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Form No. 57 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara DATE: June 23, 1969

FROM: Irving S. Friedman

SUBJECT: Supplementary Finance: Intergovernmental Group Meeting in New York June 23 - July 3

You may be interested in seeing this. For handy reference I am attaching a copy of the Action Evaluation Paper referred to in the memorandum.

ISF

cc: Mr. Knapp
Mr. Broches

FORM NO. 57

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Irving S. Friedman

DATE: June 20, 1969

FROM: N. A. Sarma N. A. Sarma

SUBJECT: Supplementary Finance: IGG Meeting in New York
June 23 - July 3

Please refer to the discussion Mr. Kamarck and I had with you this morning. I understand the following to be instructions for me in attending the above session:

In view of the delicate nature of the matters involved, especially in the context of the whole development aid effort, the discussions of commodity problem, third replenishment of IDA, we confine ourselves to the questions directly posed to us:

(i) Whether the Bank Staff Scheme could be implemented by Bank/IDA, within their existing Articles of Agreement, if the E.D.'s so agreed and if finance were made available: We have a (draft) note on this from the Legal Department, taking the view that administration of such a scheme within the Bank Group is possible by setting up an affiliated agency, or directly by the Bank or IDA (preferably the latter). Further details would depend on the specific scheme that might emerge. A brief statement to this effect would be made at the meeting, but it is not proposed to circulate the note to the Group.

(ii) Another question relates to the revision of cost estimates: We would inform the Group that we have looked at available data for more recent years also, i.e. up to 1967, and our present estimate of financial requirements is about $300 million a year. We have a paper with us on this, but would not circulate it to the Group. Any explanation that is required will be given orally. If it should become necessary to give the Group a written presentation, I am to consult you.

(iii) Relation between Supplementary Finance and Fund's Compensatory Finance Facility: During earlier discussions, we tried to clarify this point on a technical basis. If S.F. should come to be administered by Bank Group as part of the Bank Group's regular activities, the question would become part of the whole framework of continuing consultations and cooperation between the Fund and Bank Group.

On these and other questions, such as the relation with Commodity Stabilization, our response would be as Bank staff members, on a technical level, not committing the Bank; on the basis that the Board has agreed for the staff to continue to cooperate in the work of UNCTAD on S.F. We would, however, avoid giving a negative impression towards supplementary finance and be guided in substance by the Action Evaluation Paper prepared for the Board Seminar.

In particular, we on our part would avoid any discussion of S.F. in the context of IDA replenishment. We will not put on record any kind of statement that S.F. could be tied up with IDA replenishment.

In this morning's discussion, I expressed the view that this session of IGG is likely to be the final one, though there may not be complete agreement on the Report. The Report goes to the Trade and Development Board at its ninth session (August 26 - September 12). It is for the Board to take a decision, at the political level, whether to have S.F., and on what basis. It is possible at that stage they may decide to agree in principle to a scheme with or without specified characteristics, and entrust the whole matter to the Bank (not just for further study but for drawing up a scheme to be implemented in due course.)

I understand that I shall be representing the Bank staff at the IGG meeting as originally planned, and you do not propose to attend, unless you hear from me otherwise.

cc: Mr. Kamarck

Mr. Robert S. McNamara June 23, 1969

Irving S. Friedman

Supplementary Finance: Intergovernmental Group Meeting in New York June 23 - July 3

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cc: Mr. Kamarck

Mr. Irving S. Friedman June 18, 1969

N. A. Sarma N. A. Sarma

Supplementary Finance: IGG Meeting in New York - June 23 - July 3.

The IGG has posed to us a specific question: Whether the Bank Staff Scheme could be implemented by Bank/IDA, within their existing Articles of Agreement, if the Executive Directors so agreed and if finance were made available. Another main question relates to the revision of cost estimates, taking into account available data for recent years.

In the recent DAC informal meeting on Supplementary Finance (June 4) the question was raised whether there have been consultations between the Bank staff and the Fund staff on the relation between S.F. and C.F.F.; Germany and others attach importance to this. If possible, we and the Fund staff should make an agreed statement at the IGG meeting on the subject.

It is, of course, for governments to agree to implement a scheme of S.F.; it is for the Executive Board of the Bank Group to decide whether we should undertake it, if called upon. Very much would depend on the stand taken by U.S.A. and Germany. As I mentioned in my memo to you (June 6) on the Paris meeting, Group B (DAC) member countries are likely to state their respective positions at an early stage of the IGG meeting, so as to facilitate the finalizing of the report. The question of S.F. as an added function of IDA was mentioned by U.S.A., U.K., Switzerland and others. Then, finance for S.F. is to be considered along with the third IDA replenishment. Here it is not any one particular S.F. scheme that is thought of, but recognition of the purpose of S.F. and its administration by IDA on a rather discretionary basis. On each of the above questions, brief notes are attached hereto, in terms of the general discussion I had with you this morning.

Administration by Bank Group

The Intergovernmental Group has posed to us a specific question: Whether the Bank Staff Scheme could be implemented by Bank/IDA, within their existing Articles of Agreement. There is a (draft) paper on this by Mr. Szasz (Feb. 14, 1969). I have talked to Mr. Szasz and he thinks the paper can be circulated if need be. In any case, keeping in mind the background and considerations as described in the paper, the staff attending the session could state the position in terms of the following conclusion of the paper:

"The administration of the Scheme within the World Bank Group could best be assured by the creation of a special Agency affiliated with the Bank as closely as IFC or possibly even as closely as IDA. The statutes of the new organization could be drawn up by the Executive Directors of the Bank, in consultation with the Intergovernmental Group on Supplementary Financing, and should then be open to acceptance by States members of the Bank or of UNCTAD. It would be legally possible for the Scheme to be administered directly, but on a "trust fund" basis, by either the World Bank or IDA, but preferably by the latter. However, if the voting power of the Executive Directors is to reflect the participation of States in the Scheme it will be necessary to amend the Articles of Agreement of the Association."

It is, of course, for governments to agree to implement a scheme of Supplementary Finance. It is for the Executive Board of the Bank Group to decide whether we should undertake it, if called upon. We have always made this clear at previous discussions of S.F. in IGG and UNCTAD Committees.

Cost Estimates

A main question in S.F. discussions relates to estimated cost of the Scheme. In our earlier study, and during discussions, we have presented certain estimates placing financial requirements at \$300-400 million a year, on an average. The IGG has asked us to look at the cost aspect again, taking into account available data for recent years also, and we have agreed to do so.

We have done this, and a (draft) paper is available with us on the question. It is not necessary to circulate the paper as such but give a brief note to the Group as follows, and be prepared to explain further orally, as may be needed during the course of discussions.

We have considered different country samples available for different periods over 1957-67. Taking into account these available data for the entire period, i.e. including data for more recent years up to 1967, we derive an average estimate of \$1.4 billion a year for gross shortfalls. Adjusting for various factors as we did before, and subject to the limitations we have always indicated, the revised estimate of financial requirements may be placed at about \$300 million a year.

Cost Estimates for Supplementary Finance Scheme

The following alternative ways of presentation of figures may be considered:

			$ Million
I.	Gross Overall Shortfall based on historical experience		1,400
	Adjustments and other Sources of Financing		
	Internal measures of adjustment	75	
	Greater reliability of projections (including effects of better policy adherence)	200	
	Use of reserves	75	
	Fund Facility and Overages	500	
	Other Sources of Finance	50	900
	Total remaining Shortfalls for S.F.S. (i.e. total cost assuming all countries can use Scheme)		500
	Adjustment for Countries which do not use the Scheme, as they do not meet initial requirements or do not implement performance understandings		200
	Financial Requirements for Scheme		300

- -

II.	Gross Shortfalls		1,400
	Use of Countries' own Resources (export overages, use of reserves; internal adjustment measures)	450	450
	Better projections	200	
	Other Sources of Finance to be used	250	900
	Remaining Shortfalls		500
	Countries not using Scheme		200
	Financial Requirements for Scheme		300

- -

Relation between Supplementary Finance and Fund's Compensatory Finance Facility

This is a question that has come up during earlier discussions, and we have tried to clarify the position. We have stated that the administering agency for Supplementary Finance would need to be guided by Fund advice on matters that belong in its area of operations - monetary and exchange policies in the context of a country's development program. In view of the close relationship of Fund Facilities and Supplementary Finance, continusing consultation and cooperation between the Bank staff and Fund staff, with respect to policy measures and other matters, are requisite to the effective implementation of Supplementary Finance, if this were entrusted to Bank/IDA. If Supplementary Finance should come to be entrusted to IDA, then the question of relationship between CFF and SF would become part of the whole framework of continuing consultations and cooperation between the Fund and Bank Group.

In a more limited and technical sense, the question arises: When a country faces an export shortfall, to which facility does the country look for assistance - Fund's C.F.F. or Supplementary Finance? While use of C.F.F. is not prerequisite, it has been clearly understood that use of C.F.F. is a means of meeting a shortfall. Also, the country cannot obtain finance from both sources for the same shortfall. However, when C.F.F. finance is not available or is not adequate to meet the shortfall, recourse to S.F. would be available, subject to various conditions being satisfied. Also, if refinancing of C.F.F. in appropriate cases is included as a purpose of S.F. Scheme, such refinancing would extend the time period over which finance is available to the country. Even in these matters, Fund-Bank Group consultation and coordination would be called for and proven useful.

An agreed brief statement on the above lines by Fund and Bank Staff representatives could be made at the IGG meeting.

IDA Replenishment and Supplementary Finance

There are several possibilities that could emerge from the forthcoming IGG and Trade and Development Board discussions of S.F.

(i) There may be widely divergent views among governments with respect to the need for and feasibility of S.F., resulting in a decision not to implement it;

(ii) Governments may generally agree to the purpose of S.F. in the course of discussions this year; also indicate the limited fund they would be prepared to subscribe to it, and ask the Bank/IDA to undertake it, on the basis of such additional contributions;

(iii) Governments may only agree on the purpose of S.F. and in principle that it should be implemented, but, without mentioning amounts or their being additional, and remit the whole thing to Bank Group to be worked out as appropriate and feasible.

Especially when aid flows are stagnating, a scheme intended to meet a felt need of several LDC's could be a means of maintaining and increasing total aid flows, especially through multilateral channels. Any scheme of S.F. that only diverted existing development funds to this end would be of little interest to developing countries. We ourselves have said the resources for S.F. should be additional. This concept of additionality of funds assumes particular importance for us when the idea is put forward that S.F. be turned over to IDA as an added function and that the question of financial contributions for it be taken up together with third IDA replenishment.

As there is general concensus that Bank/IDA should be the administering agency for S.F., it may get combined with third IDA replenishment.

For us, then, it becomes all the more important to underline that resources for S.F. should be additional to a larger level of IDA replenishment. However, while being additional to IDA funds, S.F. may still involve some diversion of other aid funds from existing purposes. The advantage still would be in increased multilateral channeling of aid funds; more aid becomes untied.

From our viewpoint, i.e. in the interests of enlarging development finance flows to LDC's, attempt would be to obtain a view of the scale of the third replenishment for IDA. After that, Supplementary Finance could well become an added function of IDA, if governments so agree and our own Board concurs, provided additional resources for this purpose are contributed by governments. This is the essence of additionality for us.

