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INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

WASHINGTON, D. C. 20433 U.S.A.

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MAY 22 2013

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April 28, 1970

OFFICE OF THE PRESIDENT

*Will include in the
annual report forecast
of world market prices*

Will start with:

- 1. Policy statement of our committee in regard of command for which there may be supplies*
- 2. Comparison of
costs of production
by command by nation*

MEMORANDUM TO THE EXECUTIVE DIRECTORS

**Subject: Pearson Commission Recommendation No. 1 Concerning Impact of
New Productive Capacity on World Market Prices**

3. Study of

Recommendation

"... international agencies such as the World Bank should take into account in considering loans for agricultural projects not only the rates of return in the borrowing country, but also the impact of new production capacity on world market prices."^{1/}

Background

This recommendation appears in the context of the Commission's discussion of trade policy for primary products, particularly long-gestation crops such as coffee, cocoa and tea. The Commission comments, with respect to these commodities, that (a) demand and marketable supply are unresponsive to price changes in the short run; (b) production is subject to wide fluctuations; and (c) there have been both short-run price instability and serious price declines over the past 15 years. The Commission attributes these developments to high plantings during times of favorable prices and to the failure of producing countries as a whole to take into account the impact of their production plans on future prices.

The Commission felt that stable and remunerative prices for these commodities could be assured only by coordination of the production plans of all producing countries to bring supply into balance with demand. For this purpose, it recommended international schemes for individual commodities which would include: (a) provision for gradual expansion of the shares of new and efficient producers; (b) national production controls, preferably through imposition of special taxes; and (c) generous assistance for diversification programs. The Commission pointed out that for some commodities such planning is already in sight, but that it would be very difficult to achieve agreement on a global production plan for others. Nonetheless, it believed that both coordination of production and marketing and "associated measures" were necessary. It did not specify what the associated measures might be, beyond the action suggested for international agencies in the recommendation which is the subject of this memorandum.

^{1/} Report, page 83.

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Analysis

When the Bank calculates the rate of return on a commodity-producing project, it takes into account the estimated impact on world market prices of planned new production, including the production which it contemplates financing. The price forecasts used in this calculation reflect judgments about the response of production to price changes in countries other than the one in which the particular project is located.

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However, I believe that the Bank is likely to be financing commodity-producing projects on a scale that makes it desirable, as the Commission implies, for us to take a somewhat more sophisticated approach to the cost-benefit calculation applied to such projects. Normally we consider the implications of a prospective decline in the price of a commodity for the export earnings and national income only of the borrowing country, but not of other countries that produce and export the commodity. If, in the light of our best estimate of future price trends, a project in country A promises to yield a satisfactory rate of return, we have generally concluded that the project could appropriately be financed by the Bank Group. The only significant exception to this practice has been that, if an appropriate international commodity agreement exists, we will not finance a project that would lead to production for export of amounts of the commodity in excess of the agreed quota for the country in question.

Up to now, Bank Group financing of commodity-producing projects has probably not been extensive enough to make a perceptible impact on world prices.^{1/} In view of the growth of Bank operations likely to affect commodity production, however, I believe that we should attempt, at least as an experiment, to produce somewhat broader assessments of probable future developments affecting key commodities, as a basis for deciding whether we should or should not finance particular commodity-producing projects. Demonstration that a project in country A, in the light of the best price forecast we can obtain, will yield a satisfactory rate of return to country A would still be an essential pre-condition for Bank Group financing of the project. But it is at least conceivable that a series of projects meeting this criterion in countries A, B, C and D would have measurable and serious adverse effects in other member countries with important stakes in the commodity in question. It is certainly not possible to devise an error-proof procedure for deciding whether potential gains in one country are equivalent to, greater than, or less than potential losses to another country or

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^{1/} It should be noted, in this connection, that there is an inevitable margin of error in all price forecasts. Small changes in the output of a commodity cannot with any great confidence be credited with measurable price effects, as distinct from price changes consistent with the normal errors in price forecasts.

countries. The time scale within which evaluations are made, the difficulty of evaluating a monetary loss in a country with a very low per capita GNP as against a monetary gain in a country with a significantly higher per capita GNP or vice versa, and other technical problems mean that we shall frequently have to make judgments in cases in which none of the alternatives is unequivocally best.

Nevertheless, I believe that, in view of the number of commodity-producing projects likely to come before us, we cannot escape the responsibility for making judgments in such cases, and that we should therefore institute studies to provide us with a better foundation than we now have for making decisions on these projects. The studies I have in mind would have three stages:

(a) The first stage would be an analysis of the most likely developments in demand, production and prices for the commodity in the absence of any new action by the Bank, and assuming no new commodity agreements and no changes in the trade, tax or subsidy policies of developed countries that would significantly affect the commodity. Particular attention would be given to the projection of production, generally the weakest element in commodity forecasts. This would require a review of production policies and investment plans, and an analysis of the response of production to prices. This step would call for an expansion and regularization of work on commodity projections already being carried out by Bank staff. In this work our staff does not start from scratch. Indeed, we draw as fully as possible on the commodity studies made by other organizations, notably the FAO and UNCTAD, and the forecasts of production, consumption, prices and exports that emerge from the periodic reviews made by the various commodity study groups and international commodity organizations, such as the International Coffee Organization, the Tin Council and the Sugar Council.

(b) The second stage would be to examine how these "most likely" developments could be affected by possible changes in any of the assumed conditions, particularly by changes in the Bank's plans for investments in commodity-producing projects. Simulation techniques can be very helpful at this stage. One object of this stage of the analysis would be to try to account for the effects of a given change in production of a commodity not only on the country in which the change takes place but on other producing countries.

