The Role of the IMF in Compensatory
Financing of Commodity Fluctuations

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INTERNATIONAL MONETARY FUND
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The International Monetary Fund has, by a decision which is immediately effective, created a new facility designed to broaden its balance of payments support of member countries--particularly those exporting primary products--which experience temporary declines in their export earnings due to circumstances largely beyond their control.

Under its established practices the Fund has been able in the past to finance deficits resulting from declines in export earnings, and frequent drawings have been made for this purpose. The new facility, which would not normally exceed 25 per cent of a member's quota, would be available to members provided that the Fund is satisfied that the shortfall is of a short-term character largely attributable to circumstances beyond the country's control, and also that the member country will cooperate with the Fund in an effort to find, where required, appropriate solutions to its balance of payments difficulties.

The Fund will be prepared to authorize drawings under the new facility even if this should require a waiver under the Fund's Articles of Agreement to increase the member's outstanding drawings above the limit of 125 per cent of the member's quota. The decision also deals with the possibility of raising quotas for certain primary exporting countries, particularly those with relatively small quotas, to render the quotas for these countries more adequate in light of the fluctuations in export proceeds and other relevant criteria.

Over the years, the Fund has had considerable experience with the problems of member countries faced with difficulties as a result of variations in their export earnings. Many Fund members encountering such difficulties have turned to the Fund and have worked in close cooperation to overcome their problems. In May 1962 the Fund was invited by the United Nations Commission on International Commodity Trade to examine to what extent the Fund could play an increased part in compensatory financing of export fluctuations of primary exporting countries.

The Fund's decision is contained in the conclusion of a report on "Compensatory Financing of Export Fluctuations" now being transmitted to the United Nations. In this report, it is recognized that in addition to short-term assistance, long-range action is required to improve the economies of primary exporting countries by these countries themselves as well as by the industrialized countries. Primary exporting countries will need ready access to the markets of developed countries and sustained technical and financial assistance. For the primary producing countries the Fund can make a valuable contribution in helping to establish a climate in which appropriate long-range measures can be effectively pursued.

Mr. Jorge Del Canto

Room 807

(1) #11

February 28, 1963

To: Members of the Executive Board

From: The Secretary

Subject: Compensatory Financing of Export Fluctuations

A limited number of mimeographed copies of the agreed text of the report on Compensatory Financing of Export Fluctuations has been prepared for the information of the Executive Directors (copy attached).

Printed copies of the report are expected to be available for general distribution on Monday or Tuesday of next week.

Att:(1)

Compensatory Financing of Export Fluctuations

Report by the International Monetary Fund

February 1963

Introduction

The United Nations Commission on International Commodity Trade, at its tenth session held in Rome in May 1962, "invited the International Monetary Fund, in the light of the discussion during the tenth session, and after consideration of the questions involved, to present, as soon as possible, a report as to whether and in what way the Fund might play an increased part in the compensatory financing of export fluctuations of primary exporting countries, and to keep the Technical Working Group currently informed of the progress of its deliberations on the subject."1/

The present report by the International Monetary Fund is presented in fulfillment of the invitation extended by the Commission.

I. Previous Consideration of the Problem by the Fund

In 1960, in response to an earlier request by the Commission on International Commodity Trade, the Fund prepared a study explaining its policies and procedures bearing on the compensatory financing of fluctuations in foreign exchange receipts from the export of primary commodities.2/ The main points in this study may be briefly summarized as follows:

(1) The provision of foreign exchange to Fund members to assist in the compensation of short-term fluctuations in the balance of payments constitutes a legitimate use of Fund resources.3/ Among such fluctuations are some that arise primarily from variations in export prices and proceeds. However, in order that balance of payments deficits from this cause should be suitable for financing by the Fund, the member's policies must be such as to enable it, with the financial assistance it obtains from the Fund, to overcome its difficulties within a reasonably short period of time.

1/ United Nations, Commission on International Commodity Trade, Report on the Tenth Session (E/CN.13/55, May 31, 1962), p. 41.

2/ "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations," Staff Papers, Vol. VIII (1960-61), pp. 1-76.

3/ Since the presentation of this study in April 1960, Fund transactions with primary exporting countries have greatly increased. Outstanding drawings by low-income primary exporters have nearly doubled over the last three years. For details see Annex Table.

(2) It would be neither practicable nor desirable to make the amount of such assistance dependent on any automatic formula, or to provide any separate form of Fund assistance to deal with export fluctuations alone. The reasons for this are (a) that judgment is required to determine the extent to which export fluctuations require, and are suitable for, compensatory financing in the light of the balance of payments as a whole, and the extent to which any compensation required should be provided by international transfers rather than by national reserve movements, and (b) that, if the Fund should give too much of its assistance automatically, its ability to influence countries toward the adoption of appropriate policies would be seriously impaired. Requests for drawings for all purposes in accordance with the Articles of Agreement are, however, treated liberally if they are within the gold tranche or the first credit tranche.

(3) Fund quotas (at the end of 1959) were considered adequate to provide for its primary exporting members a supplement to liquidity which, in the majority of cases, should be sufficient, in conjunction with their own resources, to enable them to deal with payments problems created by short-term fluctuations in exports or in receipts from abroad of the order experienced since World War II, provided they did their best to keep their incomes and costs adjusted to the longer-run changes in their external purchasing power.

(4) There appeared (as of the same date) to be no reason why a shortage of Fund resources should be a factor limiting the amount of assistance that the Fund would otherwise consider it desirable to extend to its members.

(5) Consequently, it was concluded that "members of the Fund that are taking appropriate steps to preserve internal financial stability and to maintain their balance of payments in equilibrium, taking good years with bad, and that are otherwise making satisfactory progress toward the fulfillment of the Fund's purposes can anticipate with confidence that financing will be available from the Fund which, in conjunction with a reasonable use of their own reserves, should be sufficient to enable them to overcome temporary payments difficulties arising from export fluctuations."1/

1/ Ibid., p. 4.

II. Suggestions for Increased Use of Fund Resources for Compensatory Financing

Since the study summarized above was submitted to the United Nations in April 1960, the subject of compensatory financing has been actively considered within the framework of the United Nations (UN) and of the Organization of American States (OAS), in particular by the UN Committee of Experts which reported in January 1961,1/ and by the OAS Group of Experts which reported in April 1962.2/

In general, the international bodies in which the matter has been discussed have displayed understanding toward the Fund's policies on compensatory financing, as outlined above (including the restricted scope given to automatism in Fund transactions), and appreciation for the assistance which the Fund has been able to give under its present rules to primary exporting countries having export difficulties. However, certain suggestions have been made for changes in policy that would permit an enhancement of the Fund's role in compensatory financing. Moreover, it has been argued that, even if the Fund should make a reasonable degree of progress in the direction indicated, enough uncertainty would remain in the minds of governments as to their ability to draw on the Fund to justify the consideration of other possible international measures of compensatory financing. The suggestion has therefore been made that some new financial institution separate from, though possibly affiliated with, the Fund is needed to provide compensatory financing for export fluctuations, in amounts or of a kind or with a degree of automatism that is either not practicable or not desirable for the Fund. In pursuance of this line of thought, the above mentioned UN Committee of Experts worked out schemes for a Development Insurance Fund, which have subsequently been elaborated by the UN Secretariat, whereas the scheme of the OAS Expert Group is on a loan basis.

The following are the principal suggestions made by the UN and OAS Experts regarding the policies and practices of the Fund in the use of its own resources.

1. Qualitative criteria for the use of Fund resources. The UN Commission on International Commodity Trade, at its session of May 1961, "considered that it would be desirable if the Fund would study the question

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1/ United Nations, International Compensation for Fluctuations in Commodity Trade (Report by a Committee of Experts, E/CN. 13/40, New York, 1961).

2/ Organization of American States, Final Report of the Group of Experts on the Stabilization of Export Receipts (Washington, D.C., 1962).

whether the present criteria for the use of its resources are fully adapted to circumstances in which payments difficulties arise mainly from fluctuations in primary product markets."1/

2. Stand-bys or near stand-bys for compensatory financing. According to the Report of the UN Committee of Experts, "through the increased use of stand-by arrangements or consultative procedures, the Fund should aim to clarify with interested members the conditions which would assure that the full use of quota without waiver (Fund holding of 200 per cent of a member's currency) or even more will be readily granted, if it appears justifiable according to forecasts of commodity markets and other relevant considerations."2/

3. Extension of gold-tranche criterion to later tranches. The Report of the UN Committee of Experts suggests that "in so far as drawings on the Fund are automatic, a country whose export proceeds fall has reliable access to a source of compensatory financing. At present only 25 per cent of a member country's quota comes close to being automatically available. Any significant increase in this percentage which the Fund could institute would be a valuable step towards providing compensatory financing to meet the needs of primary producing countries when threatened with the adverse impact of a decline in export proceeds."3/

4. Automatic compensatory drawing rights in first credit tranche. In Appendix II of the Report of the UN Committee of Experts, one of the Experts suggested that "to offset fluctuations in the export proceeds of primary producing countries, compensatory drawings and repayments should be determined automatically by a formula. The fluctuations should be measured as a deviation from a trend which can be estimated on the basis of a moving average of three preceding years. A shortfall in export proceeds in any year should entitle the country concerned to draw from the Fund automatically up to, say, an amount which causes the Fund's holdings of the country's currency to equal 125 per cent of its quota.... Subsequently, when export proceeds are above the trend, the excess earnings should be used automatically to repay the earlier drawings."4/ From the context it appears that this Expert had in mind full compensation of shortfalls as defined, up to the 125 per cent point, and subsequent repayment of the whole of any excess of export proceeds over trend.

1/ United Nations, Commission on International Commodity Trade, Report of the Ninth Session (E/CN.13/42, May 1961), p. 21.

2/ UN Committee of Experts, op. cit., p. 29.

3/ Ibid., p. 28.

4/ Ibid., p. 81.

5. Automatic compensatory drawing rights additional to normal facilities. At the Special Meeting of the Organization of American States at Punta del Este in August 1961, Chile proposed that Fund members affected by declines in prices of important export commodities should be enabled to draw from the Fund in amounts determined by the magnitude of the price decline in question relative to the average price in the three preceding years and by the volume of exports affected. Drawings under these special arrangements would be repaid when prices rose above the average in the three preceding years. The ability of members to make ordinary drawings would not be affected by the amounts outstanding under these special arrangements.1/

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The proposals advanced, whether for new compensatory financing institutions or for changes in the policies and practices of the Fund, are evidence that the assistance provided by the Fund under present policies is considered either insufficiently automatic in character or inadequate in amount to deal with the payments problems that arise from fluctuations in exports of primary exporting countries. The question of automatism of Fund operations is discussed in Section III; that of the quantitative adequacy of members' access to the Fund, in Section IV. These sections lead to the Conclusions (set out in Section V of this report) which deal with Fund action.

III. Automatism and the Use of Fund Resources

The type of automatism envisaged in the various proposals that have been put forward--automatism of the "export compensatory" rather than of the "all purpose" type--has two principal features:

(1) A mathematical formula would be used to determine whether, and to what extent, exports in a particular year are to be considered so abnormally low as to require compensation, or so abnormally high as to permit the repayment of compensation received previously. No judgment would be made by the lending agency, in the light of any other information that might be available, as to whether, in a particular situation, the formula yields a reasonable estimate of normal exports.

1/ Pan American Union, Inter-American Economic and Social Council, Special Meeting at the Ministerial Level, Punta del Este, Minutes and Documents (Washington, D. C., 1962): Draft Resolution by the Delegation of Chile, pp. 550 ff. (in Spanish).

(2) The lending agency, whether the Fund or a new agency, would make credit available to a country without question whenever the formula pointed to a statistical justification on export grounds alone. No regard would be paid to the over-all balance of payments need for such credit, to the likelihood that the country would be able, in the light of the policies it was pursuing, to repay the credits that were being granted or, in some proposals, to the amount that the country has already borrowed. The country itself could, of course, refuse to take up credits to which it was entitled or could repay credits before maturity.

With regard to the first point, the proposals now under consideration have assumed, virtually without question, that when exports are below the average for, say, the three preceding years they can safely be assumed to be abnormally low so that compensation would be appropriate. Statistical experiments, covering the postwar period, recently made for a large number of primary exporting countries, suggest, however, that this is by no means generally the case. The fact that exports in any given year have been lower (or higher) than they were in preceding years is very often an indication of a downward (or upward) trend which may well persist for some years to come. Export proceeds that seem low in relation to those of preceding years may well appear in retrospect as rather favorable. It follows from this that automatic formulae based on past and current export data can, at best, yield only rather unsatisfactory estimates of the true trend of exports. In the absence of foreknowledge of future exports, the least inaccurate estimate of the normal level in any given year is likely to be one that attributes a great weight to the exports of the year itself. Even when this is done, however, the extent to which it is possible to adjust export proceeds by adding or subtracting compensatory receipts or repayments so as to bring them closer to their true norm or to reduce their instability is limited.1/

While great uncertainty must always attach to any attempt to estimate the medium-term trend or norm of exports, it is reasonable to assume that a better estimate could be made by the exercise of judgment based on an analysis of the causal factors at work than by any mathematical formula, however skillfully contrived, which is based on the mere statistical magnitude of current and previous exports.

In regard to the second aspect of automatism--the granting of credit irrespective of the general balance of payments situation or of the policies of the country receiving assistance--it may be useful to set out existing Fund policies and their rationale.

1/ See J. Marcus Fleming, Rudolf Rhomberg, and Lorette Boissonneault, "Export Norms and Their Role in Compensatory Financing," Part I, Staff Papers, Vol. X (1963), pp. 98-124.

Under present Fund policies "members are given the overwhelming benefit of the doubt in relation to requests for transactions within the 'gold tranche,' that is, for drawings which do not increase the Fund's holdings of the currency beyond an amount equal to the member's quota. The Fund's attitude to requests for transactions within the 'first credit tranche'--that is, transactions which bring the Fund's holdings of a member's currency above 100 per cent but not above 125 per cent of its quota--is a liberal one, provided that the member itself is making reasonable efforts to solve its problems. Requests for transactions beyond these limits require substantial justification. They are likely to be favorably received when the drawings or stand-by arrangements are intended to support a sound program aimed at establishing or maintaining the enduring stability of the member's currency at a realistic rate of exchange."1/

In the higher tranches, the Fund has therefore wished to be satisfied that a sound set of policies is being followed. The Fund may have reached this conclusion before the question of a drawing arose--e.g., if it has a stand-by arrangement with the country in question. If such policies are being followed, no change in them would be needed to meet payments difficulties that are due solely to temporary situations in foreign markets, or to such factors as a temporary fluctuation in crops. The mere fact of a falling off in exports would not be taken as an indication that a corrective program was necessary or that the corrective program already envisaged should be intensified. On the other hand, a need for corrective policies might arise either because the decline in exports appeared to foreshadow a lasting weakening of the country's balance of payments or because (though the export decline itself might be purely temporary and self-correcting) the country's monetary and financial policies were such as to provoke, sooner or later, balance of payments difficulties even under satisfactory export conditions. Recognition by the Fund of the need for corrective policies in either of the two circumstances outlined above does not mean that the Fund has seized the occasion of a member country's financial plight to press for immediate adoption of the full range of what might be construed as "ideal" policies; for example, the elimination of all payments restrictions, the adoption of full currency convertibility at an effective par value, the abolition of all multiple rates, etc. Reference to the policies followed in regard to these matters by the many countries that are using the Fund in the second or higher credit tranches or that have stand-by arrangements permitting such use would dispel at once the notion of such an approach by the Fund. In accordance, however,

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1/International Monetary Fund, Annual Report, 1962, p. 31.

with the purposes set out in Article I of the Fund's Articles of Agreement, Fund assistance, at least beyond the gold tranche, is not made available to any country that makes no effort to move toward the elimination of those aspects of its exchange and monetary policies that are detrimental to the interests of the member itself or those of other members.

The general case against providing compensatory credit without inquiry into general balance of payments need or into the policies of the country concerned has been argued at length in "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations",1/ and these arguments have not, in general, been challenged. As suggested by the UN Committee of Experts, a country exposed to export fluctuations might feel more secure if it had access to resources on which it could draw without having to satisfy any international organization or lending government as to the type of domestic or international economic policy it was pursuing. Moreover, it is possible that the availability of international credit on an automatic basis at times when exports are low, and the necessity of repaying such credit at times when exports are high, would have some effect in inducing countries to attempt to keep their domestic expenditures and imports on an even keel, on the basis of reasonable expectations as to the medium-term trend of their exports and other receipts. These potential advantages, however, have to be weighed against the disadvantages of automatic credit geared to a single element in the balance of payments. In this connection it may be appropriate to mention two considerations in particular:

(1) Even a statistically accurate determination that exports in a particular year are below normal implies nothing at all as to the cause of the shortfall. The cause may be a decline in world demand or a crop failure brought about by a natural calamity. But the reason may also lie in domestic inflation, leading to increasingly overvalued exchange rates, government purchases for stockpile at prices above those prevailing in world markets, or other national policies. When declines in exports occur, a most careful consideration of their possible causes is needed in order to determine whether some of them may not be open to remedial action by the country itself, so as to prevent export declines in the future if similar circumstances recur.

Thus, while it is desirable that countries have access to financial means to compensate for fluctuations in exports, it is not particularly desirable, and may be against the genuine interest of the country concerned,

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1/ Staff Papers, Vol. VIII (1960-61), pp. 1-76.

that this finance should be provided automatically and without an exploration of the causes of the decline in exports and the measures that might be taken to improve exports in the future.

In this connection, it should be pointed out that the benefits which a country derives from reaching an understanding with the Fund as to the policies appropriate to its situation may extend beyond the financial assistance obtained from the Fund itself. In such circumstances, agreement with the Fund is likely to strengthen opinion abroad and at home regarding the country's creditworthiness, and thus to facilitate the attraction of capital from other sources, official as well as private.

