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Suggestions on Supplementary Finance

by Helmut Koinzer, Bonn

It is the intention of the present article to discuss the evolution of international consultations at the World Trade Conference and in its off-shoots towards the notion that developing countries ought to be compensated financially for the decline in their foreign currency income through a drop in their export revenue. Aid and assistance of this type has gradually become known as "supplementary financial measures".

Exports of Raw Materials

Developing countries have persistently pressed upon the attention of others the fact that their income derived from exports, which largely also determines their capacity to pay for their imports, especially for the supply of foreign investment goods, depends on the export of basic commodities. For, 88 per cent of their total export earnings derive from exports of basic commodities. However, the markets for such commodities have a very slowly increasing absorptive capacity, and they also suffer from wild price fluctuations. This has led developing countries to arguing that the uncertainty derived from such basic conditions affects their development planning adversely, because unforeseen falls in export earnings will threaten their development programmes. Therefore, demands for their being screened against the impact of this alleged insecurity have been raised by developing countries already for a long time. A number of international organisations and bodies have discussed and eventually rejected many plans that had been conceived to this end. In 1963, these efforts were at last crowned by success when the International Monetary Fund (IMF) set up "compensating financing facilities". Under this title, the IMF makes available drawing rights which serve to bridge over short-term fluctuations in export income, above and below the general trend. Compensating financing funds were enlarged in 1966. They offer all member countries of the IMF to draw upon the fund, or speaking economically, to raise medium-term credits, up to 50 per cent of their IMF quotas, subject to the following conditions:

☐ The drop in export earnings is of a short-term nature and has been caused mainly by events for

which the applicant country cannot be held responsible.

☐ The applicant country will cooperate with the IMF in looking for suitable methods to overcome its payment crisis.

Though this kind of compensating finance methods have been applied increasingly, and their high utility can hardly be denied, developing countries have put forward demands that go much further. They assert that the facilities offered by the IMF do not mitigate the long-term problems and, moreover, do not correspond sufficiently with their development needs.

The First World Trade Conference

During the First Conference on World Trade, which was convened to Geneva in 1964, the demand for help for the developing countries in tiding them over the longer-term decline in their export earnings had been one of the focal financial subjects on the agenda. The representatives of developing countries often argued their case with passion, and the developed countries did not turn a deaf ear to them but indicated that they were willing to subject the problem to a thorough examination. Without a single adverse vote¹, but with the socialist countries abstaining, the Conference adopted a recommendation moved by both the UK and Sweden, No. A. IV. 18², which, in an introduction, agrees that "adverse movements of export earnings by developing countries may become disruptive for their development", and calls upon the World Bank to examine the feasibility of a new scheme for providing supplementary finance. The recommendation defines the aims to be supported by such a scheme as follows:

"The new Scheme should aim to deal with problems arising from adverse movement in export proceeds which prove to be of a nature or duration which cannot adequately be dealt with by

¹ France, however, cast its vote only under the reservation that the instability of export earnings can only be overcome by creating "organised", i.e. managed or manipulated, markets.

² In this context, in speaking of Recommendation No. A. IV. 18, the author refers only to its first part. Its second part contains the requirements of the developing countries which go much further and the international discussion following upon the First World Trade Conference has tacitly disregarded them.

short-term balance of payments support. Its purpose should be to provide longer-term assistance to developing countries which would help them to avoid disruption of their development programs."

Unfavourable developments in export earnings are defined as a "decline of reasonable expectations". The Recommendation also states that supplementary finance should be made available if and when the IMF has already granted compensating financing facilities and it has been found impossible to foretell the type, the duration, and the after-effects of the decline in export earnings. Recommendation No. A. IV. 18 advises that the operation of the new scheme should be vested in IDA (the International Development Agency). IDA would have to examine all the pertinent economic facts before deciding whether and to what extent financial assistance should be granted for obviating the necessity to interrupt a given development programme.

The following typical examples are quoted:

- ☐ After having received compensating finance, the country in question suffers a further decline in export earnings in ensuing years.
- ☐ At the time when repayment of compensating finance falls due, export earnings have not yet sufficiently recovered for enabling the debtor country to redeem its debt without creating a risk for its development.
- ☐ A given decline in export earnings can be shown immediately not to be of a short-term nature only.

The "World Bank Plan"

Carrying out one of the suggestions thrown out by Recommendation No. A. IV. 18, the expert staff of the World Bank—which means, not its Board and Directors—have written an expert opinion which, in interpreting the Recommendation very liberally, proposes a comprehensive system of supplementary finance. This staff paper has not been before the Board and Directors of the World Bank for their scrutiny and eventual approval. To describe the paper, as has become usual, as a "World Bank Plan" is therefore definitely misleading. It ought to be known as a Plan of the World Bank Staff.