(c) The third stage would be to attempt, in the light of the analytical work of stage two, to reach whatever findings prove possible as guidance for future Bank operations affecting the commodity, and as a foundation for such advice on investments in the production of the commodity as the Bank may be asked to give to member governments.

There may be cases in which the studies could provide clear guidance. In many, perhaps most, cases the conclusions of such studies would not be unequivocal, but even in those cases the studies would give us a better basis than we now have for making the judgments which have to be made implicitly in any case each time we pass on a commodity-producing project.

Conclusion

The Bank's present policies with respect to loans for agricultural projects and assistance to diversification programs go far to meet the Commission's recommendation, but I believe that we should try to go farther. I propose that, to assist us both in considering Bank financing and in formulating policy advice, we carry out, on an experimental basis, appropriate studies, along the lines outlined in this memorandum, for certain commodities that are of major importance to our developing member countries.

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Robert S. Mc Namara

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July 31, 1970
R70-156

MEMORANDUM TO THE EXECUTIVE DIRECTORS

Subject: Pearson Commission Recommendation No. 2 Concerning Supplementary Finance

Recommendation

"Discussions should be expedited leading to a program of supplementary finance to deal with problems caused by unexpected and sustained short-falls in the export earnings of developing countries."^{1/}

Comment

The Executive Directors will recall that, in 1964, "UNCTAD I" asked the Bank to study the feasibility of a scheme for supplementary financial measures, and that a Bank staff study was transmitted to the Secretary-General of the United Nations in December 1965. The scheme set forth in the study was explicitly predicated on the assumption that it would be supplementary to and not a substitute for existing forms of aid.

The study was considered by UNCTAD's continuing organ, the Trade and Development Board (TDB), and also by an Inter-Governmental Group on Supplementary Financing. Thereafter, in September 1969, the TDB invited the Bank to consider working out new arrangements for supplementary finance and, if appropriate, to consider introducing them. The TDB resolution asks the Bank to consider such arrangements on the basis of the conclusions of the Inter-Governmental Group and of the views expressed in the TDB. It directs the Bank's attention particularly to the conclusion of the Inter-Governmental Group that "It is the general consensus of the Group that it would be of little value merely to divert available resources from basic development finance for the purposes of supplementary financing."^{2/}

^{1/} Report, page 97.

^{2/} The TDB resolution and the conclusions of the Inter-Governmental Group, together with information on the voting record in the TDB, were distributed to the Executive Directors under Documents SecM69-442, dated September 17, 1969, and SecM69-442/1, dated September 22, 1969.

As the Executive Directors know, agreement has just been reached on the amount of new resources which the Part I countries intend, subject to legislative action, to contribute to the Third Replenishment of IDA. I have inquired whether these countries are prepared to consider contributing additional funds to IDA for the purposes of a scheme of supplementary finance. The responses to these inquiries indicate that there would, at best, be very limited support among the governments of Part I countries for making any such additional contribution to IDA for the purposes of supplementary finance, at least during the period of the Third Replenishment, although a few of those governments would not wish to rule out the possibility of using a part of the replenishment funds (and perhaps some Bank resources as well) for supplementary financing purposes.

In view of the responses of the Part I countries and the fact that additionality has consistently been an integral element of the supplementary finance concept, I have concluded that consideration of a scheme for supplementary financial measures should, for the time being, be put aside. However, if it should appear that, for a given country at a given time, an unexpected shortfall in export earnings has disrupted the country's investment program, I do not think we should regard ourselves as precluded from considering that case on its merits. Unless the Executive Directors are of a different view, I intend to report these conclusions to the next meeting of the TDB, in August.

Robert S. Mc Namara





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1. Only for tea is there an inter-agree. provided for a buffer stock
2. Only for coffee in addition is there an inter agree. such is satisfactory as a foundation for a buffer stock - members inter agree to not use a buffer stock because of various reasons for some of them

CONFIDENTIAL

April 28, 1970

MEMORANDUM TO THE EXECUTIVE DIRECTORS

3. Cocoa + rubber are only covered for which inter agree sets for buffer stocks in support of buffer stocks

Subject: Pearson Commission Recommendation No. 3 Concerning Financing of Buffer Stocks

Recommendation

"Financing of reasonable buffer stocks in support of well-conceived commodity agreements and policies should be recognized as a legitimate object of foreign aid."^{1/}

Background

This recommendation is one of several directed to improving the trading position of countries heavily dependent on production and export of agricultural commodities, tree crops, and raw materials. The Commission was chiefly concerned with the removal of obstacles which face producers of these commodities in the developing countries when they seek to increase exports to the developed countries. It found that in recent years progress had been made towards a solution of commodity problems, noting particularly the international agreements on coffee, wheat, tin, olive oil and sugar, as well as the continuing negotiations on marketing arrangements for cocoa, tea, bananas, and fats and oils. But the Commission concluded that "lack of funds to finance buffer stocks and facilitate diversification programs continues to impede progress in this area" and that easing "financial constraints" would help to promote sound commodity arrangements.^{2/} Then followed the recommendation quoted above.^{3/}

^{1/} Report, page 97.

^{2/} Report, page 85.

^{3/} In the same section of the report the Commission recommended that discussions leading to a new program of supplementary finance to assist countries experiencing unexpected short-falls in export earnings should be expedited. This recommendation is being treated separately.

Analysis

I. Nature of the Commodity Problem

There are two related but separate aspects to the commodity problem: adverse long-term trends in prices and export earnings, and wide short-term swings in these same variables.