(2) The total amount of short-term credit made available to a country by one agency or under one arrangement cannot be totally divorced from the amount made available on similar terms by another agency or under another arrangement by the same agency. It would be shortsighted to think that a country would be fully justified in borrowing a relatively large amount on short term to compensate for an export shortfall while totally disregarding the amount that it had already borrowed on short term for other purposes. Prudent countries would themselves see to it that their total indebtedness did not exceed what they could reasonably expect to repay, and this would take into account all indebtedness of a similar character. It would seem to be dubious wisdom to set up the terms of lending of an international agency in such a manner as to put governments under internal pressure to borrow sums that they themselves might consider beyond the bounds of prudence. If there are sensible limitations on total short-term borrowing, these limitations should be taken into account not only by the borrowing country itself but also in the policies of the international agency extending the credit.

IV. Quantitative Adequacy of Drawing Facilities in the Fund

The UN Committee of Experts responsible for producing International Compensation for Fluctuations in Commodity Trade calculated that 14 out of 46 primary producing countries experienced, over the years 1953-59, cumulative shortfalls of exports, when compared with average annual exports over the three preceding years, of such magnitude that to compensate them fully would have compelled them, after using up 125 per cent of their IMF quotas, to dip into their own reserves to an extent exceeding 30 per cent of reserves at the end of 1959.1/

1/ UN Committee of Experts, op. cit., pp. 25-29.

The Experts did not offer an opinion as to whether these facilities, had they been available on an automatic basis, would have been adequate to meet, to a reasonable extent, the need for compensatory financing of export fluctuations. However, they pointed out that if only the 25 per cent of quota constituting the gold tranche had been made available by the Fund to meet the cumulative export shortfalls, 20 of the countries concerned would have had to draw down their reserves by more than 30 per cent to achieve full compensation. These near-automatic facilities, they implied, were insufficient; and even if a reasonable degree of progress were made by the Fund in extending the automatism of drawings in many cases, the uncertainty of drawings would, they considered, offer a serious handicap to the object of continuity in development expenditure.

In a UN Secretariat Study,1/ it was calculated

(a) that for the average primary exporting member of the Fund the average shortfall in export earnings (compared with the mean of the previous three years' exports) over the period 1953-60 was approximately equal to half of its (1961) quota; and that in only half of the countries would drawings of up to 50 per cent of quota have sufficed to offset the average annual shortfall for years in which shortfalls occurred;2/and

(b) that if each primary exporting member had sought to compensate 100 per cent of its export shortfalls by drawing on the Fund and had used 60 per cent of export excesses for repayment, subject to a limit of cumulative net drawings of 50 per cent of quota, primary exporting members could have compensated in this way about one third of their total shortfalls.3/

The authors of the study made it clear that their calculations were not intended to reflect on, or measure, the adequacy of the Fund as a means of assisting member countries, since usually reserves and other sources of credit could also be drawn upon and since Fund drawings are not limited to 50 per cent of quota.

1/ Consideration of Compensatory Financial Measures to Offset Fluctuations in the Export Income of Primary Producing Countries: Stabilization of Export Proceeds Through a Development Insurance Fund (E/CN.13/43, January 1962).

2/ Ibid., pp. 46-48 (Table 10) and p. 49.

3/ Ibid., p. 54.

The question of the quantitative adequacy of drawing facilities in the Fund to meet the needs for compensatory financing of export fluctuations is a difficult one, and no answer can be made to it without the help of many arbitrary suppositions. In arriving at these suppositions the following considerations are relevant:

(1) In the first place, as is generally recognized, Fund facilities are intended to be used in conjunction with national reserves and other sources of finance.

(2) Again, account has to be taken of the fact that all these forms of international liquidity are required to meet payments deficits arising not only from export shortfalls but also from fluctuations in other items in the balance of payments, notably fluctuations in imports. These fluctuations in other items are, indeed, rather more important than export shortfalls in the causation of payments deficits. Moreover, reserves cannot safely be run down to zero even to meet the severest drains. On the other hand, the various possible causes of deficit are unlikely to exercise their maximum effect simultaneously.

(3) In seeking to measure the probable need for compensatory financing of export shortfalls, it is impracticable to measure such shortfalls from a five-year moving average centered on the middle year (as was done in "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations") and misleading to measure them from a moving average of the preceding three years (as was done by the UN Experts and Secretariat and by the OAS Experts). As has been pointed out elsewhere,1/ the five-year moving average centered on the current year, while it may be considered an "ideal" norm from which to measure export deviations, is not usable in practice since foreknowledge of the exports of future years is necessarily lacking. It would seem desirable, however, that the "practical" norm from which export deviations are measured should be close to this "ideal" norm insofar as the latter can be predicted on the basis of existing knowledge. Such a prediction is perhaps best made by the exercise of judgment in the light of all relevant information. If, however, the practical norm is defined by an automatic formula involving the exports of current and previous years, statistical calculations show that the formula, if it is not to diverge unnecessarily from the ideal norm, must give considerable weight to the current year's exports. Moreover, as was argued in "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations," the compensation of

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1/ Fleming, Rhomberg, and Boissonneault, op. cit.

fluctuations should, in principle, be partial only. This implies that a target level of export availabilities1/ that is somewhat closer to actual exports than is the ideal norm be chosen. The result will be to increase still further the weight that should be given to the current year's exports in the calculation of the practical norm, or alternatively--what amounts to the same thing--deviations of actual exports from the practical norm should themselves be compensated only in part.

In Table 1 it is assumed that drawings on the Fund or drafts on national reserves will be made to cover two thirds of the shortfalls of actual exports with respect to a practical export norm defined as an average of exports in the present and two preceding years, with weights of 50 per cent given to the present year and 25 per cent to each of the two preceding years. It is assumed that two thirds of export surpluses with respect to this norm are used to repay drawings or reconstitute reserves. In order to ensure that countries with a downward long-term trend in exports do not indefinitely increase their claims on compensatory financing, it is assumed that drawings are repaid, or drafts on reserves are made good, in the fourth and fifth years of the drawing. In column 1 of the table, the maximum net cumulative requirements for compensatory financing over the period 1951-61 on these assumptions 2/ are shown for low-income primary exporting members of the Fund.

Columns 2, 3, and 4 present three alternative measurements of the means presently available to meet the requirements set forth in column 1. Column 2 shows one third of each country's potential external liquidity, defined as its unused potential drawing facilities with the Fund (through the fourth credit tranche) plus its gross reserves of gold and convertible currency, as of mid-1962. The assumption underlying this column is that one third of external liquidity is approximately what can be used to meet export fluctuations, the remainder being required for basic reserves and for other types of payments deficits insofar as these coincide with export shortfalls. Column 3 shows one half of the excess of each country's potential external liquidity, as of mid-1962, over a presumed minimum reserve equal to the value of one month's imports at the 1961 rate.

1/ That is, export proceeds adjusted for compensatory receipts and payments.

2/ The assumptions are the same as those underlying Scheme 24 in Table 5 in the study by Fleming, Rhomberg, and Boissonneault, op. cit.--a scheme which yields export availabilities considerably closer to target and considerably smoother over time than those of Scheme 1 (the OAS Scheme) in that table.

Column 4 gives each member country's Fund quota as of mid-1962. The assumption underlying column 4 is that each member would be in a position to use up to one half of its quota for the purpose of financing export fluctuations and would match this amount by an equal use of its own reserves, so that the combined use of reserves and Fund resources would amount to 100 per cent of quota.

The problem of the adequacy of Fund resources (in conjunction with national reserves) in meeting needs for the compensatory financing of export fluctuations is approached differently in columns 2 and 3 on the one hand, and in column 4 on the other. A comparison of column 1 with column 2 or 3 affords a measure of the extent to which member countries might have been able to meet export fluctuations of a defined magnitude on the basis of their external liquidity as of a given moment of time (viz., mid-1962). A comparison of column 1 with column 4 affords a measure of the extent to which member countries could meet such fluctuations on the basis of their normal drawing power in the Fund, starting from a position in which drawings for the purpose of export compensation are zero and assuming that the member will have adequate independent reserves to use pari passu with drawings on the Fund. In all cases, the need for financing is measured in relation to the experience of a particular decade (1951-61) and on the basis of specific assumptions regarding the degree of compensation. The comparisons of column 1 with columns 2 and 3 would seem the more relevant when considering the need for adding to the resources available to countries for compensatory financing. The comparison with column 4 is the more relevant when considering the adequacy of the Fund quotas of individual members.

It might be argued that parts of the reserves of some countries are virtually unusable, in that they are pledged against certain liabilities, or for other reasons. To some extent this factor is taken into account in the concept of minimum reserves underlying the calculations in columns 2 and 3. However, since no allowance has been made for this factor in column 4, column 5 has been added to show the extent to which the compensatory financing of export fluctuations would be limited if countries' use of external liquidity for this purpose were to be limited to 50 per cent of Fund quotas--a rather extreme assumption in most cases.

The differences between the alternative measures of the means available for compensatory financing of export fluctuations shown in columns 2, 3, 4, and 5, and the computed requirements for such financing shown in column 1, are set forth in columns 6, 7, 8, and 9, respectively. It is noteworthy that the incidence of "minus" signs in columns 6 and 7 is almost identical. One third of external liquidity as of mid-1962 would have been inadequate to cover maximum compensatory requirements of only 9 countries out of 47. One half of the excess of such liquidity over one month's imports would have been similarly inadequate in 8 of the same 9 countries. A limitation of financing to 100 per cent of quota as shown in column 8 would again have restricted export compensation in only 9 countries. Since these groups partially overlap, 16 member countries would have been limited by one or the other criterion. The more stringent limitation of financing to 50 per cent of quota, illustrated in columns 5 and 9, would result in "minus" signs in 9 countries in addition to those referred to above. In view of the necessarily somewhat arbitrary nature of the criteria employed in these calculations, and their uniform application to all countries regardless of special circumstances, the results for individual countries should not be taken too seriously. The calculations do, however, yield a general impression of the magnitude of the problem.

In a few countries with declining medium-term trends over the 1951-61 period, limitation of the finance available for automatic compensation over that period would probably have exercised a beneficial effect through limiting the need for repayment at times when exports were low in relation to trend.

V. Conclusions: Fund Action in Connection with Export Fluctuations

(1) The financing of deficits arising out of export shortfalls, notably those of primary exporting member countries, has always been regarded as a legitimate reason for the use of Fund resources, which have been drawn on frequently for this purpose. The Fund believes that such financing helps these members to continue their efforts to adopt adequate measures toward the solution of their financial problems and to avoid the use of trade and exchange restrictions to deal with balance of payments problems, and that this enables these members to pursue their programs of economic development with greater effectiveness.

(2) The Fund noted in its 1962 Annual Report that trends in prices of basic commodities in the past few years have adversely affected the export earnings of many Fund members, which has increased the strain on their reserves. In view of this and in order to ensure the maximum effectiveness for its support to members--in particular, primary exporting members--that are faced with fluctuations in export proceeds, the Fund is taking the action set forth below.

A. Quotas

(3) The quotas of many primary exporting countries, taken in conjunction with a reasonable use of their own reserves, are at present adequate for dealing with export fluctuations such as have occurred during the past decade. In those instances, however, where adjustment of the quotas of certain primary exporting countries, and in particular of countries with relatively small quotas, would be appropriate to make them more adequate in the light of fluctuations in export proceeds and other relevant criteria, the Fund is willing to give sympathetic consideration to requests for such adjustment.

B. Drawing policies

(4) Under the present policies and practices on the use of Fund resources, any member is given the overwhelming benefit of the doubt in relation to requests for transactions within the gold tranche, and the Fund's attitude to requests for transactions within the first credit tranche is a liberal one provided the member itself is making reasonable efforts to solve its problems. In the higher credit tranches too, where

a member's policies are consistent with Fund policies and practices on the use of Fund resources in these tranches, the Fund gives assistance, on a substantial scale, toward meeting temporary payments deficits, including deficits arising out of export shortfalls. The policies and practices of the Fund on drawings and stand-by arrangements have been developed in order to help members to meet more effectively their temporary balance of payments difficulties and to enable them, where necessary, to pursue policies aimed at restoring external and internal equilibrium. Fund assistance in accordance with these policies and practices has made an effective contribution to the solution of the difficulties of these members and the achievement of equilibrium. It has often led, moreover, to the provision of further resources from public and private sources for meeting immediate and longer-term needs. In the application of its policies and practices governing the use of its resources, the Fund's attitude has been a flexible one, and account has been taken of special difficulties facing members.

(5) The Fund has reviewed its policies to determine how it could more readily assist members, particularly primary exporters, encountering payments difficulties produced by temporary export shortfalls, and has decided that such members can expect that their requests for drawings will be met where the Fund is satisfied that

(a) the shortfall is of a short-term character and is largely attributable to circumstances beyond the control of the member; and

(b) the member will cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties.

The amount of drawings outstanding under this decision will not normally exceed 25 per cent of the member's quota, and the drawings will be subject to the Fund's established policies and practices on repurchase. When drawings are made under this decision, the Fund will so indicate in an appropriate manner.

(6) In order to implement the Fund's policies in connection with compensatory financing of export shortfalls, the Fund will be prepared to waive the limit on Fund holdings of 200 per cent of quota, where appropriate. In particular, the Fund will be prepared to waive this limit (i) where a waiver is necessary to permit compensatory drawings to be made under paragraphs (4) and (5) above, or (ii) to the extent that drawings in accordance with paragraph (5) are still outstanding.

Whenever the Fund's holdings of a member's currency resulting from an outstanding compensatory drawing under paragraph (5) are reduced, by the member's repurchase or otherwise, this will restore pro tanto the member's facility to make a further compensatory drawing under that paragraph, should the need arise.

(7) In order to identify more clearly what are to be regarded as export shortfalls of a short-term character, the Fund, in conjunction with the member concerned, will seek to establish reasonable estimates regarding the medium-term trend of the member's exports on the basis of appropriate statistical data in conjunction with qualitative information about its export prospects.

(8) The provision of credit to deal with the balance of payments effects of export fluctuations provides immediate relief for a country's short-term difficulties. In many cases, however, it will also be necessary to introduce measures of a policy character in order to attain a satisfactory and lasting solution to a country's balance of payments problems. Members generally have actively cooperated with the Fund to find and adopt the measures necessary to this end. Beyond immediate balance of payments difficulties, the primary exporting countries are, in many instances, facing unfavorable long-term export trends, and all are trying to meet the challenge of achieving more rapid and sustained development through a strengthening and broadening of their economies. The last mentioned problem will require action in many fields and over many years by both the primary exporting countries and the industrial countries, separately and in concert, including readier access to the markets of the developed countries for the products of the developing countries and an appropriate and sustained flow of technical and financial assistance to the developing countries. The Fund considers that its activities can provide valuable assistance in helping to establish a climate within which longer-term measures can be more effectively pursued.

Table 1. Adequacy of External Liquidity to Finance Fluctuations in Exports of Some Fund Members

(In millions of U.S. dollars)

Member	Maximum Financial Requirements Indicated by 1951-61 Experience1/ (1)	Assumed Limits of Finance Available: One third of external liquidity2/ (2)	One half of excess external liquidity3/ (3)	Fund Quota4/ (4)	One half of Fund Quota4/ (5)	Excesses or Deficiencies (-) in Available Financing: Column 2 minus column 1 (6)	Column 3 minus column 1 (7)	Column 4 minus column 1 (8)	Column 5 minus column 1 (9)
Argentina	192.3	101.3	91.2	280.0	140.0	-91.0	-101.1	87.7	-52.3
Bolivia	18.8	9.1	10.4	22.5	11.2	-9.7	-8.4	3.7	-7.6
Brazil	130.8	206.6	249.2	280.0	140.0	75.8	118.4	149.2	9.2
Burma	20.5	56.5	75.7	30.0	15.0	36.0	55.2	9.5	-5.5
Ceylon	25.8	42.6	49.0	45.0	22.5	16.8	23.2	19.2	-3.3
Chile	54.8	35.0	28.0	100.0	50.0	-19.8	-26.8	45.2	-4.8
Colombia	79.5	66.7	76.8	100.0	50.0	-12.8	-2.7	20.5	-29.5
Costa Rica	5.8	10.0	10.6	15.0	7.5	4.2	4.8	9.2	1.7
Cyprus	4.5	22.9	29.6	11.2	5.6	18.4	25.1	6.7	1.1
Dominican Republic	8.3	11.9	14.5	15.0	7.5	3.6	6.2	6.7	-0.8
Ecuador	5.8	13.8	15.9	15.0	7.5	8.0	10.1	9.2	1.7
El Salvador	7.8	15.4	18.6	11.2	5.6	7.6	10.8	3.4	-2.2
Ethiopia	4.7	29.6	40.6	13.2 5/	6.6 5/	24.9	35.9	8.5	1.9
Ghana	21.8	75.4	96.8	35.0	17.5	53.6	75.0	13.2	-4.3
Greece	12.3	116.7	145.3	60.0	30.0	104.4	133.0	47.7	17.7
Guatemala	5.7	22.5	28.2	15.0	7.5	16.8	22.5	9.3	1.8
Haiti	7.3	5.3	6.6	11.2	5.6	-2.0	-0.7	3.9	-1.7
Honduras	7.0	7.9	8.8	11.2	5.6	0.9	1.8	4.2	-1.4
India	148.0	305.6	368.2	600.0	300.0	157.6	220.2	452.0	152.0
Indonesia	135.0	89.9	101.8	165.0	82.5	-45.1	-33.2	30.0	-52.5
Iran	289.7	96.4	119.6	70.0	35.0	-193.3	-170.1	-219.7	-254.7
Iraq	54.7	56.0	67.1	15.0	7.5	1.3	12.4	-39.7	-47.2
Jordan	2.7	20.8	26.4	8.0 5/	4.0 5/	18.1	23.7	5.3	1.3
Korea	8.1	72.5	96.2	18.8	9.4	64.4	88.1	10.7	1.3
Lebanon	3.3	64.1	81.8	6.8	3.4	60.8	78.5	3.5	0.1
Libya	1.7	36.3	48.2	11.0 5/	5.5 5/	34.6	46.5	9.3	3.8
Malaya	246.0	290.1	404.8	32.5 5/	16.2 5/	44.1	158.8	-213.5	-229.8
Mexico	60.2	185.6	231.1	180.0	90.0	125.4	170.9	119.8	29.8
Morocco	2.8	81.2	103.2	52.5	26.2	78.4	100.4	49.7	23.4
Nicaragua	3.4	12.9	16.2	11.2	5.6	9.5	12.8	7.8	2.2
Nigeria	15.8	80.0	94.1	50.0	25.0	64.2	78.3	34.2	9.2
Pakistan	143.0	142.1	186.4	150.0	75.0	-0.9	43.4	7.0	-68.0
Panama	1.8	10.3	9.4	0.5	0.2	8.5	7.6	-1.3	-1.6
Paraguay	4.0	5.0	5.9	11.2	5.6	1.0	1.9	7.2	1.6
Peru	11.0	42.2	43.8	32.5 5/	16.2 5/	31.2	32.8	21.5	5.2
Philippines	15.2	46.7	40.1	75.0	37.5	31.5	24.9	59.8	22.3
Saudi Arabia	4.2	114.3	158.9	55.0	27.5	110.1	154.7	50.8	23.3
Sudan	32.8	63.9	86.1	15.0	7.5	31.1	53.3	-17.8	-25.3
Syrian Arab Republic	28.2	9.2	6.7	15.0	7.5	-19.0	-21.5	-13.2	-20.7
Thailand	24.8	175.7	243.4	45.0	22.5	150.9	218.6	20.2	-2.3
Tunisia	18.8	30.3	36.6	18.3 5/	9.2 5/	11.5	17.8	-0.5	-9.6
Turkey	51.3	85.9	107.6	86.0	43.0	34.6	56.3	34.7	-8.3
United Arab Republic	77.8	77.9	89.3	90.0	45.0	0.1	11.5	12.2	-32.8
Uruguay	60.3	82.8	115.6	30.0	15.0	22.5	55.3	-30.3	-45.3
Venezuela	0	229.5	295.9	150.0	75.0	229.5	295.9	150.0	75.0
Viet-Nam	34.7	60.4	80.0	18.5 5/	9.2 5/	25.7	45.3	-16.2	-25.5
Yugoslavia	9.0	36.3	16.6	120.0	60.0	27.3	7.6	111.0	51.0
Total	2,101.8	3,453.1	4,876.8	3,203.3	1,601.4	1,351.3	2,175.0	1,101.5	-500.4

