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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

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January 31, 1967

Supplementary Financial Measures: Additional Papers

1. Attached for your information are six notes and technical papers* which relate to the Bank study, "Supplementary Financial Measures". These were prepared by Bank staff in response to comments and requests for elaboration made when the Bank's proposal was discussed at the meeting of the UNCTAD Committee on Financing and Invisibles in April 1966 and at the first session of its Intergovernmental Group in October 1966. The papers were sent by Mr. Friedman to Dr. Raul Prebisch, Secretary General of UNCTAD, during December 1966-January 1967.

C. F. Owen
Secretary

* Attachments:

1. Supplementary Finance: Consideration of Import Prices
2. Export Projections in the World Bank
3. The Contribution of "Invisibles" to Foreign Exchange Earnings
4. Supplementary Finance: "Form and Terms of Assistance"
5. The Policy Package of the Supplementary Finance Scheme
6. Shortfalls and "Overages" in the Supplementary Finance Scheme

Secretary's Department

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

BANK STUDY ON SUPPLEMENTARY FINANCIAL MEASURES

. . . .

Notes and Technical Papers

IBRD STAFF

January 31, 1967

SUPPLEMENTARY FINANCE: CONSIDERATION OF IMPORT PRICES

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

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

(a) Is it possible to obtain an estimate of the additional cost that might be incurred by the proposed Scheme if provision were made to take adverse movements in import prices into account in the administration of the Scheme.

(b) In what way could a provision that movements in import prices be taken into account in determining the amount of aid that the Scheme should make available to a given country be administered.

(c) What is the availability and character of existing import price indexes for the developing countries and what are the solutions to the statistical problems that these may present.

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

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

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

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

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

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

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

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

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

I.B.R.D. Staff
January 20, 1967

EXPORT PROJECTIONS IN THE WORLD BANK

Introduction

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

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

Commodity Projection Work

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

(a) the need in the low income countries heavily dependent on exports of primary products to know the likely world demand prospects for these products, since the latter will influence the resources available for development, and also will help to determine whether the production of these products should be stimulated or not;

(b) the search by the less developed countries for increased stability in their export prices, and for solutions to the surpluses that have developed from time to time in some of their major export products;

(c) the widespread adoption of full employment and a steady increase in per capita income as major national policies or goals in most countries, which, if quantified, in turn require quantitative estimates of major imports in the future;

(d) the desire in many industrialized countries dependent on supplementary imports of food and raw materials to anticipate future trends so as to avoid disruptions in the functioning of their economies, or plan more rationally their domestic production policies in the field of primary commodities.

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

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

Purpose of Commodity Projections in the Bank

Commodity projections have the following principal uses in the Bank:

(a) for making balance of payments projections in country economic reports that assess creditworthiness or the financial feasibility of development programs, irrespective of the magnitude or nature of the World Bank

Group's lending operations in the country concerned;

(b) in formulation of economic judgments on the future allocation of investment resources among alternative lines of production in member countries, and the adequacy and feasibility of government policies affecting the development process;

(c) for the economic and financial evaluation of projects that involve primary commodities directly (e.g. development of mines, factories or agricultural smallholder production schemes) or indirectly (e.g. roads, ports or power facilities the services of which are oriented toward production and export of particular commodities);

(d) in formulation of Bank views and policies regarding the general problems of the export trade of the developing countries.

Of these primary uses of the Bank's commodity research by far the most frequent one is that relating to country economic reports, which are used for a number of purposes including assessing the creditworthiness and economic performance of member countries, the provision of technical assistance in the economic field and providing the World Bank Group and other lending institutions with an objective and carefully prepared appraisal of a country's economy and outlook from the viewpoint of development. Individual projects requiring a commodity projection as an important part of their economic evaluation also arise from time to time, past examples including projects for the production of pulp and paper, manganese and iron ore, steel, and fertilizer materials. More recently, cooperation with UNCTAD has increased the use of commodity work in the context of general policy considerations in the field of international trade and development.

Basic Approach

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

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

Methodology

Commodity projections usually consist of a group of interrelated, internally consistent estimates of the future supply, demand and price prospects of a commodity, based on explicitly stated, reasonable assumptions. These assumptions may rely heavily on past experience and particularly on observed historical relationships between the quantitatively measurable variables pertaining to a commodity (i.e. its consumption, production, stocks and price) and various macro-economic variables, such as population, gross

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

national product or income, fixed capital formation, production or consumption of other commodities, or indices of industrial production or its components. Projections are analogous to algebraic equations; indeed, at the highest levels of abstraction, if all necessary data are available, they may be expressed entirely as a set of simultaneous equations.1/

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

(a) analysis of the long term and recent trends in the production, consumption and price of the commodity; attempts to establish, through simple or multiple regression equations, what relationships exist among the relevant variables (and particularly between consumption and relevant macro-economic variables such as population, income and industrial production) and how persistent these relationships have been;

(b) preliminary projection of world or regional demand in the commodity as a function of independently projected trends in the macro-economic variables to which it has been found to be closely related and assuming constant prices;2/

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

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

(c) preliminary independent projection of future probable production or production capacity based on statistically derived supply-price functions or industry surveys of expansion plans;

(d) analysis of the effects of projected demand and capacity or output on price, including examination of the possible effects of recent or impending technological developments (e.g. trends in inter-material substitution, including new uses for some traditional products, expected changes in food habits, and changes in future costs of production due to trends in yields or productivity) on historically derived relationships; this also entails successive reconciliation of the supply and demand with price;

(e) determination of probable trade flows based on comparisons between prospective levels of consumption and production by region and/or country.

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

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

Even the most sophisticated and statistically reliable econometric model, however, is tied to structural relationships in the historical past. In a dynamic world of rapidly changing technology these historical relationships are subject to change in the future. In the final analysis, therefore, the end product of the projection process must entail expert judgment regarding such factors as the possible future impact of current and imminent developments in industrial technology and human consumption habits, impending changes in national or international economic policies, or changes in the institutional framework of an industry that could affect producer marketing strategy. For this reason it is believed that an essential feature of commodity projection work must be a competent staff of individual specialists who are not only versed in the basic analytical techniques but also have an intimate and up-to-date knowledge of all economically significant aspects of individual commodities. In addition to enabling better anticipation of future structural changes, this approach also makes possible the necessary continuous review of existing projections.

<u>Projection of Other Export Earnings</u>

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

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

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

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

THE CONTRIBUTION OF "INVISIBLES" TO FOREIGN EXCHANGE EARNINGS

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

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

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

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

THE CONTRIBUTION OF "INVISIBLES" TO FOREIGN EXCHANGE EARNINGS

Concepts

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

Item 3 - Freight and Insurance

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

Item 4 - Other Transportation

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

Item 5 - Travel

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

Item 6 - Investment Income

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

Item 7 - Government Transactions Not Included Elsewhere

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

Item 8 - Other Services

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

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

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

Statistical Limitations

There are numerous difficulties in assessing the precise contribution of receipts from "invisibles" to a country's foreign exchange earnings. The complexity of the transactions involved despite the formalized classification adopted by the IMF makes reporting difficult. Quite frequently no breakdown of the various components of "services" is given and in some instances no data whatsoever are available. A less frequent but serious difficulty arises from the fact that figures for the various items are shown on a net basis: this leads to an understatement of "gross receipts" since a credit figure under one head might be net of some payments and a 'debit' figure does not necessarily mean that the country earned nothing whatsoever from that source. A further difficulty stems from the not uncommon practice of combining receipts from more than one source or of including them in the catch-all "other services". For example, earnings from freight and insurance are sometimes included with those from "other transportation" or under "other services".

Analysis of Data

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

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

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

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

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

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

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

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

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

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

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

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

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

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

I.B.R.D. Staff
January 18, 1967

Table I

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

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

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

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

Source: IMF Balance of Payments Year Books.

