing: Interim Record of Discussions at its First Session.	TD/B/C.3 /AC.3/3/ Add.1.
9 December, 1966	Report on the first meeting of the UNCTAD Intergovernmental Group on Supplementary Financing.	SEC.M.66 -384
6 January, 1967	Letter to Dr. Raul Presbisch in answer to his of 20 December, 1966.	

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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

OFFICE OF THE SECRETARY-GENERAL OF THE CONFERENCE

REF. NO.

TDS 241(1)
Sup.Fin.Mtg.

26 January 1967

Dear Mr. Friedman,

Thank you for your letter of 20 January 1967 enclosing a brief paper on the subject of import prices in connexion with supplementary financial measures. This will be most helpful for the coming session of the Intergovernmental Group.

Yours sincerely,



Raúl Prebisch

Mr. Irving Friedman
Economic Adviser to the President
International Bank for Reconstruction
and Development
1818 H Street, N.W.
Washington, D.C.

DATE RECEIVED

JAN 30 1967

No reply necessary

RECEIVED
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1967 JAN 30 PM 10:42

INTERNATIONAL DEVELOPMENT
ASSOCIATION

INTERNATIONAL FINANCE
CORPORATION

ROUTING SLIP

Date

Jan. 20, 1967

OFFICE OF THE PRESIDENT

Name

Room No.

Mr. Woods

President's Council

Action

Note and File

Approval

Note and Return

Comment

Prepare Reply

Full Report

Previous Papers

Information

Recommendation

Initial

Signature

Remarks

Attached hereto is the final memorandum which we promised to prepare for the next session of the Intergovernmental Group on Supplementary Finance.

From

Irving S. Friedson

January 20, 1967

Dear Dr. Prebisch,

I now forward a brief paper on the subject of import prices for purposes of Supplementary Finance Scheme. In this note, the nature of the available data on import prices is discussed and the question is also dealt with whether import prices should be an integral part of the Scheme's approach. I do hope this would provide a basis for further discussion of the subject at the forthcoming session of the Intergovernmental Group.

With warm regards,

Yours sincerely,

(signed) Irving S. Friedman

Irving S. Friedman

Dr. Raul Prebisch
Secretary-General
United Nations Conference on
Trade and Development
United Nations
New York, N.Y.

cc: Mr. Sidney Dell
Office of the Secretary-General
United Nations Conference on
Trade and Development
New York, N.Y.

SUPPLEMENTARY FINANCE: CONSIDERATION OF IMPORT PRICES

1. The UNCTAD resolution suggested that 'adverse effects from significant rises in import prices' would be one of the relevant economic circumstances to be examined. The Bank Staff Study recognized that, ideally, export shortfalls should be calculated in real terms; that this could be done by concentrating attention on unforeseen deviations in the international purchasing power of exports. The Study points out, however, it may not be practicable in many cases to measure changes in import prices within a reasonable margin of error. In estimating the likely scale of operations under the Scheme, it was noted that consideration of import prices would probably make little difference.

2. The question of import prices came up for general discussion at both the meeting of the Committee on Invisibles in April 1966 and the first session of the Inter-Governmental Expert Group in October 1966. The principal questions emerging out of these discussions can be summarized as follows:

- (a) Is it possible to obtain an estimate of the additional cost that might be incurred by the proposed Scheme if provision were made to take adverse movements in import prices into account in the administration of the Scheme.
- (b) In what way could a provision that movements in import prices be taken into account in determining the amount of aid that the Scheme should make available to a given country be administered.
- (c) What is the availability and character of existing import price indexes for the developing countries and what are the solutions to the statistical problems that these may present.

3. The crucial question is whether import price indexes constitute a sufficiently accurate measure of price movements to warrant their use in any mechanism for adjusting transactions under the Scheme. A survey of the results of recent research by the Bank staff on the subject of both export and import price indexes indicates that existing indexes are used widely as a useful tool for analyzing general world trade problems. Any conclusions derived from such use, however, are subject to qualification regarding the weaknesses and limitations of the indexes; the available indexes leave much to be desired, particularly if an attempt is to be made to use them for critical measurements.

4. The principal problem lies in the inherent difficulty of devising a true indicator of price movements for a group of manufactured products, particularly capital goods, i.e. a statistical measure whose movements would reflect only changes in price and not also other changes, such as the utility or efficiency of the individual products or changes in the composition of the group. This problem still remains to be solved.

5. For a developing country the composition of imports, and particularly manufactured goods, can change rapidly. In Brazil, for example, the share of transport equipment (in terms of value) varied between 45% and 13% of total imports of manufactures in the period 1959-1963, and within the transport category, the share of motor vehicles dropped from 49% in 1959 to a negligible proportion in 1963 while the share of airplanes rose from 10% to 38%. Such shifts in composition cause price indexes to give a distorted view of the true situation. Frequent changes of index weights, under such circumstances, can also lead to exaggeration of the extent of changes in prices.

6. Another main difficulty relates to measuring price changes in the individual components of the index. Unit value indexes of machinery, for example, are frequently based on declared value divided by weight. In such a case, as the machinery becomes lighter and more efficient, its index price would automatically rise. In cases where unit values were computed by reference to numbers, a shift toward the purchase of fewer but larger machines of equal capacity would also result in an incorrect price signal. Beyond these mechanical difficulties there lies the further problem of taking account of improved quality of new products. The most familiar illustrations regarding the difficulties of reflecting quality changes are automotive tires and batteries, which have shown a continuous improvement in efficiency and service life for which, however, no adjustment is made in the unit prices used in an index.

7. Thus, the statistical difficulties involved in including a full-scale consideration of import prices in working out the Scheme are indeed real. An attempt should, of course, continue to be made for improving the data, but this is a separate and time-consuming process. Assuming this were done, should they be considered an integral part of the Scheme's approach and calculations?

8. At the time a country's development program is formulated and subsequently agreed upon for purposes of arriving at an understanding regarding basic development finance, the entire balance of payments prospects for the Plan period are considered; the import requirements are a main part of this exercise, and certain assumptions regarding the course of import prices would have been made by the country and built into the

estimation regarding import needs. There can of course be uncertainty regarding this aspect, as there can be in respect of other aspects, such as development aid and private capital flows. The Scheme itself, however, is based on the finding that export shortfalls have been a main factor of uncertainty, that they are disruptive of development, and that they are measurable. It so happens there is considerable experience in the World Bank in this area of export projections for a period of one to several years. The UNCTAD resolution addressed itself to this specific cause of disruption of the development program and seeks a remedy to it. Accordingly, the Scheme does not purport to make good shortfalls from any or all causes but only from this major one. If the Scheme, and the underlying calculations, were extended to cover other aspects like import prices, the statistical underpinning would become questionable, and implementation, therefore, might be rendered significantly more difficult.

9. At the same time, it must be recognized that for particular countries, from time to time, a significant rise in import prices may pose a difficult problem. Conversely, when a country suffers an export shortfall, simultaneously it may have been afforded considerable relief by a fall in import prices. This particular aspect merits further consideration by the Group; i.e. whether the administering agency should consider such cases, on an individual basis, after the export shortfall has occurred, on the basis of the available prices data for imports of a particular country. Here again, the question arises whether sufficiently reliable import price data would be available at the time the export shortfall became apparent. There is, of course, the other question: would import price adjustments be for total exports or only for shortfall amounts?

10. Another possible approach, in view of such statistical and other difficulties, would be not to bring into the Scheme the consideration of import prices in the initial 5 years, and based on the actual working of the Scheme in the initial period, subsequently to consider these other refinements and considerations.

OFFICE MEMORANDUM

TO: Mr. I. S. Friedman

DATE: January 20, 1967

FROM: Bela Balassa

SUBJECT: Comments on "Supplementary Finance: Consideration of Import Prices."

1. In the concluding paragraphs, the memorandum suggests two possible ways of dealing with the import price question: (a) the Group should consider the possibility that the agency administering the Scheme would deal with import prices on an individual basis in the event that either a rise of import prices creates a balance-of-payments problem for the country in question or a fall in prices cushions an export shortfall; (b) to exclude the consideration of the import price issue in the first five years of the operation of the Scheme and to reconsider the problem afterwards.
2. The first-mentioned alternative would open a Pandora-box of disagreements between the administering agency and the countries involved concerning the empirical basis of measurement; it would be especially difficult for the agency to adjust export shortfalls downwards without protest from the country in question. Accordingly, I would favor the second alternative. At the same time, it seems to me that the memorandum is rather ambiguous in its discussion of the practical obstacles to the first course of action and it lacks clarity in examining the statistical difficulties of measurement.
3. I suggest deleting the statement according to which "a survey of the results of recent research on the subject of both exports and import price indexes indicates that existing indexes are used widely as a useful tool for analyzing general world trade problems." (para. 3). Rather, it should be noted that in the use of indices their limitations are often not taken into account. In this connection, it may be added that while errors of measurement may be reduced by averaging the indices of a large number of countries, such errors can be quite large if the index of a single country is used -- as would be done under the Scheme.
4. In the following paragraphs, there is some confusion between price and unit value indices. While the former are constructed from prices of narrowly defined commodities as are domestic price indices, the latter are derived from customs data by dividing the value of trade by the quantity of exports and imports for specific products. Now, since the commodity definitions used in calculating unit value indices usually include a heterogeneous group of commodities, the reliability of the unit value indices is much lower than that of the price indices (in trade statistics, the latter are used only by Germany and Japan). The reliability of these indices is especially low in the developing countries that use much fewer -- and hence broader -- commodity groups in constructing the indices than is the case in developed countries.

5. Let me add that the conclusion reached in regard to Brazil in para. 5 is correct only if transport equipment is taken as a single commodity category in calculating unit value indices. If automobiles and airplanes are taken as separate commodities, there is no distortion due to the shift in importation from the one to the other provided that Laspeyres-type value and volume indices are used in the calculations.¹

¹

In this case, the value index has the form $\frac{\sum p_1 q_1}{\sum p_0 q_0}$ and the volume index $\frac{\sum p_1 q_1}{\sum p_0 q_1}$. Dividing the second into the first, we get $\frac{\sum p_1 q_1}{\sum p_0 q_1}$ as the unit value index.

BBalassa/pam

cc: Mr. Macone
Mr. Jalan
Mr. Gassner

TO:

A:

Mr. Irving Friedman

FOR ACTION		POUR SUITE A DONNER
FOR APPROVAL		POUR APPROBATION
FOR SIGNATURE		POUR SIGNATURE
PREPARE DRAFT		PROJET A REDIGER
FOR COMMENTS		POUR OBSERVATIONS
MAY WE CONFER?		POURRIONS-NOUS EN PARLER?
YOUR ATTENTION		VOTRE ATTENTION
AS DISCUSSED		COMME CONVENU
AS REQUESTED		SUITE A VOTRE DEMANDE
NOTE AND FILE		NOTER ET CLASSER
NOTE AND RETURN		NOTER ET RETOURNER
FOR INFORMATION		POUR INFORMATION

This is a copy of the letter
as sent to all members
of the group

Date:

18/1

CR. 13 (11-64)

FROM:

DE:

Sidney Deen

TDS241(1-1) Intergovt. Group
Suppl. Financing-2nd session.

17 January, 1967.

Dear Mr. Koinzer,

I should like to indicate where matters now stand as regards documentation for the second session of the Intergovernmental Group on Supplementary Financing. As regards the cost of the scheme, the World Bank representative will come to the second session prepared to discuss this subject orally with the Group. Regarding the relative importance of export shortfalls and other causes of instability, the World Bank considers that somewhat greater precision may be required before an effective study could be done.

There are a number of matters which could, perhaps, be considered in some depth at the second session, notably the issues considered in the World Bank's papers on Shortfalls and Overages, The Form and Terms of Assistance, and the Policy Package. I am hopeful, moreover, that the World Bank will be able to make available to the second session additional papers on the important questions connected with import prices, invisibles and the use of projections.

Other material available to the Group includes the study of the differences between methods used for the determination of export shortfalls, and the revised table requested from the International Monetary Fund by the Group, which is now in the process of being circulated. Work is also being done on the effect of recent changes in the Fund's compensatory financing facility on the cost of the scheme, although I am not sure whether the results of this work will be available to the second session of the Group.

Mr. Helmut Koinzer
Ministerialrat
Bundswirtschaftsministerium
Bonn-Duisdorf
Federal Republic of Germany

/.....
DATE RECEIVED

JAN 19 1967

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Although no paper has been received on the relationship between the World Bank's scheme and the compensatory financing facility of the Fund, the Group may consider it useful to pursue this question in greater depth with the assistance of the representatives of the World Bank and Fund.

I should like to stress that these are personal views, and that the Group is, of course, entirely free to move the discussion in any direction it chooses.

I look forward to seeing you again on 6 February.

With kindest regards.

Yours sincerely,

S.Dell, Director
New York Office of UNCTAD

*Gale
copy*

INTERNATIONAL DEVELOPMENT
ASSOCIATION

INTERNATIONAL FINANCE
CORPORATION

ROUTING SLIP

Date

January 19 1967

OFFICE OF THE PRESIDENT

Name

Room No.

Mr. Woods

President's Council

Action

Note and File

Approval

Note and Return

Comment

Prepare Reply

Full Report

Previous Papers

Information

Recommendation

Initial

Signature

Remarks

Attached are some additional memoranda
which we have sent to the Intergovernmental
Group on Supplementary Finance

Handwritten notes and signatures:
m-2
7-3
20, 1, 4, 2, 3, 7
SP

From

Irving S. Friedman

ROUTING SLIP		Date <i>1/12/68</i>
NAME		ROOM NO.
<i>Mr Friedman</i>		
To Handle		Note and File
Appropriate Disposition		Note and Return
Approval		Prepare Reply
Comment		Per Our Conversation
Full Report		Recommendation
Information		Signature
Initial		Send On
<p>REMARKS</p> <p><i>I've re-read and proofed this paper and it is O.K. Please note that on page 9, footnote 2 refers to invisibles paper. I assume that will go forward, too.</i></p>		
<p>From <i>A J Hoover</i></p>		

EXPORT PROJECTIONS IN THE WORLD BANK

Introduction

Due to the critical importance of foreign exchange earnings in the economic development and growth of less developed countries the projection of future foreign exchange earnings plays a central role in any assessment by the Bank of the problems, potential, and needs of its developing member countries. Since primary commodities account for by far the bulk of the total current account receipts of most developing countries, however, the work of the Bank in the field of export earnings has been concentrated and has been most systematically developed in the commodity sector of the export earnings situation. Attention to this sector has been further reinforced by the fact that for developing countries primary commodities frequently also raise development issues other than those related strictly to the financing of development programs.

This paper, therefore, focuses first and primarily on the Bank's work in the field of commodity projections, and secondly on the projection of other foreign exchange earnings, in the context of the country-by-country economic analysis work done in the Bank.

Commodity projection work

In the years since World War II there has been an increasing interest in the projection of demand, supply and prices of the principal internationally traded commodities over medium and longer term periods. This interest has been stimulated by a number of factors, among them:

- (a) the need in the low income countries heavily dependent on exports of primary products to know the likely world demand prospects for these products, since the latter will influence the resources available for development, and also will help to determine whether the production of these products should be stimulated or not;
- (b) the search by the less developed countries for increased stability in their export prices, and for solutions to the surpluses that have developed from time to time in some of their major export products;
- (c) the widespread adoption of full employment and a steady increase in per capita income as major national policies or goals in most countries, which, if quantified, in turn require quantitative estimates of major imports in the future;
- (d) the desire in many industrialized countries dependent on supplementary imports of food and raw materials to anticipate future trends so as to avoid disruptions in the functioning of their economies, or plan more rationally their domestic production policies in the field of primary commodities.

Some international economic organizations such as FAO and the regional commissions and including the IBRD, have been engaged in making commodity projections for some time in connection with the carrying out of their responsibilities. Work in this field, however, has never been as widespread or at such a high level of activity as it is today. Moreover, as experience is being gained, there is also developing a tendency for those engaged in this type of work to seek ways to improve and refine their methodology and to discuss with one another both the problems of commodity projection and the results of projections themselves.

The following is a brief review of the methods and problems of commodity projections based on the Bank's experience in this field.

Purpose of Commodity Projections in the Bank

Commodity projections have the following principal uses in the Bank:

- (a) for making balance of payments projections in country economic reports that assess creditworthiness or the financial feasibility of development programs, irrespective of the magnitude or nature of the World Bank Group's lending operations in the country concerned;
- (b) in formulation of economic judgments on the future allocation of investment resources among alternative lines of production in member countries, and the adequacy and feasibility of government policies affecting the development process;
- (c) for the economic and financial evaluation of projects that involve primary commodities directly (e.g. development of mines, factories or agricultural smallholder production schemes) or indirectly (e.g. roads, ports or power facilities the services of which are oriented toward production and export of particular commodities);
- (d) in formulation of Bank views and policies regarding the general problems of the export trade of the developing countries.

Of these primary uses of the Bank's commodity research by far the most frequent one is that relating to country economic reports, which are used for a number of purposes including assessing the creditworthiness and economic performance of member countries, the provision of technical assistance in the economic field and providing the World Bank Group and other lending institutions with an objective and car

prepared appraisal of a country's economy and outlook from the viewpoint of development. Individual projects requiring a commodity projection as an important part of their economic evaluation also arise from time to time, past examples including projects for the production of pulp and paper, manganese and iron ore, steel, and fertilizer materials. More recently, cooperation with UNCTAD has increased the use of commodity work in the context of general policy considerations in the field of international trade and development.

Basic Approach

The basic approach to commodity work and projections in the Bank is determined by their ultimate end-uses as outlined above. Accordingly, the Bank's commodity work is highly empirical and pragmatic. It is basically quantitative but still subject to qualitative alteration based on available information on prospective changes in technology or other factors not reflected in historical data. The bulk of the analytical work proceeds on a commodity by commodity basis.^{1/} It is characterized by continuous review and study by a specialized staff of all available information relating to the current and prospective economic and technical trends in the commodities

^{1/} Each staff member engaged in this work, however, is responsible for a group of products, rather than a single one. Consolidation of all such work in a single organizational unit responsible for analyzing export trade generally makes possible continuous cross-fertilization among the individual specialists and the testing of the consistency of the individual projections with trends in the aggregate trade of the developing countries.

of interest, including published reports and studies prepared in other organizations and institutions.