FORM No. 58 | INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Irving S. Friedman

DATE: March 28, 1969

MAR 28 1969

FROM: N. A. Sarma N. A. Sarma

SUBJECT: S.F.: Cost Estimates

Attached hereto is a note, which takes into account projections data for more recent years (up to '67); it is to be forwarded to UNCTAD Secretariat, for distribution to IGG.

The revised estimate of financial requirements is \$250-300 mn. (Please see pp. 4-5.)

cc: Messrs. Macone; Sundrum; Taylor

DRAFT
N. A. Sarma
March 28, 1969

COST ESTIMATES FOR SUPPLEMENTARY FINANCE SCHEME

Any cost estimate can only be a rough order of magnitude derived from certain available data for a particular past period with such special features as might characterize that period. There can be no historical basis for making a precise estimate of future costs. The attempt can only be to arrive at an estimate of finance for the scheme with which the scheme might reasonably be expected to operate successfully for the purposes set out in the Recommendation on S.F. Nor can the estimate refer to the requirements of each year, but only an annual average for a period of, say, 5 years. Again, the various estimates for past periods of gross and net shortfalls themselves are better presented in a range of totals, rather than in single numbers. But, for convenience of presentation, a single figure, at mid-point of the range or suitably adjusted, needs to be considered, and is, therefore, only illustrative.

In the 1965 Bank Staff Study, gross aggregate shortfalls were placed between \$1 bn. - \$2 bn. a year, and for convenience \$1.6 bn. was adopted, which corresponded to the mid-point of the range and most nearly to the experience of the larger, 18 country, sample for the most recent period 1959-63 for which data were available. After crediting overages and drawings under CFF, the global net shortfall was placed at \$1.2 bn. a year (the range was \$900 mn.- 1500 mn.).

Several other adjustments were made to arrive at an estimate that would indicate the financing requirements of the Agency. They were: the number of developing countries likely to utilize the scheme in the initial years, the likely improvement in the preparation and use of export projections as compared to the period of the simulation exercise, the extent to which the developing countries would be expected to meet shortfalls on their own and, finally, the possible contribution to meet export shortfalls from sources of finance other than the IMF Compensatory Facility. Under the Supplementary Finance Scheme, a developing country is expected to meet the problem of an unexpected export shortfall to some extent with its own means, which include the use of its own reserves and internal adjustments involving a reduction in demand for foreign exchange. It is understood that these measures could be undertaken in a number of cases without disrupting the development effort in which the country was engaged. Although the extent to which each individual country could do so would vary from case to case, an attempt was made to assess the probable order of magnitude of the effort which might be considered reasonable when all developing countries are grouped together. It was clear from the beginning that, given the nature of the problem, it was not possible to quantify these factors in any exact way. On the other hand, to estimate even the rough order of magnitude of the amount of resources needed to run the Agency during an initial period, it was necessary to attribute some orders of magnitude to the different factors mentioned above. On this basis, it was estimated that the effect of taking these factors into account would be to reduce the net shortfalls of $1.2 billion to an annual average of $300 - $400 million for the initial five years, which would have to be covered by the Supplementary Finance Agency.

The following explanatory table was presented to the members of the IGG, indicating how the $300 - 400 million a year cost estimate could be derived.

Cost Estimates for Supplementary Finance Scheme, for initial five years: Computation in Bank Staff Study

		$ millions
Gross Overall Shortfall Based on Historical Experience		1600
Adjustments and Other Sources of Financing		
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 Agreement, reduces shortfalls. Moreover, the amount assumed above for bilateral aid programs 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.

The Bank staff have now examined the cost estimates again, taking into account also the available data for more recent years, i.e. up to 1967. The main data are presented in the tables attached hereto. (Please see the explanatory note by Mr. Taylor.) Merchandise export projections are available for a 13 country group for the periods 1957-61 as well as 1961-67; data for a 17 country group are available for 1959-61 and 1961-67; data for 24 countries are available for 1961-67. Using all these sets of data, global gross and net shortfalls in exports can be estimated for all developing countries for the respective periods. The range for global gross and net shortfalls, unadjusted for any factor, turns out to be wider than in our earlier presentation. Mainly, the explanation is in the much longer period (11 years) for which data are available and the considerable variation in circumstances prevailing during different periods within this 11 year period. For instance, net declines in prices from 1957 to 1959 and 1959 to 1961 were considerable. Net (total) shortfalls during the period 1957-61 reached high levels. The conditions in world trade, and in exports of developing countries during 1964-67, were very different, and buoyant. Prior projections for such a period are to be expected to turn out to be very cautious, especially when the preceding period called for no optimism. Again, it so happened that there were more successive revisions of country export projections in this period. Net (total) shortfalls amounted to less than \$500 mn. a year in this period.

The range of global gross shortfalls we derive is from \$890 mn. (1961-67 weighted average) to \$2190 mn. (1957-61 weighted average): The mid-point total, weighted by number of years, would be \$1650 mn. However, adjusted for various factors over the entire period, and not taking into account the unusually high figures for a particularly short period, we derive a gross shortfall of $1.4 bn., as the average estimate for the entire period 1957-67, taking all the available data for 13 country, 17 country, 24 country samples.

Adjusting for CFF transactions and overages, we derive a range for net shortfalls of $460 mn. (1961-67 average) - $1465 mn.(1957-61 average). The adjusted average for the whole period 1957-67 is $850 mn. (though the mid-point weighted for years of the range end points would be higher at $940 mn.).

As noted earlier, these various data relate to earlier years. On a proportionate basis, applying them to the 1969 total exports of developing countries, we may place the net global shortfall at about $900 mn. for 1969 - i.e. a little over 2 per cent of total exports. Applying this percentage to an increasing export total, for 1975 one may place net (global) shortfall at over $1100 mn. Any such simple extrapolation into the future has only limited use or significance. Estimates for more recent years, especially for 1965-67, have been lower. On a balance of such considerations, we can proceed to derive a cost estimate for the scheme from global shortfalls (annual, illustrative, averages) of $1.4 bn. gross, and $850 mn. net.

The various factors to be adjusted for have been mentioned earlier: internal measures; greater reliability of projections, use by countries of their own foreign exchange reserves, other sources of finance from bilateral aid programs, and adjustment for countries that do not use the scheme, being mainly exporters of oil or manufactures, or on policy performance considerations. As already stated, it is not possible to quantify these adjustment factors with any precision: at best they can only be indicated as broad orders of magnitude. During the two or three years of discussions of this subject, the developing countries have come to appreciate the nature of policy understandings and other initial requirements. Thus, the reduction for non-participation would need to be somewhat smaller now. The projections work itself has improved and, as recent years' data bring out, projections tend to be conservative. Therefore, the allowance for greater reliability of projections would now be smaller. Roughly, one may allow \$150 mn. for use of reserves and internal measures of adjustment, \$50 mn. for other sources, \$150 mn. for effect of better projections, and another \$200 mn. - 250 mn. for countries that may not participate or qualify.

Accordingly, the financial requirements for the Scheme in 1969 may be placed at about \$250 mn - 300 mn. Looking ahead, say, for the five years 1971-75, the requirements may seem to increase, with the rising levels of exports and with fuller participation by developing countries. On the other hand, with increased sophistication of projection work and greater accuracy of projections, and due to the effect of the conclusion and working of commodity agreements, the requirements would be reduced. Thus, one may expect that a total of \$1500 mn. for five years (or an average of \$300 mn. a year) would be adequate finance for the Scheme. As recommended by the IGG, a fixed fund of that magnitude could be provided and the Agency entrusted with the Scheme be asked to manage the Scheme within that total for five years.

Table 1: ANNUAL AGGREGATED SHORTFALLS FOR VARIOUS GROUPS OF COUNTRIES OVER INTERVALS OF TIME, 1957-67

Item of Comparison	1957-61		1959-61		1961-67	
	Million US$	% of Exports	Million US$	% of Exports	Million US$	% of Exports
Thirteen Country Group: Average Annual Shortfalls	356	8.1	423	6.0	199	3.5
Seventeen Country Group: Average Annual Shortfalls	-	-	423	6.0	238	2.7
Twenty-four Country Sample: Average Annual Shortfalls	-	-	-	-	378	2.6

Table 2: ANNUAL AVERAGE NET SCHEME DRAWINGS ADJUSTED FOR CFF TRANSACTIONS AND OVERAGES, (i.e. NET SHORTFALLS) FOR SELECTED GROUPS OF COUNTRIES AND INTERVALS, 1957-67

	1957-61 (5 year average)		1959-61 (3 year average)		1961-67 (7 year average)	
	Amount $ mn.	% of Exports	Amount $ mn.	% of Exports	Amount $ mn.	% of Exports
(With Lower CFF Projections)						
13 countries	276.2	6.2	-	-	89.4	1.5
17 countries	-	-	302.0	4.3	89.4	1.0
24 countries	-	-	-	-	188.0	1.3
(With Higher CFF Projections)						
13 countries	249.8	5.7	-	-	98.7	1.7
17 countries	-	-	293.3	4.1	98.7	1.1
24 countries	-	-	-	-	186.3	1.3

Table 3: ALTERNATE PROJECTIONS OF AVERAGE ANNUAL GROSS SHORTFALLS1/ 1969 and 1975, WITH COMPARISONS, 1957-67 FOR ALL DEVELOPING COUNTRIES2/

(Yearly Average, $ Million)

Classification of Estimate or Projection	Estimates of Range in Shortfalls, 1957-67	Projections of Gross Shortfalls 1969	1975
Highest Estimated Shortfalls, 1957-67			
1957-61 weighted average3/	2,190		
High Projections4/		1,330-1,500	1,870 - 2,125
Lowest Estimated Shortfalls, 1957-67			
1961-67 average3/	895		
Low Projections5/		855 - 1,000	1,285 - 1,500
Average Estimated Shortfalls, 1957-67	1,415		

1/ Gross shortfalls are aggregated relative to Type C Composite Projections in Bank Staff Study.

2/ Estimates and projections are for all developing countries, consistent with the classification of same used by International Monetary Fund, e.g., World Trade Statistics in International Financial Statistics.

3/ Estimates of historical yearly shortfalls are consistent with extrapolations from Table 1, for both 1957-61 and 1961-67. Estimates given in this table are slightly higher than such calculations would develop, however, because additional, independent tabulations were incorporated into these averages.

4/ High projections are consistent with the range assumption that gross shortfalls would be between 120-125% of the comparable Net Scheme Drawings (Table 4).

5/ Low projections assume that gross shortfalls would be between 130-140% of the Net Scheme Drawings (Table 4).

Table 4: ALTERNATE PROJECTIONS OF AVERAGE ANNUAL NET SCHEME DRAWINGS[1/] (NET SHORTFALLS) 1969 and 1975, WITH COMPARISONS, 1957-67

Classification of Estimate or Projection (Annual Drawings)	Estimates of Range in Annual Net Drawings	Projections of Net Scheme Drawings		Alternate Assumptions Consistent with Attainment of Projected Net Drawings	
	1957-67	1969	1975	Net Drawings as Percent of total Exports	Growth Rate of Exports 1960 - 75[2/]
	(yearly average, current $US million)				
Highest Estimated Drawings, 1957-1967 1957-1961 (wtd.average)[3/]	1,465	-	-	-	-
High Projection Participation by All Developing Countries	-	1,000-1,200	1,700	2.5-3.0	5.0
Lowest Estimated Drawings, 1957-1967 1961-1967 average[3/]	462	-	-	-	-
Low Projection Participation by All Developing Countries	-	600	900	1.5	5.6
Average Estimated Drawings (1957-67)	850	-	-	-	-

Footnotes on following page.