Table II

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

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

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

Source: IMF Balance of Payments Yearbooks

Table III

Average Annual Receipts from Merchandise Exports and Invisibles, 1956-1963

-in $ million-

	Exports including non-monetary gold	Freight insurance and other Transportation	Travel	Investment Income	Government n.i.e.	Other Services	Total Services (2-6)	Private Transfers	Total Invisibles (7+8)	Total Current Account Receipts
Argentina	1068	92	6	20	10	31	157	4	161	1229
Bolivia	66	*	1	*	2	1	4	1	5	71
Brazil	1337	46	14	3	25	66	154	15	169	1506
Burma	236	4	*	4	7	6	22	2	24	260
Ceylon	363	24	2	6	8	10	50	1	52	415
Chile	445	24	20	-	12	7	62	7	69	514
China (Taiwan)	188	11	2	1	11	5	30	10	40	228
Colombia	533	37	16	1	4	30	88	5	93	626
Costa Rica	84	3	7	*	2	6	18	2	20	104
Dominican Republic	149	6	5	1	2	5	18	2	21	170
Ecuador	139	-	4	*	3	3	10	1	11	150
El Salvador	124	1	5	1	2	5	12	2	14	138
Ethiopia	75	4	2	2	8	1	17	3	20	95
Ghana	301	8	3	12	3	22	49	*	49	350
Guatemala	119	2	6	1	4	3	16	1	17	136
Haiti	37	2	6	-	3	1	12	5	17	54
Honduras	74	1	1	1	1	2	6	*	7	81
India	1380	88	32	36	86	78	320	129	449	1829
Indonesia	771	16	*	7	4	19	46	*	46	817
Iran	800	4	6	2	22	20	54	3	57	857
Iraq	600	20	18	11	10	*	60	1	61	661
Israel	203	61	24	11	7	29	131	199	330	533
Jordan	14	2	9	2	4	17	34	3	37	51
Korea	37	5	1	4	68	3	81	31	111	148
Libya	70	3	2	2	34	13	54	1	55	125
Malawi, Rhodesia, Zambia	560	14	9	31	2	25	81	30	111	671
Mexico	828	*	539	-	11	41	591	5	596	1424
Morocco	351	18	26	6	136	8	195	11	206	557
Nicaragua	77	7	2	*	3	4	16	*	16	93
Pakistan	376	15	1	8	39	31	94	12	106	482
Panama	55	7	29	2	4	44	86	3	89	144
Paraguay	38	1	1	-	2	2	5	1	7	45
Peru	417	11	20	*	7	20	57	9	66	483
Philippines	542	5	3	7	58	52	125	54	179	721
Sudan	189	2	1	5	6	10	23	1	24	213
Syria	146	24	11	-	13	10	58	9	67	213
Thailand	401	10	6	7	19	11	53	5	58	459
UAR	476	156	9	16	4	79	263	13	276	752
Uruguay	151	4	27	1	3	3	36	*	37	188
Venezuela	2467	25	2	14	2	66	110	-	110	2577
Vietnam	69	5	-	6	3	20	33	15	48	117
Total	16356	768	878	231	654	809	3331	596	3931	20,287

* Indicates an amount less than 1.

N.B. Discrepancy in totals due to rounding.

Source: IMF Balance of Payments Yearbooks

Table IV

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

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

Source: Table III
* Indicates an amount less than 1.

SUPPLEMENTARY FINANCE: "FORM AND TERMS OF ASSISTANCE"

Form of Assistance

As in the case of the provision of any type of long-term aid, Supplementary Finance could be provided to a country by the Agency in three forms: a) related to projects; b) related to a list of goods and services for which the funds could be used; and c) as an outright transfer of cash to the country. One prerequisite in determining the choice of one of these three forms as the appropriate one for Supplementary Finance is that of "timeliness"; that is, such assistance should be forthcoming shortly after an unexpected shortfall has been identified so that it avoids the disruption of the development program which would otherwise occur. Consideration of the "timeliness" criterion leads to the discarding of the alternative of linking Supplementary Finance to projects. Administration of aid through them is a time consuming process, which does not meet the need to have assistance provided in a matter of a few months or less. The choice between the other two alternative ways of providing Supplementary Finance cannot be decided on economic grounds. Whatever alternative is chosen, the fundamental need for the Agency to be satisfied that the resources thus transferred are used effectively and for worthwhile development purposes is met by the fact that satisfactory performance of the members under the Scheme is a prerequisite to the assistance and that access to it depends on the implementation of a development program and related policies previously agreed with the Agency. It may, however, be mentioned that of the alternatives previously mentioned, if it is found necessary to relate the assistance to particular goods and services, the procedures adopted would have to take into consideration the particular situation of each country concerned, so as to ensure that the requisite of "timeliness" is fulfilled. This consideration suggests that, in order to ensure the most efficient operation of the Agency, the choice of the form of assistance should be left to the discretion of the Agency to work out with the member country requesting assistance so that the development program may go forward.

Terms of Assistance

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

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

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

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

(i) entirely "Bank countries",

(ii) entirely "IDA countries",

(iii) "hard-blend" countries, which receive assistance mainly from the Bank but also some IDA finance, and

(iv) "soft-blend" countries which receive assistance mainly from the IDA, but also some Bank finance.

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

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

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

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

The concluding paragraph in the chapter on the form and terms of assistance in the Study had pointed to the possibility that there may be circumstances under which the Agency could request advance repayment of its credits to a country. It has been suggested that this idea would be self-defeating since it would run counter to the basic rationale behind foreign assistance. As it is clearly stated in the Study, the circumstances which would make advance repayment possible are probably infrequent, and it is not envisaged that developing countries which still have a "resource gap" would be asked for advance repayment. It is only in cases where the resource and foreign exchange position of the country improves so substantially over time that it could afford to repay its debt to the Agency before maturity (e.g. due to the discovery of oil or the emergence of a new export factor) without affecting its attainable rate of growth that the Agency may retain the right to request repayment earlier than originally stipulated.

I.B.R.D. Staff
December 14, 1966

THE POLICY PACKAGE OF THE SUPPLEMENTARY FINANCE SCHEME

1. Introduction

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

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

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

2. The Development Program

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

In evaluating a country's development program, two aspects have to be considered. In the first place, given the long-term goals of the country, the program must be formulated to achieve those goals as efficiently as possible. In the second place, the policies associated with the program should be such as to mobilize the required amount of the country's own resources. In addition, the viability of a development program depends on whether foreign assistance is likely to be available on a sufficient scale. As of the present time, creditor countries have not been able to make firm commitments of their assistance to the developing countries over medium-term periods, covering their development programs. Even if firm commitments cannot be made from the creditor countries, there must be some indication that the scale on which external assistance is envisaged for the development program is adequate and realistic.

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

3. Export Policies

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

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

4. Monetary and Financial Policies

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

5. Adjustments to Changing Conditions

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

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

In the past, when developing countries were faced with large and unexpected shortfalls of their export earnings, they often had to make serious adjustments in their investments, amounting to a disruption of their development programs. The establishment of the Supplementary Financing Scheme will remove this cause of a disruption of development programs. There may, however, be cases where the whole export picture of a country or the market for its major export has suffered so drastically that it becomes desirable to have a major revision of the development program, which was based on an earlier export projection. Such instances are likely to be infrequent within the planning periods of about five years covered by the Scheme, but when this type of change occurs, the allocation of investments to the sectors producing the exports for which market conditions have changed seriously has to be reconsidered. While the sectoral composition of the development program might need to be altered, it should generally be possible to maintain the scale of the program and the Agency would provide assistance to meet shortfalls from the original export projection. If, however, it is agreed between the Agency and the country that the change in the export prospects of a country is a fundamental one, then a new development program and associated policy package based on a revised export projection will have to be drawn up.