The Bank's commodity projections assume substance in two forms: individual basic commodity studies and unpublished internal staff papers. Most of the work is in the form of staff papers that form substantial dossiers on most of the principal internationally traded primary commodities of importance to the developing countries. Over the years, however, basic studies involving projections have been circulated to member governments of the Bank on coffee, medium and extra-long staple cotton, wool, rubber, pulp and paper, fats and oils, aluminum, lead and zinc, iron ore and manganese ore. Projections of other major commodities plus revisions of the studies just mentioned have taken the form of internal staff papers.

Methodology

Commodity projections usually consist of a group of inter-related, internally consistent estimates of the future supply, demand and price prospects of a commodity, based on explicitly stated, reasonable assumptions. These assumptions may rely heavily on past experience and particularly on observed historical relationships between the quantitatively measurable variables pertaining to a commodity (i.e. its consumption, production, stocks and price) and various macro-economic variables, such as population, gross national product or income, fixed capital formation, production or consumption of other commodities, or indices of industrial production or its components. Projections are

analogous to algebraic equations; indeed, at the highest levels of abstraction, if all necessary data are available, they may be expressed entirely as a set of simultaneous equations.^{1/}

Briefly, at present the procedure commonly used in the Bank involves these basic steps:

- (a) Analysis of the long term and recent trends in the production, consumption and price of the commodity; attempts to establish, through simple or multiple regression equations, what relationships exist among the relevant variables (and particularly between consumption and relevant macro-economic variables such as population, income and industrial production) and how persistent these relationships have been;
- (b) Preliminary projection of world or regional demand in the commodity as a function of independently projected trends in the macro-economic variables to which it has been found to be closely related and assuming constant prices;^{2/}

^{1/} The Bank's current research program in the field of commodity studies calls for increasingly combining the more advanced econometric techniques with the more traditional econometric methods.

^{2/} The projection of the macro-economic variables lies in a separate field of endeavor and for purposes of this paper may be considered as "given". In recent years the Bank has relied for such projections on the work of the OECD, governmental and other planning bodies or institutions in the developed countries and assessments contained in its own economic reports in the case of most developing countries. The macro-economic variables most commonly projected are gross national product (or national income) and industrial production. Very briefly, such projections for the industrialized countries (which are the biggest consumers of primary products) lean heavily on assumptions concerning the future size and composition of the population and the labor force. On the basis of further assumptions concerning working hours, productivity, and the rate of capital inputs, a framework is created for estimating GNP or national income at some future date under conditions of full employment, assuming the absence of war or any serious depression in the intervening years. (This does not exclude cyclical behavior except that which is so violent as to have far-reaching retarding or other disruptive effects on the economy).

- (c) Preliminary independent projection of future probable production or production capacity based on statistically derived supply-price functions or industry surveys of expansion plans;
- (d) Analysis of the effects of projected demand and capacity or output on price, including examination of the possible effects of recent or impending technological developments (e.g., trends in inter-material substitution, including new uses for some traditional products, expected changes in food habits, and changes in future costs of production due to trends in yields or productivity) on historically derived relationships; this also entails successive reconciliation of the supply and demand with price;
- (e) Determination of probable trade flows based on comparisons between prospective levels of consumption and production by region and/or country.

These steps lead to an estimate of future demand, supply and price on a global basis. The global consumption estimates usually consist of the aggregation of country or regional consumption projections. The production estimates are often derived from global, regional or individual country supply analyses, depending on which ones show the most stable characteristics in relation to price and demand trends. In a growing number of cases, e.g., copper, lead, zinc, iron ore, tea, rubber, coffee, pulp and paper, and fertilizer raw materials, comprehensive industry or inter-governmental surveys of planned expansions are also available. Country shares implied or explicit in the global analysis are evaluated and are subject to readjustment in the light of findings in individual countries by Bank economic missions. If mission reports indicate that

major readjustments are required in previous estimates of prospective supplies from countries accounting for an important share of the market, the existing projections are reviewed to determine the possible effect on demand, prices, and the shares of other producing countries.

On the basis of the Bank's experience in the past, it appears that mastery of the art of projecting demand objectively is far more advanced than that of projecting supply and price. However, much progress is being made, especially through the increasing use of the econometric approach, in the development of improved objective techniques for deriving reliable functions encompassing all the variables. Essential to this progress is the continuation of the very encouraging rate of growth in the volume and quality of economic statistics gathered and published under the auspices of national governments, industry associations, the United Nations and its specialized agencies and other international organizations.

Even the most sophisticated and statistically reliable econometric model, however, is tied to structural relationships in the historical past. In a dynamic world of rapidly changing technology these historical relationships are subject to change in the future. In the final analysis, therefore, the end product of the projection process must entail expert judgment regarding such factors as the possible future impact of current and imminent developments in industrial technology and human consumption habits, impending changes in national or international economic policies, or changes in the institutional framework of an industry that could affect producer marketing strategy. For this reason it is believed that an essential feature of commodity projection work must be a competent staff of individual specialists who are not only versed in the basic analytical

techniques but also have an intimate and up-to-date knowledge of all economically significant aspects of individual commodities. In addition to enabling better anticipation of future structural changes, this approach also makes possible the necessary continuous review of existing projections.

Projection of other export earnings

In order to complete the projection and analysis of the prospective balance of payments of borrowing member countries, the Bank also must make projections for their prospective earnings from exports of products other than primary commodities and from sources other than merchandise. The development of such projections has been traditionally decentralized in the Bank and has been carried out on a relatively ad hoc or country-by-country basis. There are a number of reasons for this procedure. Firstly, for most developing countries, non-primary merchandise exports^{1/} form a very marginal and often extremely diversified part of total exports. Secondly, the same is largely true, in most cases, of earnings from invisibles.^{2/} Thirdly, for many of the components of both the residual merchandise exports and for invisible earnings, there is no world market that can be clearly defined, or profitably followed on a continuous basis.

Projections of these export earnings items, therefore, are made by each country economic mission to the extent necessary in the light of their importance for the country in question and for the problem at hand. In general, projection of these items relies heavily

1/ For purposes of this paper certain intermediate products, such as unwrought metals, cotton and jute textiles, and lumber and plywood are considered to be primary commodities.

2/ See Document on the contribution of invisibles to foreign exchange earnings.

on an analysis of past trends. In addition, however, members of country missions review these trends, whenever they are of significance, with responsible government agencies and officials in order to determine the effect of relevant government policies and programs, and prospective developments in domestic capacity (in the case of manufactures), on the possible impact on future earnings from these sources. To the extent that these items become of generally increasing significance to developing countries, increasing attention may be expected to be devoted to them in the context of the Bank's work. In items where a "world market" concept is conceivable (e.g., in tourism) more systematic and continuous studies no doubt will be attempted. Where such a concept does not apply, the problem would probably be handled through more intensive study on a country-by-country basis.

THE CONTRIBUTION OF "INVISIBLES" TO FOREIGN EXCHANGE EARNINGS

1. In the IBERD Staff Study on Supplementary Financial Measures, export receipts from which shortfalls are to be measured have been defined to include "merchandise and, where appropriate, invisible items". At the meeting of the Committee on Financing and Invisibles in April 1966 where the Study was considered, and later at the first meeting of the Intergovernmental Group on Supplementary Financing, questions were raised as to the reliability of statistics on invisibles as well as the practicability of including these in the definition of export receipts from which shortfalls could be measured.

2. The attached note examines the importance and composition of invisibles in the aggregate exchange earnings of 41 developing countries. The available statistics show that on an average, invisibles have been quite significant in the total current account receipts of the countries studied, but the average has been considerably affected by the importance of invisibles in a few countries (e.g. Korea, Jordan, Israel, Panama, Libya, Mexico, Vietnam, Morocco). Moreover, the composition of invisibles differs among countries: for example, in Mexico the major item has been tourism, in Korea, government transactions and in Israel private transfers. The principal question is whether shortfalls in some of these items should be included in the definition of export receipts for the purposes of Supplementary Finance Scheme.

3. In the opinion of the IBERD Staff, the judgment as to whether it is appropriate to include invisibles should depend not only on the size of

invisibles in the current account earnings of a country, but also on the nature of invisibles as well as their composition. The appropriateness of including invisibles for the purpose of a Supplementary Finance Scheme would then have to be decided on a country by country basis.

THE CONTRIBUTION OF "INVISIBLES" TO FOREIGN EXCHANGE EARNINGS

Concepts

Invisibles are defined to include the following broad categories of transactions and are identified in the balance of payments as formulated by the IMF in the following manner:

Item 3 - Freight and Insurance

This relates to freight received by domestic carriers on shipments to foreign countries as also to freight received for transport of goods between any two foreign countries. Similarly, insurance covers insurance receipts on international shipments.

Item 4 - Other Transportation

This covers receipts from foreigners for services rendered by inland waterways, coastal shipping, railways and airlines, e.g. passenger fares, bunkering, stevedoring, port dues, etc.

Item 5 - Travel

The main component of this is "tourism" but it also includes receipts from foreign business travelers, students, government officials and other travelers.

Item 6 - Investment Income

Receipts under this head cover transferred income from financial investments abroad and include undistributed earnings of corporate direct investment enterprises, other undistributed dividends as also interest payable but added to principal amounts of outstanding assets.

Item 7 - Government Transactions Not Included Elsewhere

Under this head are included domestic expenditures by foreign governments in respect of their diplomatic and military personnel, payments received for services rendered under foreign aid programs, sale proceeds from purchases of real estate by foreign governments, etc.

Item 8 - Other Services

This item comprises a variety of payments received for services such as non-merchandise insurance premia, wages and salaries received by nationals from foreign non-governmental employers, management fees, underwriting commissions, etc.

The above six categories of 'invisibles' are characterized as "services" and constitute, along with merchandise exports and non-monetary gold, the goods and services account of the balance of payments. Quite frequently, the concept of a current account is also used; it includes besides the items referred to above, "private transfers".

Private transfers cover all non-governmental transactions which lack a 'quid pro quo'. They include such receipts as tax refunds received by private nationals, other taxes and fees, non-contractual pensions and, most importantly, so-called migrants' remittances, besides voluntary contributions received by private persons and institutions.

Statistical Limitations

There are numerous difficulties in assessing the precise contribution of receipts from "invisibles" to a country's foreign exchange earnings. The complexity of the transactions involved despite the formalized classification adopted by the IMF makes reporting difficult. Quite frequently no

breakdown of the various components of "services" is given and in some instances no data whatsoever are available. A less frequent but serious difficulty arises from the fact that figures for the various items are shown on a net basis: this leads to an understatement of "gross receipts" since a credit figure under one head might be net of some payments and a 'debit' figure does not necessarily mean that the country earned nothing whatsoever from that source. A further difficulty stems from the not uncommon practice of combining receipts from more than one source or of including them in the catch-all "other services". For example, earnings from freight and insurance are sometimes included with those from "other transportation" or under "other services".

Analysis of Data

Despite these limitations, the data are sufficiently reliable to reveal what relationship receipts from 'invisibles' bear to total current account earnings and which are the more important items. Data were compiled for 41 developing countries for the period 1956-1963^{1/} and the summary results are shown in Annex Table 1. The Table indicates that total receipts from invisibles as a percentage of total current account (exports plus invisibles) for the period were on an average 19.4 per cent for the 41 countries. Earnings from "services" for these countries amounted on average to \$3,335 million in the 8 years 1956-1963 and correspond to 20.4 per cent of their earnings from merchandise exports, inclusive of non-monetary gold. If private transfer payments are also taken into account, their average annual receipts from "invisibles" rises to \$3,933 million or 24.0 per cent of exports.

^{1/} The Federation of Rhodesia and Nyasaland comprising the present Malawi, Rhodesia and Zambia is treated as one area for the period in question.

For the period in question, the data also indicate that the average rate of growth in earnings from invisibles has been greater than that in merchandise exports per se, e.g. during 1956-1963 exports rose by 3.4 per cent annually, whereas earnings from invisibles rose by 4.3 percent. Consequently, the weight of "invisibles" in gross external earnings had risen somewhat: in 1956 they corresponded to about 18.6 per cent of aggregate receipts on current account; by 1963 the proportion had risen to 19.4 per cent.

Except in the recession year 1958, earnings from invisibles displayed a steadily upward trend during the period as a whole (vide Table II). The most rapid rate of growth among the various sources of earnings from invisibles was in 'private transfers' category, which averaged 9.7 per cent per year during the period. This was followed by receipts from freight (7.0 per cent per year) and travel (5.6 per cent per year).

The relative contribution of each item in the invisible earnings of each of the 41 countries is summarized in Table III. The picture that emerges is broadly as follows:

"Travel"^{1/} is the most important constituent accounting for some 22.3 per cent aggregate receipts from "invisibles". However, only in the case of Mexico was "travel" of overriding significance, contributing about nine-tenths of aggregate receipts from invisibles. Mexico also accounted for over 60 per cent of the total receipts from travel of all the 41 countries taken together.

^{1/} Source: International Travel Statistics, 1963; International Union of Official Travel Organizations.

"Freight, Insurance and Other Transportation" is the next largest source of income from invisibles in the countries studied. Together they constitute about one-fifth of the aggregate earnings from invisibles. For some countries, e.g. Argentina, Ceylon, Chile, U.A.R., receipts from this item were by far the most important in their total receipts from services.

An equally important source of invisible earnings for most countries studied is the catch-all item "other services". It accounted for a little over 20 per cent of the annual invisibles earnings for these countries.

The next largest single source of income is "Government Transactions Not Included Elsewhere". Receipts under this head constituted the most significant item in the aggregate invisible earnings for a few countries, e.g. Korea, Libya, Morocco, Pakistan, Philippines, Thailand.

Investment income receipts form but a relatively minor part of total earnings from invisibles of the less developed countries (LDCs), for the 41 countries studied. Such receipts constituting, on average, about 5.9 per cent of their gross earnings from invisibles. Nevertheless, it is significant that they were about the most volatile element in "invisible" earnings; the year-to-year fluctuations in their case being much sharper than in other items of invisibles receipts. Data also indicate that over the period 1956-1963 as a whole, the annual average receipts from this source, in contrast to other items, declined by a small amount for the group of 41 countries taken together.

Private transfers contributed on average about \$598 million to the 41 countries in 1956-1963 or 15.2 per cent of total invisibles.

Table IV shows the relative weight of invisibles in the total current account receipts of the 41 countries ranked according to the share of invisibles in total earnings. In eight of these countries (viz. Morocco, Vietnam, Mexico, Libya, Panama, Israel, Jordan and Korea) average receipts from invisibles over the period 1956-63 were over one-third of their total receipts on current account. For Panama, Israel, Jordan and Korea the contribution of invisibles was over 60%. For Panama and Jordan "other services" consisting largely of earnings of Panamanians working in the Canal Zone and Jordanians working abroad, were of overriding importance. In the case of Israel "private transfers", consisting largely of personal and institutional remittances from abroad, and for Korea "Government transactions not included elsewhere", were the largest source of income from invisibles.

However, it is interesting to note that for a majority of these countries (25 out of 41), the average contribution of invisibles over the period 1956-63 to total current account was less than 19.4%, which is the average for all 41 less-developed countries taken together. The average contribution of invisibles to the total current account of these 25 countries taken together was only 10%.

Table I

Summary Statement of Gross Receipts from Merchandise Exports, Non-monetary Gold
and "Invisibles" of 41 Less Developed Countries

-Calendar year data in millions of U.S. dollar equivalent-

	<u>1956</u>	<u>1957</u>	<u>1958</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>Annual Average 1956-63</u>
Exports of merchandise and non-monetary gold	15,294	15,778	14,711	15,502	16,465	16,575	17,416	19,109	16,357
Gross receipts from services of which:	3047	3307	3123	3025	3382	3431	3540	3820	3335
Travel	737	817	736	809	902	961	997	1066	878
Government n.i.e.	698	726	690	568	601	578	637	718	652
Investment income	238	231	200	198	245	289	219	216	231
Freight, insurance and other transportation	602	631	631	656	821	858	930	952	760
Other services	773	902	864	794	812	743	756	864	814
Total goods and services	18,341	19,085	17,835	18,527	19,848	20,006	20,955	22,929	19,692
Private transfers	448	423	435	578	627	677	763	827	598
Total gross receipts from merchandise exports and invisibles	18,789	19,508	18,270	19,104	20,474	20,682	21,719	23,756	20,290
Total Invisibles	3495	3730	3558	3603	4009	4108	4303	4647	3933

N.B. Totals may not add up because of progressive rounding.

Source: IMF Balance of Payments Year Books.

Table II

Annual Percent Changes in Gross Receipts from
Invisibles and Merchandise Exports of 41 countries, 1956-63

	<u>1956-57</u>	<u>1957-58</u>	<u>1958-59</u>	<u>1959-60</u>	<u>1960-61</u>	<u>1961-62</u>	<u>1962-63</u>	<u>Cumulative Annual Average 1956-63</u>
Freight, Marine Insurance and Other Transportation	4.8	0	4.0	25.2	4.5	8.4	2.4	7.0
Travel	10.9	-9.9	9.9	11.5	6.5	3.7	6.9	5.6
Investment Incomes	-3.0	-13.4	-1.0	23.7	18.0	-24.2	-1.4	-.2
Government, n.i.e.	4.0	-5.0	-17.7	5.8	-3.8	10.2	12.7	.9
Other Services	16.7	-4.2	-8.1	2.3	-8.5	1.7	14.3	2.0
Total Services	8.5	-5.6	-3.1	11.8	1.4	3.2	7.9	3.4
Private Transfers	-5.6	2.8	32.9	8.5	8.0	12.7	8.4	9.7
Total Invisibles	6.7	-4.6	1.3	11.3	2.5	4.7	8.0	4.3
Merchandise Exports and non-monetary gold	3.2	-6.8	5.4	6.2	.7	5.1	9.7	3.4
Total Receipts	3.8	-6.4	4.6	7.2	1.0	5.0	9.4	3.5

N.B. A minus (-) sign is for a decline.

Source: IMF Balance of Payments Yearbooks

Table III.