Footnotes to Table 4

1/ Net Scheme Drawings are Supplementary Financing Scheme (Net) Shortfalls relative to Type C; after allowing for CFF and overages.

2/ Percentages compounded annually. These assumed rates of growth are identical with projections of growth in volume of exports of developing countries 1960-75 by the UNCTAD Secretariat. Low growth rate is consistent with lower of two assumptions concerning rate of growth in GDP in developed countries. "General Survey of Trade Prospects and Capital Needs for Developing Countries", Ch. II., Tables II.3 and II.4. UNCTAD, TD/34/Supp.1, 1967. Lower rates of growth are consistent with assumptions concerning lower average levels of commodity prices and therefore, higher net drawings expressed in terms of percentages of exports from participating developing countries.

3/ Averages of estimated yearly drawings for all developing countries during the selected periods were developed from several estimates of net drawings of groups of countries for which calculations of gross shortfalls were available. These estimates generally are consistent with extrapolations of data from Table 2 but, because they consider other weighting procedures, are slightly larger than such simple calculations would give.

SUPPLEMENTARY FINANCING WITHIN THE WORLD BANK GROUP

Legal Considerations

I. Introduction and Background

1. The first United Nations Conference on Trade and Development (UNCTAD) recommended that the International Bank for Reconstruction and Development (IBRD or World Bank) be invited to study the feasibility of a Scheme for dealing with "problems arising from adverse movement in export proceeds -- which cannot adequately be dealt with by short-term balance of payments support" such as can be made available by the International Monetary Fund (IMF), by providing long-term assistance to developing countries to enable them to "avoid disruption of their development programs". The principles on the basis of which the study was to be conducted foresaw that the Scheme "be provided with resources by contributions from participating countries shared between them on an equitable basis" in the form of "additional commitments, prescribed in advance" to which "all the major Part I member countries" of the International Development Association (IDA) should contribute and which "would be administered under the . . . Association", which would also perform the examinations of economic circumstances prerequisite to grants of assistance from the Scheme (UNCTAD Recommendation A-IV-18, Part A, reproduced as Annex I to the "Study" referred to in the next paragraph).

2. On December 6, 1965 the President of the World Bank transmitted to the Secretary-General of the United Nations a "Study on Supplementary Financial Measures" (circulated to UNCTAD under cover of document TD/B/43); this paper had been prepared by the staff of the Bank ~~but~~ was not considered by the Executive Directors . While the Study was "carried out in the spirit of the UNCTAD resolution" and recalled its assumption that the Scheme would be administered under IDA, it did "not, however, address itself to the question of the administering Agency". It was recognized that in any case "the closest cooperation will be required with the IBRD and the IMF regardless of the nature of the Agency carrying out the Scheme" (id, p. 5).

3. The "Final Report" of the Intergovernmental Group on Supplementary Financing, as adopted by the Group at its third session held at Geneva from 30 October to 13 November 1967 (document TD/33), recorded the:

> "general agreement in the Group that the creation of a new Agency for the administration of the Scheme would be unnecessary, uneconomic and would create considerable complications, and that among the existing international agencies the Bank group would be the most appropriate. It further agreed that the Scheme should be administered in close co-operation with the IMF. The specific arrangements which would be necessary would require further consideration. It was also agreed that the largest possible number of developing countries should be eligible for participation in the Scheme, whether or not they were currently receiving assistance from the IDA. It was agreed that the question of countries not members of the IMF and the Bank required further consideration and legal advice." (id, Chapter III, paras. 100 and 101).

4. At its fourth session in October 1968, the Intergovernmental Group agreed on a program of work (TD/B/) including extensive

further examinations relating to the "World Bank Staff Scheme". One point on which the Bank was requested to submit written comments:

> "A. (iii) to what extent could the proposed SFM Bank Staff scheme be implemented by the Bank and the IDA, within their existing articles of agreement, if the Executive Directors so agreed and the necessary funds were made available?" (Emphasis added)

5. This memorandum is designed to answer the latter question. However, as it may not be possible to give an unqualified positive answer if the terms of the query are construed narrowly, the possibility of establishing a new organization, closely affiliated with the World Bank Group, is also explored.

II. Outline of the Bank Staff Scheme*

6. For the Scheme to become operational, it would first of all be necessary to obtain funds or adequate pledges from capital exporting States, amounting to $1.5 to 2 billion for an initial experimental period of five years.

7. The Agency administering the Scheme would have to agree separately with each potential beneficiary State on a "policy understanding", which would include:

(i) A statement of the State's development program and economic policies throughout the "projection period" (tentatively set at five years);

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* As presented in the original World Bank Study and interpreted in the light of a set of "follow-up technical notes or papers" prepared by its Secretariat and circulated under cover of document TD/B . . ., and as restated in Chapter II of the Final Report (supra, para. 3) of the Intergovernmental Group.

(ii) a forecast of export expectations - i.e., a detailed projection of net export proceeds during the agreed period;

(iii) a specification of the economic adjustments the State should make and of the other external resources it should draw on, if unexpected shortfalls in its export earnings should develop, before it draws on the resources of the Scheme.

8. This policy package would be revised from time to time during the period to which it relates, on the basis of periodic consultations between the State and the Agency.

9. If the State concerned should claim an export shortfall during the projection period, the Agency would determine:

(i) whether the State was complying with the agreed program and policies;

(ii) the amount of the "shortfall", measured by comparing the actual export results as against the forecasts in the policy understanding. In doing so the Agency might have to take into account the effects of changes in the price of imports (i.e., even though the amount of export earnings are as predicted these earnings may no longer purchase the same volume of imports) as well as the possibility that export receipts had only been maintained at the predicted level by increasing the volume of exports in a falling market;

(iii) the amount of offsets to be taken into account before the resources of the Scheme (which is to act as "residual lender") may be used. These offsets might include:

(A) all or part of any "overages" (calculated as in (ii)) that the State had accumulated from its exports earlier in the period;

(B) other resources the State can draw on, such as assistance from IMF's Compensatory Financing Facility, and other lines of available credit;

(C) other internal economic adjustments that would not inhibit the agreed development program.

(iv) how to ration the available resources among the potential recipients if these resources might be insufficient to meet all demands expected (either on a year-to-year basis, or for the entire projection period);

(v) the terms of the assistance -- which would probably be long-term concessional credits determined individually and flexibly for each State, taking into account its over-all financial and economic position. These credits would, however, be subject to quick repayment if export overages should occur during the balance of the projection period (i.e., the assistance would initially be in the form of "contingent credits", to be refinanced at the end of the period), and be subject even later to prematuring if the State's foreign exchange position should improve substantially.

III. Significant Features of the Scheme from an Organizational Point of View

(a) Decisions to be taken by the Agency

10. No matter how the Scheme is finally formulated, it will be necessary for the Agency administering it to take a number of discretionary decisions, which must, however, be subject to the "policy understanding" reached with each State. It is of course possible, and indeed desirable that as far as feasible the range of discretionary issues be reduced by resolving them, either in general or with reference to each State separately, at some stage in advance of the occurrence of a shortfall and the submission of a demand for assistance; this might be done:

(i) In the instrument by which the Scheme itself is established;

(ii) In general regulations concerning the formulation of "policy understandings", promulgated by the governing organ of the Agency -- such regulations will of course have to be consistent with the above-mentioned basic instrument, and within the authority granted to such organ by that instrument;

(iii) In the policy understanding reached with each State -- which in turn must be consistent with any applicable regulations;

(iv) In general regulations promulgated by such governing organ regarding the carrying out of the Agency's responsibilities once a shortfall has occurred -- these regulations will of course also have to be consistent with the basic instrument and within the authority of the promulgating organ, and may in no case derogate from any obligation of the Agency under a particular "understanding" with a participating State.

11. Following is a sample of the principal potential issues that will have to be resolved at one of these appropriate stages, or at the latest in connection with the implementation of particular requests:

(i) The admission of potential beneficiary States to the Agency (while an initial list can be established concurrently with the Scheme, later decisions about admissions and removals will be required);

(ii) The approval, modification and termination of policy understandings;

(iii) The approval of the export projections as part of the policy understandings;

(iv) The determination of the factors (e.g., changes in import or export prices) to be taken into account in measuring the extent of a shortfall;

(v) The determination of the external resources that a State is expected to tap before becoming eligible to receive residual aid from the Scheme;

(vi) Requiring a State to make internal economic adjustments to reduce the demands on the Scheme;

(vii) The rationing of restricted resources;

(viii) Setting the terms of the assistance granted;

(ix) Demanding that a State repay prematurely the credit granted, if its economic position should unexpectedly improve.

(b) Political questions

12. One of the crucial elements in establishing the Scheme will undoubtedly be the formula regulating voting powers in the governing organ of the Agency. It may be ~~appears likely~~ that some type of weighted voting will be necessary, presumably related largely to the size of the contribution of States to the Scheme but in any case guaranteeing a minimum vote to all participants. While such devices are used by the World Bank and by IDA, it cannot be assumed ~~is unlikely~~ that the distribution of the franchise in relation to the Scheme would automatically be the same as in either of these organizations. Since the Articles of Agreement of neither organization provide for their Executive Directors to have their votes weighed differently on different issues, this could only be accomplished by amending the Articles, or by establishing a separate organization with a governing organ consisting of

the Executive Directors of the three existing institutions of the World Bank Group, but whose voting rights would be governed by a special formula. The latter is the solution adopted when first the International Finance Corporation (IFC) and later IDA were established by the World Bank.

13. The membership of the Agency will presumably have to be open not only to the members of the World Bank, but to all members of UNCTAD. While the accommodation of non-members of the World Bank among the contributors to or the beneficiaries of the Scheme should not in itself cause any legal difficulties (particularly if the Scheme is administered on a "trust fund" basis, as discussed in paragraph 22), the inclusion of representatives of such States on the governing organ of the Scheme would be impossible under the current Articles of Agreement of the Bank or IDA.

(c) Staff

14. The Agency would have to command a staff (either its own or that of any organization(s) with which it is affiliated) with the requisite expertise to make the various types of decisions required to operate the Scheme. In particular, it must be able to develop reasonable export projections, evaluate the merits and prospects of development plans, be able to take account of various economic factors such as the impact of changes in export/import price indices on a country's export results, and be knowledgeable about the reaonable adjusting measures a State might be expected to take and the alternative sources of credit it might rely on when faced with an export shortfall.

15. The expertise described above is available within the Bretton Woods organizations. Whether it lies closer to that of IMF or of the World Bank Group will depend largely on the terms under which the Scheme is ultimately established, and in particular on the extent to which the evaluation of development plans, both at the stage of formulating policy understandings and of considering the adjustments necessary in the face of a shortfall, will form an important task of the Agency; to the extent that such evaluations are emphasized will the required expertise be that of the staffs of the World Bank and IDA. However, in any case arrangement should be made under which the Agency could also draw on the personnel of IMF.

16. No matter what the legal form of the Agency is, if arrangements can be made for it to draw freely on the staffs of the World Bank Group, and as far as necessary on that of IMF, then the true cost of administering the Scheme can probably be kept very low.