Because of the need for these various adjustments, to meet the effects of a shortfall, policies agreed upon in the initial understanding cannot be assumed to be frozen at the time. On the contrary, they would be adapted to the particular circumstances which will occur in the course of a planning period. These adjustments would be made in consultation with the Agency, which would presumably look to the World Bank and the International Monetary Fund for advice on matters falling within their respective fields.

6. Periodic Review

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

I.B.R.D. Staff
December 14, 1966

SHORTFALLS AND "OVERAGES" IN THE SUPPLEMENTARY FINANCE SCHEME

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

2. An essential feature of the Scheme is an understanding between the Agency and the country on an export projection for a period, over which the country has formulated a development plan. The export projection indicates the amounts of foreign exchange which the country may reasonably anticipate earning from its exports in each year of this period. Such projections are based on reasonable assumptions regarding world trade developments, and on the assumption that specific policies will be followed. Such projections, together with projections of other items affecting foreign exchange availability, would be required by developing countries irrespective of the existence of supplementary finance, in order to judge the feasibility of

their development programs. Agreement on these export projections between the country and the Agency would reflect the financial viability of the development plan in terms of internal and external resources, or in other words, from the point of view of availability of adequate domestic savings and foreign exchange.

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

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

Adjustments in Shortfalls and Overages

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

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

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

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

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

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

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

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

Financial Relations between the Agency and the Country

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

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

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

where

S = accumulated shortfalls during the projection period

O = accumulated overages during the projection period

a = agreed coefficient of adjustment of consumption

R = agreed use of reserves

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

I.B.R.D. Staff
December 14, 1966

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

ECONOMIC COMMITTEE

EC/M/66 - 20

May 4, 1966

Meeting on Supplementary Financial Measures*

1. At the Economic Committee meeting on April 26, 1966,1/ the Chairman reported on the UNCTAD meeting2/ which discussed the Bank Staff Study on Supplementary Financial Measures.

2. There was considerable support at the UNCTAD meeting for the Scheme advanced in the Bank's study, and agreement that it dealt with a major problem. The reactions of the less developed countries were favorable, which seemed to have come as a surprise to the representatives of the developed countries. There was widespread agreement about the desirability of the Scheme, and most questions related to clarification of technical points and how the Scheme would work in practice. The Bank representatives, reflecting the tenor of the Study, took a neutral position on the possible administering agency, but there was a general expectation at the meeting that the Bank Group would administer the Scheme.3/

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* NOTE: In order to facilitate presentation, the Chairman's initial statement, and subsequent responses to questions from the Committee members, are integrated according to subject matter. A formal report on the UNCTAD meeting is being prepared for distribution to the Board and the Staff.

1/ Members of the Committee present: Messrs. Friedman (Chairman), Kamarck, Adler, Edelman, Gilmartin, Larsen, Lipkowitz, McDiarmid, Weiner. Also present: Messrs. Orvis Schmidt, Hoffman, Wouters. A number of staff members from the Area, Economics and Projects Departments audited the meeting.

2/ Committee on Invisibles and Financing related to Trade (Trade and Development Board, UNCTAD) Geneva, April 13-20.

3/ Mr. Orvis Schmidt reported that delegates to the recent meeting of the Inter-American Economic and Social Council (CIES) in Buenos Aires all spoke approvingly of the Scheme and also of the IMF compensatory financing scheme.

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3. A resolution which was adopted at the meeting[1] established, subject to the approval of the UNCTAD Board, an intergovernmental group to study the Scheme further and to submit a report, possibly in September- October, for consideration by the UNCTAD Committee at its second session in November 1966.[2] This meeting might take place in Geneva or New York, but Washington was also being considered because the technical knowledge of specialists at the Bank and the Fund could then be utilized. The Bank and the Fund Staff have been asked to assist in the work of the intergovernmental group. Some assignments for staff members should be completed by June 1 to be ready for the group's first meeting in early July. Dr. Raul Prebisch, Secretary General of UNCTAD, hoped that an international agreement for implementing the Scheme would be ready in time for the 1967 UNCTAD Conference.[3]

4. A New Relationship in Development: The UNCTAD Committee meeting gave the participants the feeling that a new relationship could be established between developed and less developed countries. The O.E.C.D. countries had indicated their desire to do more to help the less developed countries, which welcomed the expression of mutual responsibility for development. The less developed countries particularly welcomed the prospect of additional aid through an international agency which would be multilateral and non-political. As a result, they were prepared to accept the requirements of the economic performance criteria on which the Scheme was based.

5. IDA Resources and Total Aid: Representatives of the less developed countries were in favor of the Scheme, so long as it would provide truly supplementary assistance. They did not want funds, which would otherwise go to IDA, to be diverted to the Scheme. The developed countries also agreed with this basic notion. No one challenged the figure of \$300-\$400 million per year (on average) as being too high, (although representatives of certain developed and less developed countries were more worried whether this amount would be adequate), or the general need for more money for development finance.

6. Relationship to IMF Operations: The Bank representatives, in response to questions from different country representatives, had confirmed

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1/ Copies of this resolution of the Committee on Invisibles and Financing related to Trade, together with the statement by Dr. Raul Prebisch at the plenary meeting, were distributed on April 28, 1966 (EC/M/66-18).

2/ The group consists of representatives of the following countries:

a) Developed countries: (6) -- France, Germany, Japan, Sweden, United Kingdom, United States.

b) Less developed countries: (7) -- Argentina, Brazil, Ceylon, Ghana, India, U.A.R., Yugoslavia.

There was provision for 2 more members, in case the Eastern Bloc countries wish to join the group.

3/ The Conference is expected to take place in Geneva in May, 1967.

that the Scheme was based on the assumption of an active IMF compensatory financing scheme.

7. Economic Performance: More experience would be required in order to achieve improved performance evaluation; the criteria would have to be general enough to be acceptable to the less developed countries, yet, specific enough to be meaningful. There were a number of major problems in clearly establishing the concepts and criteria for economic performance, which were essential for effective policy formulation. A number of Economic Committee meetings, or meetings of several sub-groups, would be held to discuss these problems, and Fund staff invited to attend.

8. At the UNCTAD meeting the Bank representatives, in response to questions, had emphasized the identity of the economic performance criteria that would be used in the Scheme with those used in basic development finance. Representatives of the less developed countries seemed to accept the view that, what was already being done in practice in several instances, could become a practice of general application. They were considerably interested in the arrangements for consultative groups.

9. The representatives of the developed and the less developed countries expected the cooperation of the Fund with the administering agency. Mr. Friedman indicated that discussions with the Fund on economic performance would probably take place; joint Bank/Fund work in this field, he felt, was desirable and feasible.

10. Commodity Agreements: Some representatives of both developed and less developed countries (France, Belgium, Nigeria, Ghana) emphasized that implementation of the Scheme should not endanger the arranging of new commodity agreements, or the operation of established ones. The Bank representatives had emphasized that the Scheme and commodity agreements were not mutually exclusive, and that work on commodity agreements should continue. Indeed, the estimated financing of the Scheme assumed the effective operation of existing commodity agreements.

11. Division of Ideas: Certain differences of opinion persisted after the end of the UNCTAD meeting, the main ones relating to the size of the Scheme. Some country representatives were still concerned that the \$300-\$400 million per year envisaged would not prove adequate. The Bank representatives had emphasized that the Scheme assumed the possibility of assistance through bi-lateral aid and IMF operations. The possible adequacy of the financing envisaged for the Scheme depended, among other things, on further discussions with international aid agencies. Other differences of opinion, related to the relationships between the Scheme and commodity agreements, and to the making of the export projections. It was interesting that these differences of opinions did not exist between developed and less developed countries, but rather that developed and less developed countries were represented in the different groups of thought.