Average Annual Receipts from Merchandise Exports and Invisibles, 1956-1963
-in \$ million-

	Exports including non-monetary gold	Freight insurance and other transportation	Travel	Investment Income	Government n.i.e.	Other Services	Total Services (2-6)	Private Transfers	Total Invisibles (7+8)	Total Current Account Receipts
Argentina	1068	92	6	20	10	31	157	4	161	1229
Bolivia	66	*	1	*	2	1	4	1	5	71
Brazil	1337	46	14	3	25	66	154	15	169	1506
Burma	236	4	*	4	7	6	22	2	24	260
Ceylon	363	24	2	6	8	10	50	1	52	415
Chile	445	24	20	-	12	7	62	7	69	514
China (Taiwan)	188	11	2	1	11	5	30	10	40	228
Colombia	533	37	16	1	4	30	88	5	93	626
Costa Rica	84	3	7	*	2	6	18	2	20	104
Dominican Republic	149	6	5	1	2	5	18	2	21	170
Ecuador	139	-	4	*	3	3	10	1	11	150
El Salvador	124	1	5	1	1	5	12	2	14	138
Ethiopia	75	4	2	2	8	1	17	3	20	95
Ghana	301	8	3	12	3	22	49	*	49	350
Guatemala	119	2	6	1	4	3	15	1	17	136
Haiti	37	2	6	-	3	1	12	5	17	54
Honduras	74	1	1	1	1	2	6	*	7	81
India	1380	88	32	36	86	78	320	129	449	1829
Indonesia	772	16	*	7	4	19	46	*	46	817
Iran	800	4	6	2	22	20	54	3	57	857
Iraq	600	20	18	11	10	*	60	1	61	661
Israel	203	61	24	11	7	29	131	199	330	533
Jordan	14	2	9	2	4	17	34	3	37	51
Korea	37	5	1	4	68	3	81	31	112	148
Libya	70	3	2	2	34	13	54	1	55	125
Malawi, Rhodesia, Zambia	560	14	9	31	2	25	81	30	111	671
Mexico	828	*	539	-	11	41	591	5	596	1424
Morocco	351	18	26	6	136	8	295	11	206	557
Nicaragua	77	7	2	*	3	4	16	*	16	93
Pakistan	376	15	1	8	39	31	94	12	106	482
Panama	55	7	29	2	4	44	86	3	89	144
Paraguay	38	1	1	-	2	2	5	1	7	45
Peru	417	11	20	*	7	20	57	9	66	483
Philippines	542	5	3	7	58	52	125	54	179	721
Sudan	189	2	1	5	6	10	23	1	24	213
Syria	146	24	11	-	13	10	58	9	67	213
Thailand	401	10	6	7	19	11	53	5	58	459
UAR	476	156	9	16	4	79	263	13	276	752
Uruguay	151	4	27	1	3	3	36	*	37	188
Venezuela	2467	25	2	14	2	66	110	-	110	2577
Vietnam	69	5	-	6	3	20	33	15	48	117
Total	14356	768	878	231	654	809	3331	596	3931	20,287

* Indicates an amount less than 1.

N.B. Discrepancy in totals due to rounding.

Source: IMF Balance of Payments Yearbooks

Table IV

Invisibles as % of Total Current Account for 41 Countries
(Annual Average, 1956-63)

	<u>Services</u>	<u>Private Transfers</u>	<u>Total Invisibles 1+2</u>	<u>Total Current Account</u>	<u>Invisibles as % of Total Current Account</u>
Venezuela	110	-	110	2577	4.3
Indonesia	46	*	46	817	5.6
Iran	54	3	57	857	6.7
Bolivia	4	1	5	71	7.2
Ecuador	10	1	11	150	7.5
Honduras	6	*	7	81	8.8
Burma	22	2	24	260	9.2
Iraq	60	1	61	661	9.2
El Salvador	12	2	14	138	10.1
Brazil	154	15	169	1506	11.2
Sudan	23	1	24	213	11.3
Dominican Republic	18	2	21	170	12.4
Guatemala	16	1	17	136	12.5
Ceylon	50	1	52	415	12.6
Thailand	53	5	58	459	12.6
Argentina	157	4	161	1229	13.2
Chile	62	7	69	514	13.5
Peru	57	9	66	483	13.7
Ghana	49	*	49	350	14.0
Colombia	88	5	93	626	14.8
Paraguay	5	1	7	45	15.6
Malawi, Rhodesia, Zambia	81	30	111	671	16.5
Nicaragua	16	*	16	93	17.2
China	30	10	40	228	17.6
Costa Rica	18	2	20	104	19.2
Uruguay	36	*	37	188	19.7
Ethiopia	17	3	20	95	21.1
Pakistan	94	12	106	482	22.0
India	320	129	449	1829	24.6
Philippines	125	54	179	721	24.8
UAR	263	13	276	752	27.2
Haiti	12	5	17	54	31.4
Syria	58	9	67	213	31.6
Morocco	195	11	206	557	37.0
Vietnam	33	15	48	117	41.0
Mexico	591	5	596	1424	41.9
Libya	54	1	55	125	44.0
Panama	86	3	89	144	61.8
Israel	131	199	330	533	61.9
Jordan	34	3	37	51	74.0
Korea	81	31	111	148	75.0

Source: Table III

* Indicates an amount less than 1.

file
Intergovernmental

January 18, 1967

Dear Dr. Prebisch,

I am transmitting herewith copies of two additional papers prepared for the Intergovernmental Group on Supplementary Finance. I am also sending copies to Mr. Dell.

We are working on a paper on Import Prices which I hope to be able to send to you shortly, with a copy to Mr. Dell.

Sincerely yours,
(signed) Irving S. Friedman

Irving S. Friedman

Dr. Raul Prebisch
UNCTAD
New York, N.Y.

cc: Mr. Sidney Dell
Office of the Secretary-General
New York, N.Y.

Above Papers sent to
Ms. Woods + PC 1/19/67
[Handwritten scribbles and initials]

January 17, 1967

Dear Sidney,

Thanks for your letter of January 12.

Although I have no objection to the releasing of correspondence between Raul and myself, your proposal to do nothing more about it is fine with me.

Yours sincerely,

Irving S. Friedman

Mr. Sidney Dell
New York Office
UN Conference on Trade and Development
United Nations
New York, N.Y.

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Group Suppl.Financing

12 January, 1967.

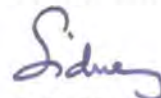
Dear Irving,

Thank you for your letter of January 9 with which you enclosed a copy of your letter to Dr. Prebisch of January 6.

The idea of releasing the exchange of correspondence was not mine but was suggested to me by James Mark, and I am grateful to you for not interposing any objection. I myself, however, did not particularly care for the idea. James Mark, of course, simply wants to give guidance to the group, but a release of the correspondence might give the impression that we were trying to build up some kind of record, which is the furthest thing from my mind.

I shall therefore probably not do anything about James' suggestion, unless you yourself want me to, which I should imagine is not the case.

Yours sincerely,



S.Dell, Director
New York Office of UNCTAD

Mr. Irving S. Friedman
Economic Adviser to the President
International Bank for Reconstruction
and Development
1818 H Street, N.W.
Washington D.C. 20433

DATE RECEIVED

JAN 16 1967

JAN 16 10 55 AM 1967

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COMMUNICATIONS

201-111

January 9, 1967

Dear Mr. Dell,

I am attaching copy of a letter which I am sending to Raul. I gather that you would like to release the exchange of correspondence between Raul and myself - I have no objections.

Sincerely yours,

(signed) Irving S. Friedman

Irving S. Friedman

Mr. Sidney Dell
Office of the Secretary-General
UNCTAD
United Nations
New York, N.Y.

ROUTING SLIP

Date
January 9, 1967

OFFICE OF THE PRESIDENT

Name

Room No.

Mr. Sarma

1036

Action

Note and File

Approval

Note and Return

Comment

Prepare Reply

Full Report

Previous Papers

Information

Recommendation

Initial

Signature

Remarks

Please inform Fund of this reply before
it goes out, particularly the reference
to what the Fund is doing on item 6.

*I have informed Mr Fleming
Sarma 1/9*

From

Irving S. Friedman

January 6, 1967

Dear Dr. Prebisch,

Thank you for your letter of December 20, 1966. The three papers I forwarded to you earlier deal with some of the questions that were raised in the discussion of Supplementary Financing at the April 1966 meeting of the Committee on Invisibles. These, as you know, also cover some of the questions which were subsequently taken up in the first session of the Intergovernmental Group. It is my understanding that these and other aspects of Supplementary Finance would be considered further by the Group.

The Intergovernmental Group had also requested certain specific studies, to which you refer in your letter. We have given some thought to the question of the relative importance of export shortfalls and other causes of instability (Item 1). We feel that some further discussion is called for regarding the scope and purpose of such a study but, in any case, would be happy to give our thoughts on this subject at the meeting. Our paper on Policy Package could provide a useful basis for Item 2. In fact, this subject of Item 2 was dealt with fairly extensively in our original study itself, as well as in our statements at earlier meetings, and I wonder if any additional paper is now required until after our study is discussed in more detail. Item 6 is being attended to by the Fund staff in consultation with the Bank staff. As regards Item 5, it may be annotated on the lines suggested by you.

We will also be prepared to discuss at the meeting in detail any other aspects of the Bank staff Study, in particular the underlying principles and purposes as well as possible procedures for implementation.

With warm regards,

Sincerely yours,

(signed) Irving S. Friedman

Irving S. Friedman

Dr. Raul Prebisch
UNCTAD
New York, N.Y.

cc: Mr. Sidney Dell
Office of the Secretary-General
New York, N.Y.

Form No. 75
(2-60)

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL FINANCE
CORPORATION

INTERNATIONAL DEVELOPMENT
ASSOCIATION

ROUTING SLIP

Date

January 5, 1966

NAME

ROOM NO.

Mr. Irving S. Friedman

1223

To Handle

Note and File

Appropriate Disposition

Note and Return

Approval

Prepare Reply

Comment

Per Our Conversation

Full Report

Recommendation

Information

Signature

Initial

Send On

REMARKS

Herewith revised draft reply to
Mr. Prebisch, please.

From N. A. Sarma

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT
ASSOCIATION

INTERNATIONAL FINANCE
CORPORATION

December 27, 1966

Copies have been sent to:-

Messrs. Frank, Kamarck and Macone for
comment; Mr. Sarma to prepare a reply;
and Mr. Jalan for information.

See - weekly for

draft from Sarma -

156

*send copies of 3 papers to
UNCTAD to PC. — with*

3 papers sent December 28, 1966

comment
"As requested"

Harley - balance sheet -
but bias - suggests not
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America - H - p 3

p 29

summary

OED

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p 82

Creditors report
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INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT
ASSOCIATION

INTERNATIONAL FINANCE
CORPORATION

Ex-ante report of guaranteed
foreign banks - sees to deal
with short public credit debts
city ceiling of \$100 million

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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

OFFICE OF THE SECRETARY-GENERAL OF THE CONFERENCE

REF. NO.

TDS 241(1)
Sup.Fin.Mtg.

20 December 1966

Dear Mr. Friedman,

Thank you for your letter of 14 December with which you were good enough to enclose copies of three papers prepared by the staff of the World Bank in response to requests expressed by the Intergovernmental Group on Supplementary Financing. These papers will be processed and distributed immediately with the attribution requested. I should appreciate your help in indicating the extent to which these papers, or others that you may be preparing respond to the requests listed in section II (page 14) of the interim record of discussions (TD/B/C.3/AC.3/3/Add.1), of which a copy is attached. This would enable us to prepare the annotated agenda for the second session of the Group.

In this connexion you will note that item 3 was to be prepared by the International Monetary Fund. Item 4 has been prepared by the UNCTAD Secretariat, copies of the first and second drafts having been supplied to you previously. As regards item 5, we propose to annotate the agenda as follows: "The representative of the World Bank will be ready to discuss the methods used by the Bank in arriving at its estimates of the annual cost of the Scheme (in quantitative terms) at the second session of the Intergovernmental Group".

Mr. Irving S. Friedman
Economic Adviser to the President
International Bank for Reconstruction
and Development
1818 H Street, N.W.
Washington, D.C. 20433

DATE RECEIVED

DEC 27 1966

UNITED NATIONS



NATIONS UNIES

-2-

What I should now like to ask, therefore, is the extent to which the three papers submitted respond to the requests contained in items 1, 2 and 6, or whether any further papers are planned in connexion with these items.

Yours sincerely,

A handwritten signature in dark ink, appearing to read 'Raúl Prebisch', with a long, sweeping flourish extending to the right.

Raúl Prebisch

ROUTING SLIP

Date

December 28/66

OFFICE OF THE PRESIDENT

Name

Room No.

Mr. Kamarek

800

Mr. Frank

F-1160

Mr. Sarna

1036

Mr. Macone

G-1038

Mr. Jalen (info.)

1026

Action

Note and File

Approval

Note and Return

Comment

Prepare Reply

Full Report

Previous Papers

Information

Recommendation

Initial

Signature

Remarks

Please discuss this and let me have
your comments.

From

Irving S. Friedman

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT
ASSOCIATION

INTERNATIONAL FINANCE
CORPORATION

Mr. Gassner needs your approval
to have Statistics Division
carry out this study.

Should circulate to
Bureau and others -
SFS Group - and
discussed by them
(including Warren) - T 54

OFFICE MEMORANDUM

TO: Mr. Irving S. Friedman

DATE: December 22, 1966

FROM: H. Gassner *HG*SUBJECT: SUPPLEMENTARY FINANCE - Comparative Significance of Various Causes of Foreign Exchange Shortfall

It was suggested at the first meeting of the Intergovernmental Group on Supplementary Financing that a study be made of the relative importance of export shortfalls and other causes of instability in the external financing of development. The following paper suggests some approaches to attempting to measure relative importance. Whatever the results of these studies may show as to the comparative importance of shortfalls of export earnings, aid, and foreign private investment, a case can and should be made for concentrating attention on export shortfalls due to the greater amenability of this problem to solution through international action than is the case with regard to shortfalls of foreign private investment or aid.

I - Comparative Magnitude of Export Shortfalls, "Aid Shortfalls", and "Private Investment Shortfalls".

reference

Mr. T. Sears of USAID, has demonstrated that decreases from the previous year's level of private capital inflow exceeded similar decreases in export earnings in ten out of the twelve developing countries studied. However, the proposed Supplementary Finance Scheme is not aimed primarily at smoothing over year to year variations in foreign exchange availability, but rather at avoiding disruption in soundly conceived development programs. To compare the importance of unexpected changes in various sources of foreign exchange in disrupting development programs, it would be beneficial if deviations from predicted values of these foreign exchange sources could be measured over a five year period. However, while the Bank's economic reports provide for many developing countries a source of five year projections of export earnings prepared independently of national political pressures, which can be compared with actual results, there is no source of similar projections for flows of public assistance or private capital. It is therefore proposed to try to guess what levels of public assistance and private capital flows a reasonable prognosticator would have chosen in 1958, and to compare the shortfalls from these "hypothetical projections" for the period 1959-1963 with the shortfalls of export earnings from the values projected in 1958 Bank economic reports. The eighteen countries included in sample 2 (1959-1963) of the simulation exercise for studying the magnitude of export shortfalls would be the sample employed. While this procedure is not fully satisfactory, it is the best alternative available in light of the absence of actual 1958 predictions of public assistance and foreign private investment levels.

In order to prevent the 1958 "hypothetical projections" from being too distorted by hindsight, it is suggested that a rule of thumb for projection be applied to all countries. If we assume that the average level of aid to the developing countries for the period 1950-55 was attained in 1953, then the increase in aid over the period 1953-58 was at the average rate of 15% per year. The average rate of annual increase in private capital flow between the period 1950-55 and the period 1956-59 (excluding the oil countries) was 10% a year. It is tentatively suggested that the basis of the "hypothetical projections" for each country for the period 1959-1963 be a 15% annual increase in aid and a 10% annual increase in private capital inflow from assumed 1957 values of the average level of aid (or capital inflow) for the period 1956-58.

No immediate decision need be taken on this study, since Statistical Division cooperation is not required.

II - Examination of Regression data

Due to the somewhat arbitrary nature of the above approach, it is suggested that in addition partial correlation coefficients be employed to measure the relative effect on government investment and imports of capital goods, intermediate products, and raw materials of year-to-year changes in exports, aid, and foreign private investment. The necessary data appears to be available for the period 1958-64 for 25-30 countries. For each country and for all countries combined the regression equations and the partial correlation coefficients would be obtained using the following equations:

$$I_g = a_1 X_{-1} + b_1 X + c_1 P_{-1} + d_1 P + e_1 A + f_1 R_{-2}$$

$$M_k = a_2 X_{-1} + b_2 X + c_2 P_{-1} + d_2 P + e_2 A + f_2 R_{-2}$$

$$M_{k+r} = a_3 X_{-1} + b_3 X + c_3 P_{-1} + d_3 P + e_3 A + f_3 R_{-2}$$

where

X = exports

A = bilateral and multilateral assistance

P = private capital inflows plus private transfers

R = reserves

I_g = government investment

M_k = imports of capital goods

M_{k+r} = imports of capital goods, intermediate products, and raw materials.

December 22, 1966

to allow data from various countries to be combined, all variables would be expressed as a percentage of the average value of that variable over the period 1958-64 for the particular country.

Work would proceed in two stages. For each country a correlation matrix would be obtained, and variables would be eliminated when necessary in order to eliminate collinearity. Then the regression equations and partial correlation coefficients would be calculated.

This statistical approach was discussed with Mr. Sundrum before his departure. During informal discussions with the Statistics Division it was estimated that this process would take about two to three weeks from the time that the required data was submitted. It was also implied that this would not be an undue burden. Your approval is requested for asking the Statistics Division to perform the study as outlined above.

DRAFT REPORT

1. The Group discussed certain aspects of the Scheme in a business-like manner under the Chairmanship of Mr. Mermolja of Yugoslavia. All members of the Group were present, including a representative from Poland.

The Bank Representatives were called on to explain many aspects of the Scheme while the Fund Representatives explained the Compensatory Finance Scheme. The discussions were greatly facilitated and sharpened by the circulation of a comprehensive note by the German Representative and by the oral contributions of the various representatives. All members of the Group participated actively in the deliberations, plus a number of observers.