1/ As described on page 12 of the text.

2/ A country's external liquidity is defined as its gross gold and convertible foreign exchange reserves plus its total tranche position with the IMF. Figures given are for mid-1962. A country's total tranche position with the IMF is the amount that it could still draw, as of a given date, if its justification were sufficient, without increasing the Fund's holdings of its currency above 200 per cent of its quota.

3/ Excess external liquidity (as of mid-1962) is defined as external liquidity (described in footnote 2) less average monthly imports (for 1961).

4/ Quotas given are for mid-1962.

5/ Quotas to be increased by annual installments, as follows: Ethiopia to \$15 million by September 1963; Jordan to \$11.25 million by July 1964; Libya to \$15 million by September 1963; Malaya to \$37.5 million by October 1963; Peru to \$37.5 million by September 1963; Tunisia to \$22.5 million by May 1964; and Viet-Nam to \$22.5 million by November 1963.

Annex Table
Net Fund Drawings1/ of Some Fund Members2/
1947 - 1962

	Cumulative 1947-57	1958	1959	1960	1961	1962	Cumulative3/ 1947-62	Available under Stand-By Arrangement, End 1962
Argentina	75.0	-	72.5	48.5	31.0	-9.0	218.0	50.0
Bolivia	6.5	2.0	2.4	-1.5	-2.0	1.3	8.5	6.5
Brazil	75.0	37.6	-20.2	47.7	40.0	-17.5	162.5	-
Burma	15.0	-3.0	-4.0	-4.0	-4.0	-	-	-
Ceylon	-	-	-	-	11.2	11.2	22.5	-
Chile	31.1	10.6	-	-12.4	59.3	-12.7	76.0	-
Colombia	25.0	5.0	-15.0	-15.0	65.0	7.5	72.5	-
Costa Rica	-	-	-	-	7.5	-4.1	3.4	11.6
Dominican Republic	-	-	-	9.0	-	-	9.0	-
Ecuador	5.0	-5.0	-	-	14.0	-2.2	11.9	2.0
El Salvador	-	-	5.5	5.7	-3.2	-8.0	-	11.2
Ghana	-	-	-	-	-	14.2	14.2	-
Guatemala	-	-	-	-	-	5.0	5.0	-
Haiti	1.0	2.5	1.9	-1.3	-1.3	1.9	4.8	5.0
Honduras	3.8	-3.8	3.8	1.2	1.2	1.3	7.5	3.8
India	200.0	-	-	-72.5	122.5	25.0	275.1	75.0
Indonesia	55.0	-	-9.0	-18.5	33.7	21.2	82.5	-
Iran	25.3	-8.4	-11.9	45.0	-12.0	-37.9	-	-
Mexico	-	-	-	-	45.0	-45.0	-	-
Nicaragua	3.8	-1.9	-1.9	-	4.5	-	4.5	-
Pakistan	-	-	-	12.5	-	-	12.5	-
Paraguay	5.5	0.8	-1.5	0.1	-1.6	-1.8	1.5	5.0
Peru	-	10.0	-10.0	-	-	-	-	30.0
Philippines	15.0	-	-6.2	3.3	-2.9	25.4	34.6	40.4
Sudan	-	5.0	1.2	-0.4	-2.9	-2.9	-	-
Syrian Arab Republic	-	-	-	15.0	-0.7	3.4	17.7	-
Turkey	21.5	17.0	-3.0	-3.0	10.5	5.5	48.5	-
United Arab Republic	30.0	-	-2.7	25.2	-2.7	57.4	107.2	5.0
Uruguay	-	-	-	-	-	15.0	15.0	15.0
Yugoslavia	-	22.9	-	-	67.5	-7.5	82.9	-
Total	593.5	91.3	1.9	84.6	479.6	46.7	1,297.8	260.5

Source: International Monetary Fund, International Financial Statistics.

1/ Minus sign indicates net repayment.
2/ Countries are those given in Table 1 which have drawn on the Fund.
3/ Totals may not equal sums of annual data because of rounding.

For Immediate Attention

Mr. Jorge Del Canto

Room 807

(1) #1

SM/63/15
Supplement 1
Revision 1

February 28, 1963

To: Members of the Executive Board

From: The Secretary

Subject: Compensatory Financing of Export Fluctuations

In the light of discussions with several Executive Directors following yesterday's meeting (EBM/63/8, February 27, 1963), the Managing Director proposes the attached text as the decision taken at that Meeting. The decision will be deemed approved if no objection or comment is received in the Office of the Secretary before the close of business on Friday, March 1, 1963.

Att:(1)

Other Distribution:
Department Heads
Division Chiefs

I. The report entitled "Compensatory Financing of Export Fluctuations" is approved for transmittal to the United Nations.

II. The following shall be recorded as the decision of the Executive Board on the compensatory financing of fluctuations in exports of primary exporting countries:

(1) The financing of deficits arising out of export shortfalls, notably those of primary exporting member countries, has always been regarded as a legitimate reason for the use of Fund resources, which have been drawn on frequently for this purpose. The Fund believes that such financing helps these members to continue their efforts to adopt adequate measures toward the solution of their financial problems and to avoid the use of trade and exchange restrictions to deal with balance of payments problems, and that this enables these members to pursue their programs of economic development with greater effectiveness.

(2) The Fund noted in its 1962 Annual Report that trends in prices of basic commodities in the past few years have adversely affected the export earnings of many Fund members, which has increased the strain on their reserves. In view of this and in order to ensure the maximum effectiveness for its support to members--in particular, primary exporting members--that are faced with fluctuations in export proceeds, the Fund is taking the action set forth below.

A. Quotas

(3) The quotas of many primary exporting countries, taken in conjunction with a reasonable use of their own reserves, are at present adequate for dealing with export fluctuations such as have occurred during the past decade. In those instances, however, where adjustment of the quotas of certain primary exporting countries, and in particular of countries with relatively small quotas, would be appropriate to make them more adequate in the light of fluctuations in export proceeds and other relevant criteria, the Fund is willing to give sympathetic consideration to requests for such adjustment.

B. Drawing policies

(4) Under the present policies and practices on the use of Fund resources, any member is given the overwhelming benefit of the doubt in relation to requests for transactions within the gold tranche, and the Fund's attitude to requests for transactions within the first credit tranche is a liberal one provided the member itself is making reasonable efforts to solve its problems. In the higher credit tranches too, where a member's policies are consistent with Fund policies and practices on the use of Fund resources in these tranches, the Fund gives assistance, on a substantial scale, toward meeting temporary payments deficits, including deficits arising out of export shortfalls. The policies and practices of the Fund on drawings and stand-by arrangements have been developed in order to help members to meet more effectively their temporary balance of payments difficulties and to enable

them, where necessary, to pursue policies aimed at restoring external and internal equilibrium. Fund assistance in accordance with these policies and practices has made an effective contribution to the solution of the difficulties of these members and the achievement of equilibrium. It has often led, moreover, to the provision of further resources from public and private sources for meeting immediate and longer-term needs. In the application of its policies and practices governing the use of its resources, the Fund's attitude has been a flexible one, and account has been taken of special difficulties facing members.

(5) The Fund has reviewed its policies to determine how it could more readily assist members, particularly primary exporters, encountering payments difficulties produced by temporary export shortfalls, and has decided that such members can expect that their requests for drawings will be met where the Fund is satisfied that

(a) the shortfall is of a short-term character and is largely attributable to circumstances beyond the control of the member; and

(b) the member will cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties.

The amount of drawings outstanding under this decision will not normally exceed 25 per cent of the member's quota, and the drawings will be subject to the Fund's established policies and practices on repurchase. When drawings are made under this decision, the Fund will so indicate in an appropriate manner.

(6) In order to implement the Fund's policies in connection with compensatory financing of export shortfalls, the Fund will be prepared to waive the limit on Fund holdings of 200 per cent of quota, where appropriate. In particular, the Fund will be prepared to waive this limit (i) where a waiver is necessary to permit compensatory drawings to be made under paragraphs (4) and (5) above, or (ii) to the extent that drawings in accordance with paragraph (5) are still outstanding.

Whenever the Fund's holdings of a member's currency resulting from an outstanding compensatory drawing under paragraph (5) are reduced, by the member's repurchase or otherwise, this will restore *pro tanto* the member's facility to make a further compensatory drawing under that paragraph, should the need arise.

(7) In order to identify more clearly what are to be regarded as export shortfalls of a short-term character, the Fund, in conjunction with the member concerned, will seek to establish reasonable estimates regarding the medium-term trend of the member's exports on the basis of appropriate statistical data in conjunction with qualitative information about its export prospects.

(8) The provision of credit to deal with the balance of payment effects of export fluctuations provides immediate relief for a

country's short-term difficulties. In many cases, however, it will also be necessary to introduce measures of a policy character in order to attain a satisfactory and lasting solution to a country's balance of payments problems. Members generally have actively co-operated with the Fund to find and adopt the measures necessary to this end. Beyond immediate balance of payments difficulties, the primary exporting countries are, in many instances, facing unfavorable long-term export trends, and all are trying to meet the challenge of achieving more rapid and sustained development through a strengthening and broadening of their economies. The last mentioned problem will require action in many fields and over many years by both the primary exporting countries and the industrial countries, separately and in concert, including readier access to the markets of the developed countries for the products of the developing countries and an appropriate and sustained flow of technical and financial assistance to the developing countries. The Fund considers that its activities can provide valuable assistance in helping to establish a climate within which longer-term measures can be more effectively pursued.

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

For Immediate Attention

Mr. Jorge Del Canto

Room 807

(1)

SM/63/15
Supplement 1

February 27, 1963

To: Members of the Executive Board

From: The Secretary

Subject: Compensatory Financing of Export Fluctuations

Attached is the staff's understanding of the decision taken by the Executive Board at Meeting 63/8, February 27, 1963. The decision will be deemed approved if no objection or comment is received in the Office of the Secretary before the close of business on Thursday, February 28, 1963.

Att:(1)

Other Distribution:
Department Heads
Division Chiefs

I. The report entitled "Compensatory Financing of Export Fluctuations" is adopted and approved for transmittal to the United Nations.

II. The following paragraphs shall be included in the section entitled "Use of Fund's Resources and Stand-By Arrangements" in the Fund's publication "Selected Decisions of the Executive Directors."

1. The Fund has reviewed its policies to determine how it could more readily assist members, particularly primary exporters, encountering payments difficulties produced by temporary export shortfalls, and has decided that such members can expect that their requests for drawings will be met where the Fund is satisfied that

(a) the shortfall is of a short-term character and is largely attributable to circumstances beyond the control of the member; and

(b) the member will cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties.

The amount of drawings outstanding under this decision will not normally exceed 25 per cent of the member's quota, and the drawings will be subject to the Fund's established policies and practices on repurchase. When drawings are made under this decision, the Fund will so indicate in an appropriate manner.

2. In order to implement the Fund's policies in connection with compensatory financing of export shortfalls, the Fund will be prepared to waive the limit on Fund holdings of 200 per cent of quota where appropriate. In particular, the Fund will be prepared to waive this limit (a) where a waiver is necessary to permit compensatory drawings to be made under the Fund's policies including paragraph 1 above, or (b) to the extent that drawings in accordance with paragraph 1 are still outstanding.

Whenever the Fund's holdings of a member's currency resulting from an outstanding compensatory drawing under paragraph 1 are reduced, by the member's repurchase or otherwise, this will restore <u>pro tanto</u> the member's facility to make a further compensatory drawing under that paragraph, should the need arise.

FOR AGENDA

Mr. Jorge Del Canto

Room 807

(1)

SM/63/15
Correction 2

February 26, 1963

To: Members of the Executive Board

From: The Secretary

Subject: Compensatory Financing of Export Fluctuations

Attached are a list of corrigenda to the draft report on "Compensatory Financing of Fluctuations in Exports of Primary Exporting Countries" and a proposed additional table "Net Fund Drawings of Some Fund Members."

This subject has been placed on the agenda of Meeting 63/8, Wednesday, February 27, 1963.

Att: (2)

Other Distribution:
Department Heads
Division Chiefs

Compensatory Financing of Export Fluctuations

Corrigenda

A.

Page 1, paragraph 4

Attach following footnote at the end of the first sentence, ending in "resources."

3/ Since the presentation of this study in April 1960 Fund transactions with primary exporting countries have greatly increased. Outstanding drawings by low income primary exporters have nearly doubled over the last three years. For details see Annex Table.

B.

Page 5, Heading of Section III to read:

Automatism and the Use of Fund Resources

C.

Page 6, Replace last paragraph by:

"In regard to the second aspect of automatism--the granting of credit irrespective of the general balance of payments situation or of the policies of the country receiving assistance--it may be useful to set out existing Fund policies and their rationale.

D.

Page 8, lines 4 and 5, replace by:

"aspects of its exchange and monetary policies that are detrimental to the interests of the member itself or those of other members."

E.

Page 12, middle paragraph, last line:

replace "each primary exporting member of the Fund" by "low income primary exporting members of the Fund."

F.

Page 15, conclusion 2, replace by:

"The Fund noted in its 1962 Annual Report that trends in prices of basic commodities in the past few years have adversely affected the export earnings of many Fund members, which has increased the strain on their reserves. In view of this and in order to ensure the maximum effectiveness for its support to members, in particular primary exporting members, that are faced with fluctuations in export proceeds, the Fund is taking the action set forth below."

G.

Page 17, first paragraph (second paragraph of conclusion 7):

change as indicated:

"Whenever the Fund's holdings of a member's currency resulting from an outstanding compensatory drawing under paragraph 6 are reduced, by the member's repurchase or otherwise, this will restore pro tanto the member's facility to make a further compensatory drawing under that paragraph, should the need arise."

Annex Table

Net Fund Drawings1/ of Some Fund Members2/

1947 - 1962

	Cumulative 1947-1957	1958	1959	1960	1961	1962	Cumulative3/ 1947-1962	Available under Standby Arrangement End 1962
Argentina	75.0	-	72.5	48.5	31.0	-9.0	218.0	50.0
Bolivia	6.5	2.0	2.4	-1.5	-2.0	1.3	8.5	6.5
Brazil	75.0	37.6	-20.2	47.7	40.0	-17.5	162.5	-
Burma	15.0	-3.0	-4.0	-4.0	-4.0	-	-	-
Ceylon	-	-	-	-	11.2	11.2	22.5	-
Chile	31.1	10.6	-	-12.4	59.3	-12.7	76.0	-
Colombia	25.0	5.0	-15.0	-15.0	65.0	7.5	72.5	-
Costa Rica	-	-	-	-	7.5	-4.1	3.4	11.6
Dominican Republic	-	-	-	9.0	-	-	9.0	-
Ecuador	5.0	-5.0	-	-	14.0	-2.2	11.9	2.0
El Salvador	-	-	5.5	5.7	-3.2	-8.0	-	11.2
Ghana	-	-	-	-	-	14.2	14.2	-
Guatemala	-	-	-	-	-	5.0	5.0	-
Haiti	1.0	2.5	1.9	-1.3	-1.3	1.9	4.8	5.0
Honduras	3.8	-3.8	3.8	1.2	1.2	1.3	7.5	3.8
India	200.0	-	-	-72.5	122.5	25.0	275.1	75.0
Indonesia	55.0	-	-9.0	-18.5	33.7	21.2	82.5	-
Iran	25.3	-8.4	-11.9	45.0	-12.0	-37.9	-	-
Mexico	-	-	-	-	45.0	-45.0	-	-
Nicaragua	3.8	-1.9	-1.9	-	4.5	-	4.5	-
Pakistan	-	-	-	12.5	-	-	12.5	-
Paraguay	5.5	0.8	-1.5	0.1	-1.6	-1.8	1.5	5.0
Peru	-	10.0	-10.0	-	-	-	-	30.0
Philippines	15.0	-	-6.2	3.3	-2.9	25.4	34.6	40.4
Sudan	-	5.0	1.2	-0.4	-2.9	-2.9	-	-
Syrian Arab Republic	-	-	-	15.0	-0.7	3.4	17.7	-
Turkey	21.5	17.0	-3.0	-3.0	10.5	5.5	48.5	-
United Arab Republic	30.0	-	-2.7	25.2	-2.7	57.4	107.2	5.0
Uruguay	-	-	-	-	-	15.0	15.0	15.0
Yugoslavia	-	22.9	-	-	67.5	-7.5	82.9	-
Total	593.5	91.3	1.9	84.6	479.6	46.7	1,297.8	260.5

Source: International Monetary Fund, International Financial Statistics.