12. Staff Requirements: The question was raised as to the adequacy of the Bank staff to undertake the work involved in judging performance e.g. the role played in consultative groups. Mr. Friedman felt that an increase in staff (of loan and project officers, as well as economists) would probably be necessary, although there was the question of how rapidly new staff could be assimilated. However, if additional staff were not recruited now, the Bank would not be equipped to take on more of such work, even in four to five years time.

C. F. Owen
Secretary

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

ECONOMIC COMMITTEE

EC/M/66 - 18

April 28, 1966

Supplementary Financial Measures

1. The Committee on Invisibles and Financing related to Trade (Trade and Development Board, U.N.C.T.A.D.) met in Geneva during April 13-20, 1966, to discuss the Bank's study on Supplementary Financial Measures.

2. Attached for your information are copies of the statement by Dr. Raul Prebisch at the plenary meeting of the Committee, and the Committee's joint draft resolution. These documents are distributed at Mr. Friedman's request.

C. F. Owen
Secretary

Attachments (2)

D I S T R I B U T I O N

Committee:

The Economic Adviser to the President, Chairman
Director, Economics Department
Director, Special Economic Studies
Director, EDI
Special Adviser to the President (Mr. Rist)
Senior Adviser, Economics Department
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United Nations Conference on Trade and Development

TRADE AND DEVELOPMENT BOARD
Committee on Invisibles and Financing
related to Trade
Resumed first session
Geneva, 13-20 April 1966

SUPPLEMENTARY FINANCIAL MEASURES

Brazil, India, Sweden, United Arab Republic, United Kingdom of Great Britain and Northern Ireland, Yugoslavia: joint draft resolution

The Committee on Invisibles and Financing Related to Trade:

TAKING NOTE of Recommendation A.IV.18 of the first UNCTAD and having regard to the discussions of the Committee during its resumed first session,

EXPRESSING its considerable appreciation for the study prepared by the staff of the IBRD, in response to the invitation of the first UNCTAD under Part A of that Recommendation,

NOTING that the existing international financial machinery does not include a mechanism designed to deal with problems arising from adverse movements in export proceeds which prove to be of such a nature or duration that they cannot adequately be dealt with by short-term balance of payments support, and to provide longer term assistance to developing countries which would help them to avoid disruption of their development programmes and that, accordingly, appropriate measures should be introduced,

Without prejudice to current and future work towards agreement on individual commodities in international trade and other practical measures to achieve a stabilization of commodity markets, including the process of organization of markets, expresses the hope that the relationship of any measures taken under the recommendation in question with this other work will be studied in the Committee on Commodities and in other competent organs of the UNCTAD;

TD.66-923

NOTING the considerable measure of support in the Committee for the concept of supplementary financial measures elaborated in the IBRD staff study;

AGREES that the scheme of supplementary financial measures set out in the study prepared by the staff of the International Bank for Reconstruction and Development in accordance with that Recommendation should be further studied and elaborated in the light of the discussions of this Committee, as a means of dealing with this question, and therefore

DECIDES for this purpose, subject to the approval of the Board, to establish under Rule 63 of the Rules of Procedure of the Committee a small group of representatives of governments, with the requisite expertise, consisting of 13 to 15 members, to study and report on this matter to the second session of the Committee, with the terms of reference set out in the annex to this resolution;

INVITES representatives of the staff of the IBRD and the IMF as well as representatives of such other bodies as the Group may consider appropriate to assist in the work of the intergovernmental group and in particular to prepare such factual material as may be required to enable the group to accomplish its task.

ANNEX

TERMS OF REFERENCE FOR INTERGOVERNMENTAL GROUP

1. The Group should examine the study presented to the Secretary-General by the staff of the IBRD, in the light of the discussion of it in the Committee. The Group should submit a report on the study (with such modifications to the Scheme as it may consider appropriate) as a means of achieving the objective set out in Part A of Recommendation A.IV.18 of the First Conference. Having regard to the timetable for the next Conference, the Group should endeavour to submit the report in good time for consideration by the Committee at its second session, in November 1966.

2. The Group should pay special attention to the following points:

(i) Questions affecting the scope of the Scheme, including the treatment of overages and the regard to be paid to import prices.

(ii) The form, terms and conditions for the provision of financial assistance to countries participating in the Scheme.

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

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

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

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

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

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

(ix) The status, membership and functions of the Agency and its relations with other international bodies, having regard to paragraphs 7 and 8 of Part A of Recommendation A.IV.18.

3. The Group may also put forward suggestions, for further consideration by governments, of ways in which the Scheme might be financed.

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United Nations Conference on Trade and Development

TRADE AND DEVELOPMENT BOARD
Committee on Invisibles and Financing related to Trade
Resumed first session
Geneva, 13-20 April 1966.

STATEMENT BY DR. RAUL PREBISCH
SECRETARY-GENERAL OF UNCTAD,
AT THE TWENTY-EIGHTH PLENARY MEETING OF THE COMMITTEE
ON 13 APRIL 1966

Mr. Chairman,

I thank you for giving me the floor to speak on the Study by the International Bank for Reconstruction and Development on Supplementary Financial Measures, the importance of which you have rightly stressed. This report, which the Committee is going to consider at its present meeting, is of great significance, not only because of the subject matter itself, but also because this is the first opportunity UNCTAD has had since the 1964 Conference of engaging in a discussion which will no doubt be very fruitful.

It will be recalled that, at the Geneva Conference the developing countries stressed the need for measures against the continual fluctuations in the external sector of their economy. It was in response to that concern that the United Kingdom and Swedish delegations submitted a draft resolution which led to the report we are now about to examine. The discussion therefore has a concrete proposal as its starting point.

It is a matter for satisfaction that UNCTAD is thus entering a new field of activity. It has been repeatedly stressed that UNCTAD should not be merely a forum for the discussion of problems, but also an adequate instrument for solving them in practice. Hence the great significance of this meeting of the Committee, which is called upon to study a programme and a practical solution presented to us with all the authority of the International Bank.

I should like to deal with three aspects of the report. First, an examination of the proposal itself. Second, its nature and characteristics. Third, the relationship between this scheme for supplementary financing and the basic financing of economic development plans.

On the first point, we should consider whether the idea of supplementary financing which emerged from the 1964 Conference provides the best means of counteracting the effects of fluctuations in the external sector of the developing countries. I have no hesitation in saying that it is an adequate solution and perfectly compatible with other methods of reducing the extent of these fluctuations. I refer, in particular, to the arrangements or agreements relating to primary commodities, in other words to the organization of markets. I do not believe that these agreements offer an alternative to supplementary financing, but merely another convergent means of solving the problem of external fluctuations. I say this for two reasons. First, because not all primary commodities can be the subject of stabilization agreements and secondly, because these agreements are not generally intended to establish a fixed price, but rather a maximum and minimum between which market prices can continue to fluctuate. This is true of the cocoa agreement which UNCTAD is now considering with, I am sure, very good prospects of overcoming the differences which still divide the countries interested in that commodity.

Accordingly, even where satisfactory commodity agreements are arrived at, there will still be a margin of fluctuation which will require supplementary financing to obviate the effects of such fluctuation on the economy of developing countries.

The Study submitted by the Bank has the unquestionable merit of frankly recognizing that it is very difficult, if not impossible, to formulate a systematic economic development policy and apply it in a development plan, if all the fundamental calculations for the plan are upset by external fluctuations. This constitutes a very positive contribution to the solution of one of the most serious problems facing the developing countries.