Although reference is frequently made to the "commodity problem" in general, not all primary commodities produced and exported by the developing countries can be placed in the problem category. The commodities which pose the greatest difficulties are for the most part agricultural, and are characterized by sluggish growth in export markets as well as by short-term price instability. The basic reason for price fluctuations lies in the interaction between, on the one hand, an inelastic demand with respect to price and, on the other, unplanned changes in supply due to natural causes, such as weather and pests. This interaction induces wide fluctuations in prices in a direction inverse to changes in production. Shifts in demand in the industrialized countries can also trigger market fluctuations, but for many agricultural commodities, in contrast to metals, these are generally of lesser importance. Even for metals, demand-induced instability is less severe than it was prior to World War II, because the degree of business fluctuations in the industrialized countries has been substantially moderated.

The slow growth in world demand is chiefly responsible for adverse longer-term trends in a number of primary commodities. A variety of forces underlies the sluggish growth in demand. Some of the most difficult cases - rubber, cotton, jute and abaca - are affected by competition from synthetics. Ignoring for the moment the interconnections between short-term instability and longer-term trends, it is fair to say that adverse longer-term trends present by far the more important problem. For those countries fortunate enough to be exporting commodities for which recent and prospective trends in prices and/or earnings are favorable, such as petroleum and most of the metals, the fact that the prices of some of these commodities are subject to wide short-term fluctuations is of secondary consideration. Similarly, those countries whose exports are concentrated in commodities with adverse long-term trends in prices and earnings are more concerned that their earnings are growing at an unsatisfactory rate than that the level fluctuates widely from year to year.^{1/}

^{1/} As pointed out in a report to the First U.N. Conference on Trade and Development, the principal concern of exporters "has been with the prospects for their total export proceeds (depending on volume as well as price) and with the average level of export proceeds over a number of years, measured in terms of import purchasing power, not merely with short-term fluctuations in money terms." Gerda Blau, "International Commodity Arrangements and Policies," Proceedings of First UNCTAD, Vol. III, page 142 (1964).

It is true that highly unstable prices may accentuate adverse longer-term trends in commodity markets. Price instability may depress the demand for natural products if close synthetic substitutes with more stable and predictable price behavior are available. Temporary high prices reflecting supply shortages due to natural phenomena, such as drought or pests, may induce uneconomic investment in new productive capacity for commodities with a long gestation period (e.g., coffee, cocoa). When the new production ultimately comes onto the market, it accentuates the underlying adverse longer-term trend. It is generally agreed, however, that short-term instability only contributes to the major problem of long-term adverse trends, and that, to handle the latter, the forces determining the trends must be dealt with more directly.

II. Role of Commodity Agreements and Buffer Stocks

Commodity agreements can be useful in connection with both short-term price stabilization and longer-term price trend objectives.

There has long been general support, in principle, for the price stabilization aspects of commodity arrangements. Excessive price fluctuations serve no economic purpose and sometimes even impart the wrong economic signals, as when temporary high prices stimulate excessive investment in new production. Moreover, both importing and exporting countries have an interest in lopping off the peaks and troughs in prices. No transfer of real income from one group to the other over the long term is involved in price stabilization arrangements. Yet, partly because, as noted above, short-term price fluctuations are not a matter of primary concern to exporting countries and partly because, as it appears, "neither exporters nor importers were prepared to pay a substantial premium for this kind of insurance,"^{1/} there has been only limited success in negotiating price stabilization agreements, notwithstanding the general support for their objectives. mgf

There is much greater divergence of view with respect to the desirability of seeking, through commodity arrangements, to alter the long-term trend of commodity prices. An adverse long-term trend reflects oversupply in relation to demand; to change the trend therefore requires controlling the supplies offered on the world market. Arrangements for such controls are designed to alter the terms of trade in favor of the producing countries over an extended period of time, and thereby to accomplish, through higher market prices, a real transfer of resources from the consuming (developed) countries to the exporting (developing) countries. The fact that the interests of the developed and developing countries in this objective of commodity agreements are divergent is a primary reason why such agreements have been so difficult to negotiate.

The role of international buffer stocks in commodity agreements is a limited one. Buffer stocks are a useful device for moderating short-term

^{1/} Ibid.

price fluctuations. But for improving the longer-term price prospects for a commodity through control of supplies on the world market, export quotas and diversification programs are the principal instruments. In fact, an international buffer stock without export quotas would be a risky proposition: if unlimited supplies were thrown on the market, the attempt to maintain a floor price would quickly exhaust its financial resources. It is significant that, in the one case where a buffer stock was successfully negotiated (tin) and in the other cases where it has been seriously discussed (e.g., cocoa), the buffer stock arrangement, designed for short-term stabilization purposes, was coupled with arrangements for export quotas designed to control supplies coming onto the world market over the longer term.

In the case of some commodities, the creation of international buffer stocks could aggravate the long-term problem by easing the pressure on individual countries to reduce production. With export quotas but without international buffer stocks, producing countries must themselves carry and finance large national stocks and thus have every incentive to curtail investment output. This is undoubtedly among the reasons why there is no buffer stock arrangement in the coffee and sugar agreements. Experience under the coffee agreement during a long period of over-supply in relation to demand has demonstrated that, without recourse to an international buffer stock, export quotas can bring about a substantial degree of price stabilization, as well as an orderly growth of export earnings above the amounts which would have been realized in the absence of the agreement.