1/ Minus sign indicates net repayment.

2/ Countries are those given in Table 1 which have drawn on the Fund.

3/ Totals may not equal sums of annual data because of rounding.

Mr. Jorge Del Canto

Room 807

(1) #1

SM/63/21

February 20, 1963

To: Members of the Executive Board

From: The Secretary

Subject: Allocation of Reductions in Fund Holdings of a Currency

Attached for the information of the Executive Directors is an explanatory note on paragraph 6 of the Conclusions of the draft report on "Compensatory Financing of Fluctuations in Exports of Primary Producing Countries" (SM/63/15).

Att: (1)

Other Distribution:
Department Heads
Division Chiefs

Explanatory Note on the Allocation of
Reductions in Fund Holdings of a Currency

Prepared by the Legal Department
(In consultation with the Office of the Treasurer)

Approved by Joseph Gold

February 20, 1963

1. Paragraph 6 of the Conclusions of the draft report on the Compensatory Financing of Fluctuations in Exports of Primary Producing Countries (SM/63/15) refers to the amount of drawings "outstanding" under paragraph 6, and the second paragraph of paragraph 7 amplifies this reference as follows:

> "Whenever the Fund's holdings of a member's currency resulting from an outstanding compensatory drawing are reduced, by the member's repurchase or otherwise, this will restore pro tanto the member's facility to make a further compensatory drawing under this decision, should the need arise."

The purpose of this note is to explain this paragraph in the light of Fund practice.

2. The paragraph in the Conclusions is intended to make it clear that when part or all of a drawing under the compensatory drawing facility is deemed to have been eliminated, the facility is restored pro tanto and can be exercised again when the terms of paragraph 6 are met. This elimination can come about as a result of repurchase by the member that made the drawing or by the Fund's sale of the member's currency. In view of these two possibilities, the language has been drafted in terms of the reduction of the Fund's holdings of the member's currency resulting from the transaction and not merely repurchase of that currency. The language is similar to the languag of one of the standard clauses in stand-by arrangements:

> "Not later than three years after each purchase of exchange by [the member] under this arrangement, [the member] shall repurchase from the Fund an equivalent amount of [its currency]; provided that if [the currency] held by the Fund as a result of transactions under this arrangement are reduced by repurchases under Article V, Section 7, or otherwise, such reductions shall be credited against the earliest amounts that become payable under this paragraph [ ] ..."

3. Notwithstanding the fungibility of the Fund's holdings of a currency, the need to determine whether a particular reduction in the holdings is to be deemed a reduction in respect of the holdings acquired in a particular

transaction has arisen frequently in Fund practice where more than one drawing is outstanding. The occasions on which it will be necessary to do this will be even more frequent as the number and diversity of the Fund's operations increase. The following are examples of some of the occasions on which the allocation that has been described must be made:

(a) When a member draws, it makes a representation or enters into a commitment to repurchase at a more or less precise date unless the Fund's holdings are otherwise reduced. If a member has made two or more drawings and the Fund's holdings of the member's currency are reduced, it is necessary to determine which repurchase undertaking is discharged thereby. If this were not done, the dates when the rest of the repurchases must be made would not be known.

(b) The standard clause on repurchase in stand-by arrangements quoted above makes it necessary to decide whether a reduction in the Fund's holdings resulting from repurchase or sale of the currency must be deemed to be a reduction of holdings acquired as the result of drawings under the stand-by arrangement or as the result of other drawings. This is necessary in order to determine when repurchase undertakings must be performed in accordance with the terms of the arrangement and in what amounts.

(c) Under stand-by arrangements, drawing rights can be augmented if a repurchase is made in respect of a drawing made under the stand-by arrangement or at the time when the arrangement is granted, but the rights are not augmented for other repurchases. Therefore, it is necessary to determine the drawing against which a repurchase is to be allocated.

(d) Under Paragraph 11(c) of the General Arrangements to Borrow, the Fund must repay lenders when a purchaser for the benefit of whose drawings the Fund activated the Arrangements makes a repurchase, but this does not apply where the repurchase is made under Article V, Section 7(b) and can be identified as being in respect of a drawing of non-borrowed currency or where the repurchase is made in discharge of a commitment given in respect of a drawing of non-borrowed currency.

4. The problem of allocating reductions against particular holdings is complicated not only by the fungibility of holdings but also by the fact that reductions may come about in a number of ways:

(i) Repurchases under Article V, Section 7(b). These may be produced by increases in the Fund's holdings of the repurchasing member's currency resulting from its drawings or by increases in its monetary reserves or by both. It will not always be possible to identify a repurchase under the provision as being in respect of a particular drawing in any automatic way, e.g., where the obligation results from an increase in monetary reserves.

(ii) Repurchases in discharge of an undertaking. There will often be no difficulty in allocating these against particular drawings because the member will specify the undertaking that it is purporting to discharge.

However, even when a member is discharging a specific commitment there may be difficulty, e.g., where there is an agreed schedule of repurchases covering two or more drawings.

(iii) Repurchases not identified by the member as being in respect of a particular undertaking. For example, the member may be repurchasing in advance of the dates fixed under various repurchase commitments. Its sole intention may be to repurchase, without having formed an intention to discharge some specific undertaking.

(iv) Sales of a member's currency. These clearly cannot be allocated in any automatic way against holdings resulting from particular drawings.

5. Although the circumstances producing the problem of allocating reductions are complex, it has been found that a few rules suffice to settle the problem in practice. However, these rules might have to be amplified in certain cases, but it is not proposed to deal with these possible complications in this paper. The basic rules are as follows:

I. In making a repurchase which does not accrue under Article V, Section 7(b), the member may always identify the undertaking it is intending to discharge. This undertaking is then deemed to have been discharged pro tanto, and the holdings resulting from the drawing to which the undertaking was attached are deemed to have been reduced by the same amount. All other repurchase undertakings and the maturities under them will remain unaffected.

II. If a member makes a repurchase which does not accrue under Article V, Section 7(b) and does not identify the repurchase undertaking it is intending to discharge, it is asked to do so. Normally, it will be best advised to discharge the undertaking with the earliest maturity. If it does not do this, it will, in effect, accelerate repurchase because a later maturity will be discharged first and an earlier maturity will remain to be discharged.

III. If a member when asked does not identify the undertaking which it is discharging, it is deemed to be discharging the first maturity.

IV. The Fund is required by the General Arrangements to Borrow to determine, if it can, the drawings in respect of which repurchase obligations accrue under Article V, Section 7(b), and it is advisable to regard this as a rule of general application. As the Arrangements themselves recognize, it is not always possible to identify an obligation under Article V, Section 7(b) as being in respect of a particular drawing. Examples of cases in which it will be possible are those in which the obligation arises in respect of a financial year in which only one drawing was outstanding, or where several drawings were outstanding but only one drawing was made in the year and the obligation arises solely because of an increase in the Fund's holdings.

V. Where it is not possible to identify a repurchase that accrues under Article V, Section 7(b) as being in respect of a particular drawing, the maturity principle of III is applied.

VI. Where the Fund sells a member's currency, this is deemed to reduce holdings in accordance with the maturity principle of III. *

VII. Where, in accordance with the foregoing rules, a reduction is deemed to be in respect of Fund holdings acquired under a stand-by arrangement, the reduction is deemed to be in respect of the earliest drawings under the arrangement. This is again the maturity principle, and it is prescribed by the standard clause in stand-by arrangements.

VIII. For the purposes of these rules, it is necessary to establish a precise date in applying the undertaking of the Decision of February 13, 1952 before a repurchase schedule is adopted under that Decision. This is necessary because of the obscurity of the language of the Decision: "exchange purchased from the Fund should not remain outstanding beyond the period reasonably related to the payments problem for which it was purchased from the Fund. The period should fall within an outside range of three to five years." For the purposes of these rules only, this should be treated as a three-year maturity before a repurchase schedule is established.** Once a schedule is adopted, the maturities become those of the schedule.

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* It is recognized that alternative rules could be formulated for V and VI which would permit a member to specify the drawings against which reductions under V and VI should be allocated, on the analogy of I and II, with the maturity principle applying only if the member fails to specify. Normally, this would not produce different results from the maturity principle, because that principle is most advantageous for members from the point of view of repurchase. However, other considerations might possibly affect a member's judgment, e.g., the desire to restore a drawing facility under a stand-by arrangement or paragraph 6 of the Conclusions on Compensatory Financing, even though this was not most advantageous in regard to the accrual of repurchase maturities. The reason why V and VI have not been formulated so as to give members a discretion to allocate reductions is that, in contrast to cases under I and II, the reductions are never the result of an initiative on the member's part.

** Among the reasons for this are: (i) The Decision is based on the consultation date of Article V, Section 8(d), which arrives not later than three years after a drawing. Consultation would not be necessary if repurchase had already taken place, which seems to imply something in the nature of an initial maturity which can, however, quite properly be put off to a date or dates within the next two years. (ii) This seems to have been the reasoning on which the standard repurchase term of stand-by arrangements is based. It will be recalled that this is three years after a drawing.

6. Two further comments may be useful in connection with the rules stated above:

[A] The rules are based on neither LIFO (last in, first out) nor FIFO (first in, first out) in relation to movements in the Fund's holdings of a currency. They are based in the main on the maturity dates for repurchase undertakings. For example, the maturity principle will mean that a repurchase undertaking associated with a later drawing is deemed to be discharged first if that undertaking matures before an undertaking associated with an earlier drawing. A different result would be reached by the automatic application of FIFO in the circumstances that have been supposed, and the later maturity would be discharged first. In these circumstances, FIFO would result in the acceleration of repurchases and would lessen the effective period for which the Fund's resources could be used under its policies. The automatic application of LIFO could also have this effect where later drawings carry later repurchase undertakings than earlier drawings.

[B] The rules that have been stated above are confined to the purposes for which they are necessary, all of which require the identification of the particular drawings that are "offset" by reductions. They do not affect principles which the Fund has established for other purposes and on the basis of different reasoning. These other purposes do not involve the need to identify reductions but only the crediting of them against the total Fund holdings of a member's currency. For example, LIFO applies to the calculation of charges, but this is because the system of charges is based on the total period during which the Fund's holdings in excess of quota have been continuously at the same level. Again, the Fund's tranche policy is based on a system which does not require the allocation of reductions against particular drawings in particular tranches. All reductions are credited against the highest tranche in which currency is held, because the tranche policy is based on a member's total outstanding use of the Fund's resources.

FOR AGENDA

Mr. Jorge Del Canto

Room 807

(1) #1

SM/63/15
Correction 1

February 12, 1963

To: Members of the Executive Board

From: The Secretary

Subject: Compensatory Financing of Export Fluctuations

The attached page 5 of SM/63/15 has been amended to move the first paragraph of Section III to Section II as the concluding paragraph and to insert the last sentence.

Att: (1)

Other Distribution:
Department Heads
Division Chiefs

5. Automatic compensatory drawing rights additional to normal facilities. At the Special Meeting of the Organization of American States at Punta del Este in August 1961, Chile proposed that Fund members affected by declines in prices of important export commodities should be enabled to draw from the Fund in amounts determined by the magnitude of the price decline in question relative to the average price in the preceding three years and by the volume of exports affected. Drawings under these special arrangements would be repaid when prices rose above the average in the three preceding years. The ability of members to make ordinary drawings would not be affected by the amounts outstanding under these special arrangements.1/

The proposals advanced, whether for new compensatory financing institutions or for changes in the policies and practices of the Fund, are evidence that the assistance provided by the Fund under present policies is considered either insufficiently automatic in character or inadequate in amount to deal with the payments problems that arise from fluctuations in exports of primary exporting countries. The question of automatism of Fund operations is discussed in Section III; that of the quantitative adequacy of members' access to the Fund, in Section IV. These sections lead up to the Conclusions which deal with Fund action, set out in Section V of this report.

III. Automatism in the Use of Fund Resources

The type of automatism envisaged in the various proposals that have been put forward--automatism of the "export compensatory" rather than the "all purpose" type--has two principal features:

1. A mathematical formula is used to determine whether, and to what extent, exports in a particular year are to be considered so abnormally low as to require compensation, or so abnormally high as to permit the repayment of compensation received previously. No judgment would be made by the lending agency, in the light of any other information that might be available, as to whether, in a particular situation, the formula yields a reasonable estimate of normal exports.

2. The lending agency, whether the Fund or a new agency, would make credit available to a country without question whenever the formula pointed to a statistical justification on export grounds alone. No regard would be paid to the over-all balance of payments need for such credit, to the likelihood that the country would be able, in the light of the

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1/ Pan American Union, Inter-American Economic and Social Council, Special Meeting at the Ministerial Level, Punta del Este, Minutes and Documents (Washington, D. C., 1962): Draft Resolution by the Delegation of Chile, p. 550 ff. (in Spanish).

policies it was pursuing, to repay the credits that were being granted or, in some proposals, to the amount that the country has already borrowed. The country itself could, of course, refuse to take up credits to which it was entitled or could repay credits before maturity.

With regard to the first point, the proposals now under consideration have assumed, virtually without question, that when exports are below the average for, say, the three preceding years they can safely be assumed to be abnormally low so that compensation would be appropriate. Statistical experiments, covering the postwar period, recently made for a large number of primary exporting countries, suggest, however, that this is by no means generally the case. The fact that exports in any given year have been lower (or higher) than they were in preceding years is very often an indication of a downward (or upward) trend which may well persist for some years to come. Export proceeds that seem low in relation to those of preceding years may well appear in retrospect as rather favorable. It follows from this that automatic formulae based on past and current export data can, at best, yield only rather unsatisfactory estimates of the true trend of exports. In the absence of foreknowledge of future exports, the least inaccurate estimate of the normal level in any given year is likely to be one that attributes a great weight to the exports of the year itself. Even when this is done, however, the extent to which it is possible to adjust export proceeds by adding or subtracting compensatory receipts or repayments so as to bring them closer to their true norm or to reduce their instability is limited.1/

While great uncertainty must always attach to any attempt to estimate the medium-term trend or norm of exports, it is reasonable to assume that a better estimate could be made by the exercise of judgment based on an analysis of the causal factors at work than by any mathematical formula, however skillfully contrived, which is based on the mere statistical magnitude of current and previous exports.

In regard to the second aspect of automatism--the fact that credit is to be granted irrespective of the general balance of payments situation or of the policies of the country receiving assistance--it is necessary to consider whether and to what extent such automatism already exists, or is desirable, within the Fund.

1/ See J. Marcus Fleming, Rudolf Rhomberg, and Lorette Boissonneault, "Export Norms and their Role in Compensatory Financing" Part I Staff Papers, Vol. X (1963).

FOR AGENDA

Mr. Jorge Del Canto

Room 807

(1) #1

SM/63/15

February 11, 1963

To: Members of the Executive Board

From: The Secretary

Subject: Compensatory Financing of Export Fluctuations

Attached is the draft prepared by the staff of the Report on the Compensatory Financing of Fluctuations in Exports of Primary Exporting Countries.

This matter will be placed on the agenda of a meeting tentatively scheduled for February 27.

Att:(1)

Other Distribution:
Department Heads
Division Chiefs

Compensatory Financing of Fluctuations in Exports of Primary Exporting Countries

Report by the International Monetary Fund

February 1963

Introduction

The United Nations Commission on International Commodity Trade, at its tenth session held in Rome in May 1962, "invited the International Monetary Fund, in the light of the discussion during the tenth session, and after consideration of the questions involved, to present, as soon as possible, a report as to whether and in what way the Fund might play an increased part in the compensatory financing of export fluctuations of primary exporting countries, and to keep the Technical Working Group currently informed of the progress of its deliberations on the subject."1/

The present report by the International Monetary Fund is presented in fulfillment of the invitation extended by the Commission.

I. Previous Consideration of the Problem by the Fund

In 1960, in response to an earlier request by the Commission on International Commodity Trade, the Fund prepared a study explaining its policies and procedures bearing on the compensatory financing of fluctuations in foreign exchange receipts from the export of primary commodities.2/ The main points in this study may be briefly summarized as follows:

1. The provision of foreign exchange to Fund members to assist in the compensation of short-term fluctuations in the balance of payments constitutes a legitimate use of Fund resources. Among such fluctuations are some that arise primarily from variations in export prices and proceeds. However, in order that balance of payments deficits from this cause should be suitable for financing by the Fund, the member's policies must be such as to enable it, with the financial assistance it obtains from the Fund, to overcome its difficulties within a reasonably short period of time.

1/ United Nations, Commission on International Commodity Trade, Report on the Tenth Session (E/CN.13/55, May 31, 1962), p. 41.

2/ "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations," Staff Papers, Vol. VIII (1960-61), pp. 1-76.