IV. Alternative Means of Implementing the Scheme within the World Bank Group

(a) New or existing organizations

17. The question addressed to the Bank by the Intergovernmental Group relates to the implementation of the Scheme by the Bank or IDA (paragraph 4 above). The Group's earlier report to UNCTAD recorded the conclusion that "the creation of a new Agency for the administration of the Scheme would be unnecessary, uneconomic and would create considerable complications"; however, it was recognized "that the question of countries not members of

the IMF and the Bank required further consideration and legal advice" (paragraph 3 above).

18. This conclusion reflects the current general resistance to the establishment of new organizations, as apparent from the recent decision to incorporate the Special Drawing Rights Facility within IMF, from the proposal that the International Investment Insurance Scheme be accommodated within IFC, and from the decisions of the United Nations General Assembly to establish UNCTAD, UNIDO and the Capital Development Fund as organs of the United Nations rather than as separate specialized agencies. The specific arguments against the creation of a new organization to administer the Scheme can be summarized as follows:

(i) The statutes of any new organization would normally take the form of an international treaty, whose negotiation may be considerably more complicated than the adoption of the Scheme by the competent organ of an existing organization -- even though in the latter case too extended negotiations, particularly among the potential contributors, may be necessary.

(ii) A new organization usually requires an independent staff, which is wasteful both because of the necessity of creating a number of purely administrative services, and in respect of the Scheme in particular since much of the substantive work might be performed by the operating staffs of existing organizations, almost as part of their routine work.

(iii) If the Scheme is to be administered by a governing organ independent of that of existing institutions, it may be necessary to establish appropriate coordinating machinery to avoid policy conflicts with the organizations performing related tasks.

19. These arguments are, however, addressed primarily to the issue of the creation of an organization completely independent of any existing one. But they are not necessarily relevant to the creation of yet another organization within the World Bank Group, to be at least as closely affiliated with the Bank as IFC and probably as intimately as IDA:

(i) The formulation of the statutes of the Agency need not involve a more elaborate procedure than would be required for a decision of the Executive Directors of the World Bank or of IDA to assume administration of the Scheme, for in either case the necessary instrument could be formulated (as were the Articles of Agreement of IFC and IDA) by the Executive Directors of the Bank; even the informal collaboration in this process of representatives of non-members of the Bank should not prove to be too difficult. Furthermore, embodiment of the statutes of the Agency in a new treaty instrument would have at least one distinct advantage: since it appears clear, from the considerations discussed in paragraphs 12 and 13, that if the Scheme is to be administered by the Bank or by IDA it would be necessary to amend the Articles of Agreement of the organization concerned, that process of amendment would require the consent of even some of those members of the organization as are not interested in participating in the Scheme; on the other hand, the bringing into force of a new treaty would primarily require the concurrence of only the interested States -- though naturally at least the tacit consent of a majority of the members of the Bank is necessary for the establishment of a closely affiliated institution.

(ii) The creation of a new organization does not necessarily imply the establishment of a separate staff: for example, the World Bank and IDA have identically the same staff, and the World Bank and IFC have common administrative but separate operational staffs. Contrarywise, the administration of the Scheme within an existing organization does not guarantee that no new staff will be created, for international organizations have frequently found it necessary to implement certain operations through practically independent (and often geographically separated) units with their own administrative structures.

(iii) If the Agency were established with statutes similar to the Articles of Agreement of IFC or IDA, then its political governing organs (Board of Governors, Executive Directors, President) would be identical to those of the Bank -- except for any minor adjustments necessary to allow non-members of the Bank to be represented. The possibility of conflict and the need for coordinating machinery would thus automatically fall away.

(b) Integral operation or trust arrangement

20. If the Scheme is to be operated directly by IDA (see paragraphs 24 and 25 below), this could be done in two alternative ways:

(i) As an integral operation, subject to IDA's normal rules regarding the raising and disbursing of funds.

(ii) As a "trust" arrangement, subject to special rules.

21. The first of the above alternatives does not appear to be a convenient or even a feasible method for administering the Scheme. Though Article III of the Articles of Agreement of IDA allows considerable flexibility as to the terms and conditions of additional subscriptions to the Association, certain restrictions in that Article (in particular, Section 1(c)) and in Article IV (in particular Section 2) might not be compatible with the establishment and effective operation of the Scheme; even aside from these statutory difficulties, the current procedure for raising additional funds for IDA under Section 1 of Article III (for example IDA Board Resolution

No. 48) is quite different from that which would have to be envisaged for the Scheme. Also, in view of the concessional terms on which credits under the Scheme are to be granted, borrowing of capital funds under Section 5(i) of Article V is probably not feasible. More seriously, the disbursement rules of Section 1 of Article V are not fully compatible with the administration of the Scheme: paragraph (b) requires that the financing provided by the Association should, "except in special circumstances . . . be for specific projects", and the same is implied by paragraph (h); paragraph (d) requires that the merits of each proposal be carefully studied -- which might be incompatible with the semi-automatic, rapid procedure foreseen for disbursements under the Scheme.

22. None of the above difficulties would arise if the Scheme were to be administered as a "trust", whose terms could not of course be radically incompatible with those of the Articles of Agreement of the administering organization, but need not conform to its modus operandi in detail. Though the Articles of Agreement of IDA do not explicitly provide for the assumption by it of responsibilities for trust funds and indeed it has never yet done so, the similar silence of the Articles of Agreement of the World Bank has not prevented that organization from assuming responsibility for several major and minor trusts, such as the Indus, Tarbela and Nam Ngum Development Funds and possibly the Coffee Diversification Fund.

(c) World Bank or IDA

23. Under any of the arrangements discussed above, the question arises whether the Agency should be, or be closely associated with, the World Bank or IDA. This question too should be examined in the light of the respective Articles of Agreement of the two organizations, as well as of relevant policy consideration.

24. From the point of view of the Articles of Agreement, there are few relevant differences. In particular, with regard to the administration of a trust fund, neither charter contains any relevant guide-lines or obstacles.

25. General policy considerations suggest that if the Scheme is to be operated by one of the organizations, that this be done by IDA. The credits to be granted under the Scheme are to be generally or at least frequently on concessional terms -- which is the method of lending for which the Association was created and which distinguishes it from the World Bank. Somewhat similar reasons as led to the creation of IDA, the "soft-loan window of the Bank", as an independent organization, in order to underline the differences between its operations and those for which the Bank must raise funds on the international money market, suggest that this distinction be preserved by having the Scheme operated by IDA rather than by the Bank.

26. Since the Bank and IDA have identically the same Governors, Executive Directors, President, officers and staff, this consideration offers no basis for distinguishing between the organizations.

27. However, should it be decided to establish a separate organization closely affiliated with the World Bank Group (paragraph 19), then it would

seem advantageous to associate the new institution with the Bank rather than with IDA. One reason is that the Bank's membership is actually larger than that of IDA (and under the Articles of Agreement of the latter can in no case become smaller) -- so that the adjustments that will be necessary if there should be members of the Agency that are not also members of the organization with which it is to be affiliated (and whose Executive Directors would constitute the membership of its own governing board) will be fewer and less drastic in respect of the Bank than of IDA. Furthermore, conceptually, it is simpler and thus preferable for the World Bank to act as the senior and central organization of a cluster of other institutions affiliated with it, than to build up a more elaborate configuration in which some new affiliates are dependent from organizations themselves junior to the Bank.

V. Conclusions

28. The administration of the Scheme within the World Bank Group could best be assured by the creation of a special Agency affiliated with the Bank as closely as IFC or possibly even as closely as IDA. The statutes of the new organization could be drawn up by the Executive Directors of the Bank, in consultation with the Intergovernmental Group on Supplementary Financing, and should then be open to acceptance by States members of the Bank or of UNCTAD.

29. It would be legally possible for the Scheme to be administered directly, but on a "trust fund" basis, by either the World Bank or IDA, but preferably by the latter. However, if the voting power of the Executive Directors is to reflect the participation of States in the Scheme it will be necessary to amend the Articles of Agreement of the Association.

DRAFT
N. A. Sarma
March 27, 1969

COST ESTIMATES FOR SUPPLEMENTARY FINANCE SCHEME

Any cost estimate can only be a rough order of magnitude derived from certain available data for a particular past period with such special features as might characterize that period. There can be no historical basis for making a precise estimate of future costs. The attempt can only be to arrive at an estimate of finance for the scheme with which the scheme might reasonably be expected to operate successfully for the purposes set out in the Recommendation on S.F. Nor can the estimate refer to the requirements of each year, but only an annual average for a period of, say, 5 years. Again, the various estimates for past periods of gross and net shortfalls themselves are better presented in a range of totals, rather than in single numbers. But, for convenience of presentation, a single figure, at mid-point of the range or suitably adjusted, needs to be considered, and is, therefore, only illustrative.

In the Bank Staff Study, gross aggregate shortfalls were placed between $1 bn. - $2 bn. a year, and for convenience $1.6 bn. was adopted, which corresponded to the mid-point of the range and most nearly to the experience of the larger, 18 country, sample for the most recent period 1959-63 for which data were available. After crediting overages and drawings under C.F.F., the global net shortfall was placed at $1.2 bn. a year (the range was $900 mn.- 1500 mn).

Several other adjustments were made to arrive at an estimate that would indicate the financing requirements of the Agency. They were the number of developing countries likely to utilize the scheme in the initial years, the likely improvement in the preparation and use of export projections as compared to the period of the simulation exercise, the extent to which the developing countries would be expected to meet shortfalls on their own and, finally, the possible contribution to meet export shortfalls from sources of finance other than the IMF Compensatory Facility. Under the Supplementary Finance Scheme, a developing country is expected to meet the problem of an unexpected export shortfall to some extent with its own means, which include the use of its own reserves and internal adjustments involving a reduction in demand for foreign exchange. It is understood that these measures could be undertaken in a number of cases without disrupting the development effort in which the country was engaged. Although the extent to which each individual country could do so would vary from case to case, an attempt was made to assess the probable order of magnitude of the effort which might be considered reasonable when all developing countries are grouped together. It was clear from the beginning that, given the nature of the problem, it was not possible to quantify these factors in any exact way. On the other hand, to estimate even the rough order of magnitude of the amount of resources needed to run the Agency during an initial period, it was necessary to attribute some orders of magnitude to the different factors mentioned above. On this basis, it was estimated that the effect of taking these factors into account would be to reduce the net shortfalls of $1.2 billion to an annual average of $300 - $400 million for the initial five years, which would have to be covered by the Supplementary Finance Agency.

The following explanatory table was presented to the members of the IGG, indicating how the $300 - 400 million a year cost estimate could be derived.

Cost Estimates for Supplementary Finance Scheme, for initial five years: Computation in Bank Staff Study

		$ millions
Gross Overall Shortfall Based on Historical Experience		1600
Adjustments and Other Sources of Financing		
Internal Measures of Adjustment	75	
Greater Reliability of Projections	350	
(effects of new use for projections, need for international agreement on projection, improvement in techniques and data, effects of better policy adherence, etc.)		
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 programs 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.