Another consideration points toward possible conflict between buffer stocks and the achievement of the longer-term goals of commodity policy. When a buffer stock is proposed to be included as an integral part of a commodity agreement, the agreement must specify ceiling and floor prices. The difficulties of negotiating a commodity arrangement even under favorable circumstances are sizeable enough; they are increased when specific prices must be agreed upon before the arrangement comes into effect.^{1/}

It should also be noted that the need for international buffer stocks as an adjunct of broader commodity agreements has been appreciably reduced by the existence of the IMF's "compensatory financing" facility. Whereas buffer stocks are designed to reduce instability in export earnings by moderating price fluctuations through market intervention, "compensatory financing" can offset for a time the balance of payments impact of falling prices and consequently reduced export earnings, through virtually automatic three-to-five-year loans. Under "compensatory financing," a country may draw up to 50 per cent of its IMF quota (although normally not more than 25 per cent in any 12 months) without in any way affecting its

^{1/} Negotiation of a cocoa agreement went on so long, because of controversy over the range of prices to serve as a basis for buffer stock operations, that in the course of the negotiations the market situation changed significantly and some of the principal participants declined to proceed on the previously agreed basis.

access to regular Fund drawings. From the scheme's beginning, in 1963, through 1969, 19 countries had drawn a total of nearly \$400 million under the "compensatory" arrangements.

III. Buffer Stocks and the Bank

It follows from what has been said above that there are not likely to be many new international buffer stocks established. Nonetheless, in those few cases where buffer stock arrangements are agreed upon as part of a comprehensive international commodity agreement, they should, if properly designed, be able to contribute to the stabilization and strengthening of the market in the commodities concerned. Any such agreements should therefore be regarded by the World Bank as a welcome development.

In the discussions of recent years, however, the importance of buffer stocks per se has tended to escalate and has taken on an almost symbolic character as indicative of the international community's willingness to do something concrete about the commodity problem. It seems to have been widely assumed that the availability of adequate sources of finance would remove a major obstacle to the establishment of buffer stocks and thus clear the way for negotiation of broader commodity agreements.

The true sequence would seem to run the other way. For the reasons already stated, the main constraint on the establishment of international buffer stocks lies in the complex of obstacles which impedes conclusion of commodity arrangements involving limitations on exports and production. These include conflicting producer-consumer views of the long-run price objectives underlying the size of total quotas; differing views among producers concerning the proper basis for allocating country quotas; the need to reconcile the desire for higher prices with the danger of encouraging substitution; the need to build into the agreement both strong incentives for diversification and disincentives for perpetuating over-production; and a variety of negotiating and enforcement problems. The requisite agreement on the maximum and minimum prices at which the manager of the buffer stocks should sell or buy the commodity has proved the most intractable problem of all.

If the other conditions were satisfied, it is doubtful that finance would be a serious obstacle to the inclusion of buffer stocks as part of international commodity agreements. The buffer stock may be financed through an export levy, as was contemplated in the cocoa negotiations; to the extent that, over the relevant price range, demand is less elastic than supply, the incidence of such a tax would fall mainly on the importing countries. Where such self-financing is contemplated, outside funds would be needed primarily to pre-finance the buffer stock, enabling it to buy in the market, for perhaps five years, prior to the build-up of internal funds. Had the draft cocoa agreement been in effect during the period 1960-68, the proceeds of the export levy would have been more than sufficient to finance both the acquisition of stocks and their carrying costs,

without external assistance. Even if the agreement had come into force in 1965, when it would have been necessary to make large stock purchases immediately, the export levy would have obviated the need for short-term assistance beyond two years.^{1/} Medium-term commercial financing might well be available, although the new IMF financial facility, referred to in the pages which follow, provides greater assurance of funds and cheaper access to them. In any event, whatever inhibition may have been created in the past by the absence of an established source of financing for international buffer stocks, I believe the problem has been largely dissipated. This view finds confirmation in the statement made in July 1969 by the Advisory Committee to UNCTAD: "The Committee felt that the provision of pre-finance was no longer the most important obstacle to the setting up of a buffer stock scheme."^{2/}

To place the matter further in perspective, something should be said about the relationship between the IMF and the World Bank in the financing of buffer stocks. As already pointed out, international stocking operations should be designed primarily for cushioning short-term disturbances. Any long-term holding of stocks to facilitate the structural adjustment of production to demand under international commodity agreements should be primarily the responsibility of national governments; this is because the cost of stockholding will exert additional leverage on governments to hasten the adjustment. If this premise is accepted, it follows that the major burden of financial assistance to international buffer stocks should appropriately be carried by the IMF, the agency primarily concerned with short-term stabilization.

Under the new IMF buffer stock financing plan,^{3/} a member may draw up to 50 per cent of its quota to meet obligations assumed under an international buffer stock scheme. This amount may be drawn in a single year, but is subject to an overriding limit of 75 per cent of quota for drawings under the "compensatory financing" facility and the buffer stock scheme together. Neither type of drawing reduces the amount which a member can draw from the IMF on regular conditions; nor, with one minor exception,^{4/} does it affect the degree of conditionality of regular drawings. When the recently authorized increases in IMF quotas become effective, expected to be in late 1970, drawing rights under the buffer stock scheme are to be enlarged proportionately.

^{1/} IMF, "Some Aspects of Fund Liquidity and Buffer Stock Financing," March 28, 1969.

^{2/} UNCTAD, "Report of the Advisory Committee to the Board and to the Committee on Commodities on its Third Session," July 25, 1969.

^{3/} Decision No. 2772-(69/47), June 25, 1969, "The Problem of Stabilization of Prices of Primary Products," Report of the Executive Directors.