3/2. It was agreed that the assistance provided under the Scheme should be of a long term nature and on concessional terms. In principle invisibles should be included when feasible. In some cases projections might well be possible for example where tourism was important. While it would be desirable to adjust for import prices it seemed impracticable because of statistical complexities and inadequacies. The proposed export projections were carefully reviewed and discussed in some detail. The general feeling was that export projections of this kind formed a useful and feasible basis for the operations of the Scheme, especially taking into account the scope for improvement. However, one representative remained sceptical particularly of the wisdom of relating financial assistance to such export projections.

4/3.

The content of the policy package was discussed at some length and a number of questions were raised. Mr. Friedman emphasized the central importance of performance understandings to the whole Scheme. All the representatives of the developing countries expressed their acceptance of the need for such performance understandings. They emphasized that for various reasons it would not be practicable or desirable to publicize detailed understandings. The public policy understandings should be expressed in broad macro-economic terms such as export earnings, public and private investment and domestic savings; private policy understandings between the country and the Agency would implement these broad publicized commitments. The actuality of performance would be checked at the time of shortfalls as well as during the projection periods. Thus the Scheme was essentially administered and not automatic even though it aimed at speedy and timely assistance when needed.

5A.

The cost of the Scheme was discussed at some length. Some representatives expressed concern that the Scheme seemed open-ended. Several representatives requested a quantification of the factors taken into account in deriving the Bank's Staff estimate of \$300-\$400 million a year for the initial five years of the Scheme's operations. A tabulation was given to the Group indicating how these figures were derived and this tabulation was discussed. Mr. Friedman pointed out that the cost figures were derived on the basis of available historical data regarding shortfalls and should not be taken as precise or

certain forecasts of the amounts that will be needed in the future. The cost estimates were made to guide the countries at arriving at a judgment of what amount of financial resources would be needed to give the Scheme a reasonable chance of success. The alternative method of arriving at a cost figure was through negotiations and bargaining without the benefit of a reasoned initial starting point. The Bank Staff recognized that there was the possibility that these cost estimates might prove too low or too high. The Scheme therefore provided for rationing, if needed, since the initial sum of resources would be limited. The Scheme was thus not open-ended. It was generally agreed to use the Bank's cost estimates as a basis for future deliberations.

67.

The feasibility of the proposed Scheme was thoroughly discussed. One representative felt that it would prove unworkable because of the very broad nature of the policy package and the number of countries involved. The Bank Representative pointed to the work that was already being done in the field of examination of development programs and related policies. It was not intended that the Supplementary Finance Scheme would go significantly beyond what was already becoming the general practice in this field. Given close collaboration between the World Bank Group and the Fund with the Agency, the Scheme should prove to be feasible and would not involve such extra work either for the countries or the Agencies concerned.

by nearly all delegations

J.B.S.
The ~~general~~ viewpoint was expressed that administration of Supplementary Finance should be entrusted to the Bank Group, i.e. to IDA or another affiliate of IDA, if agreeable to the World Bank. As membership would be universal the question would arise of how non-members of IDA could participate in the Scheme, perhaps by parallel arrangements, etc.

~~The Chairman indicated that the Group would appreciate the Bank's views on this matter and suggested that it would be most helpful if these views were available at the next Session of the Group. The Bank Representative stated that this matter would have to be referred to the Bank for decision but that he felt it safe to say that any Bank decision on this matter would assume closest collaboration with the IMF in implementing the Scheme.~~

J.B.S.
The Bank Staff was requested to prepare a background paper on the other external causes of instability beyond the members control. Mention was made particularly of import requirements such as food and changes in this regard. It was clarified that the purpose of such a paper was not to extend the scope of the Scheme or to prepare other schemes to handle these problems or to arrive at a quantitative estimate of the possible cost of such other schemes. With this understanding, the Bank Representatives undertook to do a background paper on this subject.

2. The discussions in the Group and informal conversations outside, brought out that the majority of the Members supported the Scheme essentially as proposed by the Bank Staff. ~~This was the clear impression that emerged~~

towards the end of the Meetings. There were ^{also} some Representatives who extended general support and indicated favorable reaction, ^{but} without being ^{as} definitive. Two

countries, both potential donors, were ~~not~~ critical. ^{but one} indicated that ^{they} would ^{be generous} reconsider ^{its} their views in the light of the discussion and the other indicated that supplementary finance could ~~be~~ useful to these countries enable to conclude commodity agreements

December 14, 1966

Dear Mr. Prebisch,

The UNCTAD Intergovernmental Group on Supplementary Financing, at their first meeting in October, 1966, had requested the Bank staff to prepare some papers to explain or elaborate certain aspects of the Study on Supplementary Financial Measures. The three papers forwarded herewith are in response to that request: 1) Supplementary Finance: Form and Terms of Assistance, 2) The Policy Package of the Supplementary Finance Scheme, and 3) Shortfalls and Overages in the Supplementary Finance Scheme. A few other papers on certain statistical aspects are in preparation. As in the case of the Study itself, these papers are Bank staff papers and I would appreciate that they be so labeled when transmitting them or otherwise circulating them.

I trust the Intergovernmental Group will find these papers useful to their discussions.

With warm regards,

Sincerely yours,

Irving S. Friedman

Irving S. Friedman
The Economic Adviser to the President

Mr. Raul Prebisch
Secretary-General, UNCTAD
New York Office
United Nations, New York

cc (with enclosures) to:

Mr. Sidney Dell, Director
New York Office, UNCTAD
United Nations, New York

*Above 3 papers sent to
Mr. Woods & P.C. 12/28/66
with comment ~ as requested ~*

OFFICE MEMORANDUM

TO: FILES

DATE: December 13, 1966

FROM: Andrew M. Kamarek

SUBJECT: Bank Comments on Paper Prepared by UNCTAD Secretariat on Comparison of
Techniques of Projection

I called Sidney Dell of UNCTAD Monday afternoon, December 12, and communicated to him the points covered by Mr. Sarma's memorandum to me on the above subject.

Mr. Dell accepted all three of the specific comments on the Bank Scheme. He said that he was impressed with the point that the merits of the Bank and Fund methods should be judged in accordance with the basic objectives of the Scheme since that is what is relevant, but he was not ready to agree to it. He said that he would have to think about it some more.

He also asked when the Bank papers would be arriving. I told him it was a question of getting the final comments from the interested parties in the Bank. He said that he had to know by Thursday when the papers were coming since on Thursday the decision would be taken as to whether to postpone the next meeting of the Intergovernmental Group. I suggested that he plan to phone Mr. Friedman on Wednesday afternoon to get the final story. He said that he would.

cc: Messrs. Friedman ✓
Sarma
Sundrum

Mr. Friedman

December 8, 1966

Mr. S. Dell, Director
New York Office of UNCTAD
United Nations
New York, New York

Dear Sidney:

Thank you for sending me a draft provisional agenda for the second session of the Inter-Governmental Group on Supplementary Financial Measures with your letter of 5 December 1966.

Your annotation to item 4 makes it clear to me that item 7 'adoption of the report ... to the Committee on Invisibles and Financing related to Trade' will be, as we agreed at the first session, a statement on the proceedings rather than a final report. I suppose this will be clear to others as well.

Your news about IERD and your own papers is encouraging. I hope that all concerned will heed our Postmaster General's advice to mail early and avoid the Christmas rush.

Best regards.

Sincerely,

Jo W. Saxe
Associate Assistant Administrator
for Multilateral Aid Programs

PC:JSaxe:is:12/8/66

DATE RECEIVED

DEC 12 1966

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REFERENCE:

TDS 241(1)
Sup.Fin.Mtg.

5 December 1966

Dear Jo,

I enclose herewith a draft provisional agenda for the second session of the Inter-Governmental Group. I believe this is along the lines discussed with you earlier and the annotations spell out the matter.

Irving Friedman told me last week that he would be very disappointed if he could not get three or four of the papers to me this week, including (I hope) the paper on the cost of the scheme.

Our own paper on the measurement of export shortfalls is in second draft, after having been discussed with people at the Bank and the Fund, and I am hopeful that if they have no further comments, we can get that out also this week.

Yours sincerely,

A handwritten signature in cursive script that reads "Sidney".

S. Dell, Director
New York Office of UNCTAD

Mr. Jo Saxe
Associate Assistant Administrator
for Multilateral Aid Programmes
Agency for International Development
Department of State
Washington D.C. 20523

UNITED NATIONS
NEW YORK



SALES ADDRESS - UNITED NATIONS NEW YORK - ADDRESS TELEGRAPHIC

Sup. P.A. No. 8
TTS 241(1)

2 December 1966

Dear Jo,

I enclose herewith a brief provisional agenda for the second session of the Inter-Governmental Group. I believe this is along the lines discussed with you earlier and the annotations spell out the matter.

Irving Friedson told me last week that he would be very disappointed if he could not get three or four of the papers for this week, including (I hope) the paper on the cost of the scheme.

Our own paper on the measurement of export shortfalls is in second draft, after having been discussed with people at the Bank and the Fund, and I am hopeful that if they have no further comments, we can get that out also this week.

Yours sincerely,

E. Dell, Director
New York Office of UNCTAD

Mr. Jo Saxe
Associate Assistant Administrator
for Multilateral Aid Programs
Agency for International Development
Department of State
Washington D.C. 20525

1966 DEC 10 AM 9:14

COMMUNICATIONS
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Draft

5 December 1966

TRADE AND DEVELOPMENT BOARD
Committee on Invisibles and Financing
related to Trade
Intergovernmental Group on Supplementary
Financing
Second session
Geneva, 6 February 1967

PROVISIONAL AGENDA

1. Opening of the session
2. Adoption of the agenda
3. Election of Chairman
4. Consideration of the interim record of the Group's first session
5. Study of the proposed scheme for supplementary financing including consideration of the studies requested by the Group
6. Any other business
7. Adoption of the report of the Intergovernmental Group on Supplementary Financing to the Committee on Invisibles and Financing related to Trade

ANNOTATIONS TO THE PROVISIONAL AGENDA

3. Election of Chairman

At its first session the Group decided to postpone the election of a Chairman. It elected Mr. J.W. Saxo (United States) as Vice-Chairman-cum-Rapporteur.

4. Consideration of the interim record of the Group's first session

An interim record of the Group's first session (see documents TD/B/C.3/AC.3/... and TD/B/C.3/AC.3/.../Add.1) has been prepared by the secretariat on the basis of Conference Room Papers summarizing the Group's discussion of items 1-7 of its terms of reference (the terms of reference of the Group are reproduced in annex A to TD/B/C.3/AC.3/...). It should be noted that there was no opportunity for the Group to comment on the summary of discussion of items 8 and 9 of its terms of reference. The provisional summary of these items has been distributed to the Group as TD/B/C.3/AC.3/Conference Room Paper/13. In view of the limited time between the opening date of the Group's second session and 15 February 1967, the date by which documents should be distributed to the Committee on Invisibles and Financing related to Trade, the Group may wish to adopt its Interim Record, including, if possible, an approved text of Conference Room Paper 13, as its interim report to the Committee. A supplementary statement on the proceedings of the second session of the Group could be prepared at the end of the session, for submission to the Committee.

5. Study of the proposed scheme for supplementary financing including consideration of the studies requested by the Group

To facilitate its consideration of this matter the Group has before it the following material:

- (1) Study on Supplementary Financial Measures by the staff of the International Bank for Reconstruction and Development (TD/B/43).

- (ii) Report of the Committee on Invisibles and Financing related to Trade on its resumed first session (TD/B/T3-TD/B/C.3/22).
- (iii) Consideration of the Scheme for supplementary financial measures contained in the report of the International Bank for Reconstruction and Development - Note by the Secretary-General of UNCTAD (TD/B/C.3/25).
- (iv) Compensatory Financing of Export Fluctuations, a second report by the International Monetary Fund (Washington, 28 September 1966).

In addition, studies on the following subjects have been requested of the World Bank, the International Monetary Fund and the UNCTAD secretariat and will be distributed to the Group before its second session:

- (i) The relative importance of export shortfalls and other causes of instability in the external financing of development and to the extent possible, estimates of the effects of these causes on selected countries.
- (ii) The way in which supplementary finance would fit into the existing international financial system.
- (iii) A revision (to include data as recent as possible) of Table I, "Adequacy of External Liquidity to Finance Fluctuations in Exports of Some Fund Members", on page 19 of the study produced in 1963 by the International Monetary Fund, Compensatory Financing of Export Fluctuations.
- (iv) The difference between and the respective merits of the methods used for the determination of export shortfalls.
- (v) The methods used by the Bank staff in arriving at its estimates of the annual cost of the Scheme (in quantitative terms).
- (vi) An estimate of the effects of recent changes in the Fund's compensatory financing facility on the annual cost of the Scheme.

OFFICE MEMORANDUM

TO: Mr. Irving S. Friedman

DATE: December 12, 1966

FROM: N. A. Sarma

*Sarma*SUBJECT: A paper prepared by UNCTAD Secretariat on Comparison of Techniques of Projection

Attached hereto is a copy of a brief comment which I have just sent to Mr. Kamarck, together with the draft of a paper on comparison of Bank and Fund methods of projecting exports or export norms, prepared by the UNCTAD Secretariat, which Mr. Sidney Dell has sent to Mr. Kamarck for comments from the Bank. The paper is a revision of an earlier draft which we discussed with some members of UNCTAD Secretariat at a meeting on the 1st of December.

OFFICE MEMORANDUM

TO: Mr. Andrew Kamarck

DATE: December 12, 1966

FROM: N. A. Sarma

SUBJECT: A Paper prepared by UNCTAD Secretariat on Comparison of Techniques of Projection

This brief comment is prepared in consultation with Messrs. Isaiah Frank, Sundrum, Macone and Gassner. I am sending a copy to Mr. Friedman. You may like to have a word with him.

The main point that we made at our earlier meeting with members of the UNCTAD Secretariat was that any comparison of the merits of the methods of calculating shortfalls must relate to a single objective, and that in this context, this objective must be that implied in the UNCTAD Resolution. The present paper goes some way towards this point of view in the statement on page 1 that "The method proposed in the Bank staff study is in accordance with and responds to the basic objectives of the Scheme as defined in the UNCTAD recommendation". However, the present draft, like the first draft, ends with the statement that the "merits of the two methods of calculation depend upon the basic merits of the two schemes themselves". Perhaps this point should be further discussed at the next meeting of the Expert Group. For the time being, we might send the following comments on the interpretation of the Bank Scheme.

Paragraph 3 It may be useful to avoid use of the word 'norm' in connection with the Bank Scheme, as this might lead to comparison with the Fund procedure and objective.

Footnote, Page 6

This footnote is not clear and may be omitted. In any case, projections should be referred to as "agreed" rather than "negotiated".

Paragraph 15

The last sentence could be elaborated to point out that the Bank Scheme is such that, to the extent that instability of export earnings is predictable, its disadvantages would be reduced by taking account of such instability in the planning of the development program.

CC: Professor Frank
Messrs. Macone, Sundrum, Gassner

80000
Dec 6

Second draft

2 December 1966

A COMPARISON OF METHODS USED FOR THE CALCULATION
OF EXPORT SHORTFALLS IN THE IBRD STAFF SCHEME FOR
SUPPLEMENTARY FINANCE AND THE REVISED IMF FACILITY
FOR COMPENSATORY FINANCE*

Introduction

1. The Bank staff scheme was prepared in response to UNCTAD recommendation A.IV.18 requesting the Bank to study the feasibility of a new 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".^{1/} An "adverse movement" was defined as a "shortfall from reasonable expectations". The method proposed in the Bank staff study for the calculation of export shortfalls, which involves spelling out "reasonable expectations" in a precise export projection, is in accordance with and responds to the basic objectives of the scheme as defined in the UNCTAD recommendation. The IMF compensatory financing facility was originally devised at the invitation of the United Nations Commission on International Commodity Trade, at its tenth session held in Rome in May 1962,^{2/} and has recently been amended, in the light of, among other things, UNCTAD recommendation A.IV.17.^{3/} This facility is designed to compensate for fluctuations about an export trend,

* With regard to the IBRD scheme, all references in this paper are to the scheme as expounded in the IBRD staff study "supplementary Financial Measures" (TD/B/43); all references to the revised IMF scheme are to the IMF second report on "Compensatory Financing of Export Fluctuations", 1966.

1/ United Nations Conference on Trade and Development, Final Act and Report, Annex A.IV.18.
2/ United Nations Commission on International Commodity Trade, Report on the Tenth Session (E/CN.13/55, 31 May 1962).
3/ Ibid., Annex A.IV.17.

and accordingly provides for a different conception of export shortfalls from the one adopted in the Bank staff scheme. Thus the differences in methods used for the calculation of export shortfalls under the two schemes are fundamentally an expression of their different, though mutually supporting, basic objectives. In what follows, an attempt will be made, first, to present an outline of methods for the calculation of export shortfalls used in the two schemes, and secondly, to compare the two methods on the basis of such information as is currently available.

IBRD scheme for supplementary finance

2. The starting point of the IBRD scheme is the fact that in view of the often crucial importance of foreign exchange for successful implementation of a development plan, an unexpected fall in exports may upset the plan. Thus the primary objective of the scheme is to avoid the disruption of a sound development programme in the event of export shortfalls from "reasonable expectations".

3. The quantification of "reasonable expectations" sets the norm; and the extent to which actual exports during a given period fall short of this norm provides a measure of the export shortfall for that period.^{1/} Under the scheme, reasonable export expectations are to be "spelled out in the form of a precise projection" (p. 8).

4. Since the primary objective is to avoid the disruption of a development programme, the time period covered by the export projection "will be synchronized with the appropriate time horizon of planning in a member country - normally within a range of four to six years" (p. 9). The export projection "would be treated as an integral part of the development programme and therefore would be subject to revision only as part of a total recasting of the entire development programme" (p. 9). The projection, which is an

^{1/} This means that in so far as any movements in exports were entirely expected or foreseen, there would be no shortfall under the scheme.

ex ante estimate of the export earnings during the entire plan period, will be established "at the beginning of a plan period and not at the actual time of export difficulties" (p. 30).

5. The technique used for projections involves an assessment of the country's export prospects for the plan period as revealed by an analysis of the prospective conditions of demand and supply for the major export commodities. The projections will "take account not only of the existing objective factors, whether domestic or international, relevant to future prospects", but will also include "the impact of new policy measures designed to modify the effects of these objective factors" (p. 30).

Wherever possible, the Bank would seek to forecast the actual values of exports for each year of the plan, taking into account the probable effects both of trend factors and of short-term or cyclical factors as currently foreseen.