I should now like to examine briefly some of the main characteristics or modalities, of the Bank's study. It is essentially based on a projection of a country's exports. The idea that the projection of exports constitutes an essential element of any economic development plan is fully accepted, so that there is no need to discuss it, although, from the technical point of view, there may be differences of opinion regarding the methods used (or which should be used) in making the projections or the criterion on which this work should be based.

The Bank has used the projection method to determine the magnitude of the supplementary financing. At the same time, it has used it to introduce the closely related concept of exports which at a given moment are larger than those forecast in the projection. The Bank uses the term "overages" - i.e. excesses - to describe this and considers that the excess of exports over the projected figures must subsequently be taken into account in determining the amount of supplementary financing which a country should receive when there is a shortfall. This means that there would be some off-setting between a present deficit and a past surplus with respect to the projected figures. This point should be examined in detail. What will a country do when its exports exceed the projected figures? Will it accumulate additional monetary reserves if its reserves are already at a satisfactory level? Will it increase its reserves and await a fall in exports to bring them into play? Will it invest the reserves if they appear excessive in the light of the country's experience, or will it use them to import capital goods?

In the thirties, when I had played some part in my country's Central Bank, I had occasion to recommend an anti-cyclical policy based on the formation of additional monetary reserves during the upward phase of the cycle, when exports are increasing, so as to have resources available to face the downward phase. To this end, the Central Bank put notes or bonds on the market so as to withdraw the excess money created by abundant exports and at the same time accumulated reserves. Thus the anti-cyclical policy was combined with an anti-inflationary policy, by withdrawing excess purchasing power from the market.

A policy of that type was quite understandable at the time, for two main reasons. First, because we were then living under the tremendous impression created by the world depression, and considerations of stability prevailed over considerations of development in the central banks of the developing countries, the aim being to avoid any further serious contraction of the economy. Another basic consideration was that the world then had no international credit machinery to cover a deficit in the balance of payments, whether it was cyclical or not. Today, Mr. Chairman, I would not advocate a policy of that nature. I believe that now, when considerations of economic development prevail, reserves in excess of what prudence requires a central bank to maintain should be used to acquire capital goods. We should consider this point and explore the possibility that, in the event of a cyclical recession, the external resources thus used in boom periods can be recovered through the agency of international credit organizations. I would like to submit this idea for the consideration of Mr. Friedman and, of course, of the group of experts which will be set up to consider this problem if the suggestion made a moment ago by the Chairman is adopted by this Committee and by the Trade and Development Board.

A point of considerable interest with regard to supplementary financing is that it would be granted on terms similar to those of basic financing. On this point I should like to ask the distinguished representative of the Bank a few questions. If the basic financing of a plan has been granted on certain specific terms as to interest rates and duration, and a contraction of external origin then occurs which reduces a country's capacity for saving, will supplementary financing be granted on the same terms as the basic financing although the country's capacity for saving has altered? Or, will supplementary financing be adjusted to take account of the worsened conditions which have arisen for reasons beyond the country's control? Will it not be necessary in some cases to consider loans for longer periods or at lower rates of interest, so as not to place the country in difficulties with regard to the fulfilment of its obligations?

This whole concept is based on the need to face the consequences of an unexpected fall in exports. Projections are made on the basis of certain conditions, and when these conditions change supplementary financing comes into play. It is conceivable that, in certain specific cases, projections should be made bearing in mind a tendency for the terms of trade to deteriorate. It is not my intention to give, at this stage, any interpretation of the Bank's report or of the interesting paper recently read at Chatham House by Mr. Friedman; but I would like to ask this question: what would happen if a tendency for the terms of trade to deteriorate, which had not been observed at the time when a development plan was formulated, were to appear during its implementation? The Bank's study only mentions the case of a fall in exports, which may be due to a decrease in their physical volume or to a fall in prices and rightly offers supplementary financing as a means of dealing with the consequences. But I wonder what would happen if the fall in export prices were to coincide with a substantial increase in the price of imports, resulting in a decrease in the external purchasing power of a country. Could a country obtain supplementary financing in those circumstances? I take the liberty of putting these questions to Mr. Friedman, because I believe they will make it easier to understand the problem.

Lastly, without making an exhaustive analysis of the modalities of the scheme, I think it is important to examine the magnitude of the resources which the Bank recommends should be mobilized for supplementary financing. The study mentions an amount of $300 to $400 million a year, on the basis of previous experience and of a detailed analysis of export trends for a large group of countries. It also arrives at the conclusion that the average size of past fluctuations is about $1,600 million, and rightly maintains that part of this amount could be provided from monetary reserves, IMF drawings, other types of credit and, lastly, by restricting some imports. It is no doubt of the greatest importance to study this aspect of the question, but I believe that only when the scheme is put into operation will it be possible accurately to define the nature and magnitude of the resources that will have to be brought into play. I have the fullest confidence that the scheme is feasible and, what is more, that it can be effectively implemented. In this connexion, I should like merely to refer to import restrictions. In his recent work, Mr. Friedman speaks of the possibility of placing restrictions on certain superfluous or luxury imports. This is a point of great interest. Supplementary financing should be accompanied by a rational anti-cyclical policy to be pursued by the developing countries, which would use every means in their power to mitigate the consequences of external fluctuations and to avoid excessive indebtedness.

Everything possible must be done to ensure that international financial resources are used to cover the savings deficit or the difference between the investments a country wishes to make under its plan and the amount of internal resources it mobilizes. In any case, except in exceptional circumstances, these external resources must not be used to meet consumer needs, for sooner or later they will have to be repaid to the lending agencies; it is of the greatest importance that they should be used for investment, not for financing external payments deficits, although certain circumstances may make this inevitable. It is true that some countries have carried the policy of import substitutes to a point where no margin is left for restricting imports when an adverse movement of the cycle occurs. Other countries, however, still have a margin of imports which, although not necessarily luxury goods, could be reduced or deferred, because they are not indispensable for economic development. On the other hand, it would be difficult to curtail, for example, imports of semi-finished articles, essential consumer goods, or certain capital goods. Consideration should be given to this aspect, with a view to reducing the need for supplementary financing as much as possible. The criterion I am putting forward is not that of financial institutions, but the one which should guide the developing countries, because their investment needs are so great that it would be truly deplorable if resources of this kind were not used for investment.

The third aspect of the study to which I wish to refer is the connexion between supplementary financing and the basic or regular financing of a development plan. As I have said before, one of the main features of the Bank's proposals is the fact that the whole system is based on the idea of planning. We are well aware that the technique of good planning includes the projection not only of exports, but also of the internal savings which a country must mobilize to demonstrate its own effort under the development policy and also a projection of the external resources available for executing the plan. All these projections will, of course, be carefully scrutinized by the agencies concerned with the financing of a programme.

In addition to its technical character, this analysis has a very important implication. So far, save in a few exceptional cases, the policy has been to finance isolated projects without having any overall idea of the external contributions a country requires to carry out its plan. The fact that the projection of the external resources required for financing an economic development plan is accepted, means, if I am not mistaken, acceptance in principle of the idea that international lending agencies, when studying a plan as a whole, recognize the need to settle on a certain volume of external resources beforehand; in other words, while the essential idea of financing specific projects has not been abandoned, the need to decide beforehand the total amount of external aid which a programme or plan of five, six or seven years may require, now appears to be recognized. This seems to me to be of the greatest importance from the point of view not only of basic, but also of supplementary financing.

What does "supplementary" mean? It means that outside financial resources are added to those previously provided for under a plan. The determination of these basic resources is of special importance, since, if this fundamental principle is not accepted, supplementary financing may well be provided at the expense of the basic financing when, on the contrary, what is desired is the addition of supplementary to basic financing, in order to enable a country to carry on its development plan without any serious disruption. It is an accepted principle, which seems to me to be self-evident, that if a group of international institutions recognizes, in some form, the need to provide resources during the lifetime of a plan, it should make a thorough study of that plan, of its soundness as regards the objectives in view, of the resources required to carry it out and of its other characteristics.