The Bank staff have now examined the cost estimates again, taking into account also the available data for more recent years, i.e. up to 1967. The main data are presented in the tables attached hereto, and the methodology for updating the data is explained in the technical note attached hereto. Merchandise export projections are available for a 13 country group for the periods 1957-61 as well as 1961-67; data for a 17 country group are available for 1959-61 and 1961-67; data for 24 countries are available for 1961-67. Using all these sets of data, global gross and net shortfalls in exports can be projected for all developing countries for the respective periods. The range for global and net shortfalls, unadjusted for any factor, turns out to be much wider than in our earlier presentation. Mainly the explanation is in the much longer period (11 years) for which data are available and the considerable variation in circumstances prevailing during different periods within this 11 year period. For instance, net declines in prices from 1957 to 1959 and 1959 to 1961 were considerable. Net (total) shortfalls during the period 1957-61 average around \$2 bn. The conditions in world trade, and in exports of developing countries during 1964-67 were very different, and buoyant. Prior projections for such a period are to be expected to turn out to be very cautious, expecially when the preceding period called for no optimism. Again, it so happened that there were more successive revisions of country export projections in this period. Net (total) shortfalls amounted to less than \$500 mn. a year in this period.

The range of global gross shortfalls we derive is from \$890 mn. (1961-67 weighted average) to \$2190 mn (1957-61 weighted average): The mid-point total, weighted by number of years, would be \$1650 mn. However, adjusted for various factors over the entire period, and not taking into account the unusually high figures for a particularly short period, we derive a gross shortfall of $1.4 bn., as the <u>average</u> estimate for the entire period 1957-67, taking all the available data for 13 country, 17 country, 24 country samples.

Adjusting fof CFF transactions and overages, we derive a range for net shortfalls of $460 mn. (1961-67 average) - $1465 mn. (1957-61 average). The adjusted average for the whole period 1957-67 is $725 mn. (though the mid-point weighted for years of the range end points would be higher at $880 mn).

As noted earlier, these various data relate to earlier years. On a proportionate basis, applying them to the 1969 total exports of developing countries, we may place the <u>net</u> global shortfall at about $800 mn. for 1969 - i.e. about 2 per cent of total exports. Applying this percentage to an increasing export total, for 1975 one may place net (global) shortfall at $1100 mn. Any such simple extrapolation into the future has only limited use or significance. We can proceed to derive a cost estimate for the scheme from global shortfalls (annual, illustrative averages) of $1350 mn. gross, and $800 mn. net.

The various factors to be adjusted for have been mentioned earlier: internal measures; greater reliability of projections, use by countries of their own foreign exchange reserves, other sources of finance from bilateral aid programs, and adjustment for countries that do not use the scheme, being mainly exporters of oil or manufactures, or on policy performance considerations. As already stated, it is not possible to quantify these adjustment factors with any precision: at best they can only be indicated as broad orders of magnitude. During the two or three years of discussions of this subject, the developing countries have come to appreciate the nature of policy understandings and other initial requirements. Thus, the reduction for non-participation would need to be smaller now. Also, the projection work itself has become increasingly sophisticated, and as recent years' data bring out, projections tend to be conservative. Therefore, the allowance for greater reliability of projections would now be smaller. Roughly, one may allow $150 mn. for use of reserves and internal measures of adjustment, $50 mn. for other sources, $150 mn. for effect of better projections, and another $150 mn. - 200 mn. for countries that may not qualify.

Accordingly, the financial requirements for the Scheme in 1969 may be placed at about $250 mn. - 300 mn. Looking ahead, say, for the five years 1970-75, one may expect that a total of $1500 mn. (or an average of $300 mn. a year) would be adequate finance for the Scheme. In any case, as recommended by the IGG, a fixed fund of that magnitude could be provided and the Agency entrusted with the Scheme be requested to manage the Scheme within that total for five years.

Table 1: ANNUAL AGGREGATED SHORTFALLS FOR VARIOUS GROUPS OF COUNTRIES OVER INTERVALS OF TIME, 1957-67

Item of Comparison	1957-61		1959-61		1961-67	
	Million US$	% of Exports	Million US$	% of Exports	Million US$	% of Exports
Thirteen Country Group: Average Annual Shortfalls	356	8.1	423	6.0	199	3.5
Seventeen Country Group: Average Annual Shortfalls	-	-	423	6.0	238	2.7
Twenty-four Country Sample: Average Annual Shortfalls	-	-	-	-	378	2.6

Table 2: ANNUAL AVERAGE NET SCHEME DRAWINGS ADJUSTED FOR CFF TRANSACTIONS AND OVERAGES, (i.e. NET SHORTFALLS) FOR SELECTED GROUPS OF COUNTRIES AND INTERVALS, 1957-67

	1957-61 (5 year average)		1959-61 (3 year average)		1961-67 (7 year average)	
	Amount $ mn.	% of Exports	Amount $ mn.	% of Exports	Amount $ mn.	% of Exports
(With Lower CFF Projections)						
13 countries	276.2	6.2	-	-	89.4	1.5
17 countries	-	-	302.0	4.3	89.4	1.0
24 countries	-	-	-	-	188.0	1.3
(With Higher CFF Projections)						
13 countries	249.8	5.7	-	-	98.7	1.7
17 countries	-	-	293.3	4.1	98.7	1.1
24 countries	-	-	-	-	186.3	1.3

Table 3: ALTERNATE PROJECTIONS OF AVERAGE ANNUAL GROSS SHORTFALLS[1] 1969 and 1975, WITH COMPARISONS, 1957-67 FOR ALL DEVELOPING COUNTRIES[2]

(Yearly Average, $ Million)

Classification of Estimate or Projection	Estimates of Range in Shortfalls, 1957-67	Projections of Gross Shortfalls 1969	1975
Highest Estimated Shortfalls, 1957-67			
1957-61 weighted average[3]	2,190		
High Projections[4]		1,330-1,500	1,870 - 2,125
Lowest Estimated Shortfalls, 1957-67			
1961-67 average[3]	895		
Low Projections[5]		855 - 1,000	1,285 - 1,500
Average Estimated Shortfalls, 1957-67	1,415		

1/ Gross shortfalls are aggregated relative to Type C Composite Projections in Bank Staff Study.

2/ Estimates and projections are for all developing countries, consistent with the classification of same used by International Monetary Fund, e.g., World Trade Statistics in International Financial Statistics.

3/ Estimates of historical yearly shortfalls are consistent with extrapolations from Table 1, for both 1957-61 and 1961-67. Estimates given in this table are slightly higher than such calculations would develop, however, because additional, independent tabulations were incorporated into these averages.

4/ High projections are consistent with the range assumption that gross shortfalls would be between 120-125% of the comparable Net Scheme Drawings (Table 4).

5/ Low projections assume that gross shortfalls would be between 130-140% of the Net Scheme Drawings (Table 4).

Table 4: ALTERNATE PROJECTIONS OF AVERAGE ANNUAL NET SCHEME DRAWINGS[1] (NET SHORTFALLS) 1969 and 1975, WITH COMPARISONS, 1957-67

Classification of Estimate or Projection (Annual Drawings)	Estimates of Range in Annual Net Drawings	Projections of Net Scheme Drawings		Alternate Assumptions Consistent with Attainment of Projected Net Drawings	
	1957-67	1969	1975	Net Drawings as Percent of total Exports	Growth Rate of Exports 1960 - 75[2]
	(yearly average, current $US million)				
Highest Estimated Drawings, 1957-1967 1957-1961 (wtd.average)[3]	1,465	-	-	-	-
High Projection Participation by All Developing Countries	-	1,000-1,200	1,700	2.5-3.0	5.0
Lowest Estimated Drawings, 1957-1967 1961-1967 average[3]	462	-	-	-	-
Low Projection Participation by All Developing Countries	-	600	900	1.5	5.6
Average Estimated Drawings (1957-67)	850 ~~725~~	-	-	-	-

Footnotes on following page.

Footnotes to Table 4

1/ Net Scheme Drawings are Supplementary Financing Scheme (Net) Shortfalls relative to Type C; after allowing for CFF and overages.

2/ Percentages compounded annually. These assumed rates of growth are identical with projections of growth in volume of exports of developing countries 1960-75 by the UNCTAD Secretariat. Low growth rate is consistent with lower of two assumptions concerning rate of growth in GDP in developed countries. "General Survey of Trade Prospects and Capital Needs for Developing Countries", Ch. II., Tables II.3 and II.4. UNCTAD, TD/34/ Supp.1, 1967. Lower rates of growth are consistent with assumptions concerning lower average levels of commodity prices and therefore, higher net drawings expressed in terms of percentages of exports from participating developing countries.

3/ Averages of estimated yearly drawings for all developing countries during the selected periods were developed from several estimates of net drawings of groups of countries for which calculations of gross shortfalls were available. These estimates generally are consistent with extrapolations of data from Table 2 but, because they consider other weighting procedures, are slightly larger than such simple calculations would give.

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

INTERNATIONAL FINANCE CORPORATION

April 3 1969

MR. FRIEDMAN:

MR. SARMA NEEDS TO SEE YOU ANY TIME ON FRIDAY TO CLEAR THE ATTACHED PAPER. (HE HAS PROMISED UNCTAD TO PHONE THEM ON MONDAY RE PUTTING THIS ITEM ON THE PROVISIONAL AGENDA FOR THE JUNE MEETING.)

SUBJECT TO YOUR OK HAVE SET UP 2:30 PM FRIDAY APRIL 4. (Mr. Sarma said he will wait back to see you if 2:30 isn't convenient -- but important that he see you tomorrow.)

SECOND
DRAFT
RCTaylor
March 27, 1969

(Subject to some revision, jdl) Seering 3/28

TO: Files

FROM: Richard C. Taylor

SUBJECT: Updating and Modification of Calculatings Concerning Export Shortfalls from "Reasonable Expectations" Pertinent to Estimating Annual Capital Requirements for the Operation of a Supplementary Financing Scheme, with Particular Reference to Hypothetical Computations Covering 1957-67

1. This memorandum presents results for 1964-67 of calculations of Export Shortfalls 1/ and overages 2/ similar to those published earlier for 1957-63. 3/ Inferences are made concerning the probable average size of annual gross shortfalls and net drawings for such a Supplementary Financing Scheme operating during 1957-67. Finally, projections of current and near-term annual scheme drawings under alternate assumptions are provided. The attached Methodological Note gives additional details concerning the basis and nature of the calculations used to develop these estimates.

1/ Total amount by which actual export earnings for selected groups of developing countries were over-estimated by composites of Bank projections of exports of these same countries.

2/ Under-estimates of actual export earnings, derived in a similar manner.

3/ Annex IV of the study "Supplementary Financing Measures" by the IBRD Staff, December 1965.

Annual Differences Between Actual Export Proceeds and Composite Bank Projections of Export Earnings, for Selected Groups of Developing Countries, 1957-67

2. Yearly shortfalls and overages for three different groups of countries during 1964-67 are presented in Appendix Table 1. Aggregated overages far exceeded shortfalls during each of these four years except 1967, when total shortfalls increased markedly and, for at least two groups of countries, reached levels greater than the comparable 1957-63 or 1959-63 averages. Likewise, overages occurred more often than shortfalls, within a given year, except during 1967. On balance, these composite projections under-estimated actual export earnings during 1963-66 by approximately 7 percent. This error could be compared with similar over-estimations of actual export proceeds during 1958-60. Projections of total exports for the other four years between 1957 and 1967 were quite close to actual earnings.