6. To sum up, export norms under the IBED scheme would be spelled out in the form of an export projection for the entire duration of the development plan at the time when the plan is launched. The export projection would be established largely on the basis of an analysis of export prospects for major commodities.

IMF compensatory financing facility

7. The IMF facility is designed to help Fund members, particularly primary exporters, encountering payments difficulties resulting from temporary export shortfalls. A temporary export shortfall for any given year is measured as a shortfall from the medium-term trend value of exports for that year, defined, in an ideal sense, as an unweighted moving average of actual exports for the five-year period centred on the year of the shortfall. In the IMF view,

this definition of the trend itself is such as "to make it likely - though one can never be certain - that shortfalls with respect to it will be of short duration" (p. 6).

8. The practical problem is that of getting the best possible approximation to the ideal norm, taking into account the fact that the ideal norm for the current year requires information on exports for the two succeeding years which can never be predicted with complete accuracy. In estimating the practical norm, the Fund uses the two separate methods described below and the results of both these methods are used in arriving at the final estimate of the norm.

9. The first method involves the application of a statistical formula whereby the medium-term trend value for any twelve-month period is estimated as the weighted average of actual exports for the period in question and the two preceding twelve-month periods - a weight of 0.50 being attached to exports of the twelve months for which the shortfall is being estimated, while exports of the two preceding periods are assigned a weight of 0.25 each. The Fund arrived at these weights on the basis of statistical analysis of the past experience of 48 countries. The Fund states that while its statistical formula gives a precise answer, "no formula can be devised that gives a good approximation of the medium-term trend, as here defined, solely on the basis of past statistical data" (p. 6).

10. The second method involves a forecast of exports for the two years following the year of the shortfall, thereby making it possible to calculate an average of five years centred on the shortfall year. The export forecast for the two succeeding years is established "largely on the basis of commodity analysis, taking into account the prospective price movements for the commodity

in question and the prospective volume movements in the country in question" (p. 7). It will be noted that this forecasting technique is essentially the same as the one proposed in the IBRD scheme for establishing export projections.^{1/} However, under the IMF scheme, the average value of projected exports for the two succeeding years must lie within a predetermined range. Thus "the average level of exports predicted for the two years following the shortfall year will not be assumed to exceed by more than 10 per cent the average level experienced in the two years preceding the shortfall year and will not be assumed to be less than the level of exports experienced in the shortfall year itself" (p. 8).

11. The Fund states that neither of the two methods can by itself provide a satisfactory approximation to the ideal norm or trend. Since, however, the second method has been found to give better results than the first, it is given greater weight in the final estimate of the medium-term trend value.

Comparison of export shortfalls under the two schemes

12. It will be apparent that the definitions of export shortfalls under the two schemes are greatly influenced by their respective objectives.

^{1/} Although the forecasting techniques used for export forecasts by the two agencies are the same, there is no assurance that their projections for any given period would coincide unless, of course, they were both projecting for a specified future year at the same time. For example, if a development plan starts in the year t , the Agency administering the scheme for supplementary finance would project exports for the entire plan period at the beginning of the plan. This would include projections for the year $t + 1$ and $t + 2$, the very years for which the IMF would also need to project exports in order to get the medium-term trend value for the year t . However, the Fund projection for these two years would be made at the end of year t , while the IBRD projection would have been made at or before the beginning of the year. As such, the two need not coincide despite the essential similarity of methods used.

(a) Subject to certain conditions and limitations, the Bank scheme is designed to provide countries with a guarantee of the export proceeds envisaged as part of a pre-agreed development programme. The scheme provides that shortfalls from the pre-agreed level of export proceeds would be promptly made good (though not necessarily entirely through the scheme itself), subject to any adjustments required in certain circumstances, notably in the event of a structural shift in world demand, which might necessitate a revision of the entire plan and hence also of the export projections.

(b) The Fund facility, on the other hand, is not directly linked to the planning process as such, and is not intended to guarantee the integrity of a development programme. Its objective is to help in offsetting fluctuations about a medium-term trend of exports, whether such fluctuations are foreseen or not.

(c) The Fund facility is not designed to deal with the adverse effects of a downward medium-term trend in exports because the facility is addressed to fluctuations about that trend and not to the trend itself. The Bank scheme also does not deal with the adverse effects of a downward trend in exports if the trend is foreseen.

(d) It may further be noted that export norms under the Bank scheme would be established for a period of, say, five years at the beginning of the planning period,^{1/} while under the Fund facility export norms are established in respect of a particular year only at the end of that year.

13. A careful examination of the historical evidence provided in the IBRD report does not make it possible to determine any consistent or

^{1/} However, under the Bank scheme, new norms have to be negotiated for each development plan; so that over the life of any development plan as a whole, the average period covered by pre-agreed export norms (and hence by guarantees of supplementary finance) would be half of the duration of the plan - 2 1/2 years in the case of a five-year plan.

systematic relationship between the export norms (and shortfalls) that would emerge under the two schemes. Depending on circumstances, any shortfall estimated under the Bank scheme might be equal to, or greater or lesser than, the corresponding Fund estimate.

14. Only in the limiting cases referred to in paragraph 10 above would there be any basis on which to anticipate a particular relationship between the Bank and Fund shortfalls. In other words, if the Bank scheme were, in a particular case, to project a value of exports higher than that given by the maximum possible value of the Fund norm, any Bank shortfall would in that case be greater than the Fund shortfall. On the other hand, if the Bank were, in a particular case, to project a value of exports lower than that given by the minimum value of the Fund norm, any Fund shortfall would in that case exceed the Bank shortfall.

15. As mentioned earlier, the merits of the two schemes depend upon these objectives and not upon the methods of calculating the shortfalls. Even in the case where the calculation of a shortfall under the Fund facility gives a result larger than the corresponding shortfall emerging from the Bank scheme's export projection, the Fund facility would not fulfil the objective of the Bank scheme - namely to provide an advance assurance of export proceeds that form the basis of the development plan as originally formulated. By the same token, the Bank scheme is not intended to fulfil the stabilizing role envisaged for the Fund's compensatory financing facility.

16. It should be noted that if the above reasoning is correct, the basic difference between the two schemes (and their methods of calculation of export shortfalls) does not rest on the distinction that the IMF facility deals with short-term export shortfalls while the Bank scheme would take

care of "persistent" shortfalls. It is true that the definition of medium-term trend value in the IMF scheme is such as "to make it likely that export shortfalls with respect to it will be of short duration"; but as the IMF itself points out, one can never be certain that it will always be so. The truth is that it is generally not possible to judge immediately whether a particular shortfall is a temporary event or the beginning of a new trend. Thus at times the Fund facility may compensate for a decline in exports which later turns out to be persistent even though this was not the intention at the time accommodation was granted. Similarly, the Bank scheme will register shortfalls whenever actual exports are lower than projected exports, whether the shortfalls are due to short-term or to persistent factors. Moreover, it must be noted that the Bank scheme will not compensate for a persistent decline where it is foreseen at the time a projection is established. Hence whether or not the cause of a decline is persistent does not provide a sufficient basis for differentiation of export shortfalls under the two schemes.

Conclusion

17. To sum up, an analysis of the method whereby shortfalls are calculated under the two schemes does not yield any systematic pattern of relationships between the two shortfalls. The Bank scheme is intended to deal with problems posed by the unpredictability of exports while the Fund scheme is designed to deal with the instability of exports. While the two sets of problems are related they are not synonymous. The objectives of the two schemes are mutually consistent and tend to support one another, and both schemes therefore have an essential role to perform. Thus prospective export shortfalls under the two schemes respond to their differing objectives, and the merits of the two methods of calculation likewise depend upon the basic merits of the two schemes themselves.

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United Nations Conference on Trade and Development

TRADE AND DEVELOPMENT BOARD
Committee on Invisibles and Financing
related to Trade
Intergovernmental Group on Supplementary
Financing
Second session
Geneva, 6-17 February 1967^{1/}

PROVISIONAL AGENDA

1. Adoption of the agenda
2. Election of Chairman
3. Consideration of the interim record of the Group's first session
4. Study of the proposed scheme for supplementary financing including consideration of the studies requested by the Group
5. Any other business
6. Adoption of the report of the Intergovernmental Group on Supplementary Financing to the Committee on Invisibles and Financing related to Trade

^{1/} The duration of the session may be extended up to 3 weeks, if necessary.

ANNOTATIONS TO THE PROVISIONAL AGENDA

Item 1 Adoption of the Agenda

Item 2 Election of Chairman

At its first session the Group decided to postpone the election of a Chairman. It elected Mr. J. W. Saxe (United States) as Vice-Chairman-cum-Rapporteur.

Item 3 Consideration of the interim record of the Group's first session

An interim record of the Group's first session (see documents TD/B/C.3/AC.3/3 and TD/B/C.3/AC.3/3/Add.1) has been prepared by the secretariat on the basis of Conference Room Papers summarizing the Group's discussion of items 1-7 of its terms of reference (the terms of reference of the Group are reproduced in annex A to TD/B/C.3/AC.3/3). It should be noted that there was no opportunity for the Group to comment on the summary of discussion of items 8 and 9 of its terms of reference. The provisional summary of these items has been distributed to the Group as TD/B/C.3/AC.3/Conference Room Paper/13. In view of the limited time between the opening date of the Group's second session and the date by which documents should be distributed to the Committee on Invisibles and Financing related to Trade (15 February 1967), the Group may wish to adopt its Interim Record, including, if possible, an approved text of Conference Room Paper 13, as its interim report to the Committee. A supplementary statement on the proceedings of the second session of the Group could be prepared at the end of the session, for submission to the Committee.

Item 4 Study of the proposed scheme for supplementary financing including consideration of the studies requested by the Group

To facilitate its consideration of this matter the Group has before it the following material:

- (i) Study on Supplementary Financial Measures by the staff of the International Bank for Reconstruction and Development (TD/B/43).
- (ii) Report of the Committee on Invisibles and Financing related to Trade on its resumed first session (TD/B/73 - TD/B/C.3/22).

- (iii) Consideration of the Scheme for supplementary financial measures contained in the report of the International Bank for Reconstruction and Development - Note by the Secretary-General of UNCTAD (TD/B/C.3/25).
- (iv) Compensatory Financing of Export Fluctuations, a second report by the International Monetary Fund (Washington, 28 September 1966).

In addition, a number of other studies were requested from the International Bank for Reconstruction and Development, the International Monetary Fund and the UNCTAD secretariat. In response to this request the Group will have before it at its second session the following papers:

- (i) Supplementary finance: Form and terms of assistance (by the staff of the IBRD);
- (ii) The policy package of the supplementary finance scheme (by the staff of the IBRD);
- (iii) Shortfalls and overages in the supplementary finance scheme (by the staff of the IBRD);
- (iv) A comparison of methods used for the calculation of export shortfalls in the IBRD staff scheme for supplementary finance and the revised IMF facility for compensatory finance (by the UNCTAD Secretariat).

It is hoped that papers on certain statistical aspects will also become available in time for the second session.

As regards the methods used by the staff of the IBRD in arriving at its estimates of the annual cost of the scheme (in quantitative terms), the representative of the IBRD will be ready to discuss this subject at the second session of the Intergovernmental Group.

Item 5 Any other business

Item 6 Adoption of the report of the Intergovernmental Group on Supplementary Financing to the Committee on Invisibles and Financing related to Trade

See annotations to item 3 above.

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REFERENCE TDS241(1-1) Intergovt.
Group Suppl. Financing.

9 December, 1966.

Dear Irving,

I hate to have to come back to this question of documents, knowing as I do the many burdens upon you at the present time.

Nevertheless I am forced to do so because if we do not get at any rate the main documents to Geneva for processing next week, it will not be possible to get them out in time for the second session of the Intergovernmental Group on 6 February. In that case we would have to propose a postponement of the Intergovernmental Group - which in turn will be quite a problem because of the congestion of our calendar.

I should greatly appreciate any information you can give me on the timing of your documents.

Yours sincerely,



S. Dell, Director
New York Office of UNCTAD

Mr. Irving Friedman
Economic Adviser to the President
International Bank for Reconstruction
and Development
1818 H Street, N.W.
Washington D.C. 20433

DATE RECEIVED

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COMMUNICATIONS

SUPPLEMENTARY FINANCE: "FORM AND TERMS OF ASSISTANCE"

Form of Assistance

As in the case of the provision of any type of long-term aid, Supplementary Finance could be provided to a country by the Agency in three forms: a) related to projects; b) related to a list of goods and services for which the funds could be used; and c) as an outright transfer of cash to the country. One prerequisite in determining the choice of one of these three forms as the appropriate one for Supplementary Finance is that of "timeliness"; that is, such assistance should be forthcoming shortly after an unexpected shortfall has been identified so that it avoids the disruption of the development program which would otherwise occur. Consideration of the "timeliness" criterion leads to the discarding of the alternative of linking Supplementary Finance to projects. Administration of aid through them is a time consuming process, which does not meet the need to have assistance provided in a matter of a few months or less. The choice between the other two alternative ways of providing Supplementary Finance cannot be decided on economic grounds. Whatever alternative is chosen, the fundamental need for the Agency to be satisfied that the resources thus transferred are used effectively and for worthwhile development purposes is met by the fact that satisfactory performance of the members under the Scheme is a prerequisite to the assistance and that access to it depends on the implementation of a development program and related policies previously

agreed with the Agency. It may, however, be mentioned that of the alternatives previously mentioned, if it is found necessary to relate the assistance to particular goods and services, the procedures adopted would have to take into consideration the particular situation of each country concerned, so as to ensure that the requisite of "timeliness" is fulfilled. This consideration suggests that, in order to ensure the most efficient operation of the Agency, the choice of the form of assistance should be left to the discretion of the Agency to work out with the member country requesting assistance so that the development program may go forward.

Terms of Assistance

Here, as elsewhere, the approach of the Study has been pragmatic and flexible. The principal idea underlying the attitude of the Study on the question of terms is to emphasize the need for tailoring these terms to individual country situations which differ markedly in export outlook, debt structure, savings potentiality etc.

Given the outstanding debt position of many developing countries, the World Bank, the Development Assistance Committee of the O.E.C.D. and others have been arguing for softer terms on development assistance. The terms on which a developing country receives development finance should be determined on the basis of an examination of the over-all financial and economic position of a country - not only the present but the future outlook as well.

On the subject of terms of financing, the Study expressed the view that supplementary finance should be treated on the same basis as basic development finance. This view is based on the argument that financial assistance under the Scheme is intended to enable countries to carry out

their development programs, which would otherwise be disrupted. Hence, the terms of such assistance should be those appropriate for the financing of long-term investments. This is particularly true regarding the maturity of credits provided for this purpose, as short-term financing of such investments is undesirable and has been at the root of many debt crises in the developing countries. Since we have argued that the terms of basic development finance should be determined by the economic outlook in a country, we also feel that the same considerations should apply in determining the terms on supplementary assistance. Given the present indebtedness problems of developing countries, and the fact that in several countries the debt servicing ratio has already reached serious proportions, which severely limits the capacity of these countries to undertake further debt on any but the "softest" terms, it is clear that terms on supplementary finance (as also on basic development finance) for some countries, should be something like IDA terms. Though the precise terms on which a country receives supplementary finance could be decided individually, for administrative convenience it may be possible to decide broad categories of terms within which different developing countries would fall. In this way it may be useful to indicate in advance to the member countries the particular group to which they belong without having to specify the precise terms of a credit, which can then be left to be determined at the time of the shortfall.

An illustration of the division of countries to such categories is provided by the practice of the World Bank group. While the terms of Bank lending are generally the same for all borrowers - repayment periods related to the life of the project and interest determined by the rates at

which the Bank borrows - repayments are at times related to the debt servicing capacity of the country. The IDA credits are interest-free (with only a service charge of $3/4$ of 1%) and maturity of fifty years (including the grace period of ten years). By varying the Bank-IDA mix in the total volume of lending to countries, it has been possible for the Bank, in effect, to have different average terms for different countries depending on the economic conditions and outlook. The flexibility that the Bank has been able to exercise in determining average terms of lending to member countries has, of course, been limited by the availability of IDA funds. Nevertheless, within these limits, it has been possible to achieve marked variety of terms on development assistance from the Bank group. There are now broadly four categories of countries:

- (i) entirely "Bank countries",
- (ii) entirely "IDA countries",
- (iii) "hard-blend" countries, which receive assistance mainly from the Bank but also some IDA finance, and
- (iv) "soft-blend" countries which receive assistance mainly from the IDA, but also some Bank finance.

Granting the need for flexibility in the terms of supplementary and development finance, there is an interesting question which is sometimes raised: should not the terms of supplementary finance be more lenient than those of basic finance (even in the ideal case) because of the fact that

(a) following a contraction in exports, the savings and debt servicing capacity of the country would have diminished and (b) the bridging of the exchange gap through the Scheme can only insure a continuation of development according to the plan but does not generate extra foreign currency earnings in the future. The idea behind the former argument is that the terms of basic finance would be determined at the beginning of the plan period or in yearly aid negotiations, on the basis of the expected outlook of the country's debt servicing and saving capacities. If an export shortfall subsequently occurs, the question is whether there are reasons to suppose that the outlook has changed or not. If it has not, the terms for Supplementary Finance should be the same as those currently prevailing for basic finance. It should be recognized that, for practical purposes, these terms are associated with a range of values of the relevant factors which affect their choice. An increase in the amount of long-term indebtedness because of the Supplementary Finance received - with all other factors remaining constant - would not by itself require different terms for aid. However, if the occurrence of the shortfalls leads to a reassessment of the country's debt servicing capacity and saving potentiality, the more lenient terms which would be required for Supplementary Finance would, it is argued, be only a reflection of the new terms which would now be deemed necessary for basic finance too. This may be associated with a revision of the development program if it is agreed that a fundamental change in the country's economic outlook has occurred.