Basically, this staff paper proposes that the agency entrusted with administering the supplementary funds draw up, in each case, a formal agreement with the applicant country on its development programme and on the measures required for carrying it out. One of the crucial parts of such a policy understanding is to be a firm advance estimate of the exports of the applicant country over the period of the development plan.

Should actual export earnings then prove to be lower than anticipated, the applicant country will have a basic claim to quick and full compensation

for the shortfall, provided, of course, that it has adhered, all the time, to the policy understanding, so that the decline in its exports cannot be ascribed to its own defaulting actions or omissions. The compensation that will actually be granted will be equal to the difference between actual export earnings and anticipated export earnings, which is described as the "gross decline", but less

- ☐ the amounts by which actual exports have been higher than their anticipated value in other years of the plan period;
- ☐ calling, as far as it is possible, on available foreign currency and/or gold reserves of the applicant country;
- ☐ using drawing rights with the IMF, if such are still available;
- ☐ amounts whose non-payment may be overcome by the applicant country through taking its own compensatory measures, in so far as these do not do any harm to its development programme.

The sum thus arrived at will be called the net decline, and funds equal to this net amount will be made available. Should the funds held by the agency not be sufficient for covering all the claims made, the funds will be pro-ratoned according to previously declined principles.

Drawing upon their own experiences, and upon forward estimates and a number of reasoned assumptions, the World Bank experts believed that such a scheme could be financed by an initial endowment with between \$ 300 and 400 million per annum.

This tentative project produced by the World Bank experts met with widespread agreement at first. Developing countries interpreted it as meeting with their requirements amply, viz. that their development plans ought to be insured against sudden drops in export earnings. Most industrialised countries welcomed the possibility to exert a beneficial influence on the economic policies of developing countries through the suggested policy understandings.

The Finance Committee of the World Trade Conference appointed a special expert body for examining the World Bank staff paper, the Inter-governmental Group on Supplementary Financing (IGG). IGG has held three series of meetings, in October, 1966, and in April and November, 1967, submitting a so-called Final Report (Document TD/33) to the Second Conference on World Trade.

The World Bank Staff Paper Criticised

As the deliberations of IGG progressed, a number of industrialised countries gradually built up their criticism against the World Bank Staff Paper, and this became keener with the progress of time. Developing countries, on the other hand, con-

sistently supported the Paper, through trying to weaken those of its traits which appeared to be uncomfortable to them, and advocating certain "improvements" — naturally, improvements only from their point of view. Thus, they thought and desired that policy understandings must not be binding enough to interfere with their sovereign freedom of decision on economic policies. On the other hand, they pointed out, with some justice, that not only reductions in export earnings will cause uncertainty of all development planning, since such planning is unsafe also unless so-called basic finance for it is certain beyond doubt. What they wished for, in other words, was an amplification of all policy understandings by promises of the creditor countries to support their development programmes financially over the whole planning period.

What some of the industrialised countries did not like, on the other hand, were mainly the advance projections of export earnings, the more or less automatic operation of the scheme, and the likely financial effects of the plan produced by the World Bank experts.

Of the advance projections of export earnings, which formed a basic element of the World Bank staff plan, it was said that they are far too uncertain for basing financial obligations and claims upon them. Besides, the difference between these forecasts and the actual income from exports could not be seen by the critics as a reasonable basis for computing the volume of required development aid, because the amount to be paid in compensation would thereby be tied to the precision with which future developments can be foretold: the greater the accuracy of the projection, the less aid is to be made available, and the lower its quality, the larger will be the difference between estimates and the actual volume of earnings, and the greater the generosity of the helpers.

In rejoinder, developing countries replied, precisely because all advance calculations of export earnings were necessarily uncertain, their development programmes which had to be based on such estimates must be safeguarded against their failure.

The more or less automatic operation of the proposed mechanism—so the industrialised countries fear—may increase the risk that, because compensation for the failure to earn sufficient foreign currency is made such a certainty, essential improvements in the economic structure of developing countries will deliberately be neglected.

The answer given to this objection by developing countries was that compensation must, as much as possible, be paid with certainty and quickly, lest the main purpose of supplementary finance be vitiated.

The critics of the Plan also argued that its financial effects would be unpredictable. Because the proposed mechanism is to work automatically to a high degree, it would not be possible to limit the funds to be spent, as industrialised countries tended to believe.

Other Plans

Because some industrialised nations whose representatives sat on IGG took such an adverse attitude to the World Bank staff paper, IGG was not able to produce unanimous recommendations and conclusions. Its Report (TD/33) is still subject to controversy, though the majority opined that the World Bank staff paper had, on the whole, done well in trying to fill the Recommendation No. A. IV. 18 with life.

IGG's Report contains two alternative suggestions which were developed in the course of IGG's deliberations. They are printed in the Report's fourth chapter.

The "alternative plan A"—also known as the method of IDA using its discretion—uses any past decline in exports as the basis for calculating future aid. If a developing country claims that a drop in its exports makes it eligible for further help, IDA will examine the justice of this claim. Should IDA have need to base its decision on certain material and substantive data, it might be possible for the Agency to use as the basis of its deliberations the difference between actual export income of the last year and the average export income during the preceding two or three years.