^{4/} Drawings under the buffer stock scheme which might be made while the member still had some automatic drawing rights available would eliminate the automatic rights.

Given the sizeable resources now available through the IMF, any role for the World Bank in the financing of buffer stocks would necessarily be residual, to take care of cases in which, for one reason or another, IMF financing proves inadequate. Any assessment of the amount of World Bank financing which might be needed if the Bank decided to assume such a role must be highly speculative. Among the relevant variables are the probability of international agreements being negotiated for particular commodities; the prospect that they would provide for the establishment of buffer stocks; the size of the buffer stock; the spread of the agreed price range; the relative emphasis placed in the agreement on buffer stock operations as against other stabilization techniques; the extent to which partial rather than full payment would be made upon the acquisition of buffer stocks (e.g., the half-payment provision in the cocoa agreement); the extent to which a country's drawing rights under the IMF buffer stock scheme may have been reduced by prior drawings under the "compensatory financing" scheme in excess of 25 per cent of quota; and the extent to which disbursements lag behind commitments (the timing of the former depending on the precise state of the market, the latter becoming effective when the agreement enters into force).

Notwithstanding these uncertainties, the World Bank staff has attempted to estimate the possible magnitude of calls for Bank assistance to supplement IMF financing; this has been done through a quantitative analysis^{1/} covering the 14 commodities identified by the UNCTAD Secretariat as candidates for international buffer stocks: coffee, cocoa, tea, sugar, pepper, lauric oils and seeds, rubber, jute and allied fibers, hard fibers, copper, tin,^{2/} lead, zinc and tungsten.

The analysis confirms that there would be, at best, an exceedingly modest residual role for the World Bank in financing capital contributions to international buffer stocks. Sixty-one of our developing country members export commodities for which an international buffer stock exists or may conceivably be established. When account is taken of the prospective increases in IMF quotas, those countries will have access to \$3.2 billion of drawings under the IMF buffer stock facility. This should, the study indicates, suffice to meet all, or nearly all, requirements over the period 1973-77. There are at most six countries,

^{1/} The principal uncertainties underlying the analysis concern the probability of a buffer stock agreement being signed for each of the commodities by 1972; the most likely size of each buffer stock; and the probability distribution of disbursements expressed as a fraction of commitments. To safeguard against understatement, it was assumed that the recent commodity stabilization decisions of the IMF and the World Bank would encourage international commodity agreements involving buffer stocks.

^{2/} As noted earlier, an international buffer stock in tin already exists, but serious consideration has been given to increasing its size from 12 per cent of world exports to perhaps 18 per cent.

according to the study, which might require assistance supplementary to their IMF buffer stock tranches, and the largest amount by which their net cumulative disbursements might exceed their drawing rights would be only around \$60 million over the 1973-77 period.^{1/} Given all the uncertainties involved, this figure should be taken as an indication of the order of magnitude of the maximum calls which might be made on the Bank, excluding the possibility that the Bank might refinance IMF drawings.

As for refinancing, the report of the IMF Directors on stabilization of prices, cited above, clearly contemplates that an IMF member may be allowed to make a new drawing for commodity financing, after having reconstituted the IMF facility by repurchasing. It also makes plain that new drawings cannot be taken for granted: the IMF will in each case determine whether a new drawing would be compatible with the intended short-term character of the buffer stock financing facility. If the IMF concluded that such new financing would not be desirable, it seems highly unlikely that the World Bank would be prepared to undertake it. But even if it were, net cumulative disbursements for refinancing over the 1973-77 period would be unlikely to exceed \$200 million, and would probably be of the order of \$100 million, and this on very optimistic assumptions as to the number of international buffer stock agreements likely to be concluded in the next five years.

In sum, a residual lending role for the World Bank, to supplement buffer stock drawings from the IMF, would imply, as a probable maximum, a call upon Bank resources of around \$60 million over the five years 1973-77, or an average of about \$12 million a year; the greater likelihood is that the amount involved would be even less or that there would be no call on the Bank at all. Even if account is taken of the theoretical, although very unlikely, possibility that the World Bank would have occasion to refinance buffer stock drawings from the IMF, the net aggregate call upon the Bank would be very unlikely to exceed an average of \$50 million a year. The amount would in all probability be much smaller.

Conclusion

I have no difficulty in accepting the view of the Commission that the financing of buffer stocks in support of well-conceived commodity agreements is a legitimate object of external assistance. However, it also appears that (a) international buffer stocks have only a limited role to

^{1/} This is predicated on the assumption that the full 50 per cent of IMF quotas would be available for buffer stock financing. Up to half this amount, however, would be unavailable if a country had had full prior access to its drawing rights under the IMF "compensatory financing" facility. Use of the latter has in fact been modest: current outstanding drawings are approximately \$200 million and have never exceeded \$300 million. If allowance is made for the possibility that half of the IMF buffer stock financing might be used up, a few additional countries might look to the Bank for financing. The additional amounts involved would, however, still be small.

play in dealing with the commodity problem, the buffer stock arrangement for tin being the only one thus far negotiated; (b) insufficiency of finance is not one of the principal constraints upon the establishment of buffer stocks; and (c) the IMF is the primary, and very likely a wholly adequate, source of such international financing as may be needed. In the circumstances, and given the divergence of views among the Executive Directors on the question of direct Bank Group financing of national contributions to buffer stock financing, I do not believe that there is any need at this time to consider whether we should go further than the decision taken by the Executive Directors in their report to the Board of Governors on the commodity problem in June 1969.^{1/} Should such a need develop in the future, I will recommend to the Executive Directors that the Bank act to meet it.