2. It would be neither practicable nor desirable to make the amount of such assistance dependent on any automatic formula, or to provide any separate form of Fund assistance to deal with export fluctuations alone. The reasons for this are (a) that judgment is required to determine the extent to which export fluctuations require, and are suitable for, compensatory financing in the light of the balance of payments as a whole, and the extent to which any compensation required should be provided by international transfers rather than by national reserve movements, and (b) that, if the Fund should give too much of its assistance automatically, its ability to influence countries toward the adoption of appropriate policies would be seriously impaired. Requests for drawings for all purposes in accordance with the Articles of Agreement are, however, treated liberally if they are within the gold tranche or the first credit tranche.

3. Fund quotas (at the end of 1959) were considered adequate to provide for its primary exporting members a supplement to liquidity which, in the majority of cases, should be sufficient, in conjunction with their own resources, to enable them to deal with payments problems created by short-term fluctuations in exports or in receipts from abroad of the order experienced since World War II, provided they did their best to keep their incomes and costs adjusted to the longer-run changes in their external purchasing power.

4. There appeared (as of the same date) to be no reason why a shortage of Fund resources should be a factor limiting the amount of assistance that the Fund would otherwise consider it desirable to extend to its members.

5. Consequently, it was concluded that "members of the Fund that are taking appropriate steps to preserve internal financial stability and to maintain their balance of payments in equilibrium, taking good years with bad, and that are otherwise making satisfactory progress toward the fulfillment of the Fund's purposes can anticipate with confidence that financing will be available from the Fund which, in conjunction with a reasonable use of their own reserves, should be sufficient to enable them to overcome temporary payments difficulties arising from export fluctuations."1/

1/ Ibid., p. 4.

II. Suggestions for Increased Use of Fund Resources for Compensatory Financing

Since the study summarized above was submitted to the United Nations in April 1960, the subject of compensatory financing has been actively considered within the framework of the United Nations (UN) and of the Organization of American States (OAS), in particular by the UN Committee of Experts which reported in January 1961,1/ and by the OAS Group of Experts which reported in April 1962.2/

In general, the international bodies in which the matter has been discussed have displayed understanding toward the Fund's policies on compensatory financing, as outlined above (including the restricted scope given to automatism in Fund transactions), and appreciation for the assistance which the Fund has been able to give under its present rules to primary exporting countries having export difficulties. However, certain suggestions have been made for changes in policy that would permit an enhancement of the Fund's role in compensatory financing. Moreover, it has been argued that, even if the Fund should make a reasonable degree of progress in the direction indicated, enough uncertainty would remain in the minds of governments as to their ability to draw on the Fund to justify the consideration of other possible international measures of compensatory financing. The suggestion has therefore been made that some new financial institution, separate from, though possibly affiliated with the Fund is needed to provide compensatory financing for export fluctuations in amounts, or of a kind, or with a degree of automatism that is either not practicable or not desirable for the Fund. In pursuance of this line of thought, the above mentioned UN Committee of Experts worked out schemes for a Development Insurance Fund, which have subsequently been elaborated by the UN Secretariat, whereas the scheme of the OAS Expert Group is on a loan basis.

The following are the principal suggestions made by the UN and OAS Experts regarding the policies and practices of the Fund in the use of its own resources.

1. Qualitative criteria for the use of Fund resources. The UN Commission on International Commodity Trade, at its session of May 1961, "considered that it would be desirable if the Fund would study the question

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1/ United Nations, International Compensation for Fluctuations in Commodity Trade (Report by a Committee of Experts, E/CN. 13/40, New York, 1961).

2/ Organization of American States, Final Report of the Group of Experts on the Stabilization of Export Receipts (Washington, D.C., 1962).

whether the present criteria for the use of its resources are fully adapted to circumstances in which payments difficulties arise mainly from fluctuations in primary product markets."1/

2. Stand-by or near stand-bys for compensatory financing. According to the Report of the UN Committee of Experts "Through the increased use of stand-by arrangements or consultative procedures, the Fund should aim to clarify with interested members the conditions which would assure that the full use of quota without waiver (Fund holding of 200 per cent of a member's currency) or even more will be readily granted, if it appears justifiable according to forecasts of commodity markets and other relevant considerations."2/

3. Extension of gold-tranche criterion to later tranches. The Report of the UN Committee of Experts suggests that "In so far as drawings on the Fund are automatic, a country whose export proceeds fall has reliable access to a source of compensatory financing. At present only 25 per cent of a member country's quota comes close to being automatically available. Any significant increase in this percentage which the Fund could institute would be a valuable step towards providing compensatory financing to meet the needs of primary producing countries when threatened with the adverse impact of a decline in export proceeds."3/

4. Automatic compensatory drawing rights in first credit tranche. In Appendix II of the Report of the UN Committee of Experts, one of the Experts (M. L. Qureshi) suggested that "to offset fluctuations in the export proceeds of primary producing countries, compensatory drawings and repayments should be determined automatically by a formula. The fluctuations should be measured as a deviation from a trend which can be estimated on the basis of a moving average of three preceding years. A shortfall in export proceeds in any year should entitle the country concerned to draw from the Fund automatically up to, say, an amount which causes the Fund's holdings of the country's currency to equal 125 per cent of its quota.... Subsequently, when export proceeds are above the trend, the excess earnings should be used automatically to repay the earlier drawings."4/ From the context it appears that Mr. Qureshi had in mind full compensation of shortfalls as defined, up to the 125 per cent point, and subsequent repayment of the whole of any excess of export proceeds over trend.

1/ United Nations, Commission on International Commodity Trade, Report of the Ninth Session (E/CN.13/42, May 1961), p. 21.

2/ UN Committee of Experts; *op. cit.*, p. 29.

3/ *Ibid.*, p. 28.

4/ *Ibid.*, p. 81.

5. Automatic compensatory drawing rights additional to normal facilities. At the Special Meeting of the Organization of American States at Punta del Este in August 1961, Chile proposed that Fund members affected by declines in prices of important export commodities should be enabled to draw from the Fund in amounts determined by the magnitude of the price decline in question relative to the average price in the preceding three years and by the volume of exports affected. Drawings under these special arrangements would be repaid when prices rose above the average in the three preceding years. The ability of members to make ordinary drawings would not be affected by the amounts outstanding under these special arrangements.1/

III. Automatism in the Use of Fund Resources

The proposals advanced, whether for new compensatory financing institutions or for changes in the policies and practices of the Fund, are evidence that the assistance provided by the Fund under present policies is considered either insufficiently automatic in character or inadequate in amount to deal with the payments problems that arise from fluctuations in exports of primary exporting countries. The question of automatism of Fund operations is discussed in this section; that of the quantitative adequacy of members' access to the Fund, in Section IV.

The type of automatism envisaged in the various proposals that have been put forward--automatism of the "export compensatory" rather than the "all purpose" type--has two principal features:

1. A mathematical formula is used to determine whether, and to what extent, exports in a particular year are to be considered so abnormally low as to require compensation, or so abnormally high as to permit the repayment of compensation received previously. No judgment would be made by the lending agency, in the light of any other information that might be available, as to whether, in a particular situation, the formula yields a reasonable estimate of normal exports.

2. The lending agency, whether the Fund or a new agency, would make credit available to a country without question whenever the formula pointed to a statistical justification on export grounds alone. No regard would be paid to the over-all balance of payments need for such credit, to the likelihood that the country would be able, in the light of the

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1/ Pan American Union, Inter-American Economic and Social Council, Special Meeting at the Ministerial Level, Punta del Este, Minutes and Documents (Washington, D. C., 1962): Draft Resolution by the Delegation of Chile, p. 550 ff. (in Spanish).

policies it was pursuing, to repay the credits that were being granted or, in some proposals, to the amount that the country has already borrowed. The country itself could, of course, refuse to take up credits to which it was entitled or could repay credits before maturity.

With regard to the first point, the proposals now under consideration have assumed, virtually without question, that when exports are below the average for, say, the three preceding years they can safely be assumed to be abnormally low so that compensation would be appropriate. Statistical experiments, covering the postwar period, recently made for a large number of primary exporting countries, suggest, however, that this is by no means generally the case. The fact that exports in any given year have been lower (or higher) than they were in preceding years is very often an indication of a downward (or upward) trend which may well persist for some years to come. Export proceeds that seem low in relation to those of preceding years may well appear in retrospect as rather favorable. It follows from this that automatic formulae based on past and current export data can, at best, yield only rather unsatisfactory estimates of the true trend of exports. In the absence of foreknowledge of future exports, the least inaccurate estimate of the normal level in any given year is likely to be one that attributes a great weight to the exports of the year itself. Even when this is done, however, the extent to which it is possible to adjust export proceeds by adding or subtracting compensatory receipts or repayments so as to bring them closer to their true norm or to reduce their instability is limited.1/

While great uncertainty must always attach to any attempt to estimate the medium-term trend or norm of exports, it is reasonable to assume that a better estimate could be made by the exercise of judgment based on an analysis of the causal factors at work than by any mathematical formula, however skillfully contrived, which is based on the mere statistical magnitude of current and previous exports.

In regard to the second aspect of automatism--the fact that credit is to be granted irrespective of the general balance of payments situation or of the policies of the country receiving assistance--it is necessary to consider whether and to what extent such automatism already exists, or is desirable, within the Fund.

1/ See J. Marcus Fleming, Rudolf Rhomberg, and Lorette Boissonneault, "Export Norms and their Role in Compensatory Financing" Part I Staff Papers, Vol. X (1963).

Under present Fund policies "members are given the overwhelming benefit of the doubt in relation to requests for transactions within the 'gold tranche,' that is, for drawings which do not increase the Fund's holdings of the currency beyond an amount equal to the member's quota. The Fund's attitude to requests for transactions within the 'first credit tranche'--that is, transactions which bring the Fund's holdings of a member's currency above 100 per cent but not above 125 per cent of its quota--is a liberal one, provided that the member itself is making reasonable efforts to solve its problems. Requests for transactions beyond these limits require substantial justification. They are likely to be favorably received when the drawings or stand-by arrangements are intended to support a sound program aimed at establishing or maintaining the enduring stability of the member's currency at a realistic rate of exchange."1/

In the higher tranches, the Fund has therefore wished to be satisfied that a sound set of policies is being followed. The Fund may have reached this conclusion before the question of a drawing arose, e.g. if it has a stand-by arrangement with the country in question. If such policies are being followed, no change in them would be needed to meet payments difficulties that are due solely to temporary situations in foreign markets, or to such factors as a temporary fluctuation in crops. The mere fact of a falling off in exports would not be taken as an indication that a corrective program was necessary or that the corrective program already envisaged should be intensified. On the other hand, a need for corrective policies might arise either because the decline in exports appeared to foreshadow a lasting weakening of the country's balance of payments or because (though the export decline itself might be purely temporary and self-correcting) the country's monetary and financial policies were such as to provoke, sooner or later, balance of payments difficulties even under satisfactory export conditions. Recognition by the Fund of the need for corrective policies in either of the two circumstances outlined above does not mean that the Fund has seized the occasion of a member country's financial plight to press for immediate adoption of the full range of what might be construed as "ideal" policies, for example, the elimination of all payments restrictions, the adoption of full currency convertibility at an effective par value, the abolition of all multiple rates, etc. Reference to the policies followed in regard to these matters by the many countries that are using the Fund in the second or higher credit tranches or that have stand-by arrangements permitting such use would dispel at once the notion of such an approach by the Fund. In accordance, however,

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1/ Annual Report, 1962, page 31.

with the purposes set out in Article I of the Fund's Articles of Agreement, Fund assistance, at least beyond the gold tranche, is not made available to any country that makes no effort to move toward the elimination of those aspects of its exchange and monetary policies which are detrimental to its own interests in the long run, and very often in the short run as well.

The general case against providing compensatory credit without inquiry into general balance of payments need or into the policies of the country concerned has been argued at length in "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations", 1/ and these arguments have not, in general, been challenged. As suggested by the UN Committee of Experts, a country exposed to export fluctuations might feel more secure if it had access to resources on which it could draw without having to satisfy any international organization or lending government as to the type of domestic or international economic policy it was pursuing. Moreover, it is possible that the availability of international credit on an automatic basis at times when exports are low, and the necessity of repaying such credit at times when exports are high, would have some effect in inducing countries to attempt to keep their domestic expenditures and imports on an even keel, on the basis of reasonable expectations as to the medium-term trend of their exports and other receipts. These potential advantages, however, have to be weighed against the disadvantages of automatic credit geared to a single element in the balance of payments. In this connection it may be appropriate to mention two considerations in particular:

1. Even a statistically accurate determination that exports in a particular year are below normal implies nothing at all as to the cause of the shortfall. The cause may be a decline in world demand or a crop failure brought about by a natural calamity. But the reason may also lie in domestic inflation, leading to increasingly overvalued exchange rates, government purchases for stockpile at prices above those prevailing in world markets, or other national policies. When declines in exports occur, a most careful consideration of their possible causes is needed in order to determine whether some of them may not be open to remedial action by the country itself, so as to prevent export declines in the future if similar circumstances recur.

Thus, while it is desirable that countries have access to financial means to compensate for fluctuations in exports, it is not particularly desirable, and may be against the genuine interest of the country concerned,

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1/ *Op. cit.*

that this finance should be provided automatically and without an exploration of the causes of the decline in exports and the measures that might be taken to improve exports in the future.

In this connection, it should be pointed out that the benefits which a country derives from reaching an understanding with the Fund as to the policies appropriate to its situation may extend beyond the financial assistance obtained from the Fund itself. In such circumstances agreement with the Fund is likely to strengthen opinion abroad and at home regarding the country's creditworthiness, and thus to facilitate the attraction of capital from other sources, official as well as private.

2. The total amount of short-term credit made available to a country by one agency or under one arrangement cannot be totally divorced from the amount made available on similar terms by another agency or under another arrangement by the same agency. It would be shortsighted to think that a country would be fully justified in borrowing a relatively large amount on short-term to compensate for an export shortfall while totally disregarding the amount that it had already borrowed on short-term for other purposes. Prudent countries would themselves see to it that their total indebtedness did not exceed what they could reasonably expect to repay, and this would take into account all indebtedness of a similar character. It would seem to be dubious wisdom to set up the terms of lending of an international agency in such a manner as to put governments under internal pressure to borrow sums that they themselves might consider beyond the bounds of prudence. If there are sensible limitations on total short-term borrowing, these limitations should be taken into account not only by the borrowing country itself but also in the policies of the international agency extending the credit.

IV. Quantitative Adequacy of Drawing Facilities of the Fund

The UN Committee of Experts responsible for producing International Compensation for Fluctuations in Commodity Trade calculated that 14 out of 46 primary producing countries experienced, over the years 1953-59, cumulative shortfalls of exports, when compared with average annual exports over the three preceding years, of such magnitude that to compensate them fully would have compelled them, after using up 125 per cent of their IMF quotas, to dip into their own reserves to an extent exceeding 30 per cent of reserves at the end of 1959.1/

1/ UN Committee of Experts, op. cit., pp. 25-29.

The Experts did not offer an opinion as to whether these facilities, had they been available on an automatic basis, would have been adequate to meet, to a reasonable extent, the need for compensatory financing of export fluctuations. However, they pointed out that if only the 25 per cent of quota constituting the gold tranche had been made available by the Fund to meet the cumulative export shortfalls, over 20 of the countries concerned would have had to draw down their reserves by more than 30 per cent to achieve full compensation. These near-automatic facilities they implied, were insufficient; and even if a reasonable degree of progress were made by the Fund in extending the automatism of drawings in many cases, the uncertainty of drawings would, they considered, offer a serious handicap to the object of continuity in development expenditure.

In a UN Secretariat Study,1/ it was calculated

> -- that for the average primary exporting member of the Fund the average shortfall in export earnings (compared with the mean of the previous three years' exports) over the period 1953-60 was approximately equal to half of its (1961) quota; but that in only half of the countries would drawings of up to 50 per cent of quota have sufficed to offset the average annual shortfall for years in which shortfalls occurred;2/ and
>
> -- that if each primary exporting member had compensated 100 per cent of its export shortfalls by drawing on the Fund and had used 60 per cent of export excesses for repayment, up to a limit of cumulative net drawings of 50 per cent of quota, primary exporting members could have compensated in this way about one third of their total shortfalls.3/

The authors of the study made it clear that their calculations were not intended to reflect on, or measure, the adequacy of the Fund as a means of assisting member countries, since usually reserves and other sources of credit could also be drawn upon and since Fund drawings are not limited to 50 per cent of quota.

1/ Consideration of Compensatory Financial Measures to Offset Fluctuations in the Export Income of Primary Producing Countries: Stabilization of Export Proceeds Through a Development Insurance Fund (E/CN.13/43, January 1962).

2/ *Ibid.*, pp. 46-48 (Table 10) and p. 49.

3/ *Ibid.*, p. 54.

The question of the quantitative adequacy of drawing facilities in the Fund to meet the needs for compensatory financing of export fluctuations is a difficult one, and no answer can be made to it without the help of many arbitrary suppositions. In arriving at these suppositions the following considerations are relevant:

1. In the first place, as is generally recognized, Fund facilities are intended to be used in conjunction with national reserves, and other sources of finance.

2. Again, account has to be taken of the fact that all these forms of international liquidity are required to meet payments deficits arising not only from export shortfalls but also from fluctuations in other items in the balance of payments, notably fluctuations in imports. These fluctuations in other items are, indeed, rather more important than export shortfalls in the causation of payments deficits. Moreover, reserves cannot safely be run down to zero even to meet the severest drains. On the other hand the various possible causes of deficit are unlikely to exercise their maximum effect simultaneously.