The other idea - that the Scheme can only insure a continuation of development according to the plan but does not generate extra foreign currency earnings in the future - is only partially true. It would depend on what the expected exports were meant to finance. If there are export (or re-export) industries, by making possible the implementation of original investment or production targets, the Scheme does contribute to an expansion in exports (now or in future) over what would have been otherwise possible. The real question, however, is that since supplementary finance is a credit, an export shortfall covered in this manner would increase the total indebtedness of the country over what would have been the case otherwise (had this shortfall never occurred); and therefore the terms of these credits should be as soft as possible unrelated to the terms on which the country receives basic finance. The validity of this point of view depends on how one looks at supplementary finance. If one thinks of it in terms of "compensation", that is compensating the developing countries in some sense for their unexpected export shortfalls, then of course supplementary assistance should be grants (to equate it to export earnings). If, however, as viewed in the Study, supplementary assistance is an emergency development credit to augment the long-term flow of capital to the extent of an export shortfall, then there is no reason why it should be treated any differently from basic finance so far as terms are concerned. This, of course, increases the indebtedness of the country; but if the terms of additional indebtedness are tailored to the country's debt servicing capacity, this is no more than what a country would have been willing to undertake, in the form of basic finance, had the "unexpected" shortfall been in fact "expected" at the

beginning of the planning period. In the event of an export shortfall, the availability of supplementary finance is tantamount to an increase in the flow of basic development finance in mid-period in order to support an agreed plan.

Some have suggested the idea of "rotation of funds" for the Scheme by making such assistance short-term, or at least medium-term (10 to 15 years). Our view on this is that relatively quick repayments of supplementary finance by countries which are likely to be dependent on foreign capital and are already in critical indebtedness position "would usually mean that they would have to borrow elsewhere in order to repay the amounts due to the Agency; the alternative of retarding the development process runs counter to the very purpose of supplementary finance" (p. 60, Study). As we see it, supplementary finance is not temporary balance of payments support - to tide over year to year imbalances - or a "bailing out" operation, but a species of development finance, extended on the same basis and for the same purposes as basic development finance - to promote long-term growth of the country. Only in the case of those developing countries where there are good reasons to expect the resource gap to close in the near future while maintaining an adequate rate of economic growth and where the present indebtedness position is comfortable, would it make economic sense to prescribe relatively short repayment periods.

The concluding paragraph in the chapter on the form and terms of assistance in the Study had pointed to the possibility that there may be circumstances under which the Agency could request advance repayment of its credits to a country. It has been suggested that this idea would be self-defeating since it would run counter to the basic rationale behind

foreign assistance. As it is clearly stated in the Study, the circumstances which would make advance repayment possible are probably infrequent, and it is not envisaged that developing countries which still have a "resource gap" would be asked for advance repayment. It is only in cases where the resource and foreign exchange position of the country improves so substantially over time that it could afford to repay its debt to the Agency before maturity (e.g. due to the discovery of oil or the emergence of a new export factor) without affecting its attainable rate of growth that the Agency may retain the right to request repayment earlier than originally stipulated.

THE POLICY PACKAGE OF THE SUPPLEMENTARY FINANCE SCHEME

1. Introduction

The UNCTAD Resolution A.IV.18 of 1964 called for a scheme to provide long-term assistance to developing countries which would help them to avoid the disruption of their development programs due to unexpected shortfalls in their export earnings. The Bank Staff Report on Supplementary Financial Measures proposes a scheme for this purpose. An integral part of this proposal is a mutually agreed projection of 'reasonable expectations' of export earnings over a period of years, so that this could be used to determine whether and to what extent an 'unexpected shortfall' of export earnings occurred during the period. Another basic feature of the scheme is a 'policy package', i.e. an agreement between the Agency^{1/} administering the scheme, and a member country about the development program to be undertaken by the country and a set of basic development policies which are objectively regarded as appropriate by the international community. An important purpose of drawing up the policy package is to have a method of determining whether a shortfall is due to factors beyond the control of the country or not. A shortfall occurring in a country which has been following the policy package is 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

^{1/} This memorandum does not attempt to specify the nature of the Agency, or the extent to which it will be guided by the advice of other international financial agencies in reaching understandings with its members.

to receive assistance from the Agency, without a time-consuming study of the causes and consequences of such shortfall at the time it occurs. It is hoped, in this way, that the assistance provided by the Agency will be both certain and prompt in times of difficulty. This paper is a further elaboration of the nature of such a policy package.

2. The Development Program

A basic element of the initial understanding between the Agency and a country is the development program which the country intends to undertake. Some developing countries have already reached the stage of being able to formulate comprehensive and systematic medium-term development programs, covering a period of about five years. However, some other countries have not yet reached that stage, but even in this case, there would be partial public investment plans; in these cases, the Agency would adopt a flexible interpretation of the criteria of potential disruption. While it is not necessary or desirable that all countries should have systematic and comprehensive plans, there must be some conscious attempt to lay down objective and specific courses of action for the future, irrespective of the existence of supplementary finance. It is only on the basis of such targets for future action that any meaning can be given to the idea of potential disruption of a development program. Whether or not these targets can be quantified will depend on the countries, but in most cases, it is likely that it would be feasible and desirable to quantify such targets.

In evaluating a country's development program, two aspects have to be considered. In the first place, given the long-term goals of the country, the program must be formulated to achieve those goals as efficiently as possible. In the second place, the policies associated with the program should

be such as to mobilize the required amount of the country's own resources. In addition, the viability of a development program depends on whether foreign assistance is likely to be available on a sufficient scale. As of the present time, creditor countries have not been able to make firm commitments of their assistance to the developing countries over medium-term periods, covering their development programs. Even if firm commitments cannot be made from the creditor countries, there must be some indication that the scale on which external assistance is envisaged for the development program is adequate and realistic.

The World Bank has been engaged in providing technical and financial assistance to the developing countries in connection with their development efforts and in making periodic reviews of these efforts, partly for its own operational needs and partly in its role of coordinating aid to the developing countries from various sources. In evaluating the development programs of its member countries for the purposes of supplementary finance, the Agency could avail itself of this experience of the World Bank.

3. Export Policies

A matter of special importance, both in connection with the financing plan and the projection of a country's export earnings, is the set of policies which a country intends to pursue in connection with its exports. The exports of a country depend, not only on the conditions of world trade, but also on the country's own policies. In order to make a reasonable projection of export earnings, we must consider the conditions of world trade, the policies of other countries and also the country's own policies affecting its exports.

The policies which are relevant relate to contemplated investments, particularly in the export sector, the incentives to be given to producers in this sector and the exchange and trade policies which might affect the country's competitive position in world trade.

4. Monetary and Financial Policies

Another element of the policy package that has to be a part of the initial understanding is the set of monetary and financial policies of the developing country, as these would affect the development program itself, the mobilization of domestic resources for the program, and the balance of payments. The monetary and financial policies would presumably need to be compatible with the objective of the Supplementary Finance Scheme to maintain the scale of the development program. However, quantitative precision in such matters cannot be achieved over a period as long as five years. In reaching an understanding with a member country, the Agency could avail itself of the experience and advice of the International Monetary Fund on matters falling within the field of the Fund's responsibilities.

5. Adjustments to Changing Conditions

When a development program is drawn up, an attempt is made to estimate the likely future values of many variables, using all such information as is available at the time. However, the actual changes of these variables are unlikely to conform exactly to expectations. Those concerned with formulating development programs must, therefore, recognize this possibility, and incorporate some method of adjusting the country's policies to changing conditions.

When a country suffers an export shortfall, in addition to any assistance it receives from the Agency, the country itself should make an effort to offset a part of this shortfall without disrupting its development program. One possibility for some countries is to reduce consumption; to some extent this would follow automatically because of the fall in incomes of the export sector; in addition there may be deliberate attempts to restrict consumption of non-essential items over and above the automatic adjustments which would result from the income changes. Further, in some cases, countries affected by export shortfalls may be able to use a part of their reserves to meet the loss of export earnings. In order that the obligations of the Agency and the country are clear-cut from the beginning, and to avoid delays in providing assistance at the time of the shortfall, there should be an agreement in the initial understanding about these ways of meeting any shortfall. In addition, some countries may also be able to borrow short-term funds from other sources for this purpose, although the Agency might have to refinance such loans.

In the past, when developing countries were faced with large and unexpected shortfalls of their export earnings, they often had to make serious adjustments in their investments, amounting to a disruption of their development programs. The establishment of the Supplementary Financing Scheme will remove this cause of a disruption of development programs. There may, however, be cases where the whole

export picture of a country or the market for its major export has suffered so drastically that it becomes desirable to have a major revision of the development program, which was based on an earlier export projection. Such instances are likely to be infrequent within the planning periods of about five years covered by the Scheme, but when this type of change occurs, the allocation of investments to the sectors producing the exports for which market conditions have changed seriously has to be reconsidered. While the sectoral composition of the development program might need to be altered, it should generally be possible to maintain the scale of the program and the Agency would provide assistance to meet shortfalls from the original export projection. If, however, it is agreed between the Agency and the country that the change in the export prospects of a country is a fundamental one, then a new development program and associated policy package based on a revised export projection will have to be drawn up.

Because of the need for these various adjustments, to meet the effects of a shortfall, policies agreed upon in the initial understanding cannot be assumed to be frozen at the time. On the contrary, they would be adapted to the particular circumstances which will occur in the course of a planning period. These

adjustments would be made in consultation with the Agency, which would presumably look to the World Bank and the International Monetary Fund for advice on matters falling within their respective fields.

6. Periodic Review

For the purpose of the Supplementary Financing Scheme, it is not sufficient that a satisfactory development program is agreed to at the beginning of a plan period. It is also necessary that such a development program and associated policies are implemented during the plan period. This requires periodic review and consultations between the Agency and the member countries similar to those of such institutions as the World Bank and the International Monetary Fund. In the course of such periodic reviews, it may be found that a country is not following the policies agreed to initially; in that case, the country will no longer be eligible for assistance from the Agency in the event of unexpected shortfalls occurring in the future, until such time as the country conforms to these policies, or a new understanding is arrived at.

SHORTFALLS AND "OVERAGES" IN THE SUPPLEMENTARY FINANCE SCHEME

1. The Supplementary Finance Scheme has been proposed, on the basis of UNCTAD Resolution A.IV.18, to help avoid the disruption of well conceived development programs, which have commanded international support for their financing, when this disruption could potentially be caused by a lack of foreign exchange due to an unexpected export shortfall. It is thus analogous to an insurance fund for protecting development programs from one particular unforeseen and unavoidable circumstance - a shortfall of actual export earnings from the expected values. In the event of such a shortfall, the Scheme would assist a developing country by providing long-term credits to prevent a disruption of its development program. This paper elaborates on the method by which to determine the amount of financial assistance that a country can expect from the Scheme.

2. An essential feature of the Scheme is an understanding between the Agency and the country on an export projection for a period, over which the country has formulated a development plan. 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. Such projections are based on reasonable assumptions regarding world trade developments, and on the assumption that specific policies will be followed. Such projections, together with projections of 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. Agreement on these export projections between the country and the Agency would reflect the financial viability of the development plan in terms of internal and external resources, or in other words, from the point of view of availability of adequate domestic savings and foreign exchange.

3. Given such an agreed projection of export proceeds on which a 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 basic principle proposed in the Scheme is 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" - the amounts by which actual exports exceed projected exports in other years within the same planning period. In this way, the country uses any overages it earns during a projection period to finance shortfalls which occur in that same period. Because overages may occur before or after particular shortfalls, it is proposed that the assistance provided by the Scheme during a projection period should be in the form of 'contingent credits', in the sense that a part or whole of it may be repaid within the projection period. At any time during the projection period, the total contingent credits extended by the Scheme to a country would equal the total shortfalls net of total overages which have already occurred up to that time; if an overage occurs after such contingent credits have been advanced, then the overage

would be used to repay such loans. All the contingent loans which remain outstanding at the end of the period would be converted to a long-term credit, equal to the total shortfalls less total overages which occurred during the entire period. However, there are certain other adjustments which have to be made in this calculation, and these are described below.

Adjustments in Shortfalls and Overages

4. When actual exports fall short of projected exports, the need for extra foreign exchange to maintain the agreed development program is not necessarily equal to the entire amount of such shortfall. One reason is that when an export shortfall occurs, the income of the export sector is correspondingly lower. This may affect its consumption and investment expenditures. Depending on the economic conditions in a country and the kind of policies which the country adopts, there may be room to absorb part of the loss of expected foreign exchange receipts through a reduction in consumption expenditures without disrupting the development program. This reduction in consumption may include deliberate attempts to restrict consumption of 'non-essential' items over and above the induced adjustments which would result from the income changes.

5. In the same way that shortfalls will cause a decrease in consumption expenditures through the process of income reduction, overages will operate in the reverse direction, as incomes in the export sector tend to rise. There will be a tendency for foreign exchange requirements to increase to meet the increased consumption expenditures which will absorb part of the unexpected receipts. Therefore, in calculating the financial assistance provided by the Scheme, the amounts of shortfalls and of overages must be reduced by a factor to take account of the income effect on consumption expenditures, so that the financial assistance of the Scheme is

more closely related to the actual changes in the demand for foreign exchange. An exact calculation of the changes in foreign exchange requirements due to shortfalls and overages of export earnings is, of course, a very complicated matter, depending on many variables on which adequate information may not be readily available. Therefore, for practical purposes, it may be sufficient to agree on a percentage factor which may be applied to both shortfalls and overages. In any case, it may be expected that such percentage factors would be small, relative to total shortfalls or overages.

6. Another element that has to be taken into consideration in calculating the financial assistance to be provided by the Scheme is the extent to which a country may be able to use its own reserves to meet a part of unexpected shortfalls. Where a country and the Agency ^{1/} agree that the country's reserves position is such that a part of it can be used for this purpose, an item indicating the extent of such use would be shown in the initial understanding. In reaching such an understanding, it must be noted that a country would have to use its own reserves to meet unforeseen events other than unexpected export shortfalls, and the usual leads and lags in foreign exchange payments and receipts; further, a part of its reserves may have already been committed for development expenditures. To the extent that it is possible to agree on a certain amount that a country would use out of its reserves to meet unexpected shortfalls, the eventual demand for funds from the Scheme will be correspondingly diminished. On the other hand,

^{1/} This memorandum does not attempt to describe the Agency, or the extent to which it will be guided by the advice of other international financial agencies in reaching understandings with its members.

the level of reserves for a number of developing countries is such that this item of the understanding may, for practical purposes, be zero for many countries.

7. Finally, under the Scheme, the availability of other sources of finance to meet export shortfalls has to be taken into account in calculating the financial assistance to be provided by the Scheme. In the international financial machinery there exists one type of arrangement which is specifically designed to meet problems arising from export fluctuations, the Compensatory Financing Facility of the International Monetary Fund. In addition, there are some other bilateral sources of assistance, for example, the emergency foreign trade loans of the U.S. Export-Import Bank, the program loans and the Food for Peace Program of the U.S. Agency for International Development, and the World Food Program. The extent to which these sources of finance could be utilized by a country would have to be made a part of the initial understanding between the country and the Agency. This would, of course, call for coordination with these other bilateral agencies, though these agencies would be guided by their own policies and procedures. In cases where these agencies cannot give the necessary assurance or fail to provide the agreed assistance, the Agency would be responsible for providing adequate financing in the event of an export shortfall.

8. In the Scheme, the shortfalls and overages are considered in terms of the gross value of exports. This raises the question of whether the exports should not be measured on a 'value added basis', especially to take account of the import-content of exports. From the point of view of operationality, however, it is considered that, as a general rule, the

magnitude of the problem is not important and that the adoption of the value added basis would introduce too many complications. It may perhaps be left to the Agency to use the value added basis for particular countries in which the problem might prove to be significant.

Financial Relations between the Agency and the Country

9. Based on the above considerations, the amount of credits which a country can expect in the event of a shortfall and the amount of repayments can be expressed by the formulae presented below. They indicate the outstanding indebtedness which a country is entitled to have with the Agency at the end of any intermediate year and at the final year of a projection period. The credits which the country receives during the projection period are regarded as "contingent" credits being subject to repayment in case of subsequent overages during the same period. The outstanding amount of credits received at the end of the projection period would then be converted into a final long-term credit.

10. The maximum outstanding indebtedness which the country would be entitled to have with the Agency at the end of any intermediate year during the projection period (L_t) would be given by the result of the following calculation (when positive):

$$L_t = (S - a.S) - (O - a.O) - R - F.$$

where

S = accumulated shortfalls during the projection period

O = accumulated overages during the projection period

a = agreed coefficient of adjustment of consumption

R = agreed use of reserves

F = agreed amount of outstanding loans from bilateral sources of finance to meet export shortfalls (at the end of the year).

11. When the outstanding indebtedness increases from the end of one year to the next, the country would receive a contingent credit equal to the difference. On the other hand, if it decreases, the country would have to pay the difference to the Agency. This repayment would obviously have to be made only to the extent that there still existed an outstanding amount of contingent credits. In terms of the above formula, the amount of credits received (+) by the country or repaid (-) to the Agency is given by:

$$X = L_t - L_{t-1}$$

where L_t and $L_{t-1} > 0$.

The method suggested above indicates the maximum extent to which countries can resort to the Agency. However, a country is expected to use the Compensatory Financing Facility of the International Monetary Fund to cover the shortfalls to the extent that the country is eligible to do so under that Facility. In such a case, any subsequent overage would first be available to effect repurchases under that Facility as they fall due.

12. The amount of outstanding indebtedness at the end of the projection period (which would be equal to the total of the contingent credits received less the repayments, if any, made during the projection period) would then be transformed into a long-term credit. In addition, the Agency may also have to take over any short-term indebtedness that the country may have incurred for this purpose. The use of other short or medium-term sources is justifiable only in cases where shortfalls prove, after the event, to have been temporary; if it proves to be persistent, the Scheme should, in effect, finance such a shortfall by repaying such short-term debt. An alternative would be for the repayment of short and medium-term debt to be taken into account in the discussions of overall financing of the next plan.

13. The transactions between the country and the Scheme ("contingent" credit or repayment of a "contingent" credit) would take place on a yearly basis. Given the usual delay in getting data on actual exports to be compared with the projection, there might be a lag of a few months for the calculations to be made and for the eventual loan from the Supplementary Scheme to be made available. It is to be hoped that the existence of the Scheme in operation might contribute to improve the speed with which these data would be prepared. Moreover, it would be possible to operate on the basis of preliminary data, if they could be considered reliable enough, subject to adjustment when the final data become available.