3. Comparisons of average yearly aggregated shortfalls for the same groups of countries indicated a marked decline in such differences between actual and projected values during 1961-67, compared with 1957-61 and 1959-61 (Table 1).[4/] When average yearly shortfalls for each group are expressed as percentages of exports from these same countries, a close similarity of results, for any of the three intervals, can be noted. Compared with earlier five and three year periods, shortfalls during 1961-67 were much smaller, on the average, and little differences is apparent between the results presented for the three groups of countries.[5/]

4/ The decision to compare average yearly shortfalls during three different periods of unequal length between 1957 and 1967 reflects both the availability of export projections for additional countries in 1959 and 1961, and the marked differences in general commodity price behavior during 1957-67 and 1961-67. Commodity price levels had declined steadily from 1958 through 1960, but stabilized in 1961, rose sharply during the next several years, and then declined during 1966-67. Generally speaking, commodity prices during 1967-68 were at approximately their 1961 levels. (IBRD Primary Commodity Price Index for Low and Medium Income Primary Producers, for all commodities including petroleum).

5/ Most of the inter-period differences in the relative size of total shortfalls for any group of countries apparently can be explained by comparative changes in average price level and net change in prices. Also, successive revisions of country export projections were used more frequently in developing composite projections since 1961, than during the previous five years.

Reductions in Gross Shortfalls in Exports Attributable to Compensatory Finance Facility (CFF) Transactions and Use of Scheme Overages, 1958-68

4. Comparisons of average yearly net scheme drawings[6/] were tabulated by group of countries, for similar intervals, between 1957 and 1967 (Table 2). Averages drawings for the different groups compared within the same period, would have constituted remarkably similar percentages of the contemporary export proceeds of these developing countries.

5. Transactions of the CFF and the use of overages (accrued according to scheme computations) should have been more effective in reducing gross shortfalls after 1961 than during the previous five years (Appendix Table 2). Except during 1957-59, when overages computed by Scheme calculations would have been negligible, disbursements of scheme overages apparently would have reduced gross shortfalls more quantitatively speaking than would contemporary operations of the CFF. The combined effect of these two types of adjustments evidently would have reduced these aggregated gross differences between actual and projected exports by 12-44 percent.

6/ Defined as gross shortfalls (or export shortfalls) adjusted for contemporary drawings and repayments under the CFF and for disbursements of export "overage" earnings to repay drawings made under such a Supplementary Financing Scheme. Details concerning techniques used in making these adjustments are included in the Methodological Note attached.

Inferences Concerning Gross Export Shortfalls and Net Scheme Drawings for All Developing Countries

6. Table 3 suggests that the total shortfalls in exports of all developing countries (relative to Type C Composite Export Projections) would have averaged approximately \$1.4 billion a year during 1956-67. These shortfalls probably would have been much higher during 1957-61, on the average, than during 1961-67. The range in these estimates (\$0.9-\$2.1 billion) is quite comparable to corresponding estimates published earlier,[7/] which were based partly on similar calculations covering 1957-63.

7. Projections of total gross shortfalls consistent with differing export prospects for all developing countries in 1975 were calculated. (Table 3). Alternate assumptions concerning changes in price level and annual growth rates of exports from developing countries, in the interim, explain most of the wide range in likely annual shortfalls, for both 1969 and 1975. Our high projection would probably understate near-term average yearly shortfalls if commodity prices decline persistently, without significant interruptions, during the next three to five years.

8. Similar estimates of high, low and medium annual net drawings under a Supplementary Financing Scheme operating during 1957-67 were calculated (Table 4). Our estimated range of approximately \$460 million to \$1,464 million, during 1957-67 is ~~slightly~~ somewhat wider than earlier estimates[8/], and our estimated average annual net drawing for the entire eleven year period (\$850 million) is somewhat below the mid-point of the range developed from study of the 1957-63 experience.

7/ \$1 billion to \$2 billion per year, p.120, Annex IV, ibid.

8/ \$900 million to \$1,500 million per year, p.120, Annex IV, ibid.

9. Projections of net scheme drawings consistent with 1969 and 1975 export expectations suggest the range in average net financial resources or credits adequate for operating such a scheme for one year, under different stipulations. (Table 4). Moderately lower commodity prices and modest declines in current yearly growth in export earnings jointly could cause net drawings, in the near future, to increase significantly from levels estimated for recent years[9/]. However, during the next decade, such net drawings might not exceed the amounts estimated for 1957-67, unless pronounced and persistent declines in either prices or quantities of exports should occur.

9/ Estimates for 1965-67 were $490 million a year.

Table 1: COMPARISONS OF SELECTED CHARACTERISTICS OF ANNUAL AGGREGATED SHORTFALLS FOR VARIOUS GROUPS OF COUNTRIES OVER SIMILAR INTERVALS OF TIME, 1957-67

Item of Comparison	1957-61		1959-61		1961-67	
	Million US$	% of Exports	Million US$	% of Exports	Million US$	% of Exports
Thirteen Country Group: Average Annual Shortfalls Type C Composite Projection	356	8.1	423	6.0	199	3.5
Seventeen Country Group: Average Annual Shortfalls Type C Composite Projection	-	-	423	6.0	238	2.7
Twenty-four Country Sample: Average Annual Shortfalls Type C Composite Projection	-	-	-	-	378	2.6

Table 2: COMPARISONS OF ANNUAL AVERAGE NET SCHEME DRAWINGS ADJUSTED FOR CFF TRANSACTIONS AND DISBURSEMENTS OF SCHEME CREDITS FROM OVERAGES, FOR SELECTED GROUPS OF COUNTRIES AND INTERVALS, 1957-67

(Millions of US dollars or percent of exports)

	1957-61 (5 year average)		1959-61 (3 year average)		1961-67 (7 year average)	
	Amount	% of Exports	Amount	% of Exports	Amount	% of Exports
Item of Comparison:						
Net Scheme Drawings for						
Type C Projection; Lower CFF Projections						
13 countries	276.2	6.2	-	-	89.4	1.5
17 countries	-	-	302.0	4.3	89.4	1.0
24 countries	-	-	-	-	188.0	1.3
Type C Projection; Higher CFF Projections						
13 countries	249.8	5.7	-	-	98.7	1.7
17 countries	-	-	293.3	4.1	98.7	1.1
24 countries	-	-	-	-	186.3	1.3

Table 3: SUPPLEMENTARY FINANCING SCHEME: ALTERNATE PROJECTIONS OF AVERAGE ANNUAL GROSS SHORTFALLS,1/ 1969 AND 1975, WITH COMPARISONS, 1957-67 FOR ALL DEVELOPING COUNTRIES2/

(Yearly Average, Current $US Million)

Classification of Estimate or Projection	Estimates of Range in Shortfalls, 1957-67	Projections of Gross Shortfalls 1969	1975
Highest Estimated Shortfalls, 1957-67 1957-61 weighted average3/	2,190		
High Projections4/		1,330-1,500	1,870-2,125
Lowest Estimated Shortfalls, 1957-67 1961-67 average3/	893	-	-
Low Projections5/		857-1,000	1,285-1,500
Average Estimated Shortfalls, 1957-67	1415 ~~1,364~~	-	-

1/ Gross shortfalls are aggregated relative to Type C Composite Bank Projections.

2/ Estimates and projections are for all developing countries, consistent with the classification of same used by International Monetary Fund, e.g., World Trade Statistics in International Financial Statistics.

3/ Estimates of historical yearly shortfalls are consistent with extrapolations from Table 7, for both 1957-61 and 1961-67. Estimates given in this table are slightly higher than such calculations would develop, however, because additional, independent tabulations were incorporated into these averages.

4/ High projections are consistent with the basic assumption that gross shortfalls would be between 120-125% of the comparable Net Scheme Drawings presented in Table 4.

5/ Low projections assume that gross shortfalls would be between 130-140% of the Net Scheme Drawings (Low Projection) shown in Table 4.

Table 4: SUPPLEMENTARY FINANCING SCHEME: ALTERNATE PROJECTIONS OF AVERAGE ANNUAL NET SCHEME DRAWINGS 1/ 1969 AND 1975, WITH COMPARISONS, 1957-67

Classification of Estimate or Projection (Annual Drawings)	Estimates of Range in Annual Net Drawings	Projections of Net Scheme Drawings		Alternate Assumptions Consistent with Attainment of Projected Net Drawings	
	(yearly average, current $U.S. million)			Net Drawings as Percent of Total Exports	Growth Rate of Exports 1960-75 2/
	1957-67	1969	1975		
Highest Estimated Drawings, 1957-67 1957-61 (wtd. average) 3/	1,465	-	-	-	-
High Projection	-	1,000-1,200	1,400-1,700	2.5-3.0	5.0
Lowest Estimated Drawings, 1957-67 1961-67 average 3/	462	-	-	-	-
Low Projection	-	600	900	1.5	5.6
Most Likely Alternative Projections, 1968-70	-	720-880	n.c.	1.8-2.2	-
Average Estimated Drawings, 1957-67 1957-67	850	-	-	-	-

Projections

1/ Net Scheme Drawings are Supplementary Financing Scheme Shortfalls relative to Type C/. Participation by all developing countries is assumed in calculations of estimates and projections.

2/ Percentages compounded annually. These assumed rates of growth are identical with projections of growth in volume of exports of developing countries 1960-75 by the UNCTAD Secretariat. Low growth rate is consistent with lower of two assumptions concerning rate of growth in GDP in developed countries. "General Survey of Trade Prospects and Capital Needs for Developing Countries", Ch. II., Tables II.3 and II.4. UNCTAD, TD/34/Supp.1, 1967. Lower rates of growth are consistent with assumptions concerning lower average levels of commodity prices and therefore, higher net drawings expressed in terms of percentages of exports from participating developing countries.

3/ Averages of estimated yearly drawings for all developing countries during the selected periods were developed from several estimates of net drawings of groups of countries for which calculations of gross shortfalls were available. These estimates generally are consistent with extrapolations of data from Table 2, but, because they consider other weighting procedures, are slightly larger than such simple calculations would give.

Appendix Table 1: AGGREGATED DIFFERENCES BETWEEN ACTUAL EXPORT EARNINGS AND TYPE C COMPOSITE BANK PROJECTIONS, FOR THREE GROUPS OF COUNTRIES: ANNUAL, AVERAGE, AND TOTAL CALCULATIONS FOR VARIOUS PERIODS, 1957-67

(Millions of U.S. dollars or number of countries)

Item				1964	1965	1966	1967	Total (indicated period)
Thirteen Countries 1/			1957-63 Average					Eleven Years
Differences based on Type C Composite Projection								
Total shortfalls			-337.4 2/	-42	-62	-81	-352	-2,899
Total overages			251.8	734	671	541	106	3,815
No. of Countries								
Experiencing shortfalls			6.6	2	2	5	7	-
Experiencing overages			6.3	11	11	8	6	-
Total Annual Export Earnings, 13 Countries			4,603	5,798	6,189	6,683	6,623	57,512
Seventeen Countries 3/			1959-63 Average					Nine Years
Differences based on Type C Composite Projection								
Total shortfalls			-370.4 2/	-42	-62	-185	-357	-2,498
Total overages			426.6	1,066	842	776	213	5,070
No. of Countries								
Experiencing shortfalls			7.6	2	2	6	8	-
Experiencing overages			9.2	15	15	11	9	-
Total Annual Export Earnings, 17 Countries			7,469	9,212	9,614	10,205	9,999	76,374
Twenty-four Countries 4/	1961	1962	1963					Seven Years
Differences based on Type C Composite Projection								
Total shortfalls	-464	-447	-314	-121	-207	-487	-604 5/	2,644
Total overages	419	630	1,107	1,339	1,243	1,455	767 5/	6,960
No. of Countries								
Experiencing shortfalls	14	10	7	5	4	8	10	-
Experiencing overages	9	14	17	19	20	16	14	-
Total Annual Export Earnings, 24 Countries	11,912	12,608	13,776	14,905	15,667	16,658	16,884	102,410

(Footnotes: see next page)

Footnotes to Appendix Table 1

1/ These 13 countries correspond to the Sample 1-14 countries in Annex IV of the 1965 study, except that Burma was not included. For identification of the composition of this group, see page 99, Table 4, Footnote 1 of that Annex.