3. In seeking to measure the probable need for compensatory financing of export shortfalls, it is impracticable to measure such shortfalls either from a five-year moving average centered on the middle year, as was done in "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations," and misleading to measure them from a moving average of the preceding three years, as was done by the UN Experts and Secretariat and by the OAS Experts. As has been pointed out elsewhere,1/ the five-year moving average centered on the current year, while it may be considered an "ideal" norm from which to measure export deviations, is not usable in practice since foreknowledge of the exports of future years is necessarily lacking. It would seem desirable, however, that the "practical" norm from which export deviations are measured should be close to this "ideal" norm insofar as the latter can be predicted on the basis of existing knowledge. Such a prediction is perhaps best made by the exercise of judgment in the light of all relevant information. If, however, the practical norm is defined by an automatic formula involving the exports of current and previous years, statistical calculations show that the formula, if it is not to diverge unnecessarily from the ideal norm, must give considerable weight to the current year's exports. Moreover, as was argued in "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations," the compensation of

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1/ Fleming, Rhomberg, and Boissonneault, _op. cit._

fluctuations should, in principle, be partial only. This implies that a target level of export availabilities 1/ that is somewhat closer to actual exports than is the ideal norm be chosen. The result will be to increase still further the weight that should be given to the current year's exports in the calculation of the practical norm, or alternatively--what amounts to the same thing--deviations of actual exports from the practical norm should themselves be compensated only in part.

In Table 1 it is assumed that drawings on the Fund or drafts on national reserves will be made to cover two thirds of the shortfalls of actual exports with respect to a practical export norm defined as an average of exports in the present and two preceding years, with weights of 50 per cent given to the present year and 25 per cent to each of the two preceding years. It is assumed that two thirds of export surpluses with respect to this norm are used to repay drawings or reconstitute reserves. In order to ensure that countries with a downward long-term trend in exports do not indefinitely increase their claims on compensatory financing it is assumed that drawings are repaid, or drafts on reserves are made good, in the fourth and fifth years of the drawing. In column 1 of the table, the maximum net cumulative requirements for compensatory financing over the period 1951-61 on these assumptions 2/ are shown for each primary exporting member of the Fund.

Columns 2, 3, and 4 present three alternative measurements of the means presently available to meet the requirements set forth in column 1. Column 2 shows one third of each country's potential external liquidity, defined as its unused potential drawing facilities with the Fund (through the fourth credit tranche) plus its gross reserves of gold and convertible currency, as of mid-1962. The assumption underlying this column is that one third of external liquidity is approximately what can be used to meet export fluctuations, the remainder being required for basic reserves and for other types of payments deficits insofar as these coincide with export shortfalls. Column 3 shows one half of the excess of each country's potential external liquidity, as of mid-1962, over a presumed minimum reserve equal to the value of one month's imports at the 1961 rate.

1/ That is, export proceeds adjusted for compensatory receipts and payments.

2/ The assumptions are the same as those underlying Scheme 24 in Table 5 in the study by Fleming, Rhomberg, and Boissonneault, op. cit.--a scheme which yields export availabilities considerably closer to target and considerably smoother over time than those of Scheme 1 (the OAS Scheme) in that table.

Column 4 gives each member country's Fund quota as of mid-1962. The assumption underlying column 4 is that each member would be in a position to use up to one half of its quota for the purpose of financing export fluctuations and would match this amount by an equal use of its own reserves, so that the combined use of reserves and IMF resources would amount to 100 per cent of quota.

The problem of the adequacy of Fund resources (in conjunction with national reserves) in meeting needs for the compensatory financing of export fluctuations is approached differently in columns 2 and 3 on the one hand, and column 4 on the other. A comparison of column 1 with column 2 or 3 affords a measure of the extent to which member countries might have been able to meet export fluctuations of a defined magnitude on the basis of their external liquidity as of a given moment of time (viz., mid-1962). A comparison of column 1 with column 4 affords a measure of the extent to which member countries could meet such fluctuations on the basis of their normal drawing power in the Fund, starting from a position in which drawings for the purpose of export compensation are zero and assuming that the member will have adequate independent reserves to use pari passu with drawings on the Fund. In all cases, the need for financing is measured in relation to the experience of a particular decade (1951-61) and on the basis of specific assumptions regarding the degree of compensation. The comparisons of column 1 with columns 2 and 3 would seem the more relevant when considering the need for adding to the resources available to countries for compensatory financing. The comparison with column 4 is the more relevant when considering the adequacy of the quotas of individual countries.

It might be argued that parts of the reserves of some countries are virtually unusable, in that they are pledged against certain liabilities, or for other reasons. To some extent this factor is taken into account in the concept of minimum reserves underlying the calculations in columns 2 and 3. However, since no allowance has been made for this factor in column 4, column 5 has been added to show the extent to which the compensatory financing of export fluctuations would be limited if countries' use of external liquidity for this purpose were to be limited to 50 per cent of Fund quotas--a rather extreme assumption in most cases.

The differences between the alternative measures of the means available for compensatory financing of export fluctuations shown in columns 2, 3, 4, and 5, and the computed requirements for such financing shown in column 1, are set forth in columns 6, 7, 8, and 9, respectively. It is noteworthy that the incidence of "minus" signs in columns 6 and 7 is almost identical. One third of external liquidity as of mid-1962 would have been inadequate to cover maximum compensatory requirements of only 9 countries out of 47. One half of the excess of such liquidity over one month's imports would have been similarly inadequate in 8 of the same 9 countries. A limitation of financing to 100 per cent of quota as shown in column 8 would again have restricted export compensation in only 9 countries. Since these groups partially overlap, 16 member countries would have been limited by one or the other criterion. The more stringent limitation of financing to 50 per cent of quota, illustrated in columns 5 and 9, would result in "minus" signs in 9 countries in addition to those referred to above. In view of the necessarily somewhat arbitrary nature of the criteria employed in these calculations, and their uniform application to all countries regardless of special circumstances, the results for individual countries should not be taken too seriously. The calculations do, however, yield a general impression of the magnitude of the problem.

In a few countries with declining medium-term trends over the 1951-61 period limitation of the finance available for automatic compensation over that period would probably have exercised a beneficial effect through limiting the need for repayment at times when exports were low in relation to trend.

V. Conclusions: Fund Action in Connection with Export Fluctuations

1. The financing of deficits arising out of export shortfalls, notably those of primary exporting member countries, has always been regarded as a legitimate reason for the use of Fund resources, which have been drawn on frequently for this purpose. The Fund believes that such financing helps these members to continue their efforts to adopt adequate measures toward the solution of their financial problems and to avoid the use of trade and exchange restrictions to deal with balance of payments problems, and that this enables these members to pursue their programs of economic development with greater effectiveness.

2. In order to ensure the maximum effectiveness for its support to members, in particular primary exporting members, that are faced with fluctuations in export proceeds, the Fund is taking the action set forth below.

A. Quotas

3. The quotas of many primary exporting countries, taken in conjunction with a reasonable use of their own reserves, are at present adequate for dealing with export fluctuations such as have occurred during the past decade. In those instances, however, where adjustment of the quotas of certain primary exporting countries, and in particular of countries with relatively small quotas, would be appropriate to make them more adequate in the light of fluctuations in export proceeds and other relevant criteria, the Fund is willing to give sympathetic consideration to requests for such adjustment.

4. Members receiving increased quotas will be obliged to subscribe one quarter of the increase in gold. In certain circumstances this payment may be reduced under Article III, Section 4 of the Articles of Agreement. The burden of the gold payment can also be eased by a special drawing or by the member's acceptance of the quota increase in installments.

B. Drawing policies

5. Under the present policies and practices on the use of Fund resources, any member is given the overwhelming benefit of the doubt in relation to requests for transactions within the gold tranche, and the Fund's attitude to requests for transactions within the first credit tranche is a liberal one provided the member itself is making reasonable efforts to solve its problems. In the higher credit tranches too, where

a member's policies are consistent with Fund policies and practices on the use of Fund resources in these tranches, the Fund gives assistance, on a substantial scale, toward meeting temporary payments deficits, including deficits arising out of export shortfalls. The policies and practices of the Fund on drawings and stand-by arrangements have been developed in order to help members to meet more effectively their temporary balance of payments difficulties and to give them the time to introduce, where necessary, policies aimed at restoring external and internal equilibrium. Fund assistance in accordance with these policies and practices has made an effective contribution to the solution of the difficulties of these members and the achievement of equilibrium. It has often led, moreover, to the provision of further resources from public and private sources for meeting immediate and longer-term needs. In the application of its policies and practices governing the use of its resources, the Fund's attitude has been a flexible one, and account has been taken of special difficulties facing members.

6. The Fund has reviewed its policies to determine how it could more readily assist members, particularly primary exporters, encountering payments difficulties produced by temporary export shortfalls, and has decided that such members can expect that their requests for drawings will be met where the Fund is satisfied that

(a) the shortfall is of a short-term character and is largely attributable to circumstances beyond the control of the member; and

(b) the member will cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties.

The amount of drawings outstanding under this decision will not normally exceed 25 per cent of the member's quota, and the drawings will be subject to the Fund's established policies and practices on repurchase. When drawings are made under this decision, the Fund will so indicate in an appropriate manner.

7. In order to implement the Fund's policies in connection with compensatory financing of export shortfalls, the Fund will be prepared to waive the limit on Fund holdings of 200 per cent of quota where appropriate. In particular, the Fund will be prepared to waive this limit (a) where a waiver is necessary to permit compensatory drawings to be made under paragraphs 5. and 6. above, or (b) to the extent that drawings in accordance with paragraph 6. are still outstanding.

Whenever the Fund's holdings of a member's currency resulting from an outstanding compensatory drawing are reduced, by the member's repurchase or otherwise, this will restore pro tanto the member's facility to make a further compensatory drawing under this decision, should the need arise.

8. In order to identify more clearly what are to be regarded as export shortfalls of a short-term character, the Fund, in conjunction with the member concerned, will seek to establish reasonable estimates regarding the medium-term trend of the member's exports on the basis of appropriate statistical data in conjunction with qualitative information about its export prospects.

9. The provision of credit to deal with the balance of payments effects of export fluctuations provides immediate relief for a country's short-term difficulties. In many cases, however, it will also be necessary to introduce measures of a policy character in order to attain a satisfactory and lasting solution to a country's balance of payments problems. Members generally have actively cooperated with the Fund to find and adopt the measures necessary to this end. Beyond immediate balance of payments difficulties, the primary exporting countries are, in many instances, facing unfavorable long-term export trends, and all are trying to meet the challenge of achieving more rapid and sustained development through a strengthening and broadening of their economies. The last mentioned problem will require action in many fields and over many years by both the primary exporting countries and the industrial countries, separately and in concert, including readier access to the markets of the developed countries for the products of the developing countries and an appropriate and sustained flow of technical and financial assistance to the developing countries. The Fund considers that its activities can provide valuable assistance in helping to establish a climate within which longer-term measures can be more effectively pursued.

Table 1. Adequacy of External Liquidity to Finance Fluctuations in Exports of Some Fund Members

(In millions of U.S. dollars)

Member	Maximum Financial Requirements Indicated by 1951-61 Experience1/ (1)	Assumed Limits of Finance Available: One third of external liquidity2/ (2)	One half of excess external liquidity3/ (3)	Fund Quota4/ (4)	One half of Fund Quota4/ (5)	Excesses or Deficiencies (-) in Available Financing: Column 2 minus column 1 (6)	Column 3 minus column 1 (7)	Column 4 minus column 1 (8)	Column 5 minus column 4 (9)
Argentina	192.3	101.3	91.2	280.0	140.0	-91.0	-101.1	87.7	-52.3
Bolivia	18.8	9.1	10.4	22.5	11.2	-9.7	-8.4	3.7	-7.6
Brazil	130.8	206.6	249.2	280.0	140.0	75.8	118.4	149.2	9.2
Burma	20.5	56.5	75.7	30.0	15.0	36.0	55.2	9.5	-5.5
Ceylon	25.8	42.6	49.0	45.0	22.5	16.8	23.2	19.2	-3.3
Chile	54.8	35.0	28.0	100.0	50.0	-19.8	-26.8	45.2	-4.8
Colombia	79.5	66.7	76.8	100.0	50.0	-12.8	-2.7	20.5	-29.5
Costa Rica	5.8	10.0	10.6	15.0	7.5	4.2	4.8	9.2	1.7
Cyprus	4.5	22.9	29.6	11.2	5.6	18.4	25.1	6.7	1.1
Dominican Republic	8.3	11.9	14.5	15.0	7.5	3.6	6.2	6.7	-0.8
Ecuador	5.8	13.8	15.9	15.0	7.5	8.0	10.1	9.2	1.7
El Salvador	7.8	15.4	18.6	11.2	5.6	7.6	10.8	3.4	-2.2
Ethiopia	4.7	29.6	40.6	13.2 5/	6.6 5/	24.9	35.9	8.5	1.9
Ghana	21.8	75.4	96.8	35.0	17.5	53.6	75.0	13.2	-4.3
Greece	12.3	116.7	145.3	60.0	30.0	104.4	133.0	47.7	17.7
Guatemala	5.7	22.5	28.2	15.0	7.5	16.8	22.5	9.3	1.8
Haiti	7.3	5.3	6.6	11.2	5.6	-2.0	-0.7	3.9	-1.7
Honduras	7.0	7.9	8.8	11.2	5.6	0.9	1.8	4.2	-1.4
India	148.0	305.6	368.2	600.0	300.0	157.6	220.2	452.0	152.0
Indonesia	135.0	89.9	101.8	165.0	82.5	-45.1	-33.2	30.0	-52.5
Iran	289.7	96.4	119.6	70.0	35.0	-193.3	-170.1	-219.7	-254.7
Iraq	54.7	56.0	67.1	15.0	7.5	1.3	12.4	-39.7	-47.2
Jordan	2.7	20.8	26.4	8.0 5/	4.0 5/	18.1	23.7	5.3	1.3
Korea	8.1	72.5	96.2	18.8	9.4	64.4	88.1	10.7	1.3
Lebanon	3.3	64.1	81.8	6.8	3.4	60.8	78.5	3.5	0.1
Libya	1.7	36.3	48.2	11.0 5/	5.5 5/	34.6	46.5	9.3	3.8
Malaya	246.0	290.1	404.8	32.5 5/	16.2 5/	44.1	158.8	-213.5	-229.8
Mexico	60.2	185.6	231.1	180.0	90.0	125.4	170.9	119.8	29.8
Morocco	2.8	81.2	103.2	52.5	26.2	78.4	100.4	49.7	23.4
Nicaragua	3.4	12.9	16.2	11.2	5.6	9.5	12.8	7.8	2.2
Nigeria	15.8	80.0	94.1	50.0	25.0	64.2	78.3	34.2	9.2
Pakistan	143.0	142.1	186.4	150.0	75.0	-0.9	43.4	7.0	-68.0
Panama	1.8	10.3	9.4	0.5	0.2	8.5	7.6	-1.3	-1.6
Paraguay	4.0	5.0	5.9	11.2	5.6	1.0	1.9	7.2	1.6
Peru	11.0	42.2	43.8	32.5 5/	16.2 5/	31.2	32.8	21.5	5.2
Philippines	15.2	46.7	40.1	75.0	37.5	31.5	24.9	59.8	22.3
Saudi Arabia	4.2	114.3	158.9	55.0	27.5	110.1	154.7	50.8	23.3
Sudan	32.8	63.9	86.1	15.0	7.5	31.1	53.3	-17.8	-25.3
Syrian Arab Republic	28.2	9.2	6.7	15.0	7.5	-19.0	-21.5	-13.2	-20.7
Thailand	24.8	175.7	243.4	45.0	22.5	150.9	218.6	20.2	-2.3
Tunisia	18.8	30.3	36.6	18.3 5/	9.2 5/	11.5	17.8	-0.5	-9.6
Turkey	51.3	85.9	107.6	86.0	43.0	34.6	56.3	34.7	-8.3
United Arab Republic	77.8	77.9	89.3	90.0	45.0	0.1	11.5	12.2	-32.8
Uruguay	60.3	82.8	115.6	30.0	15.0	22.5	55.3	-30.3	-45.3
Venezuela	0	229.5	295.9	150.0	75.0	229.5	295.9	150.0	75.0
Viet-Nam	34.7	60.4	80.0	18.5 5/	9.2 5/	25.7	45.3	-16.2	-25.5
Yugoslavia	9.0	36.3	16.6	120.0	60.0	27.3	7.6	111.0	51.0
Total	2,101.8	3,453.1	4,276.8	3,203.3	1,601.4	1,351.3	2,175.0	1,101.5	-500.4

1/ As described on page 12 of the text.

2/ A country's external liquidity is defined as its gross gold and convertible foreign exchange reserves plus its total tranche position with the IMF. Figures given are for mid-1962. A country's total tranche position with the IMF is the amount that it could still draw, as of a given date, if its justification were sufficient, without increasing the Fund's holdings of its currency above 200 per cent of its quota.

3/ Excess external liquidity (as of mid-1962) is defined as external liquidity (described in footnote 2) less average monthly imports (for 1961).

4/ Quotas given are for mid-1962.

5/ Quotas to be increased by annual installments, as follows: Ethiopia to $15 million by September 1963; Jordan to $11.25 million by July 1964; Libya to $15 million by September 1963; Malaya to $37.5 million by October 1963; Peru to $37.5 million by September 1963; Tunisia to $22.5 million by May 1964; and Viet-Nam to $22.5 million by November 1963.

Draft JG Jan. 11, 1963

MEMORANDUM

TO: The Executive Directors

From: Managing Director

Subject: Compensatory Financing

I am sending you herewith a tentative redraft of what were paragraphs 5 and 6 of the draft decision circulated to you on December 26, 1962, arising out of further consideration and informal discussions. The attached documen t continues to be for intramural use.