I have previously referred to the need for a projection of the internal savings required for a plan. How far can the international lending agencies go in analysing purely domestic measures taken by a country? To what extent will countries submitting a plan be required to adopt a certain type of measure? These are matters which have long been under discussion.

Let us take the case of the mobilization of savings. It is obvious that in order to determine the amount of external resources, lending agencies must know the amount of internal resources, and the country in question must undertake to make its own efforts to obtain these resources. This is a matter entirely distinct from consideration of the domestic policy measures which a country will apply in order to fulfil its undertaking to mobilize its own savings.

Is a specific financial, credit, monetary or fiscal policy going to be demanded? Is it going to be decided how a country should manipulate its fiscal and monetary machinery in order to meet the savings projection, or is the country's undertaking to raise this predetermined amount sufficient? This is a matter of such importance that a dividing line must be drawn between the technical requirements of a plan and what may be called its political requirements. Since this is a point of the greatest importance and is essential in any development plan, I think that it will be discussed by this Committee not only from the point of view of supplementary financing proper, but also in a general context, since it relates to the whole concept of the financing of development plans.

I can give another example. A country may have special views on combining economic and social investments. There are countries which prefer to settle a pressing problem of low-cost housing before investing in directly productive projects. When considering a plan, should international credit institutions pass judgment on these aspects of it which concern a country's domestic policy? On the other hand, the difficulties encountered by a country in applying a particular policy within the framework of its conception of economic development can be assessed only in the light of the experience acquired by people of that country. All this suggests that a clear dividing line should be drawn between what should really be recognized as a fundamental requirement for the soundness of a plan and for its application - and no one could deny that the international credit institutions, must satisfy themselves that the plan is rational and feasible - and those other aspects which fall within a country's exclusive sovereign right of determination.

As I have said before, these matters have been widely discussed, and I might mention an experiment in that part of the world which I have so far known best, namely Latin America. When a few years ago, the Charter of Punta del Este was considered, from which the Alliance for Progress originated, a group of economists which had been consulted proposed that, without prejudice to the evaluation of economic development plans and their implementation by international credit institutions - which could not be deprived of the powers essential to them - plans should first be evaluated by a small group of impartial experts. The purpose was to ensure the greatest measure of objectivity in the analysis and at the same time to obtain impartial advice on certain fundamental aspects of economic development policy.

The idea was approved by the governments represented at Punta del Este, but not in the form in which it had been submitted: on the one hand, the number of experts was increased, but, on the other hand, the group was decapitated, in that it was deprived of a chairman. All this contributed to the failure to carry out this excellent project in the form in which it had originally been proposed by those who had conceived it.

A few days ago, at another inter-American meeting held at Buenos Aires, the idea was modified. The experts were reduced in number, and instead of acting as an independent group, they are to advise the Chairman of the inter-American Committee of the Alliance for Progress, an officer whose important duties include making recommendations on the allocation of the financial resources which the United States Government places at the disposal of Latin American countries. It is to be hoped that after this change the experts will continue to have a large measure of independence in evaluating plans and advising governments and credit agencies; this will make it possible for the experiment, which was begun a few years ago, to be refined, and for the group of experts to be very useful.

The initial proposal not only laid it down as an essential condition of external financing that a plan should exist, but also required that the plan should be submitted to the experts. These two conditions were abandoned at the time, possibly because the idea was very new, but perhaps experience shows that it would be advisable to reconsider them. I have ventured to recall this matter, because certain apprehensions I have noticed among some delegations of developing countries in this matter might perhaps be dispelled if it were considered desirable to set up machinery of that kind.

At any rate, the fact that a country reserves to itself certain domestic policy decisions which are its own inherent and inalienable prerogative, does not mean that it is not to that country's advantage, as experience shows, to receive technical assistance - which may be multilateral or bilateral according to choice - for the purpose of determining what kind of measures should be applied.

It will also be remembered that the regional economic commissions of the United Nations in the developing areas have established planning agencies capable of training staff and providing technical assistance to countries applying for it, with a view to advising them on programming. The International Bank, too, has an institute qualified to deal with these matters. But let me stress that this is technical, and in no case political assistance. The former is what the developing countries need; the latter is something that concerns them alone.

This Committee is meeting for only a very few days, and it cannot possibly consider all the important aspects of the Bank's report. You yourself, Mr. Chairman, in suggesting that an inter-governmental committee should be set up, have recognized the importance of the idea. I hope that the Committee on Financing and, thereafter, the Board, will approve the suggestion. However, it would also be valuable for this Committee to support, in a positive manner, the idea of supplementary financing as such, because the task of the experts would be considerably facilitated if the acceptance of the idea itself were to be taken as a starting point, which would not mean accepting all the details of the proposal. The experts would then not need to spend any time discussing whether supplementary financing is desirable or not. We all know that discussions involving decisions of that kind are always difficult. I think that this task would be made much easier if it were recognized that the Bank's report solves, in principle, the serious problem which the 1964 Conference laid before governments and which the delegations of the United Kingdom and Sweden took up. I believe, Mr. Chairman, that this would be one of the most important contributions the Committee could make, and it would define the scope of the study to be undertaken by the group of government experts, if the idea of setting up such a group is accepted.

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INTERNATIONAL DEVELOPMENT ASSOCIATION

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ECONOMIC COMMITTEE

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February 9, 1966

IBRD Study on Supplementary Financial Measures

Attached for your information is a copy of Mr. Friedman's remarks, on the Bank study on Supplementary Financial Measures, which were made to the U.N. Trade and Development Board in New York on February 7.

C. F. Owen
Secretary

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IBRD Study on Supplementary Financial Measures

Remarks by

Irving S. Friedman

at

U.N. Trade and Development Board

New York

February 7, 1966

Bank Study on Supplementary Financial Measures

Mr. President and Members of the Board:

I have been invited to come and present some thoughts on the Study prepared by the Bank staff on Supplementary Financial Measures. May I begin by expressing my appreciation for having been given this opportunity to explain further the Study and the proposed scheme to which a number of us have devoted considerable time and effort. My role in the World Bank is that of an economist and advisor on economic and financial policies. It is in that capacity that I would like to share some thoughts with you.

The Bank Study was done in response to the request from the U.N. Conference on Trade and Development and we have looked to the resolution requesting the Study for our basic terms of reference. I shall not burden you now with a detailed exposition of the scheme or the Study, for they were submitted last December 6 to the Secretary-General of the United Nations by Mr. George D. Woods, President of the World Bank. Rather, I should like to direct my remarks to some of the broader questions which in my judgment lend particular relevance to the Study in the context of the development task as a whole. From many points of view our Study and its proposals are an outgrowth of the regular work and experience of the Bank which cover all aspects of the development process. We are dealing here with a major, but only one aspect of the overwhelmingly important problem of development. The fact that we are dealing with only one slice of the whole pie doesn't make it less important; great and complicated problems are often best solved piecemeal. Moreover, concentrating on a segment may throw new light on the whole and suggest new approaches and solutions to the over-all problems especially when this particular slice of the pie performs a unique function in relation to the whole. However, we cannot forget that the central preoccupation is with the entire development process as such and a proposal on a segment must fit in with a rational approach to the over-all problem.

The world clearly recognizes the importance of development, as is evidenced most immediately by the presence of you gentlemen here on the U.N. Trade and Development Board. There are many great issues involved in this field of development and many relatively unknown areas which need further exploration and enlightenment. Indeed, it is difficult to talk or consider one aspect of this problem without keeping in mind the thinking and suggestions which are being made on other aspects. However complicated the discussions and however varied the suggestions, there is a common thread that weaves through all -- what can be done to deal with the baffling problem of development in a more effective way than hitherto.