Robert S. McNamara

^{1/} "In appraising the economic performance of developing countries and their needs for financing, the Bank Group will be guided among other things by the consideration that the sound economic development of member countries can under certain conditions be effectively supported by appropriate international commodity arrangements including the holding of commodity stocks in national or international hands. While maintaining its normal lending standards, the Bank Group will, in considering development loans and credits to member countries in the course of its lending operations, take into account additional requirements for long-term external borrowing by such countries which may arise from their participation in the financing of appropriate commodity stock schemes." "Stabilization of Prices of Primary Products," Part II, Report of the Executive Directors, 1969, page 4.

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April 28, 1970

MEMORANDUM TO THE EXECUTIVE DIRECTORS

Subject: Pearson Commission Recommendation No. 4 Concerning
Financing of Regional Trade among Developing Countries

Recommendation

"Bilateral donors and international agencies should provide financial assistance to institutions, such as development banks and clearing and payment unions, which are designed to promote trade among developing countries on a regional scale."^{1/}

Background

This recommendation appears in the context of a discussion of ways in which developing countries might realize greater development benefits from increased trade among themselves. The Commission says that while the possibility of global tariff concessions and clearing arrangements should be considered by the developing countries themselves and specifically by UNCTAD and IMF, the Bank and others should also promote regional trade among LDCs by providing financial assistance to development banks, clearing houses and payments unions, which are created when regional trade arrangements are entered into. This assistance, the Commission comments, is necessary because preferential trading arrangements tend to generate unequal benefits and costs among member countries and such problems threaten the stability of the arrangement. Means should be found, therefore, to ensure an equitable distribution of benefits. While the Commission did not explicitly discuss the causes of such imbalances, it did draw attention to "the great stimulus to industrialization provided by enlarged markets,"^{2/} thus suggesting that imbalances occur chiefly as a result of imbalanced industrial development as between countries entering into such arrangements.

^{1/} Report, page 97.

^{2/} Report, page 95.

Analysis

While the Commission's recommendation covers assistance to clearing and payments unions as well as development banks, the former raises issues that concern primarily the International Monetary Fund.^{1/} This memorandum is, therefore, addressed only to the question of Bank Group assistance to development banks that have been created to facilitate economic integration under regional trade, or economic community, agreements.^{2/}

The Commission is correct in associating success in regional trade among developing countries with successful policies to encourage industrialization, particularly for production of consumer goods.^{3/} Investment assistance, therefore, clearly has a role to play in creating or expanding the production base and the infrastructure necessary to encourage the acceptance, as well as to ensure the continued economic viability, of such arrangements.

Moreover, many of the projects required may be particularly suited for investment by the regional development banks. Bank cooperation with development banks that are a part of regional trading arrangements, however, has been limited by the small number of such banks. Out of approximately 15 regional economic groupings undertaken among less developed countries, some of which have not been fully implemented, only three have included the establishment of development banks. The banks in question are the East African Development Bank and the Central American Bank for Economic Integration, which are operating, and the Caribbean Development Bank, which is just being organized.

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- ^{1/} Another recommendation, dealing with clearing arrangements for trade among developing countries, is specifically directed to the IMF "in cooperation with UNCTAD" (Report, page 94).
- ^{2/} While the objectives of the three major regional banks, the African Development Bank, the Asian Development Bank and the Inter-American Development Bank, include the promotion of regional economic cooperation, it is apparent from the context of the recommendation that the Commission had primarily in mind other kinds of organizations. Various aspects of the Bank Group's relations with the regional banks are dealt with in memoranda analyzing other recommendations of the Commission.
- ^{3/} This is shown in an analysis by Bank staff of the Central American Common Market. See "Economic Development and Prospects of Central America," Report No. WH-170a, June 5, 1967.

The World Bank Group has supported and cooperated in a number of ways with these three banks. Technical assistance has been provided in connection with the drafting of charters and during the stage of organization. Relations with the East African Development Bank have been particularly active and have included provision of an internship in the Bank for a senior member of the EADB staff. We have also offered to cooperate with these banks in the joint financing of projects.

As noted in the memorandum analyzing Recommendation No. 15 (R69-232, dated December 11, 1969), the Bank has a well-established policy of supporting national development banks, not merely because they can be effective retail outlets for dispensing external finance and technical assistance, but also because we want to help build effective local investment institutions. The three regional integration banks mentioned above have many of the characteristics of national development banks but they do differ from such banks in some respects. For example, a Bank loan to a regional integration bank would, of course, require the guarantee of at least one of the governments in the region, and as no one of the participating governments is likely to be willing to guarantee the full amount of the loan, this would in practice mean that a joint guarantee would have to be negotiated.^{1/}

Further, the national development banks, if free of political interference in their operations, can allocate their resources with the sole objective of obtaining the highest economic return to the national economy. A regional integration bank may have as an additional objective the promotion of better economic balance among the countries forming the regional economic grouping. This involves more complex judgments than are normally required for evaluating the performance of a national development bank.

Conclusion

The amount of Bank Group financial assistance that could appropriately be channeled through regional integration banks is likely to be small in the near future. Nevertheless, I think we should adopt the same positive attitude toward those institutions as we have toward national development banks, provided that the institutions in question are financially sound and well managed and we are convinced that their operations can make a significant contribution to economic integration, and therefore to economic growth, in their respective regions. Subject to these conditions, I believe that we should accept in principle the Commission's recommendation as it applies to such institutions.