January 11, 1963

Compensatory Financing

Substitute for Paragraphs (5) and (6)

(5) Under the present policies and practices on the use of Fund resources, any member is given the overwhelming benefit of the doubt in relation to requests for transactions in the gold tranche, and the Fund's attitude to requests for transactions within the first credit tranche is a liberal one provided the member itself is making reasonable efforts to solve its problems. In the higher credit tranches too, where a member's policies are consistent with Fund policies and practices on the use of Fund resources in these tranches, the Fund gives assistance, on a substantial scale, towards meeting temporary payments deficits, including deficits arising out of export shortfalls.

The policies and practices of the Fund on drawings and stand-by arrangements have been developed in order to help members meet their temporary balance of payments difficulties and give them the time to formulate and adopt policies aimed at maintaining or restoring external and internal equilibrium. Members have found that Fund assistance in accordance with these policies and practices has been an effective contribution to the solution of their difficulties and the achievement of equilibrium. It has often led, moreover, to the provision of further resources from public and private sources for meeting immediate and longer-term needs. In the application of its policies and practices governing the use of its resources the Fund's attitude has been a flexible one and account has been taken of special difficulties facing members.

(6) The Fund has been considering how it could more effectively assist members encountering payments difficulties produced by temporary export shortfalls attributable to causes largely beyond their control, in circumstances where adequate policies for coping with the member's underlying problems have not yet been formulated.

It has decided that it will take a liberal attitude towards requests from members in such cases, provided that the member is making reasonable efforts to find a solution for its underlying problems and is consulting with the Fund for this purpose, or is willing to do so promptly after the drawing. The amount of drawings of this kind outstanding will not normally exceed 25 per cent of a member's quota. When drawings are made under this paragraph the Fund will so indicate in an appropriate manner.

(7) In addition, in order to implement the Fund's policies in connection with compensatory financing of export shortfalls, the Fund will be prepared to waive, for drawings under paragraphs (5) and (6), the limit on Fund holdings of 200 per cent of quota where appropriate. In particular, the Fund will be prepared to waive this limit (i) where this is necessary to permit drawings to be made under paragraph (6), or (ii) to the extent that drawings under paragraph (6) are still outstanding.

Mr. Jorge Del Canto

Room 807

(1) #3

CONFIDENTIAL

January 7, 1963

To: Members of the Executive Board

From: The Secretary

Subject: Executive Board Informal Session No. 62/5

The attached copy of the Secretary's Journal for Informal Session No. 62/5, held on December 17, 1962, is circulated for the information of the Executive Directors.

Att:(1)

Other Distribution:
Department Heads
Division Chiefs

INTERNATIONAL MONETARY FUND

Secretary's Journal of Executive Board
Informal Session No. 62/5

10:00 a.m., December 17, 1962

Per Jacobsson, Chairman
F. A. Southard, Deputy Managing Director

Executive Directors	Alternate Executive Directors
J. J. Anjaria	
M. C. Bicalho	A. Coutinho
W. B. Dale	J. S. Hooker
J. M. Garland	F. C. Pryor
W. Hanemann	W. O. Habermeier
G. W. Klein	J. Urrutia
	J. Waitzenegger
P. Lieftinck	H. M. H. A. van der Valk
D. B. Pitblado	R. H. Bonham Carter
	L. D. Hudon
P. Reina Hermosillo	C. E. Sansón
A. Z. Saad	
S. Siglienti	
K. Skjaeveland	L. Olofsson
	A. Nikoi
G. Suzuki	
	I. S. Sun
A. van Campenhout	M. Toussaint

Roman L. Horne, Secretary
F. Hodel, Assistant Secretary

Also Present

African Department: E. L. Bornemann, Tun Wai. Asian Department: C. C. Liang. European Department: R. Evensen, C. L. Merwin, J. K. Rosenblatt. Exchange Restrictions Department: I. S. Friedman, Director; J. H. C. de Looper. Legal Department: J. Gold, General Counsel; F. Ballmann, J. G. Evans, A. S. Gerstein, G. Nicoletopoulos. Middle Eastern Department: A. R. Bengur. Research and Statistics Department: J. J. Polak, Director; W. R. Gardner, Deputy Director; O. L. Altman, G. S. Dorrance, J. M. Fleming, R. R. Rhomberg, W. H. Taylor. Western Hemisphere Department: J. Del Canto, Director; P. J. Brand. Office of the Secretary: J. W. Lang. Office of the Treasurer: R. Kroc. W. P. Cooke, Personal Assistant to the Managing Director. G. Williams, Special Representative to UN. H. G. Hopkins, Information Office. Technical Assistants to Executive Directors: J. de Groote, L. Marini, Y. Mizoe, D. W. Wilson, A. Wright.

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1. COMPENSATORY FINANCING OF EXPORT FLUCTUATIONS - FUND REPORT TO CICT

The Executive Board resumed informal discussion of a revised draft Fund report to the CICT on compensatory financing of export fluctuations (SM/62/94, Rev. 1, 11/27/62, and Cor. 1, 11/28/62).

Mr. Klein pointed out that in order to find the right solution to the problem before the Board and find the right wording for this solution, it was necessary to know what exactly was wanted. He would say that the thoughtful staff paper still showed the mark of the hesitancy with which everyone had started on this problem. The previous informal discussion had, it seemed to him, considerably contributed to a clarification of the Board's thoughts. Yet, on the basis of his own state of mind, he would say that some confusion still existed in that the Board was perhaps hoping to attain through this scheme several effects which might well be incompatible with one another.

Mr. Klein wished first to state that he believed it to be an enormous improvement that the revised paper so clearly brought out that there were fundamental difficulties at present connected with trade between the two greatest industrial centers of the world, the European and the American, and the so-called primary exporting countries. He had admired the diplomatic elegance with which Mr. Waïtzenegger and Mr. Hanemann had referred to the passages of the paper as being incomplete, maintaining that for that reason they should be dropped. He would ask them very warmly to let these passages stand and even to strengthen them by their support. That these difficulties existed was a fact. That they had a considerable bearing on the repercussions of short-term fluctuations of exports he hoped to show presently. He was far from blaming any country in particular for these difficulties. They were the result of fears, of prejudices or beliefs, of sectorial interests, of political expediency, and of historical trends. They were at present undoubtedly a source of maladjustment within the community of nations. The fact was that the world at large had been brought into contact with the West, through Western initiative. The outer world now wanted to live Western style and it could do this only by strengthening its ties with the great industrial markets, channelling toward its countries a steadily increasing stream of goods, especially capital goods from the industrial nations, which were quite happy to sell them such goods--among other reasons because it helped them maintain a high degree of employment--but could not make up their minds to let them pay for them with their products.

A very similar situation, Mr. Klein observed, prevailed during the interwar period with respect to the United States. It was then so often and insistently repeated that in the longer run the world could only buy in the United States to the extent the United States was prepared to buy from the rest of the world or to give its surplus away, that a deep change of mind came about in this country, which in a move of unparalleled generosity decided to give away huge amounts of its products, and if some market interference was still being practiced, there was good hope that this would eventually become a thing of the past. It was an illusion to believe that a group of countries could pay for with money what they were not allowed to pay for in kind, or that by actively trading among themselves they could produce the money needed to pay the Western markets. There was, therefore, a good deal of intrinsic logic in the DIF scheme, which the Board was not considering, with its periodic cancellation of unpaid balances. Mr. Klein said he readily agreed with other Directors that most enumerations of measures needed to overcome these maladjustments were likely to be incomplete. He had no difficulty in admitting that the solution could only be reached by concerted action from both sides, that countries which did not lose faith in their export production, like Australia and New Zealand, but on the contrary expanded it (though perhaps reassured by their strong link with their main foreign market where no restrictions existed), had fared much better than others who let themselves be scared into neglecting this sector. Yet all knew what was meant. He believed that everyone was in agreement that the aim was a closely and spontaneously cooperating world, knit together by a tight network of equilibrating trade currents. He asked the other Directors to consider that, while the economic initiative belonged largely to those markets where techniques had advanced fastest, the burden of adjustment, calling for recurrent painful and frustrating self-restrictive measures, devolved upon the so-called primary exporting countries, a burden which was the heavier the less intimate were the links of a country with its foreign markets, the less assured a country could be of their maintenance, let alone expansion. An example was the case of Chile when its market for saltpeter shrank drastically because fertilizers could be produced more economically by chemical reactions. Chile could not do anything about this. She could not speedily put some other product on the market to make up the loss. The initiative had to come from the industrial world, and in the meantime the burden of adjustment could not be dodged by Chile.

This situation, Mr. Klein said, again had its effects in the field of short-term export fluctuations. The less certain the market, the more would any additional, even though temporary, deficiency be felt. Whatever its cause, private finance would be less ready to help out if the long-term prospects were dim. Here, the Fund might play an important role. And if it was known that the Fund would contribute to bridge the gap, private finance might perhaps be more willing to venture forth in its turn.

It seemed to Mr. Klein that the proposed scheme had certain objective or factual aims and certain psychological aims. The factual aim was, of course, to help countries to overcome difficulties arising from these short-term export fluctuations. The country would cover the deficiency partly with past surpluses in the shape of accumulated reserves and partly with future surpluses anticipated by the Fund, since the drawings were to be repaid. It was an important feature of the scheme of far-reaching psychological implications that countries could feel that they were facing their difficulties with their own means and were not depending on charity nor taking from the rich--as some saw it--a small fraction of what the rich had taken formerly from them. Whether these fluctuations had been brought about by mistaken policies pursued by the country, was in his opinion irrelevant. The important thing was whether the country was willing to follow in the future policies aimed at minimizing the effects of the fluctuations inasmuch as this was within the power of the country. This, in his view, was very important because it would be decisive for the attitude of private finance. What the Fund could do in the field of balance of payments compensation was very limited and needed the complement of private capital flows.

It would seem, Mr. Klein said, that the facile compensation of export shortfalls might not always be a blessing. On page 13 of the revised draft report he had found a reference which seemed to purport that in certain cases, like that of Bolivia and Pakistan, generous automatic compensation payments at a certain time during the last decade would have aggravated the difficulties of later years, when repayments falling due would have to be met with still diminishing export proceeds. This showed very clearly that the short-term fluctuations to be financed had to be assessed with due regard to the over-all situation, present and prospective. A case in point was that of Argentina in 1961. A very sharp fall in wheat exports, the crop having been practically lost owing to a severe drought, had coincided with an exceptionally high import bill in the wake of an internal credit expansion, consisting to a great extent of capital goods with short-term finance. There was a considerable amount of capital flight. Drawings against the Fund were in the third credit tranche. The export shortfall accentuated the payments difficulties and added greatly to the hardships in 1962 by hardening the attitude of foreign private creditors with their Argentine debtors. The discharge of this debt led to a concentrated demand in the exchange market. The peso dropped more than the increased internal cost level would have warranted. This export shortfall was therefore most unfortunate.

Yet, Mr. Klein continued, had an automatic compensation credit been available, this might have served to extend the period of money expansion for another few months. Considering the prevailing circumstances, this would have been most likely to happen. The compensatory credit would then have financed an additional volume of flight capital. In this way, the country might have found itself in a situation no better than the present one, yet with a higher foreign debt. Under what conditions might such compensatory financing have changed the state of confidence? In Argentina, confidence was shaken by a number of largely noneconomical factors. He believed experience showed that for financial assistance to change of its own accord a shaky state of confidence, it had to be very massive. A moderate measure of financial assistance seemed to be effective mainly inasmuch as it was backing decisive government action. If, in addition to the currently negotiated stand-by, a compensatory credit tranche had been available--assuming furthermore political tranquility--a successful stabilization program might have been carried out. Capital flight might have been stopped earlier, Argentine debtors might have found easier accommodation abroad, and the peso might not have dropped to the present level. But all such outcomes were, of course, just guesses. He mentioned them because they very tellingly showed how important it was to assess each situation by its particular merits.

Turning to the various psychological effects of the proposed scheme, Mr. Klein noted that among a group of primary exporting nations the question of export proceeds was heavily charged with political emotion. This was the combined effect of their relatively passive position in the export markets and the fact that their staple export frequently had been and still was handled by foreign concerns. It was very important to avoid that excessive hopes connected with the scheme should give way to deep disappointment. For this reason, it was important that the very limited scope of compensatory financing for short-term fluctuations, which the staff had mentioned in the paper, should be very clear to all concerned.

Then, Mr. Klein observed, reference could be made to a general psychological effect if the impression could be conveyed that short-term fluctuations in the prices of raw materials no longer needed to be a cause for worry. This might induce bankers and financiers all over the world to be more forthcoming in the case of such fluctuations, which again could have a general stabilizing effect on world trade. But such generalized confidence seemed to be dependent upon the financing being completely automatic, which in many instances, he believed, would not be in the interest of the countries financed.

There was also the question of the position of the Fund, Mr. Klein continued. Owing to the conscientiousness with which the Fund had gone into the details of the difficulties of the countries asking for its assistance, the Fund was now enjoying great authority, which was sometimes burdensome to carry. A country's agreement with the Fund had turned out more than once to be the decisive consideration which would lead governments and bankers to come to the assistance of that country. Yet the Fund itself was sometimes subject to considerable pressure, not always illegitimate pressure, to help countries whose policies did not measure up to strict standards but who believed that they were justified in taking a less sound line, perhaps because the government believed that it had not the material power to do better or because the right policies were thought to entail grave social risks, or for other similar reasons. Mr. Dale, making a grouping of different cases which might come to the Fund in quest of compensatory finance, had perhaps referred to such situations in what he had termed "Case C." It was not always easy to remain firm in the face of such arguments, especially if the difficulties appeared to be attributable or to have been aggravated by external events for which the country or its government could not be held responsible. And, if the Fund's realistic standards were being respected and appreciated by some, they were resented by others who had created the image of a narrow-minded Fund which imposed checks on growth and development for the sake of a stability fetish.

There was a natural desire to build up, as Mr. Garland had put it, the image of a more positive and responsive Fund.

It might seem, Mr. Klein added, that a scheme of automatic compensatory finance could be an expedient way out. It would allow the Fund to grant aid irrespective of the policies which the assisted country proposed to follow, yet without the Fund lowering its own standards, which in this case would simply not come into play. He had not found it easy to make up his mind in the face of this tricky question. He believed, however, that this way out was not good enough. He believed that the Fund could not suffer a country to assume an additional debt for no purpose and with no benefit, as would frequently be the case if the borrowing was not followed by sound policies in the use of the loan. By now the Fund was so well apprised of the financial conditions in practically all the countries of the world, that it could not be altogether unaware when a transaction was not in the interest of the country.

For the reasons given, Mr. Klein said he was in general agreement with the conclusions set forth in the staff paper. The most important of these was contained in paragraph (3)(b). Mr. Waitzenegger had suggested that additional compensatory finance could be granted, without making conditions tighter, in the case of a country which had already drawn against the Fund and was carrying out the policies agreed upon. Mr. Klein believed that this was an acceptable criterion and that the Fund would do this in most of the cases without need of a special general decision when the policies of the country were considered in general satisfactory. But this should not apply to cases where the policy pursued could not be called sound. Consequently, the first part of the paragraph had to remain at least as drafted by the staff. It was evidently essential that the country should concur with positive action to the solution of its problems. He had also felt in sympathy with Mr. Lieftinck's careful alternative drafting of this paragraph. But, while he believed that in general the Fund should see to it that a country which had been helped tried to "adjust its total expenditures to the longer-run changes in its available resources," Mr. Klein thought that while such a policy might be applied in practice, it might not be wise to fix it for the time being in so many express and consequently limiting words. He felt much the same way as Mr. Garland, and believed that this new field should be approached in a spirit of careful experimentation, allowing experience to shape the Fund's policies. He believed that Mr. Lieftinck's concept was covered by the wider and looser wording of the staff's draft. For the same reason, Mr. Klein said that, while he was in complete agreement with the general considerations which Mr. Reina had made at the previous session, he did not think that it would be advisable to try to define in the abstract the different situations in which countries in quest of assistance might find themselves and to lay down distinctive rules in order to deal with each of them. In the same way he had found the groupings of cases made by Mr. Dale most helpful, but he would not go along, for the moment at least, with an attempt to distinguish, within an export shortfall, that part which was due to what Continental law would call force majeure and that other part which was the doing or undoing of the country, the first being compensable and the second not. Indeed, in ordinary Fund transactions, the Fund had more often than not helped countries to overcome the consequences of their own mistaken policies, without asking more of them than a pledge to follow in future a safer course.

While he therefore believed that the present wording of conclusion (3)(b) served its purpose, Mr. Klein said he understood that because of the public relations aspects referred to by several Directors, especially Mr. Dale and Mr. Garland, something more positive should be said about the additional resources which the Fund would employ in financings under a compensatory scheme. And while he believed that it would serve no purpose to limit such financing to one credit tranche, he thought the Board might perhaps say that these transactions should not for the time being push the Fund's total holdings of any one currency beyond the 225 per cent of quota mark. It might also be said, as Mr. Waltzenegger had mentioned, that when the Fund was satisfied that the country was making reasonable efforts to solve its problems, the loan might be granted "within the framework of the Fund's current arrangements with the country," that is, without making the conditions more severe, provided that in the considered judgment of the Board the circumstances of the case warranted such treatment.

Mr. Klein also said he agreed with other speakers that the last sentence of conclusion (4) and the two last sentences of conclusion (5) should be deleted, and he found that inverting the order of the paragraphs thus shortened would make for clearer exposition of the Board's thoughts. He would retain conclusion (1) as it stood.

Mr. Klein then proposed consideration of the following redraft of conclusions (2), (3), (4) and (5):

> (2) The provision of foreign exchange to its members to enable them to finance export fluctuations constitutes a legitimate use of Fund's resources, and they have been drawn on frequently for this purpose. The quotas of many countries, taken in conjunction with the reasonable use of their own reserves, are at present adequate for dealing with such export fluctuations as have occurred during the past decade, and there is room for members to make an increased use of the Fund for financing balance of payments deficits arising from export shortfalls. Where necessary, therefore, increased use could be made of the Fund's resources within the framework of the present Fund's policies, for instance by a more extensive use of stand-by arrangements.
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> (3) Members may be given further assurance that their needs in regard to compensatory financing will be more amply taken care of by the following developments.