14. The meaning of the suggested rule for calculating the indebtedness which the country is entitled to have with the Agency during a projection period can best be understood by referring to alternative situations. For example, if during the projection period, the country has only shortfalls, the loss of foreign exchange due to unexpected shortfalls in export proceeds would have been substituted by a long-term loan, and the Scheme would have allowed the country to continue its development program without disruption. At the same time, the country would have contributed its share to meet the unexpected situation by reducing to some extent its foreign exchange expenditure for consumption purposes, and by using its reserves to some extent, where feasible. This would mean that for the next projection period - unless the country's reserves had been replenished by an inflow of capital - the country would not be able to use as much of its reserves to meet future shortfalls.

15. In an alternative situation, if during the projection period the amount of shortfalls had been equal to the amount of "overages", the country would have been able not only to carry out its development efforts, but also

to maintain the expected level of consumption expenditures. Although it would have used the facilities of Supplementary Finance on a contingent basis, it would end the projection period without making a net drain on the resources of the Scheme, because it would have repaid the loans which had been received during the projection period.

16. It is worth noting that all calculations referred to above are related to a projection period. The value of accumulated shortfalls and overages at the beginning of the next projection period would be zero. This would mean that if the country had finished the previous projection period with net overages, they would not be transferred to the next projection period for purposes of the operation of the Scheme. Members who succeed in acquiring more foreign exchange than had been expected during the course of a projection period would be allowed to consolidate their advantage. However, they would begin the next phase of their development with a stronger financial position. This would be taken into account in assessing the scale of their future development program and their need for long-term capital or the possible extent to which the country would be expected to use its own reserves, in the next projection period. By not carrying the "excess of net overages" from one period to the next, the Scheme would provide a measure of incentive for developing countries to try harder to surpass their export targets.

17. According to the Scheme, a country has to use any excess export earnings to meet future shortfalls within the same projection period. It has been suggested by some that the country may as well use its overages to step up the pace of its development program, in the sense of initiating new development projects, over and above those which were initially contemplated. In other words, the stepping up of the pace of the development program would

involve an increase in the initially projected and already agreed expenditure of foreign exchange during the projection period. This argument should be considered in the context in which Supplementary Finance Scheme is supposed to work. The Scheme assumes that there is a reasonable development program for which the needed foreign financing is expected to be forthcoming, as a result of the understanding with the capital exporting countries and international financial agencies. This development program may not be as big as the country could implement, given its absorptive capacity, defined in terms of the country's ability to carry out development projects. But this is a realistic program for which it was found possible to obtain the necessary external resources for carrying it out and for which the Agency has undertaken the responsibility of providing the needed foreign exchange in case of export shortfall, so that the projected development would not be disturbed. In other words, this is a development program for which there is certainty that it will not be impaired because of lack of export proceeds.

18. It is argued that a country should not use the unexpected foreign exchange available because of the "overages" in its export proceeds to accelerate the pace of its development (assuming it had the absorptive capacity to do so); to do so would be contrary to the logic and purpose of the Scheme.

19. There is, however, the practical problem of how the authorities can resist pressures to spend the accumulating foreign exchange reserves of the country, when the advocates of a larger program point to the innumerable problems which remain to be solved in the country. The logical argument of insuring an orderly development tends to weaken as the reserves

pile up. However, there are many ways by which a country can use such foreign exchange accumulations to improve its international financial position, without holding such accumulations in forms defined as reserves in the country. Another possibility is to utilize the excess earnings from exports in part to bring forward certain development projects and corresponding imports from later years of the plan period. Further, countries which do not use up the foreign exchange corresponding to excess export earnings but hold it to meet possible future shortfalls, may have to take fiscal and other measures to counter any possible inflationary impact on the domestic monetary situation.

20. There may, however, be cases of an accumulation of unexpected earnings above certain limits, (say, 'net overages' being equal to one or two average years' export proceeds), as, for example, when a country finds a new resource leading to larger exports. In such cases, the country could initiate measures to revise its development program, taking the appropriate initiative with the Agency as well as other external financing agencies.

SUPPLEMENTARY FINANCE: CONSIDERATION OF IMPORT PRICES

1. The UNCTAD resolution suggested that 'adverse effects from significant rises in import prices' would be one of the relevant economic circumstances to be examined. The Bank Staff Study recognized that, ideally, export shortfalls should be calculated in real terms; that this could be done by concentrating attention on unforeseen deviations in the international purchasing power of exports. The Study points out, however, it may not be practicable in many cases to measure changes in import prices within a reasonable margin of error. In estimating the likely scale of operations under the Scheme, it was noted that consideration of import prices would probably make little difference.

2. The question of import prices came up for general discussion at both the meeting of the Committee on Invisibles in April 1966 and the first session of the Intergovernmental Expert Group in October 1966. The principal questions emerging out of these discussions can be summarized as follows:

- (a) Is it possible to obtain an estimate of the additional cost that might be incurred by the proposed Scheme if provision were made to take adverse movements in import prices into account in the administration of the Scheme.
- (b) In what way could a provision that movements in import prices be taken into account in determining the amount of aid that the Scheme should make available to a given country be administered.
- (c) What is the availability and character of existing import price indexes for the developing countries and what are the solutions to the statistical problems that these may present.

3. The crucial question is whether import price indexes constitute a sufficiently accurate measure of price movements to warrant their use in any mechanism for adjusting transactions under the Scheme. A survey of the results of recent research by the Bank staff on the subject of both export and import price indexes indicates that existing indexes are used widely as a useful tool for analyzing general world trade problems. Any conclusions derived from such use, however, are subject to qualification regarding the weaknesses and limitations of the indexes; the available indexes leave much to be desired, particularly if an attempt is to be made to use them for critical measurements.

4. The principal problem lies in the inherent difficulty of devising a true indicator of price movements for a group of manufactured products, particularly capital goods, i.e. a statistical measure whose movements would reflect only changes in price and not also other changes, such as the utility or efficiency of the individual products or changes in the composition of the group. This problem still remains to be solved.

5. For a developing country the composition of imports, and particularly manufactured goods, can change rapidly. In Brazil, for example, the share of transport equipment (in terms of value) varied between 45% and 13% of total imports of manufactures in the period 1959-1963, and within the transport category, the share of motor vehicles dropped from 49% in 1959 to a negligible proportion in 1963 while the share of airplanes rose from 10% to 38%. Such shifts in composition cause price indexes to give a distorted view of the true situation. Frequent changes of index weights, under such circumstances, can also lead to exaggeration of the extent of changes in prices.

6. Another main difficulty relates to measuring price changes in the individual components of the index. Unit value indexes of machinery, for example, are frequently based on declared value divided by weight. In such a case, as the machinery becomes lighter and more efficient, its index price would automatically rise. In cases where unit values were computed by reference to numbers, a shift toward the purchase of fewer but larger machines of equal capacity would also result in an incorrect price signal. Beyond these mechanical difficulties there lies the further problem of taking account of improved quality of new products. The most familiar illustrations regarding the difficulties of reflecting quality changes are automotive tires and batteries, which have shown a continuous improvement in efficiency and service life for which, however, no adjustment is made in the unit prices used in an index.

7. Thus, the statistical difficulties involved in including a full-scale consideration of import prices in working out the Scheme are indeed real. An attempt should, of course, continue to be made for improving the data, but this is a separate and time-consuming process. Assuming this were done, should they be considered an integral part of the Scheme's approach and calculations?

8. At the time a country's development program is formulated and subsequently agreed upon for purposes of arriving at an understanding regarding basic development finance, the entire balance of payments prospects for the Plan period are considered; the import requirements are a main part of this exercise, and certain assumptions regarding the course of import prices would have been made by the country and built into the

estimation regarding import needs. There can of course be uncertainty regarding this aspect, as there can be in respect of other aspects, such as development aid and private capital flows. The Scheme itself, however, is based on the finding that export shortfalls have been a main factor of uncertainty, that they are disruptive of development, and that they are measurable. It so happens there is considerable experience in the World Bank in this area of export projections for a period of one to several years. The UNCTAD resolution addressed itself to this specific cause of disruption of the development program and seeks a remedy to it. Accordingly, the Scheme does not purport to make good shortfalls from any or all causes but only from this major one. If the Scheme, and the underlying calculations, were extended to cover other aspects like import prices, the statistical underpinning would become questionable, and implementation, therefore, might be rendered significantly more difficult.

9. At the same time, it must be recognized that for particular countries, from time to time, a significant rise in import prices may pose a difficult problem. Conversely, when a country suffers an export shortfall, simultaneously it may have been afforded considerable relief by a fall in import prices. This particular aspect merits further consideration by the Group; i.e. whether the administering agency should consider such cases, on an individual basis, after the export shortfall has occurred, on the basis of the available prices data for imports of a particular country. Here again, the question arises whether sufficiently reliable import price data would be available at the time the export shortfall became apparent. There is, of course, the other question: would import price adjustments be for total exports or only for shortfall amounts?

10. Another possible approach, in view of such statistical and other difficulties, would be not to bring into the Scheme the consideration of import prices in the initial 5 years, and based on the actual working of the Scheme in the initial period, subsequently to consider these other refinements and considerations.

Form No. 75
(2-60)

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL FINANCE
CORPORATION

INTERNATIONAL DEVELOPMENT
ASSOCIATION

ROUTING SLIP

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November 25/66

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REFERENCE

TDS/241 (1-1)

28 October 1966

Dear Andy,

.....

I am enclosing for your comments the revised Summary of Discussion of item 5 of the terms of reference of the Intergovernmental Group on Supplementary Financing. The original section referring to Methodology and Projections (see page 2 of Conference Room Paper 4) was modified extensively as a result of submissions by the Bank and the United States. Marcus Fleming has also submitted paragraphs (b) and (c) of the new Section.

In the enclosed version I have combined Marcus Fleming's suggestions with those of Mr. Pereira Lira and Jo Saxe.

I will delay release of the revised Summary until I receive any comments you may have on this item.

*I'll turn -
no problem.*

Yours sincerely,

Sidney

S. Dell, Director
New York Office of UNCTAD

Andy

Mr. Andrew Kamarck
Director
Economics Department
International Bank for Reconstruction
and Development
1618 H Street, N.W.
Washington, D.C. 200433

Methodology of projections

(a) The Scheme proposes that export projections would be based on an analysis of market conditions for major export commodities. Apart from an analysis of factors influencing the evolution of demand and supply, account should be taken of the probable effects on exports of any new policies that a country might adopt to alter the existing export trend.

(b) In the administration of its compensatory financing scheme, the IMF measures short-term export shortfalls from the estimated medium-term trend value of exports for the year for which the shortfall is calculated. The medium-term trend value is defined as the annual average of the five years beginning two years before, and ending two years after, the year for which the trend value is calculated. Since exports for the last two years of this five-year period are unknown at the time of the calculation, the Fund estimates the trend value partly by direct forecast of the two years in question and partly by using a weighted average of actual exports of the first three years of the five-year period, the weights being chosen for their predictive power as shown by regression analysis.

(c) In so far as direct forecasting is employed by the Fund, the methods used are not basically different from those employed by the Bank for its longer-term projections. The average level of exports predicted by the Fund for the two years following the shortfall year is, however, subject to certain predetermined limits, in that it is assumed not to exceed by more than 10 per cent the average level of exports experienced in the two years preceding the shortfall year and not to fall below the level of exports experienced in the shortfall year itself.

(d) It was considered advisable for the World Bank and the IMF to pool their experience in forecasting exports. It was also pointed out that the

World Bank has had extensive experience over many years in making export projections directly based on commodity studies. Both institutions are, therefore, now utilizing the same methodological approach and it is expected that the Supplementary Financing Agency would take full advantage of the work of the two institutions in this field.

Distr.
RESTRICTED

TD/B/C.3/AC.3/Conf.Room Paper/13
28 October 1966

Original: ENGLISH

Trade and Development Board
Committee on Invisibles and Financing
related to Trade
Intergovernmental Group on
Supplementary Financing
Geneva 10 October 1966

The following draft paragraphs are being distributed to members of the group after the close of its first session. Since delegations had no opportunity to submit comments on the text, these paragraphs will not be included in the revised summary of discussions.

Summary of Discussion of Items 8 and 9
of Document TD/B/C.3/25

8. The comparative effects on economic development of the scheme proposed and of other possible methods which might be employed for the same purpose but with due regard to the primary task laid down in the fifth and sixth paragraphs of the resolution to which the terms of reference of the proposed Group are annexed
 - a. Various types of financial and non-financial schemes could be devised to deal with the problem of unexpected export shortfalls. There was a fear that the Scheme, valuable as it might be, might prejudice action on the more basic remedy of organization of markets. Concern was also expressed that the adoption of the Scheme should not reduce the incentive to negotiate commodity agreements.
 - b. It was agreed that while supplementary financing was not a substitute for a fundamental solution of the commodity problem, it has a useful contribution to make, and the Group should concentrate its attention in this direction.

9. The status, membership and function of the Agency and its relations with other international bodies, having regard to paragraphs 7 and 8 of Part A of recommendation A.18.

- a. According to one view, UNCTAD recommendation A.IV.18 precludes the establishment of any new Agency. On the other hand, it was suggested that the UNCTAD recommendation on this point was flexible.
- b. Nevertheless, it was considered premature at the present stage to undertake a detailed consideration of the status of the Agency and its precise relations with other international bodies since this presupposed agreement on the basic nature of the Scheme which the Agency would be required to administer. However, it was agreed that regardless of the precise legal status of the Agency, an effective implementation of the Scheme would imply the closest possible co-operation with the World Bank and the IMF.

ROUTING SLIP		Date
		November 21, 1966
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Initial		Send On
REMARKS		
<p>This came from Jo Saxe, the U.S. representative to the Inter-Governmental Group. In Geneva, Mr. Saxe had suggested the need for some further work on "relative importance of various causes of disruption" and had promised to let us have a study that AID had done on the subject. This presumably is it.</p>		
From		B. Jalan <i>Bj</i>

THE EFFECT OF VARIOUS BALANCE OF PAYMENTS ITEMS
ON FOREIGN EXCHANGE AVAILABILITY

Supplementary Financial Measures is addressed to the problem of "adverse movement in export proceeds" which can cause disruption of the development plans of developing countries. Presumably part of the disruption occurs in the following way:—/ Export proceeds fall short of "reasonable expectations" which had been incorporated into the development plan. Since foreign exchange is scarce, imports must be restricted. But imports, particularly capital goods and intermediate goods, are vital to the development program; hence, disruption. If temporary falls in the availability of foreign exchange is the central problem, concentrating on only one component of foreign exchange availability may not be the most efficient way to insure against disruption of development plans. The following balance of payments data for 12 LDC's over the last seven years suggest that components other than export proceeds have played a substantial role in declines of total foreign exchange. In eight of the countries private capital movements showed greater declines than did export proceeds; in two others, declines in government receipts of capital and transfers were greater than declines in other components. (The exact sense in which they were greater is explained below). These preliminary results suggest that declines in export proceeds may not be the primary cause of declines in foreign exchange availability; further investigation along these lines might be warranted.

But whether or not one thinks that the preceding observations are relevant to supplementary financing, the attached data sheets may be helpful in organizing thought and searching for relationships.

TABLE I

All data are taken from International Financial Statistics (June, 1966) and are expressed in millions of current U.S. dollars. All items except exports (#1) and imports (#2) were taken from the individual country tables and the line numbers refer to the (relatively) uniform numbering system employed in those tables. When currency conversions had to be made, the exchange rate for each year given at the top of the country tables was used.

The data for each of the twelve countries is arranged as follows:

<u>No.</u>	<u>Title</u>	<u>Source</u>
1	Exports	Trade Table (p.34)
2	Imports	Trade Table (p.35)
3	Trade Balance	(#1 - #2)
4	Goods and Services	Line 70
5	AID	Central Gov't Transfer, Line 71b Plus Central Gov't Capital, Line 72b
6	Private Capital	Line 72a
7	Private Transfers	Line 71a
8	Monetary Authority: Assets	Line 1
9	Monetary Authority: Liabilities	Line 3
10	Net Position	(#8 - #9)
11	Errors & Omissions	Line 76
12	Monetary Authorities	Settlement Item in Balance of Payments, Line 75

1/ Disruption stemming from policies other than import restriction which may be adopted in shortfall years are also mentioned. In addition, there is a passage on pages 50-51 of the Study which mentions the "foreign trade multiplier" effect of an export decline, a relationship which has been neglected in recent NAC/SFM meetings.

<u>No.</u>	<u>Title</u>	<u>Source</u> (continued)
13	Current Availability of Foreign Exchange	#1 + #5 + #6 + #7
14	Export Potential Disruption	$\frac{X_t - X_{t-1}}{T_{t-1}}$ for each $(X_t - X_{t-1})$ which is negative. $X_t =$ exports in year t (#1)
15	"Aid" potential disruption	$\frac{A_t - A_{t-1}}{T_{t-1}}$ for each $(A_t - A_{t-1})$ which is negative. $A_t =$ "Aid" in year t (#5)
16	Private Capital & Transfer potential disruption	$\frac{P_t - P_{t-1}}{T_{t-1}}$ for each $(P_t - P_{t-1})$ which is negative. $P_t =$ private capital + private transfer in year t (#6 + #7)

TABLE II Potential Disruption Indexes

These indexes were computed to help point out which balance of payments items had the largest impact on the total exchange availability. Three balance of payments items were focused upon.

1. Exports (X)
2. AID (A)
3. Private capital & private transfers (P).

The sum of these items is the foreign exchange availability (T) (except for invisibles on current account which were negative except in the case of India, Pakistan, Tunisia and the Philippines).

The usual type of export instability index is of the form

$$\frac{1}{n} \sum_{t=1}^n \frac{|\Delta X_t|}{X_t}$$

which gives the average annual percentage change in exports. This type of index was inadequate because the central interest was the impact of instability in the separate items (X, A, and P) on foreign exchange availability (T). Thus, for each year the percentage change of each item was weighted by the part of T that the item made up. For example, in the case of exports

$$\underbrace{\frac{X_{t+1} - X_t}{X_t}}_{\text{annual percentage change in exports}} \quad \underbrace{\frac{X_t}{T_t}}_{\text{percentage of exports in T}}$$

This gives terms such as

$$\frac{X_{t+1} - X_t}{T_t}$$

To make the index for each country, only the negative terms were added together. This was done because the interest was in potentially disruptive instability; a rapidly growing level of exports would be indicated to be potentially disruptive if positive terms were added. The sum was divided by the total number of observations, regardless of whether ΔX in each year was positive or negative, because some correction for the different lengths of the time series of data was needed.