If & when these Pks need money we are prepared to consider financing for them

Robert S. M. Naman

^{1/} There would be no such problem with respect to an IDA credit.





INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT
WASHINGTON, D. C. 20433, U.S.A.

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April 28, 1970

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MEMORANDUM TO THE EXECUTIVE DIRECTORS

WBG ARCHIVES

Subject: Pearson Commission Recommendation No. 5 Concerning Refinancing
of Export Credits

Recommendation

"Regional development banks, in cooperation with other international agencies, should take the lead in making available special funds for the refinancing of export credits granted by developing countries, and in establishing regional export credit insurance facilities."^{1/}

Background

This recommendation is one of several that derived from the Commission's analysis of the trade problems of the developing countries.^{2/} The Commission found that while several developing countries are acquiring a capacity to produce competitively priced capital goods, they are hampered in their efforts to sell such goods abroad, generally to other developing countries, by their inability to offer export credits (or credits to purchasers) on terms comparable to those offered by suppliers in developed countries who have access to highly developed export credit schemes.

The lack of adequate credit insurance arrangements was also cited by the Commission as a factor inhibiting the growth of export credits and thus of exports of capital goods from the developing countries. It pointed out that, although some developing countries have succeeded in establishing export credit insurance facilities, others have been hampered by high costs. "In this area", it said, "there are large economies of scale, and most developing countries would find it advantageous to participate in multinational and regional export credit insurance schemes."^{3/}

^{1/} Report, page 98.

^{2/} See also the memoranda analyzing Recommendations Nos. 3 and 4.

^{3/} Report, page 96.

Analysis

This recommendation is addressed primarily to the regional development banks. However, it relates to a problem that is also of concern to the World Bank. The Commission correctly observes that "The granting of export credits amounts to a medium- to long-term loan to the importers by the exporting country" and that most developing countries can ill afford to forego the foreign exchange earnings from their capital goods exports for the periods covered by such credits.^{1/}

A facility for refinancing the credits extended to exporters of capital goods by national agencies in the developing countries would enable such countries to realize promptly their foreign exchange earnings from capital goods exports. This is clearly desirable, both to strengthen their current payments balances, and to encourage further diversification of their exports by promoting the production and sale of capital goods which they are able to produce at competitive prices. As the broad objective of the international development finance institutions is to encourage the development of the whole economy of each of their member countries towards a greater degree of viability, it would seem to be entirely appropriate for such institutions to use some of their resources to promote facilities for refinancing export credits and thus encourage production for export.

The size of the problem should not, however, be exaggerated. There are relatively few developing countries in a position to produce competitively significant quantities of potentially exportable capital goods requiring financing of the export credit type, although a substantially larger number produce some goods of this character. As the Commission notes, several of the more industrially advanced developing countries already have institutional arrangements for financing such exports, but they are hampered by foreign exchange stringency as to the amount and terms of the credits they are able to provide.

The problem under consideration first became serious in some of the larger Latin American countries in the late 1950s. In response, the Inter-American Development Bank (IADB), in 1963, established a facility for refinancing export credits granted by institutions in its member countries for sales within the region of items on a prescribed list of capital goods; the amount of refinancing for any export credit under this scheme is limited to 70% of the invoiced price. Under this facility the IADB, as of December 31, 1969, had extended 11 lines of credit, totalling \$41 million. Both the Asian Development Bank and the African Development Bank have been studying the problem of refinancing export credits granted by their member countries, although no decision to mount such a program has yet been taken by either organization.

1/ Ibid.

If the regional development banks are prepared to take the lead in this area of financing, I believe that the World Bank should be willing to provide such appropriate assistance as the regional banks may request. The IADB already has gained considerable experience in this field and it would seem clearly undesirable for us to duplicate the facility it has created for the Latin American countries. The other regional banks have sufficient financial resources to create similar facilities for their members, and since neither we nor they have yet acquired expertise in this field of financing, I see no reason for us to seek to develop it if they are prepared to do so.

There remains for consideration that part of the Commission's recommendation relating to the establishment of regional export credit insurance facilities. The U.N. Secretariat, which recently prepared a descriptive analysis of export credit and export credit insurance schemes of 11 developing countries, is in the process of bringing that analysis up to date, and adding material on a twelfth country. At a later stage, the Secretariat plans to evaluate the adequacy of these arrangements. But so far as I am aware, there exists at present no analysis of the extent to which facilities of national institutions in the developing countries are adequate to protect exporters against the risk of loss on export credit, or the extent to which the absence or inadequacy of such facilities discourages producers of capital goods from selling to foreign buyers on credit terms. Clearly, if there is a need to supplement such national insurance facilities as may be available to exporters within the developing countries, this is an appropriate field for action, as the Commission suggests, for the regional development banks, particularly as a complement to such export credit refinancing facilities as they may decide to establish.

Conclusion

I hope that, in accordance with the Commission's recommendation, the regional development banks will take the lead in providing facilities for refinancing export credits extended by the developing countries and, if they find it desirable, in creating regional export credit insurance facilities. If there is any assistance which the regional banks feel that this Bank can extend in this matter, I believe that we should offer our cooperation.

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Robert S. McNamara

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INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT
WASHINGTON, D. C. 20433, U.S.A.