2/ 1957-63 average annual shortfalls are somewhat smaller than corresponding figures originally reported for Sample 1-14 countries (page 104, Table 6, of Annex IV), primarily because Burma's shortfalls were included in the latter.

3/ These 17 countries correspond to the Sample 2-18 countries in Annex IV of the 1965 study, except that Burma was not included. For further details concerning the composition of this group, see page 99, Table 4, Footnotes 1 and 2 of that Annex.

4/ These 24 countries include the 17 identified above plus Chile, Nigeria, Philippines, Republic of China (Taiwan), Turkey, Uruguay, and Venezuela.

5/ Differences shown for 1967 include calculations based on hypothetical rather than actual exports for Nigeria. Significant reductions in exports of both petroleum and coconut products from 1966 levels presumably could be attributed almost entirely to the disruptions related to the fighting in Mid-Western and Eastern Nigeria (Biafra). Projected exports of 956 $US million reflected trends in proceeds 1961-66, and should be compared with actual exports of 793 and 680, during 1966 and 1967, respectively.

Appendix Table 2: APPARENT REDUCTIONS IN GROSS SCHEME SHORTFALLS ATTRIBUTABLE TO COMPENSATORY FINANCING FACILITY TRANSACTIONS AND USE OF SCHEME OVERAGES, BY DIFFERENT SAMPLES OF COUNTRIES AND INTERVALS, 1957-67

(Percent of Gross Shortfalls, except where otherwise noted)

	1957-59	1959-61	1961-67
Number of Countries in Sample	11	16	24
Apparent Reductions (Shortfalls relative to Type C Projections)			
Basis: Shortfalls relative to Type C Projections			
CFF Transactions only 1/	11.4	8.2	12.6
Use of Scheme Overages	1.0	12.4	31.4
Total Reduction	12.4	20.6	44.0

1/ CFF Transactions (Drawings and Repayments) at the Higher of Two Levels. No adjustments made for changes in CFF drawings outstanding between the beginning and end of each period.

RCTaylor
March 28, 1969

Methodological Note

(Attachment to memorandum concerning "Updating and Modification of Calculations Concerning ... Operation of a Supplementary Financing Scheme, with Particular Reference to Hypothetical Computations Covering 1957-67", dated March 27, 1969)

Construction and Use of Composite Bank Projections

The method used to adjust all projected export earnings so as to reflect revised estimates of actual export proceeds (published by the IMF) is described in the 1965 study.1/ These adjustments improved the consistency and quality of comparisons between projected and actual export earnings in most instances.

Composite Type C Bank Projections were developed from successive country export projections prepared at irregular intervals by the IBRD Staff. Similar guidelines were used to select, retain, and replace successive projections of export earnings in the Composite Projection for that country.2/ According to this method, any given projection would not be used until it was one or two years old, and, once it was incorporated into the Composite Projection, the projection would not be replaced until it was five or six years old. In practice, the average age of the projection in current use varied between 3.2 and 4.2 years, and between 15 and 25 percent of projections in current use were replaced each year.

Type C Composite Projections were developed from 1964 through 1967 for each of the eighteen countries in Sample 2-18 Countries3/ except Burma. Since no IBRD export projections for Burma prepared since 1960 were available,

1/ Annex IV, pp. 89-91.
2/ P. 92, ibid.
3/ P. 99, Table 4, Footnotes 1 and 2, ibid.

this nation was dropped from both Sample 1-14 Countries and Sample 2-18 Countries. A third group of seven additional countries was included in the analysis of the 1961-67 period.

Gross differences between actual and projected export earnings were calculated yearly, and annual total differences were summarized by similar groups of countries (Appendix Table 1) in order to up-date earlier presentations covering the 1957-63 or 1959-63 periods.[1/]

Comparisons of Gross Annual Shortfalls

In order to make inter-period and inter-group comparisons of yearly total shortfalls[2/] for different groups of countries, these aggregated differences were averaged for several years and then expressed as percentages of annual averages of contemporary exports from these same countries (Table 1). Because data on more than one group of countries was available subsequent to 1958, and because similar periods were used for inter-group comparisons, important similarities and contrasts not previously observed[3/] were noted and used to refine estimates and projections of shortfalls for all developing countries.

Adjustment of Gross Annual Shortfalls for Hypothetical Contemporary Transactions of the Compensatory Financing Facility

Adoption of important modifications in the method previously used[4/] were suggested by two factors. First, guidelines published by the IMF concerning limits on compensatory drawings, estimations of export shortfalls,

1/ P. 99, Table 4.
2/ Over-estimations of actual export proceeds by Composite Projections.
3/ P. 104, Table 6, ibid.
4/ Pp. 105-110, ibid.

and repayment obligations, were ammended in 1966.1/ Secondly, a recent IMF Staff paper2/ proposed that more creditable estimates concerning reductions in gross shortfalls actually attributable to the use of the CFF should incorporate contemporary repayments of CFF drawings, in most instances.

Accordingly, our calculations of alternate (lower and higher) hypothetical CFF drawings and subsequent repayments for each year from 1957-67 reflected these modifications and also the current IMF country quotas. Instead of stipulating that CFF shortfalls would be calculated ex post, relative to a five-year moving average, or, alternatively, by the "general" formula developed by the IMF, our calculations of higher levels of drawings reflect higher limits of current IMF guidelines3/ concerning average level of exports predicted for the two years following the "shortfall year". Secondly, lower CFF drawings are based on the assumption that exports during these two years will, on the average, be equal to exports in the "shortfall year". Finally, our calculations reflect repayment of CFF drawings according to CFF guidelines, regardless of whether either a gross shortfall or an overage occurred during the year within which the Facility would have expected a repayment to be made. However, our estimates of apparent reductions in gross shortfalls (Appendix Table 2) do not recognize differences between the CFF balances outstanding at the beginning and the end of a given period. Actual reductions in Scheme costs attributable to the CFF would equal the amount of export overages earnings used to repay CFF drawings.

1/ "Compensatory Financing of Export Fluctuations, A Second Report by the IMF", Washington, September 1966.

2/ "Effects of Recent Changes in the Fund's Compensatory Financing Facility on the Annual Cost of the Supplementary Financing Scheme" by IMF Staff, February 3, 1967.

3/ 110% of exports in "shortfall year".

Net scheme drawings were calculated in a manner similar to that used in the 1965 study.[1/] Gross shortfalls adjusted for CFF transactions were transformed into net scheme drawings by deducting, from these adjusted gross shortfalls (or residual shortfalls), earnings equivalent to the same country's calculated export overages. However, we modified previous techniques in one minor way: no overages accrued before a shortfall occurred were used to reduce a given country's accumulative shortfalls.

Development of Estimates of the Size of a Supplementary Financing Scheme during 1957-67, Assuming that all Developing Countries Participated

"Global" gross and net shortfalls estimated in 1965 study were based on average statistics for 14 countries from 1957-63 and 18 countries from 1959-63.[2/] Aggregated average shortfalls from these two groups were expanded, by appropriate factors, so as to approximate average yearly estimates for all developing countries.

Our up-dated estimates use simple extrapolations of the average yearly shortfalls or net drawings, expressed as percentages of contemporary exports from three groups of countries, in order to estimate equivalent figures proportionate to the contemporary exports of all developing countries,[3/] for 1957-67.

1/ Pp. 113-115, ibid.
2/ Pp. 119-120, ibid.
3/ Consistent with World Trade Statistics published in "International Financial Statistics", by the IMF.

In addition, group averages of each country's cumulative shortfalls (drawings) expressed as a percent of its contemporary exports were calculated for groups and periods corresponding to those presented in Tables 1 and 2. For drawing inferences concerning the size of equivalent differences for other developing countries, during the same periods, this latter method of "sampling" probably has greater merit.

FORM No. 57 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Irving S. Friedman

DATE: June 13, 1969

FROM: N. A. Sarma N. A. Sarma

JUN 13 1969
12 30 pm

SUBJECT: Supplementary Finance: IGG Meeting in New York - June 23 - July 3.

The IGG has posed to us a specific question: Whether the Bank Staff Scheme could be implemented by Bank/IDA, within their existing Articles of Agreement, if the Executive Directors so agreed and if finance were made available. Another main question relates to the revision of cost estimates, taking into account available data for recent years. On both these, you have draft papers (one from Mr. Szasz, dated February 17; the other from me dated March 28). We would be asked about these matters in detail at the outset of the session.

In the recent DAC informal meeting on supplementary finance (June 4) the question was raised whether there have been consultations between the Bank staff and the Fund staff on the relation between S.F. and C.F.F.; Germany and others attach importance to this. If possible, we and the Fund staff should make an agreed statement at the IGG meeting on the subject. Please see (draft) note I attached hereto.

It is, of course, for governments to agree to implement a scheme of S.F.; it is for the Executive Board of the Bank Group to decide whether we should undertake it, if called upon. Very much would depend on the stand taken by U.S.A. and Germany. As I mentioned in my memo to you (June 6) on the Paris meeting, Group B (DAC) member countries are likely to state their respective positions at an early stage of the IGG meeting, so as to facilitate the finalizing of the report. The question of S.F. as an added function of IDA was mentioned by U.S.A., U.K., Switzerland and others. Then, finance for S.F. is to be considered along with the third IDA replenishment. Here it is not any one particular S.F. scheme that is thought of, but recognition of the purpose of S.F. and its administration by IDA on a rather discretionary basis. Please see (draft) note II attached hereto.

(Draft) Note I

SUPPLEMENTARY FINANCE AND FUND'S COMPENSATORY FINANCE FACILITY

When the Bank Staff Scheme was first formulated, the Fund Staff were concerned with the problems of reconciling the objective of flexible balance of payments adjustment with the implementation of a predetermined development program, and the possible differences in criteria of adjustment. This seemed also important as the scale of supplementary financing might turn out to be much larger than assistance of the Fund to developing countries--not only under CFF but also of regular Fund drawings. Further, all Fund drawings are repayable within a 3-5 year period, whereas supplementary finance drawings would be repayable on terms similar to those applicable to development finance.

Since then, during the discussions in the Inter-governmental Group and elsewhere, the relationship between S.F. and CFF has been clarified by us. In particular, we have stated that the Administering Agency for S.F. would need to be guided by Fund advice on matters that belong in its area of operations--monetary and exchange policies in the context of a country's development program. As for scale of operations, it is now agreed that S.F. cannot be open-ended but provide for a fixed fund within which operations have to be confined. The resources required are placed at $300 million a year. The drawings of LDC's from the Fund (under regular procedures and CFF together) are not likely to fall short of these magnitudes. There need be no question of any particular residual lender having a decisive leverage. A greater degree of flexibility and discretion is envisaged now in the adjustment process with respect to supplementary finance drawings. Above all, whether formalized in joint management of S.F. by the Bank Group and the Fund or not, in view of the close relationship of the

(B) functions are different but closely related
(D) If ~~goes through~~ implemented, and IBRD group administer suppl. fin. measures - can be ensured that there will be ~~close~~ consultation
(between two on these matters.)