The indexes which resulted are found in Table II. Private capital movements exerted the greatest downward influence on total exchange availability in 8 out of 12 countries.

Foreign exchange shortages are certainly not caused solely by export shortfalls. In fact this analysis indicates that private capital movements may be a more chronic factor than export shortfalls are. Such a result does not imply the necessity or desirability of capital restrictions. Rather, it shows that the whole balance of payments of a country might be more relevant than merely export proceeds for assessing potential or actual disruption.

[It would be interesting to investigate whether export shortfalls and "shortfalls" in other items caused "disruption" in the same way. Repatriation of earnings from a U.S. corporation in Brazil may be less "disruptive" (in some sense to be defined) than as shortfall in coffee proceeds.]

III. The Change in the Availability of Foreign Exchange and Its Uses -- Or "What Gets Squeezed?"

TABLE III shows time series for the twelve countries of three magnitudes.

- (1) ΔT - first differences of total foreign exchange availability. (Lines 1+5+6+7 of Table I).
- (2) ΔM - first differences of the value of imports (Table I)
- (3) ΔR - annual changes in net liquidity position (Line 75 in IFS country tables).

All figures are in millions of U.S. dollars.

The time series for all the countries were pooled to form 59 observations in all. Simple correlation analysis gave the following results:

1. The correlation coefficient between the change in foreign exchange availability and the change in the level of imports was +0.12. This was not significantly different from zero at a 5% level of confidence.
2. The correlation coefficient between the change in foreign exchange availability and the change in net reserves was +0.46. This was statistically different from zero at a 1% level of confidence.

Interpretation of these results is difficult. Imports did not always fall with declines in foreign exchange availability. In fact, changes in imports did not bear much relationship to changes in exchange availability. Apparently reserves were often used to cushion the effect of declines in

current exchange earnings and were accumulated (or replenished) when exchange became more abundant. Thus, reserves fulfilled their intended function. However, the correlation is low because in some cases of exchange stringency imports were squeezed to maintain reserves and in other cases reserves were spent to maintain imports. The relationships vary among countries and a better way of proceeding would have been to have investigated time series for each country. The time series here were too short for formal analysis of this sort, but visual analysis of Table III may be helpful.

The "slippage" in the numbers, i.e., the fact that $\Delta T + \Delta M + \Delta R$ usually does not equal zero, arises from the exclusion of current account invisibles and from inaccurate or unrecorded items which show up in errors and omissions. The errors and omissions item is frequently large and may be either positive or negative.

AA/PC
TSears:ls:8/16/66

ARGENTINA

ARGENTINA

	1959	1959/1960	1960	1960/1961	1961	1961/1962	1962	1962/1963	1963	1963/1964	1964	1964/1965	1965
EXPORTS	1009	+70	1079	-115	964	+252	1216	+149	1365	+45	1410	+83	1493
IMPORTS	993	+256	1249	+211	1460	-103	1357	-366	981	+96	1077	+121	1198
TRADE BALANCE	-16	-186	-170	-326	-496	+355	-141	+525	+384	-51	+333	-38	+295
GOODS & SERVICES	137 -2	-212	-197.7 -28	-375	-525.0 -77	+303	-267.7 -129	+502	232.0 +152	-196	35.9 +297		
AID	14.4	-7	7.7	+156	163.9	-142	22.4	+103	125.2		-32.8 ¹		
PRIVATE CAPITAL	249.0	+275	523.8	-297	227.2	-31	196.3	-296	-102.1	+71	-28.7		
PRIVATE TRANSFERS	-3.2	-4	-7.0	-6	-12.7	+8	-4.8	+5	-2				
MONETARY AUTH: ASSETS (Central Bank)	349 535	+176	386 525	-139	44 386	-272	270 114	+156	+53 270	-117	153	+83	236
MONETARY AUTH: LIABILITIES (Central Bank)	392	+88	480	-82	398	-38	360	-46	314	-106	208	-56	152
NET POSITION	-43	+88	45	-57	-12	-234	-246	+202	-44	-11	-55	+139	+84
ERRORS & OMISSIONS	-154.3	-22	-176.5	+247	706	-334	-263.4	+192	-71.6	+74	1.9		
MONETARY AUTHORITIES (75)	-118.6		-175.1		137.5		275.8		-170.1		26.0		
T = X + A + P	1240	+364	1604	-376	1228	+201	1429	-39	1590	-41	1349		

¹ Line 72b only
(Net Gov Capital)

BLE I

BRAZIL

BRAZIL

	1959	1959/1960	1960	1960/1961	1961	1961/1962	1962	1962/1963	1963	1963/1964	1964	1964/1965	1965
EXPORTS fob	1202	-13	1269	+134	1403	-189	1214	+192	1406	+27	1433	+162	1595
IMPORTS cif	1374	+88	1462	-2	1460	+15	1475	+12	1487	-24	1263	-167	1096
TRADE BALANCE	-92	-101	-193	+136	-57	-204	-261	+180	-81	+251	170	1329	499
GOODS & SERVICES	-337 -245	-211	-548 -355	+245	-303 -246	-193	-406 -235	+275	-221 -140	+289	68 1102	+122	190 +257
AID (b71 & b72)	-30	+27	-3	+157	160	+12	172	+4	176	-114	62 ¹	215	277
PRIVATE CAPITAL	241	-47	194	+22	216	-33	183	-143	40	-29	11	+145	156
PRIVATE TRANSFERS	-10	-3	-13	+12	-1	-2	-3	+6	3				
MONETARY AUTH: ASSETS	438	-73	345	+125	470	-91	379	-61	318	+50	368	+320	688
MONETARY AUTHORITY: LIABILITIES	181	+213	394	-177	217	+48	265	+33	298	-	298		
NET POSITION	257	-306	-49	+302	253	-139	114	-94	20	+50	70		688?
ERRORS & OMISSIONS	48	-38	10	+39	49	-189	-140	-2	-142	+167	25	-32	-7
MONETARY AUTHORITIES (B5)	90		334		-59		294		135		-167		-646
$V = 1 + 5 + 6 + 7$	1483	-36	1447	+331	1778	-212	1566	+49	1615	-109	1506	+522	2028

b72 only
(central post houses omitted)

AX/9 ave 1.9
 AY/9 ave 1.5
 AZ/9 ave 2.7

-9 + -10.6 + +
 + + +
 -3.4 + -2.0 -8.8 -8.7 +
 -1.8 +

TABLE I

CHILE

CHILE

	1959	1959/1960	1960	1960/1961	1961	1961/1962	1962	1962/1963	1963	1963/1964	1964	1964/1965	1965
EXPORTS	495	-7	488	+18	506	+24	530	+10	540	+84	624	+58	682
IMPORTS	413	+113	526	+72	598	-27	571	-13	558	+49	607	-3	604
TRADE BALANCE	+82	-120	-38	-54	-92	+51	-41	+23	-18	+35	+17	-95	-78
GOODS & SERVICES	-42		-177		-302		-227		-208		-145		
AID	1	+20	21	+39	60	+32	92	+31	123	-28	95		
PRIVATE CAPITAL	64	-11	53	+79	132	-96	36	-55	-19	+74	55		
PRIVATE TRANSFERS	10	+3	13	-6	7	-3	4	+	4	+4	8		
MONETARY AUTH: ASSETS	133		111		79		79		77		89		137
MONETARY AUTH: LIABILITIES	(?)		127		146		184		171		152		
NET POSITION													
ERRORS & OMISSIONS	-4		46		-23		26		70		14		
MONETARY AUTHORITIES (25)	-56		45		111		20		30		-20		
1+5+6+7	570	+5	675	+30	705	-43	662	-14	648	+134	782		
ΔX/T	.2			+		+		+		+			+
ΔR/T	.9			+		+		+		-4.3			
ΔP/T	4.7			+		-14.0		-83		+			

MALAYSIA

MALAYSIA

	1959	1959/1960	1960	1960/1961	1961	1961/1962	1962	1962/1963	1963	1963/1964	1964	1964/1965	1965
EXPORTS	809	+147	956	-98	858	-	858	+26	884	+25	909	+105	1014
IMPORTS	568 353	+135	705 454	+26	729 442	+71	800 738	+22	822 809	+2	824	+28	852
TRADE BALANCE	+241	+12	+253	-124	+129	-71	+58	+4	+62	+23	+85	+77	+162
GOODS & SERVICES			130		-18		-59		-136		-149		
"AID"			17	-2	15	+1	16	+9	25	-39	64		
PRIVATE CAPITAL			82	+10	92	+16	108	+17	125				
PRIVATE TRANSFER			-84	+7	-77	-	-77	-3	-80	-4	-84		
MONETARY AUTH: ASSETS	663		790		858		909		920		894		
ERRORS & OMISSIONS			35		36		88		62		171		
MONETARY AUTH (75)			-188		61 ⁻⁷⁹		-61		-13		37		
1+5+6+7			971	-83	888	+17	905	+49	954	-65	889		
ΔX/T	1.7				-10.1	+		+		+			+
ΔA/T	-				- .2	+		+		+			
ΔP/T	.1				+	+		+		-4			

TABLE I

AFGHANISTAN

PAKISTAN

	1959	1959/1960	1960	1960/1961	1961	1961/1962	1962	1962/1963	1963	1963/1964	1964	1964/1965	1965
EXPORTS	321	+72	393	+17	400	-3	397	+20	417	+9	426	+104	530
IMPORTS	353	+301	654	+8	642	+96	738	+151	889	+109	998	+45	1043
NET BALANCE	-32	-229	-261	+19	-242	-99	-341	-131	-472	-100	-572	+59	-513
GOODS & SERVICES	-105		-239		-273		-321		-482		-523		
INCOME	175	+144	219	-24	195	+120	315	+139	454	+52	502		
PRIVATE CAPITAL	6	+22	28	+1	29	-8	21	+49	70	-52	18		
GOVERNMENT TRANSFERS	1	-1	-	+2	2	+4	6	+18	24	-3	21		
MILITARY AUTH: ASSETS STATE BANK	404		316		277		279		307		244		221
MILITARY AUTH: LIABILITIES													
NET POSITION													
GRANTS & DONATIONS	3		11		-10		-15		-28		-22		
MILITARY AUTH: (B)	-89		-29		+60		-6		-41		60		
1959-60 + 7	503	+137	640	-14	626	+113	739	+226	965	+2	967		
LX/T	6.1	+		+		-5		+		+			+
LI/T	6.8	+		-3.8		+		+		+			
DP/T	1.3	+		+		-6		+		-5.7			

TABLE I

PHILIPPINES

	1959	1959/1960	1960	1960/1961	1961	1961/1962	1962	1962/1963	1963	1963/1964	1964	1964/1965	1965
EXPORTS	529	+31	560	-60	500	+56	556	+171	727	+15	742	+25	767
IMPORTS	577	+86	663	+15	678	-23	655	+32	687	+181	868	+26	894
TRADE BALANCE	-48	-55	-103	-75	-178	+79	-99	+139	+40	-166	-126	-1	-127
GOODS & SERVICES	-75		-144		-161		-63		+103		-24		-47
"AID"													
PRIVATE CAPITAL	64	+17	81	-36	45	-9	36	-18	18	-5	13	+84	97
PRIVATE TRANSFERS	61	-6	55	-75	-20	-7	-27	+26	-1	-74	-75	-86	-101
CENTRAL BANK	81	-1	80	-5	75	+3	78	-13	65	+28	93	-20	73
			127		54		75		110		123		177
ERRORS & OMISSIONS	-57		-45		-39		19		-150		-38		-188
MONETARY AUTHORITY (7C)	-43		-25		90		-37		-55		4		-33
$\pi = 1+5+6+7$	735	+41	776	-176	600	+43	643	+166	809	-36	773		737
$\Delta X/\pi$	1.3												
		+		-7.7		+		+		+		+	
$\Delta A/\pi$	1.6												
		+		-4.6		-1.5		-2.8		-0.6		+	
$\Delta P/\pi$	5.2												
		-1.0		-10.3		-0.7		+		-5.7		-13.7	

TABLE I

TUNISIA

TUNISIA

	1959	1959/60	1960	1960/61	1961	1961/62	1962	1962/63	1963	1963/64	1964	1964/65	1965
EXPORTS	142	-22	120	-10	110	+6	116	+9	125	+5	130	-10	120
IMPORTS	153	+38	191	+20	211	+5	216	+7	223	+25	248	-2	246
TRADE BALANCE	-11	-60	-71	-30	-101	+1	-100	+2	-98	-20	-118	-8	-126
GOODS & SERVICES	16		-62		-84		-100		106		124		
"AID"	32	+11	43	+21	64	+7	71	-19	52	+34	86		
PRIVATE CAPITAL	-	+22	22	-10	12	-4	8	+24	32	-5	27		
PRIVATE TRANSFERS	-	+2	2	-	2	-2	-	-2	-2	+3	1		
CENTRAL BANK			85		74		62		63		33		40
ERRORS & OMISSIONS	1		-2		1		-2		-1		-1		
MONETARY AUTHORITY	-37		-3		8		24						
	174	+13	187	+1	188	+7	195	+12	207	+37	244		
$\Delta X/T$	3.7												
$\Delta M/T$	1.9												
$\Delta S/T$	1.2												
		-12.6		-5.3		+		+		+			-4.1
		+		+		+		-9.7		+			
		+		-5.3		-3.2		+		-10			

TABLE I

TURKEY

	1959	1959/60	1960	1960/61	1961	1961/62	1962	1962/63	1963	1963/64	1964	1964/65	1965
EXPORTS	354	-33	321	+26	347	+34	381	-13	368	+43	411	+48	459
IMPORTS	470	-2	468	+41	509	+113	622	+69	691	-147	542	+35	577
TRADE BALANCE	-116	-31	-147	-15	-162	-79	-241	-82	-323	+192	-131	+13	-118
GOODS & SERVICES	-117		-117		-123		-235		-256		-97		-28

TURKEY

AID	170	-56	114	+25	139	-39	178	+9	187	-162	25	+66	91
PRIVATE CAPITAL	445	+7	244	-58	-34	+84	59	-43	-7	+82	75	-95	-20
PRIVATE TRANSFER	3	+2	5	+2	7	-2	5	+7	12	-10	2	+6	8
CENTRAL BANK	265		203		194		189		178		144		141
ERRORS & OMISSIONS	-72		32		33		-31		-2		28		16
MONETARY AUTHORITY	2		-56		-32		32		66		-22		-69

	542	-78	464	-5	459	+55	614	-54	560	-47	513		
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EX/T	1.4	-6.1	+	+	+	+	-2.1	+	+	+	+	+	+
DA/T	6.6	-10.3	+	+	+	+	+	+	-29.0	+	+	+	+
DI/T	5.9	+	-12.1	+	+	+	-5.9	+	+	+	+	+	-17.3

TABLE II

COUNTRY	(1) $\frac{1}{n} \sum \frac{\Delta X}{T}$ Exports	(2) $\frac{1}{n} \sum \frac{\Delta A}{T}$ "aid"	(3) $\frac{1}{n} \sum \frac{\Delta P}{T}$ private capital
ARGENTINA	1.2	3.1	8.2
BRAZIL	1.9	1.5	2.7
CHILE	0.2	0.9	4.7
COLOMBIA	1.8	.2	3.6
INDIA	0.3	1.6	1.5
MALAYSIA	1.7	-	0.1
NIGERIA	0.4	0.6	1.7
PAKISTAN	0.1	0.8	1.3
PERU	0.7	1.1	2.8
PHILIPPINES	1.3	1.6	5.2
TUNISIA	3.7	1.9	1.9
TURKEY	1.4	6.6	5.9

THESE COUNTRY'S EXPORTS ACCOUNTED FOR 29 PERCENT OF TOTAL LDC EXPORTS (1965)

COUNTRIES IN WHICH INDEX (1) (Exports) was largest = 2
 # countries in which INDEX 2 (aid) was largest = 2
 # countries in which INDEX 3 (private capital) was largest = 8

TABLE III

THE CHANGE IN THE AVAILABILITY OF FOREIGN EXCHANGE AND ITS USES *

TABLE III		1959/60	1960/61	1961/62	1962/63	1963/64	1964/65	Country	1959/60	1960/61	1961/62	1962/63	1963/64	1964/65
ARGENTINA	ΔT	+364	-376	+201	-39	-41		MALAYSIA	LT	-83	+17	+49	-65	
	ΔM	+256	+211	-103	-366	+96			ΔM	+26	+71	+22	+2	
	ΔR	+175	-138	-276	+170	-26			ΔR	+79	+61	+13	-37	
BRAZIL	ΔT	-36	+331	-212	+49	-109	+522	NIGERIA	ΔT	-11	-80	+152	+129	+157
	ΔM	+88	-2	+15	+12	-24	-167		ΔM	+19	-54	+12	+130	+69
	ΔR	-334	+59	-294	-135	+167	+646		ΔR	-9	-16	-34	+36	-14
CHILE	LT	+5	+30	-43	-4	+134		PAKISTAN	ΔT	+137	-14	+133	+226	+2
	ΔM	+113	+72	-27	-13	+49			ΔM	+301	+8	+96	+151	+109
	ΔR	-45	-111	-20	-30	+20			ΔR	+27	-60	+6	+41	-60
COLOMBIA	ΔT	-33	+41	+73	+42	+125	-57	PERU	ΔT	+79	+75	+89	+20	+99
	ΔM	+103	+38	-17	-34	+80	-133		ΔM	+55	+95	+66	+41	-4
	ΔR	0	-130	-74	-74	-19	+35		ΔR	+33	+34	+6	+19	+25
INDIA	ΔT	+6	-37	+65	+365	+586		PHILIPPINES	ΔT	+41	-176	+43	+166	-36
	ΔM	+341	+50	-84	+124	+221			ΔM	+86	+15	-23	+32	+181
	ΔR	-68	-58	-136	+23	+25			ΔR	+25	-90	+37	+55	-4

BLE III (CONT.)

		1959/60	1960/61	1961/62	1962/63	1963/64	1964/65
MISA	DT	+13	+1	+7	+12	+37	
	DM	+38	+20	+5	+7	+25	
	AR	+3	-8	-24			
IRREY	DT	-78	-5	+55	-54	-47	
	DM	-2	+41	+113	+69	-149	
	AR	+56	+32	+32	-66	+22	