In presenting the Study we were well aware of the discussions in other related fields. Indeed, as you know, the Bank itself has been engaged in inquiring further into many different aspects of the problem of development and its financing. However, in our Study, now before you, we did try to address ourselves to the specific problem which had been given to us and, with your permission I will confine my remarks to it, hopefully, without losing sight of the broader framework of the entire problem of development.

For nearly two decades the poorer countries of the world have been urged to approach their task of development in a rational and determined way. We have come to use the words "planning" or "programming" to cover this rational and determined way even though they include many different kinds of economies and economic policies with great differences in the role of governments in the economic life of the nation. For many, acceptance of the role of planning or programming was slow and difficult. Paper plans could quickly be drawn up; but, as a rational and continuous mechanism for managing an economy in order to reach certain stated goals, the process of planning has proved a tough and demanding discipline.

It has required vision, resolution, sacrifice and resistance to internal political and social pressures.

As the discussions at UNCTAD vividly demonstrated, however, no effort on the part of developing countries, however wise and steadfast, could by itself assure the success of their efforts. We all have seen how vulnerable a development program can be to unpredictable changes in the external environment beyond the control of the poorer countries themselves.

It was hardly surprising, therefore, that the disruption of development programs resulting from unpredictable adverse movements in the export receipts of developing countries -- movements which are either too prolonged or too drastic to be dealt with by available short-term balance of payments support -- should have been a matter of urgent concern two years ago in Geneva. The problem has been a persistent, nagging cause of perplexity for nearly two decades, as the world community has groped its way toward the slow perfection of development finance machinery. We have all been aware that the developing countries, and most especially the large majority whose earnings of foreign exchange come almost entirely from the export of agricultural commodities, are highly vulnerable to unforeseen declines in commodity prices and that their ability to finance development is sharply limited by the sluggishness which typifies the growth of demand for such products. This dual problem has been with us for decades constantly. At different times and in different ways, efforts have been made to cope with various aspects of it, but the problem remained and the UNCTAD responded in the resolutions well known to you.

To the leaders of many less developed countries, the problem appears to be a vicious circle. To escape from reliance upon highly volatile prices of one or a few commodities, they must look to the diversification of production and exports. This, like all early development, depends on the execution of an investment program for infrastructure and productive facilities which requires a wide range of goods and services that must be imported and paid for in foreign exchange. As the program gathers momentum, it speeds the pace of urbanization, creates the need for more capital goods and creates new consumer demands which must be met, at least in part, for they represent the newly aroused hopes of the people and are in themselves an important ingredient in the dynamics of development. But this need for more goods cannot -- and I believe should not -- be wholly satisfied through domestic production and therefore raises still further the requirement for imports. Thus the need for a constantly increasing and reasonably reliable supply of foreign exchange is frequently experienced. Less developed countries, however, are usually not greatly endowed with foreign assets or reserves upon which they can draw for such purposes. In any case, such resources are depleted in rather a short time since the external position of such countries does not usually produce enduring surpluses necessary to replenish such resources. If their programs and policies appear to be sound and prospects seem favorable, a certain amount of foreign exchange can usually be obtained in the form of official assistance and private investment from abroad. In the best of circumstances, however, by far the greater share must come from their own export earnings; in 1962, for example, which was a year of relatively low commodity prices, export receipts of the developing countries were still more than three and a half times the net inflow of official aid and private investment. So their major reliance for obtaining the needed foreign exchange must be on sales in foreign markets.

The advantages of markets are well known, but they do involve uncertainty in prices and volume of trade. For all countries these uncertainties are welcome only when there are unexpected gains, but for the poorer countries, however sensible their domestic policies might be, the unexpected declines may mean widespread hardship and setbacks, if not catastrophies.

The problem arises immediately from the unexpected decline in export earnings, but more profoundly, the problem arises because of economic development and the consequences of poverty. When countries are able to save enough foreign exchange to meet major unexpected setbacks, schemes like the one prepared by the World Bank will no longer be necessary. Unfortunately, these conditions for many countries can be achieved only in the distant future. At present, the alternatives are basically to rely upon the countries experiencing the unexpected export shortfalls to absorb most, if not all of the impact, irrespective of the retarding effect on the development process, or to provide from abroad some form of additional foreign exchange in sufficient time to substitute in whole or in part for the foreign exchange not earned because of the unexpected decline. Our proposal is to provide enough substitute foreign exchange from external sources to enable a good and previously agreed development program to be carried on without disruption, as long as the country in difficulty is following economic policies which are objectively regarded as appropriate by the international community.

Thus we were not concerned in our Study with the effect of predictable declines in export earnings, whether they result from temporary and reversible causes or from long-term shifts in the trend of demand or supply. Our assignment was to study the problem of disruption of development programs caused by unpredictable shortfalls from reasonable expectations of export earnings. Our findings after much new research and enquiry, led us to the conclusion that the problem is both real and important. To help reach a conclusion on this critical question, we drew on the rich experience of the World Bank. We did not proceed to consider how the problem might be met until the facts convinced us that there was a major problem.

When prices fall abruptly and sharply, or when they continue to decline over a long period, and if these setbacks are not foreseen and taken into account when the country plans its investment program, the results are likely to be serious for development. Ironically, they can be most serious for those very countries which have been conscientious in planning and effective in executing their development programs. An effective development program is relatively complex and its various segments are intimately interrelated. For many countries, the development program cannot leave margins of safety reflected in policies designed to accumulate and retain foreign exchange over a considerable number of years or the acceptance of deliberate unemployment or underemployment of domestic resources which may enable the country to increase quickly domestic output for export or for domestic consumption when export earnings fall unexpectedly. Sensible development programs avoid the dangers of inflation and economic strains on domestic resources and the balance of payments, but, within these limits they try to bring about the best and full use of available resources in the private and public sectors. The keystone almost invariably must be an estimate of export earnings, since as noted before, they are the major source of foreign exchange upon which the whole structure of investment frequently depends. Once a program has been designed around such a forecast and set in motion, an unexpected shortfall that cannot be offset in time can have far reaching consequences, upsetting the pattern of investment and limiting the effective use of all remaining resources, both external and domestic. In such circumstances, the government may be forced to adopt restrictive measures which further choke off the breath of development, resulting not only in retarding the rate of growth, but also in introducing uneconomic distortions and inefficiencies into the economy which may burden growth for many years, with such undesirable by-products as chronic reliance on high levels of protection or continuous need for large scale governmental subsidization.

Consequently, the disruptive effects of such events are far broader and more pervasive than the country's economic progress; it encompasses the entire society and their repercussions are felt throughout the social structure of a country. If not dealt with successfully, they produce broadening waves of disillusionment which may discredit the development program and its advocates, and may well affect the action of other developing countries.

The scheme devised by the World Bank staff to deal with the problem depends for success upon a range and degree of international cooperation which, if forthcoming, would have beneficial consequences far beyond the limits of the problem itself. The basic criteria underlying our proposal can be stated briefly: (1) Shortfalls in export earnings must be measured against objective estimates; (2) They must be of a nature or duration which could not adequately be dealt with by available short-term balance of payments support; (3) They must result from causes beyond the control of the affected country; (4) External assistance cannot be expected unless there is certainty that it is needed for development and will be used for that purpose, and therefore such assistance will require some form of administration; (5) The administering agency will be international because of the role which the agency is expected to play vis-a-vis the donor and the recipient countries; (6) Before turning to the administering agency for relief, the country must make whatever adjustments it can to offset the shortfall without disrupting its development program, and it must make all reasonable use of other available sources of finance, including any earnings which it may have had previously during the projection period in excess of the agreed export projection--what we call "overages"; (7) When a shortfall occurs which cannot be offset by other means, assistance must be timely and certain; (8) Any scheme must reconcile effectively the need for administration with the need for timeliness and certainty when the difficulties arise; (9) The terms and conditions of assistance should be similar to that on which the country receives normal development finance.