Fund facilities and S.F., continuing consultation and cooperation between the Bank Staff and Fund Staff, with respect to policy measures and other matters, are requisite to the effective implementation of S.F., if this were entrusted to Bank/IDA. A brief statement on these lines, if agreed on between the Fund and the Bank, would be helpful to discussions in IGG.

The Compensatory Financing Facility of the Fund helps to even out the availability of exchange earnings from exports for a country and thus assists a country in meeting temporary, reversible, balance of payments deficits, on the understanding that the drawings would be repaid by the member country within an outer limit of 3-5 years. The Supplementary Finance Scheme is intended to assist a developing country to maintain its development program which might otherwise be disrupted by a shortfall of export earnings from reasonable expectations on which the development program was based. The proposal for Supplementary Finance has been made because countries cannot undertake economic development programs with a longer term perspective unless there is some assurance that their export earnings will be kept up to reasonable expectations. In brief, it may be said that CFF has to do with instability, and SFS with uncertainty of export earnings.

The different purposes of the two schemes are reflected in the methods of calculating export shortfalls. Under the Supplementary Finance Scheme, export prospects are considered in the context of a development program and take account not only of various objective factors, domestic and external, but also the impact of new policy measures. Under the Compensatory Financing Facility, the Fund meets requests for drawings by members whose export proceeds over the latest twelve-month period have fallen short of the estimated medium-term trend of exports. Therefore, CFF does not need a prior export projection;

instead, the shortfall in export earnings is measured from a norm representing the medium-term trend value. The value is estimated by a statistical formula as well as a qualitative judgment. The statistical formula itself attaches a weight of .50 to exports in the shortfall year and .25 to each of the two preceding years. The qualitative estimates involve a direct forecast of exports for two years ahead. Formerly, the statistical and qualitative estimates were given about equal weight in determining trend value of exports. Currently, a somewhat greater weight is given to qualitative estimates. It is precisely because the trend or norm is a moving average for five years centered on the current, shortfall, year as the middle year that a rough balancing of shortfalls and surpluses of actual exports with respect to trend is expected over a relatively short period of time.

During the deliberations of the Intergovernmental Group, a view of supplementary finance was put forward in terms of possible refinancing of drawings under the Fund Compensatory Financing Facility. The different purposes of the two facilities would indicate that any refinancing of Compensatory Financing Facility could not be an alternative or substitute way of dealing with the problem for which supplementary finance has been proposed. Where considered appropriate, it could be an additional function of S.F., when a country is unable to repurchase its Fund drawings wholly within 5 years. The amounts that may require to be refinanced are likely to be small.

BANK GROUP AND SUPPLEMENTARY FINANCE

Briefly stated, S.F. is proposed to meet the problem of unexpected shortfalls in exports that are potentially disruptive of a developing country's development efforts. When a country has a development program that is internationally discussed, and is pursuing policies that are conducive to its implementation, it is desirable to provide it with a ready source of long-term assistance to enable it to maintain the development program when unforeseen adverse export movements occur. The exchange reserves of most LDC's being low, and while a developing country can take certain adjustment measures, in the event of serious export shortfalls, the development program is likely to be seriously affected if there is no such facility. Accordingly, the Bank Group should be interested in this purpose and should be willing to consider administering a scheme if asked to do so by governments.

S.F. is one of the few proposals in recent years in the field of development finance which has attracted wide support, and its likely cost is modest ($300 million a year). Among donor countries, only France and, perhaps, Australia, are against the idea itself; no other donor country has rejected it, though their approaches vary from that of Sweden which accepts the Bank staff scheme to that of Germany which is for a simple, largely discretionary, scheme. USA has a positive attitude towards S.F ~~recognizes S.F. as an important aspect of development finance~~, though not certain yet of the priority to be accorded to it. Among LDC's, support is near-unanimous, mostly toward the essentials of the Bank staff proposal.

Especially when aid flows are stagnating, a scheme intended to meet a felt need of several LDC's could be a means of maintaining and increasing total aid flows, especially through multilateral channels. Any scheme of S.F. that only diverted existing development funds to this end would be of little interest to developing countries. We ourselves have ~~said~~ stressed that the resources for S.F. should be additional. This concept of additionality of funds assumes particular importance for us when the idea is put forward that S.F. be turned over to IDA as an added function and that the question of financial contributions for it be taken up together with third IDA replenishment. ~~There is an advantage in~~ Keeping the negotiations for finance separate ~~for~~ from IDA replenishment and for any scheme of S.F.; may help to ensure ~~then there is~~ greater certainty of ~~ensuring the~~ additionality of funds. If the two were taken up together, negotiations for IDA replenishment may also get more complicated, especially in view of the known position of France.

Still, all are agreed that Bank/IDA should be the administering agency for S.F. Under the circumstances, S.F. may get combined with third IDA replenishment. For us, then, it becomes all the more important to underline that resources for S.F. should be additional to a larger level of IDA replenishment. However, while being additional to IDA funds, S.F. may still involve some diversion of other aid funds from existing purposes. The advantage still would be in increased multilateral channeling of aid funds; more aid becomes untied.

The U.S. is in a delicate position, from the viewpoint of timing. Unless their intimation of second IDA replenishment is forwarded officially by then, the U.S. is likely to find it very difficult to speak of S.F. and third IDA replenishment during the IGG meetings at the end of June. On such considerations, this idea may not be advanced at the forthcoming IGG meeting, and the matter may get remitted to the Trade and Development Board for later consideration.

FORM No. 57 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Irving S. Friedman DATE: June 13, 1969

FROM: N. A. Sarma

JUN 13 1969
12.30 p.m.

SUBJECT: Supplementary Finance: IGG Meeting in New York - June 23 - July 3.

The IGG has posed to us a specific question: Whether the Bank Staff Scheme could be implemented by Bank/IDA, within their existing Articles of Agreement, if the Executive Directors so agreed and if finance were made available. Another main question relates to the revision of cost estimates, taking into account available data for recent years. On both these, you have draft papers (one from Mr. Szasz, dated February 17; the other from me dated March 28). We would be asked about these matters in detail at the outset of the session.

In the recent DAC informal meeting on supplementary finance (June 4) the question was raised whether there have been consultations between the Bank staff and the Fund staff on the relation between S.F. and C.F.F.; Germany and others attach importance to this. If possible, we and the Fund staff should make an agreed statement at the IGG meeting on the subject. Please see (draft) note I attached hereto.

It is, of course, for governments to agree to implement a scheme of S.F.; it is for the Executive Board of the Bank Group to decide whether we should undertake it, if called upon. Very much would depend on the stand taken by U.S.A. and Germany. As I mentioned in my memo to you (June 6) on the Paris meeting, Group B (DAC) member countries are likely to state their respective positions at an early stage of the IGG meeting, so as to facilitate the finalizing of the report. The question of S.F. as an added function of IDA was mentioned by U.S.A., U.K., Switzerland and others. Then, finance for S.F. is to be considered along with the third IDA replenishment. Here it is not any one particular S.F. scheme that is thought of, but recognition of the purpose of S.F. and its administration by IDA on a rather discretionary basis. Please see (draft) note II attached hereto.

SUPPLEMENTARY FINANCE AND FUND'S COMPENSATORY FINANCE FACILITY

When the Bank Staff Scheme was first formulated, the Fund Staff were concerned with the problems of reconciling the objective of flexible balance of payments adjustment with the implementation of a predetermined development program, and the possible differences in criteria of adjustment. This seemed also important as the scale of supplementary financing might turn out to be much larger than assistance of the Fund to developing countries--not only under CFF but also of regular Fund drawings. Further, all Fund drawings are repayable within a 3-5 year period, whereas supplementary finance drawings would be repayable on terms similar to those applicable to development finance.

Since then, during the discussions in the Inter-governmental Group and elsewhere, the relationship between S.F. and CFF has been clarified by us. In particular, we have stated that the Administering Agency for S.F. would need to be guided by Fund advice on matters that belong in its area of operations--monetary and exchange policies in the context of a country's development program. As for scale of operations, it is now agreed that S.F. cannot be open-ended but provide for a fixed fund within which operations have to be confined. The resources required are placed at $300 million a year. The drawings of LDC's from the Fund (under regular procedures and CFF together) are not likely to fall short of these magnitudes. There need be no question of any particular residual lender having a decisive leverage. A greater degree of flexibility and discretion is envisaged now in the adjustment process with respect to supplementary finance drawings. Above all, whether formalized in joint management of S.F. by the Bank Group and the Fund or not, in view of the close relationship of the

Fund facilities and S.F., continuing consultation and cooperation between the Bank Staff and Fund Staff, with respect to policy measures and other matters, are requisite to the effective implementation of S.F., if this were entrusted to Bank/IDA. A brief statement on these lines, if agreed on between the Fund and the Bank, would be helpful to discussions in IGG.

The Compensatory Financing Facility of the Fund helps to even out the availability of exchange earnings from exports for a country and thus assists a country in meeting temporary, reversible, balance of payments deficits, on the understanding that the drawings would be repaid by the member country within an outer limit of 3-5 years. The Supplementary Finance Scheme is intended to assist a developing country to maintain its development program which might otherwise be disrupted by a shortfall of export earnings from reasonable expectations on which the development program was based. The proposal for Supplementary Finance has been made because countries cannot undertake economic development programs with a longer term perspective unless there is some assurance that their export earnings will be kept up to reasonable expectations. In brief, it may be said that CFF has to do with instability, and SFS with uncertainty of export earnings.

The different purposes of the two schemes are reflected in the methods of calculating export shortfalls. Under the Supplementary Finance Scheme, export prospects are considered in the context of a development program and take account not only of various objective factors, domestic and external, but also the impact of new policy measures. Under the Compensatory Financing Facility, the Fund meets requests for drawings by members whose export proceeds over the latest twelve-month period have fallen short of the estimated medium-term trend of exports. Therefore, CFF does not need a prior export projection;

instead, the shortfall in export earnings is measured from a norm representing the medium-term trend value. The value is estimated by a statistical formula as well as a qualitative judgment. The statistical formula itself attaches a weight of .50 to exports in the shortfall year and .25 to each of the two preceding years. The qualitative estimates involve a direct forecast of exports for two years ahead. Formerly, the statistical and qualitative estimates were given about equal weight in determining trend value of exports. Currently, a somewhat greater weight is given to qualitative estimates. It is precisely because the trend or norm is a moving average for five years centered on the current, shortfall, year as the middle year that a rough balancing of shortfalls and surpluses of actual exports with respect to trend is expected over a relatively short period of time.

During the deliberations of the Intergovernmental Group, a view of supplementary finance was put forward in terms of possible refinancing of drawings under the Fund Compensatory Financing Facility. The different purposes of the two facilities would indicate that any refinancing of Compensatory Financing Facility could not be an alternative or substitute way of dealing with the problem for which supplementary finance has been proposed. Where considered appropriate, it could be an additional function of S.F., when a country is unable to repurchase its Fund drawings wholly within 5 years. ~~Such~~ The amounts that may require to be refinanced are likely to be small.

(Draft) Note II

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