In addition, if and when compensation is to be granted, the Agency will determine the volume of such compensation on the basis of the causes and the volume of the drop in exports, on the seriousness of the threat to the applicant's development programme, on the expected evolution of exports in the future, on the applicant country's general performance, and on the amount of funds currently available to the Agency.

As predetermined already in the Resolution No. A. IV. 18, there ought to be a close interrelationship between compensating and supplementary finance. Supplementary finance should be granted only insofar as compensating finance is not sufficient, e.g. provided it is clear from the very beginning that the decline in export earnings will be a long-term affair, or if the funds of the IMF prove to be insufficient — because the applicant country has already used its full quota, or because the calculating criteria used by the IMF are different and do not make the claimant eligible for help. Should it become clear only later that the drop in export income is of a long-term nature, the amount drawn from the IMF should be refinanced.

Under the alternative suggestion A, no firm and binding policy understanding is proposed, but it provides for consultations between IDA and the participating countries.

Developing countries describe this attempt at solving their problems as unsatisfactory, since it leaves IDA too much scope for using its discretion, and this would destroy all security that the aims of supplementary financing will ever be attained.

The "alternative suggestion B" provides only for refinancing compensating financial assistance. "Reasonable expectations", of which the Resolution No. A.IV.18 speaks, are interpreted as the median trend, as defined by IMF regulations on compensating finance. If it should be found that a given applicant country, after having drawn upon the IMF, follows a suitable development policy, whilst the obligation to repay the IMF its lendings would endanger its development programme, redemption of IMF credits is to be refinanced. Besides, IDA might be authorised to grant credits under similar conditions as when countries draw upon the IMF, should a fall in export earnings (which means that export developments do not follow the median trend as defined by the IMF) not be fully compensated for by drawing rights upon the IMF.

All the developing countries unanimously turned down this proposal as well. They argue: as deviations from a known trend usually balance themselves out over a comparatively short length of time, refinance would be superfluous, except in a very few cases. Moreover, supplementary finance had not been devised for the purpose of smoothing out fluctuations of a given trend but for protecting development programmes.

The Second World Trade Conference

As indicated, IGG submitted its Final Report to the Second Conference on World Trade, which met in New Delhi during February and March of 1968. This Conference, too, treated supplementary development finance as one of the most important subjects of its financial deliberations. Developing countries had hoped that the Delhi Conference might adopt a fundamental policy decision and commission one of its committees to work out an international draft agreement on supplementary development finance. To their great disappointment, however, the parent conference of IGG, was shot through to an even stronger degree with refusals to accept the World Bank staff paper. After all, only six industrialised countries had been represented on IGG, but at the Delhi meeting, it required tough bargaining going on for many weeks to secure the adoption of a new recommendation, numbered 30 (II), which—it is true—confirms the aims set by the A.IV.18 recommendation of the First Conference but also raises a

number of questions which have not yet been answered:

- ☐ what are "reasonable expectations" will have to be defined according to an agreed method;
- ☐ the scope, character, and general acceptability of the "policy understanding" will have to be set down with some precision;
- ☐ measures are to be described which will have to be adopted by countries applying for help;
- ☐ the relations between supplementary and compensating finance measures have to be defined.

It is of importance that a demand was raised, and agreed to, for examining the quantitative effects to be expected from an interruption of economic development caused by declining export earnings, which means that creditors ought to be informed what they let themselves in for financially. Finally, the request has been made that not only the scheme submitted by the World Bank staff but also other proposals suitable for carrying out the Recommendation No. A.IV.18 ought to be examined with due attention.

IGG has now been enlarged, and 26 individual states are represented on it; it was also charged with continuing with its deliberations. The Working Group has again met in October, 1968, but it then only drew up a list of questions and problems to be studied.

Open Questions

IGG will probably hold its concluding series of meetings in June, 1969, and its agenda for this conference contains mainly the problems connected with the interdependence between compensating finance granted by the IMF and supplementary finance. Some delegates have again voiced the demand that cost estimates should be made more reliable if the Working Group is to adopt a recommendation for the approval of the World Bank staff paper. It has also been declared desirable that the scope and extent of consultations to be held between the issuing agency and the applicant developing country be clarified further — these are the deliberations leading to a "policy understanding" as recommended by the World Bank staff paper. Finally, it has been stated that investigations will be necessary into the form of economic adaptation caused by a declining export income in a given developing country. The results of such research will serve as determinants of the amount of financial aid indispensable for maintaining those imports without which a development programme could not continue. The above-mentioned alternative proposals are also to be re-examined by the Working Group. The Secretariats of the World Bank, of the International Monetary Fund, and of the Conference on World Trade have all been instructed to prepare reports on the relevant questions forming the agenda of IGG.