To meet these criteria our scheme requires that the steps necessary to make the scheme effective for each country must be worked out and agreed upon in advance. This is a process that would require the closest working relationship between the administering agency and the individual country. It would also depend upon close and continuing cooperation between the agency and other international financial institutions involved -- the World Bank, the IMF and the many other national and international agencies that are concerned with the provision of technical assistance and financial aid to the less developed countries.

The scope of such cooperation is suggested by the various elements in the agency-country understanding, which is the heart of the scheme we propose. The first requirement would be a mutually agreed projection of "reasonable expectations" of export earnings over a period of years, normally corresponding to the time horizons of the country's development program which is usually about five years. This projection would be arrived at in the context of an understanding on the program as a whole and would be subject to revision only as part of a general reshaping of the program. World Bank experience indicates that such projections are practical and feasible; we are doing it now.

The country and the agency would have to agree upon a set of basic development policies to be pursued by the country during the period covered by the projection of export earnings -- a "policy package", as we have called it in our Study. It would cover what we have called the "projection period", which is similar to what in many countries would be called the "plan period". This would include a financing plan and a projection of the balance of payments. The financing plan would cover investment in the public sector and the best estimates possible of private investment, stating the levels of anticipated investments in principal areas and estimates of domestic and external sources of financing. The balance of payments projection would include estimates of the principal components of exports, imports, use of reserves and the various categories of external financing. The financing plan and balance of payments projection would "quantify" the underlying policy understandings and would be essential in assessing performance under the scheme. Again, experience indicates that this is practical and feasible.

In working out such a policy package, full collaboration would be required with existing international financial agencies, so that the financing plan would be consistent with financial policy targets and criteria agreed upon between the country and the international financing agencies. The need for such collaboration would continue throughout the course of the agreement, for both the projection of export earnings and the policy package would be subject to regular review and, if necessary, to revision.

The agency and the country would also have to agree upon steps to be taken by the government in order to adjust to a possible shortfall in its export earnings without disrupting its development program. First, any excess of export earnings above the agreed projection experienced earlier in the projection period would be applied against the shortfall. Further steps might include appropriate use of the country's own reserves and resort to the IMF if deemed appropriate by the country and the IMF.

In addition, the agency would survey and keep under review with the government of the country and with other agencies the possibilities of using other sources of funds for offsetting shortfalls if they occurred. A number of these possibilities are mentioned in our Study. Others might appear if effective use of such emergency assistance were assured. After taking into account such other sources of assistance, the scheme would provide with certainty and in time additional foreign exchange needed to carry on the agreed development plan and policies. This is new, but it is based on related experience and we think it is practical and feasible.

As far as the developing countries themselves are concerned, the level of cooperation with the agency which would be required to assure entitlement to benefits under the scheme would constitute an innovation only in degree. Many developing countries are practicing the kind of cooperation required to reach and maintain such understandings. This is a part of their regular relationships with a number of worldwide and regional international agencies. However, I realize that the scheme would impose upon them a heavier burden of accountability for performance than many have been accustomed to in the past. I see no way out of this if the assistance provided by the scheme is to be made available with certainty and in time, and still fulfill the objective of ensuring that the resources of the scheme will be used to maintain a development program deemed worthy of support by the international community.

While we are concentrating our attention this afternoon on the proposal on supplementary finance, I must reiterate that we cannot forget the obvious fact that it deals with only part of the development problem, whether seen from the viewpoint of the developing country or from the viewpoint of the donor or creditor countries. In designing our scheme, we have tried to make it fit into the larger whole. Thus, much of what is done for the implementation of the scheme such as the so-called policy package and export projections may well become part of the broader process of providing development finance. There are already many instances of this. If so, the inclusion of such provisions in a scheme for providing supplementary finance to deal with unexpected export shortfalls, will not add responsibilities in the field of performance, but rather help ensure that these responsibilities were not assumed in vain because of failure to deal with the unexpected.

I believe that the scheme would provide both an incentive and a focus for international cooperation on a new and more fruitful scale. Since the scheme would provide international assurance of performance on the part of developing countries prepared to meet its criteria, it should allay fears that funds provided for assistance will be dissipated because of poor performance. To that extent, it should improve the international atmosphere in which the problems of development are approached. Since the development programs of participating members and the policies for their execution would be the subject of agreement with the agency, the scheme would provide a framework within which the international community could more readily judge the requirements for external assistance of all types. This would be of immediate interest to many agencies, such as the World Bank, that are concerned with the complex problems of providing or coordinating development aid. For example, the scheme's requirement for an objective estimate of export earnings would be of vital concern to all countries and agencies that are involved in providing assistance; indeed, it is important for the operations of the scheme that this export projection would be used not only to help determine the amount of possible assistance under the scheme but also the amount of normal development finance required by the country. Since the scheme requires a continuing review of the participating member's program, policies and prospects in collaboration with other agencies, it will help provide a reliable basis for the regular review of requirements for assistance.

There is no doubt that countries which fail to give a high priority to development in their public policies and actions, may not qualify for assistance under the scheme. This is deliberate, for the objective of the scheme is to assist the development process.

The basic approach is international, not unilateral. The techniques suggested are based on actual experience all over the world. The scheme does not set up theoretical or absolute standards. It deals with each country separately within a general approach. It leaves much for the administering agency. However, the general instructions to the agency are meant to be clear -- your (meaning the agency's) job is to prevent the disruption of development due to these special circumstances by being prepared to provide timely financial assistance as the lender of last resort, and to organize its relations with countries in such fashion as to ensure that the assistance will be used effectively to carry on the agreed development program or policies. We are not trying to avoid the inevitable adjustments to changing export conditions, but to ensure that the process of adjustment enables countries devoted to development to carry on this vital work.

I have not yet spoken of how much the scheme would cost. Our Study tries to make clear how we came to the estimate of a need of an additional $300 to $400 million per year, on the assumption that it would be supplementary to and not a substitute for already existing forms of aid. These estimates, as other similar estimates made by our staff, are made without any effort to inject political judgments as to the readiness of the international community to contribute the necessary funds. They are based on the best available experience and facts.

If the scheme suggested in our Study achieves international acceptance, the next step will be to consider in detail ways and means of providing the necessary financing and, more precisely, how such a scheme should be administered.

I hope that my brief remarks today will help in your further deliberations on our Study and the scheme proposed therein. I hope I have succeeded in avoiding either the role of the teacher or the advocate. For me to try to lecture you in development would be egotistical and pompous; for me to try to persuade you of one approach to a highly complicated and troublesome problem would be presumptuous and unfitting. We have done our best in our Study to tell you how we analyzed the problem, what facts we used, how we weighed the facts, what assumptions we made, and how we derived our conclusions.

The document, I am afraid, is lengthy and, at times, rather technical in language and exposition. As for the length, I can only say that our first drafts ran into many hundreds of pages and the final version is relatively brief. Already fellow economists are eager to learn more. (We know that nothing will really satisfy their hunger, for they all (including myself) live by the French proverb -- "L'appétit vient en mangeant".) As for the technical parts, they are given in the hope that they will help in achieving an objective, dispassionate and careful consideration of the major problem which is the subject of our Study.

Believing, as I do, in first things first, I hope that the world will first decide whether they agree with our diagnosis that there is a problem and what its magnitude is, and whether the Bank scheme makes sense technically and economically as an attack on this problem. We have made our small contribution; the next step -- the big one -- is yours to make.

Thank you.