OFFICE OF THE PRESIDENT

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June 17, 1970

MEMORANDUM TO THE EXECUTIVE DIRECTORS

Subject: Pearson Commission Recommendation No. 6 Concerning
Multilateral Investment Insurance

Recommendation

"... at the international level, talks leading to the establishment of a multilateral investment insurance scheme should be pursued vigorously ..." 1/

Background

This recommendation appears in the context of the Commission's consideration of ways to stimulate the flow of private foreign investment into the developing countries. The Commission comments that a multilateral investment insurance scheme "could be very helpful in mitigating the impact of an uncertain investment climate".2/ While acknowledging the value of existing bilateral investment insurance programs, the Commission ascribes several advantages to "a soundly-based multilateral system", saying that it could (a) permit insurance of investments made by investors from countries which do not have a national insurance scheme; (b) enable investments in multinational projects to be insured; (c) permit reinsurance of large risks by small bilateral programs; and (d) involve both capital-exporting and capital-importing countries in the insurance risks.

Comment

The Bank first began to concern itself with multilateral investment insurance in 1961 when it was requested by the Development Assistance Group (now the Development Assistance Committee) of the OECD to undertake a study of possible multilateral investment insurance systems. A report was prepared by the staff of the Bank and published in 1962. The report was designed to identify and focus attention on the principal issues inherent in the concept of a multilateral investment insurance scheme, which governments would find it relevant to take into account in deciding whether to create such a scheme. The report did not put forward a

1/ Report, page 109.

2/ Ibid.

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specific proposal for such a scheme and, although the indicated objective -- the encouragement of private investment flows into the developing countries -- is also an objective of the Bank, the staff report did not take a position concerning the general desirability or feasibility of establishing a multilateral scheme.

Following receipt of the Bank Staff report, meetings of experts convened by the Secretary-General of the OECD, and preparation of a report by the OECD Secretariat, the Council of the OECD in 1965 approved transmittal to the Bank of a report setting forth the principal features of a multilateral investment insurance scheme "which would be likely to receive the widest measure of support among the Organisation's Members", noting that most members of the OECD had expressed the hope that such a scheme would be established under the auspices of the Bank. In the interval, UNCTAD I had asked the Bank to expedite its studies on investment insurance, in consultation with governments in both developing and developed countries, and to submit the results of its studies and consultations to the United Nations by September 1965.^{1/} The OECD, in transmitting its report to the Bank, expressed the hope that it would assist the Bank in carrying out the UNCTAD mandate.

In the latter part of 1965, the Executive Directors of the Bank, sitting as the Committee of the Whole and taking the OECD report as a point of departure, began their consideration of the feasibility of establishing a multilateral investment insurance scheme. Following discussions of the principal issues involved, the staff prepared, for further discussion, a draft of proposed Articles of Agreement for an international investment insurance agency (R66-156, dated November 30, 1966). Following review by governments, the draft was discussed at 27 meetings of the Committee of the Whole held between May 1967 and July 1968. In the light of these discussions a second draft of Articles was prepared by the staff (R68-156, dated August 19, 1968). Governments were asked to review the second draft and to state whether they were prepared in principle to participate in an international investment insurance scheme, assuming appropriate account was taken of their views on particular provisions of the second draft of Articles. It was initially contemplated that a canvass of governments' positions would be taken in the latter part of 1968, but because a number of governments were not able by that time to formulate their views, resumption of discussions was postponed, from time to time, until mid-March of 1970.

^{1/} Reports on the status of the Bank's study have been submitted to the Secretary General of the United Nations from time to time, beginning in September 1965, and UNCTAD has also been kept informed.

Under the scheme outlined in the OECD report, loss-sharing by "host countries", i.e., countries in which insured investments were made, would not have been required; all members, however, would share in administrative expenses. In the discussion of the principal issues by the Committee of the Whole preceding preparation of the first draft of Articles of Agreement by the Bank staff, the consensus was to retain the OECD concept of no mandatory loss-sharing by host countries. The first draft of Articles reflected that view. Statements made by Directors representing developing countries during discussions in the Committee of the Whole on the first draft of Articles indicated that few developing countries would be willing to participate in the scheme if participation entailed any financial obligation. Accordingly, the second draft of Articles, like the first, was prepared on the assumption that host countries would not contribute to the financial requirements of the scheme: that is, that they would not make advances for working capital, contribute to administrative expenses, or share in risks.

At the resumed meetings of the Committee of the Whole in March 1970, a number of Directors representing developed countries said that they considered it important that provision be made for some participation by developing countries in meeting the financial requirements of the scheme. At least one such country made its participation contingent upon such a provision. The reasons advanced were the following: (a) as a matter of principle, all members of a multilateral organization should share liabilities as well as benefits; (b) both developed and developing countries had a common interest in encouraging private foreign investment, and this community of interest should be reflected in the arrangements for meeting financial obligations under the scheme; (c) the right to representation on the directorate of the proposed investment insurance agency should carry with it some financial responsibility; and (d) a sharing of risks on the part of developing countries might minimize the likelihood of action on their part giving rise to claims under the potentially most costly insurable risk (the expropriation or confiscation risk), and might help to improve the climate for foreign investment.

In view of the critical importance of this issue for the feasibility of establishing a multilateral scheme, the Committee of the Whole decided to focus upon it before resuming Article-by-Article consideration of the second draft of Articles of Agreement. Each of the developing countries was asked to consider whether it would be prepared, in principle, to take part in a multilateral investment insurance scheme if membership entailed financial participation in working capital, administrative expenses and risks, or any combination of these; each of the developed countries interested in principle in taking part in the scheme was asked to state whether its interest was conditional upon provision for financial participation by the developing countries.

This inquiry is presently under way. It is not yet evident whether, when, or how the issue will be resolved. The feasibility and desirability of vigorously proceeding with discussions of a scheme, as the Commission has recommended, are likely to depend on the outcome.

Robert S. M. Numan