(a) The Fund is now examining the quotas of the primary producing countries with relatively small quotas, in order to determine whether adjustment would be warranted considering the various functions which quotas serve and could make them more adequate to meet the country's needs in connection with export fluctuations as well as other balance of payments fluctuations.

(b) The Fund's attitudes towards requests for drawings that are related to payments difficulties attributable to causes beyond the control of the member will be a liberal one, provided that the member itself is making reasonable efforts to solve its problems. For this purpose the Fund will be prepared, in individual cases, and especially in the case of temporary export shortfalls, to increase the resources made available to a country within the framework of its current arrangements with this country and to waive, if necessary, the 200% limit to its holding of any one currency (up to the limit of a further credit tranche), if in the judgment of the Board the circumstances of the case warrant such policies.

(4) The Fund has given extensive consideration to proposals for automatic compensation of export fluctuations on the basis of a statistical criterion of export shortfalls related to export values for recent years. It concludes that the compensation that can appropriately be achieved in this manner is distinctly limited and that it may well be against a country's genuine interest if automatic finance is provided without an exploration of the causes of the decline in a country's exports and the measures to be taken to improve exports in the future.

(5) Increased action by the Fund in the field of compensatory financing, whatever its form, will channel additional resources to the primary exporting countries on a temporary basis. Any other arrangement to provide additional resources on a loan basis would inevitably be similar in many respects to Fund drawings and repurchases. It would, therefore, in the opinion of the Fund, be preferable to provide such additional resources through the Fund, to ensure coordinated, expeditious and consistent action.

Mr. Anjaria observed that a great deal of ground had already been covered by other speakers, and he was happy to note that there now appeared to be a certain consensus of approach and opinion. He welcomed the more positive and constructive line taken in the new draft as compared with the earlier one. He agreed with the presentation of the analysis and broadly with the conclusions. Obviously, the main conclusion was that Fund policy had been evolving over the last few years and that a further adaptation of it was envisaged in the light of the problem as now seen. His first suggestion would be that the report should indicate more clearly the adaptation that had already taken place and provide some statistical measure of the amount of assistance the Fund had provided in recent years by way of compensatory financing. While he realized the difficulty of isolating short-term and long-term fluctuations and the weight to be assigned to the various factors in the balance of payments in each given situation, he thought it would represent an advance if the report could show that the Fund had been dealing with this kind of problem and that the increase in the drawings by a large number of primary producing countries in recent years reflected the adaptation of Fund policies that had already taken place.

Mr. Anjaria said he was still not happy about Table 1 and its inclusion in the Fund's report. It contained such valuable information in brief compass, and it was important for the Board. But he doubted whether this information on individual countries should be given to an outside body, and particularly the material in the footnotes to pages 13 and 14. Despite the reservations or limitations stated in the text, there was, in his view, some danger of wrong inferences being drawn. It would be much better, in his view, to present the gist of the table in some other way and supplement it by illustrations of the role the Fund had played in recent years in the direction of compensatory financing.

Mr. Anjaria said it was clear from the staff paper that the question of quota increases was an entirely separate matter and not part of the Fund's central argument in this context. The crux of the new approach was policy relating to drawings. The point being put across was that the Fund was working toward a further liberalization of these policies which would enable it to finance more than it had done in the past balance of payments deficits caused by shortfalls in the export earnings of the primary producing countries. As Mr. Dale had said at the previous session, the problem for the Fund hinged around Cases C and E. The answer was being given in conclusion (3)(b), but the present formulation still did not seem quite adequate. More clarification was needed, as Mr. Garland and Mr. Klein had suggested. It seemed to Mr. Anjaria that the Board was now moving toward the position that the Fund would be neither extra strict nor extra liberal where a country already in the second credit tranche found itself in need of further assistance to overcome difficulties caused by a short-term adverse movement in its exports. In other words, the Fund would treat this as a kind of special drawing and would not insist upon a stabilization program which it might otherwise have required for a drawing beyond this tranche. On the other hand, as far as he understood the position, the Fund would not relax its basic criteria as to relevant policies because drawings on its resources were not automatic. Mr. Anjaria thought the Board was working toward agreement on a special tranche in the higher ranges, the logical conclusion of which would be to raise the maximum level of drawings to 225 per cent of quota, but whether or not anything should be said in the report on this point or whether the Board would decide each case in terms of this broad understanding was a separate matter on which he had no particular preference.

Mr. Anjaria then directed attention to the statement on page 7 of the revised report where reference was made to the Fund not insisting on certain "ideal" policies in a situation where a country found itself confronted with the kind of difficulties now under discussion. As examples of "ideal" policies, mention was made of the elimination of all payments restrictions, the adoption of full currency convertibility at an effective par value, and the abolition of all multiple rates. In his view this was not the answer. He doubted that anyone believed that, if a country did not have full currency convertibility and had some restrictions, the Fund would insist at that moment on the elimination of such restrictions or on the adoption of full convertibility and on the adoption of the so-called ideal pattern. What worried many countries was that, if a country which had drawn through, say, the first credit tranche and then ran into balance of payments difficulties caused by a shortfall in export earnings, the Fund might insist at this stage on the adoption of deflationary internal policies. In practice, he was confident that in a situation of that kind the Fund would not insist on deflationary policies that might create further difficulties in the longer run, but this was the kind of assurance needed.

Turning to the text of conclusion (3)(b) and Mr. Lieftinck's redraft, Mr. Anjaria said he would agree that the original text was in such general terms that the countries concerned would not know what was expected of them. Mr. Lieftinck had drawn attention to an aspect that was important. On the other hand, his emendation contained criteria that seemed difficult to apply because it would not only be necessary to define the longer-run availability of resources but also to define the policies that would bring about the needed adjustment to the availability of those resources. There were difficulties in respect of both these steps.

Continuing, Mr. Anjaria said he had doubts, for which he did not know the answer, about how in practice one could distinguish in fact between a short-term fall in the balance of payments due to a drop in export earnings and the longer-term trend. It was not quite clear whether there were or were not a number of clear cases where it could be said that the balance of payments difficulties were definitely a short-term phenomenon which could be met by recourse to the kind of compensatory financing arrangement now being proposed. If the answer was that the longer-run trend came at the end of a series of stages, then the operation of the whole scheme would be quite difficult. He believed some compromise between the staff's text for conclusion (3)(b) and Mr. Lieftinck's formulation would have to be found. Some assurance would be necessary that in a situation of the kind outlined on page 7 of the report the Fund would not immediately conclude that the member needed to initiate longer-run deflationary measures. He believed that what the Board was trying to say was that beyond the first credit tranche the Fund was considering some kind of liberalization up to a limit of 225 per cent of quota and that a drawing for compensatory financing purposes would not prejudice the normal drawing rights of the country concerned or alter the Fund's criteria for such drawings.

With respect to conclusion (4) and the question of a separate institution, Mr. Anjaria said he felt strongly that it would be best for the Fund to be frank, and say quite clearly that if a new institution was to be set up it should be an affiliate of the Fund. As regards the last sentence of conclusion (4), after Mr. Garland's suggestion, Mr. Anjaria said he believed the sentence should say that it would be preferable to provide additional resources through the Fund "or through a suitably organized affiliate." This should be stated straightforwardly because otherwise a new institution, with a purpose not too well defined but very similar to the Fund's, might be brought into existence, and this might not be in the interest of the Fund or the countries concerned.

Mr. Anjaria added a comment on the presentation of the two alternative changes in its policies to which the Fund did not feel attracted (SM/62/94, Rev. 1, p. 15, 11/27/62). He felt that this wording spoiled the impression of the whole section and that the point could be made earlier in the report. He would end the section with the positive statement that appeared before the two alternative changes were discussed.

Mr. Hudon said he would like to center his remarks on the conclusions of the revised staff paper and in particular on conclusion (3)(b). At the outset, he must confess that he had had some difficulty in grasping the full implications of that conclusion and that he remained somewhat puzzled by it. If, as he thought it must, the conclusion was interpreted in the light of the second paragraph of page 15 and more particularly the first sentence of that paragraph, then it seemed to him that the adoption of the draft report would result in only very slight and perhaps imperceptible changes in the existing policies and practices on drawings. The second paragraph of page 15 seemed to say in effect that the existing policies and practices for drawings in the second and further credit tranches need not be changed, because they were sufficiently flexible and liberal to take care of the needs for compensatory financing. The rule governing drawings in the first credit tranche would not apparently be changed. The only promise of change contained in the second paragraph of page 15 was the more frequent use of the waiver on holdings beyond 200 per cent of quota.

If, however, conclusion (3)(b) were read in isolation, Mr. Hudon continued, then it seemed to him that it could be interpreted very broadly and could offer more than sufficient flexibility to deal with the question of compensatory financing. As far as he could see, the conclusion provided: (a) that once it had been established that drawings were related to payments difficulties attributable to causes beyond the control of the member, such drawings could be made under the rule laid down for drawings in the first credit tranche; (b) that such drawings could be repeated and were not limited to one credit tranche; and (c) that such drawings could be made with equal ease at the higher tranche levels (say, beyond 200 per cent of quota) and at the lower tranche levels. This interpretation of conclusion (3)(b) seemed entirely justified, because (a) the words "provided that the member is making reasonable efforts to solve its problem" were identical to the words used to define the first tranche credit rule in the last Annual Report, and (b) the conclusion did not explicitly place any limitation with respect to the number of tranches or the level of holdings.

Thus, in Mr. Hudon's opinion, conclusion (3)(b) gave the Fund ample scope for dealing with and for taking a liberal attitude toward the question of compensatory financing. However, as a practical matter, it might be assumed that the words "reasonable efforts" would inevitably tend to take on a less liberal, though by no means an illiberal, meaning when drawings for compensatory purposes were made in higher tranches. Certainly their meaning would tend to evolve along these lines in his own mind. It seemed to him, therefore, that the second paragraph of page 15 should be replaced by one which would attempt to explain the meaning which, as a matter of fact, would be attached to the words "reasonable efforts." He would return to this point later. But subject to this condition regarding page 15, he would be prepared to accept conclusion (3)(b) as it now stood.

One of the main objections to the adoption of conclusion (3)(b), Mr. Hudon said, was probably presentational because the promise of action which it held could not be defined in very concrete terms. One possible way of overcoming the presentational problem would be to make available, as had been proposed, drawings for compensatory purposes to the extent of 25 per cent of quota subject to certain well-defined conditions. He had some reservations about this approach. If, on the one hand, 25 per cent of quota, plus reasonable use of a member's resources, would be sufficient to cover the needs of all members for compensatory financing, the 25 per cent limitation seemed unnecessary; if, on the other hand, 25 per cent of quota would not always be sufficient, a question of equity would arise. This approach would also lead to certain anomalous situations. One such situation would be the case of a member which, for one reason or another, would not normally be entitled to draw on the Fund, but which might nevertheless under a compensatory tranche system be entitled to draw 25 per cent of its quota. The staff had already noted in its original memorandum that it might be confusing "to the relationship between the Fund and individual members if the latter were entitled in certain circumstances . . . to obtain assistance from the Fund without regard to the member's observance of its understanding with the Fund." This observation made in connection with a fully automatic approach was equally applicable to a system involving a compensatory tranche. He believed, although he had not had the opportunity to study it in detail, that Mr. Garland's proposal met most of these reservations, and he found his approach in many ways attractive.

For his own part, Mr. Hudon said he wondered whether it would not be possible to devise a new set of policies and practices (i.e., a new set of rules) to be applicable to requests for drawings related to payments difficulties beyond the control of the member. The new rules would be tranche-for-tranche more liberal than existing policies and practices, but would carry with them a decreasing degree of automatism as one moved up the tranche scale. The graduation of automatism might be set out in terms of the causes of the export shortfall and in terms of the level of the Fund's holdings. For example, the rules might provide that, if the causes of the fall in export earnings were a natural phenomenon, such as a flood or pests, the member would qualify for at least first credit tranche treatment irrespective of the level of the Fund's holdings of its currency. To give another example, if the fall in export earnings were caused by changes in world market conditions, the member might be given, in the absence of any clear evidence to the contrary, the full benefit of the doubt that the change did not form part of a medium-term downward trend. If, however, there was clear evidence of a downward trend, the degree of automatism would not be as great, particularly if the Fund's holdings of the currency of the member concerned was high.

Mr. Hudon said he did not know whether such an approach was practical. In any event, he would be most appreciative if the staff would explore the possibilities because he believed that an approach along these lines offered a number of significant advantages. It would be completely in accord with the Fund's established policies and practices of graduated automatism; it would ensure a liberal approach to compensatory financing; it would be flexible; and it would provide room for the exercise of intelligence and judgment.

Turning to the other conclusions, Mr. Hudon said that he had no objections to conclusion (1); in fact, he welcomed it. However, he realized that the factors mentioned in the last sentence of the paragraph did not constitute a comprehensive list of the actions which had to be taken to deal with the basic problems of countries relying on proceeds of exports of primary products. The list was illustrative and perhaps this should be made clear in the conclusion.

With regard to conclusion (3)(a), Mr. Hudon did not interpret it to mean that the Fund intended to bring about a general increase in quotas in order to deal with the question of compensatory financing. He interpreted it to mean only that on the basis of available statistical evidence it appeared that the quotas of some countries might have fallen out of line with the quotas of others and that some selective adjustments in quotas might therefore be justified.

Finally, Mr. Hudon said that like other speakers he would find it difficult to accept the last two sentences of conclusion (5).

Mr. Suzuki explained that due to his prolonged trip abroad he had not personally followed the remarks and suggestions made by the other Directors at the previous informal sessions on this subject, and, therefore, he preferred to refrain from going into details even though a general statement at this stage of the Board's consideration might be somewhat amiss. He thought the revised draft report now before the Board was well written and a marked improvement over the first draft.

Mr. Suzuki wished first to state that, broadly speaking, and in view of the short- and long-term difficulties of the less developed countries with respect to their earnings from exports of their primary products, he recognized the growing necessity of exploring effective ways in which these difficulties might be eventually alleviated. Among these was the possibility of compensatory financing of the fluctuations in the export earnings of the primary producing countries. In this respect, he believed it very wise and proper that the Fund had given consideration to the question whether and in what way it ought to perform an increased role in dealing with the balance of payments effects of such export fluctuations. It was rightly stated in the draft report that the Fund purported to deal with the short-term difficulties of the countries relying on the proceeds of exports of primary products by the provision of repayable credits, but it did not purport to deal with the more basic problems of the longer run although there were difficulties, as Mr. Anjaria had mentioned, in differentiating the short-term difficulties from the long-run problems.

Continuing, Mr. Suzuki observed that however liberal the Fund intended to be in providing credit to meet export fluctuations, there were certain limits beyond which it could not go if its action were to be consistent with its Articles of Agreement. Thus, he believed the revised staff paper very well outlined what the Fund could do and what it should not do. He was satisfied that the wording used could be interpreted with some flexibility. The re-examination of the quotas of the primary producing countries, in particular those of the countries with relatively small quotas, and a reasonable liberalization of the Fund's attitude toward requests for drawings could be considered as appropriate approaches. More specifically with respect to the latter, the liberalization should not go to the extent of so-called automatic compensatory financing.

During his recent visit to Southeast Asia, Mr. Suzuki said, a Governor of the Fund for a less developed primary producing country had told him that automatic compensatory financing would not give long-term benefits to individual developing countries if it was provided without appropriate analysis of the basic causes of the export fluctuations and their effect on the balance of payments, and the Governor concurred with the conclusions in the revised draft report.

Mr. Suzuki said he expected that realistic approaches to the questions of quotas and drawings would bring about a considerable advance toward the financial solution of the short-term difficulties created by fluctuations in the export earnings of primary producing countries. Generally speaking, he supported the conclusions in the revised draft report, although he believed that both the question of quota increases and the matter of adjustment of the Fund's policies toward drawings should be subjected to further careful examination and consideration.

Mr. Toussaint explained that Mr. van Campenhout had been unexpectedly prevented from attending the meeting at this time and had requested him to express the following views on his behalf. As requested at the end of the last discussions, his comments would be directed mainly to the essence of the problem. Like other speakers, he thought that paragraph (3)(b) of the conclusions in its present form did not meet it. His comments, therefore, centered on two alternative types of proposals which had been advanced by some of the other speakers: (a) the creation of a special tranche as defined either by Mr. Dale or by Mr. Waftzenegger, on the one hand, and (b) Mr. Lieftinck's proposal, on the other. Mr. van Campenhout's preference went to the latter.

Continuing, Mr. Toussaint observed that no one had challenged the fact that the Fund could finance only deficits of a temporary character. This was not, of course, a matter of free policy. It was the very concept of the Fund as a financing institution, and it was mandatory. The Fund's present policies had made clear that not only those deficits having this character by their nature could be considered as temporary, but those which might be so qualified thanks to the corrective policies of drawing members. This was indeed a very constructive aspect of Fund policies, the basis of which would certainly be weakened if the Board became too lax in its judgment of members' corrective measures. The judgment of the temporary character of a deficit necessarily implied a judgment of members' policies. There was, in his view, no dispute on this point. However, what had been said, but not perhaps emphasized enough in the earlier discussions, was that the judgment of the Fund on the nature of a deficit must be based on the balance of payments as a whole and not on particular items.

Mr. Toussaint explained that Mr. van Campenhout's misgivings with regard to the creation of a special tranche was that it overlooked this particular point. In addition, he felt that a special tranche would constitute a privilege to a class of members and for the solution of specified problems, and he doubted that the Fund could hold to this discrimination. In short, the creation of a special tranche seemed to lead to a policy of financing individualized items of balance of payments whose temporary character would be judged out of the context of the whole situation. This would undermine the very basis of the Fund's policies. This criticism, however, did not apply to Mr. Lieftinck's suggestion, which had other advantages.

Mr. Toussaint went on to say that the problem the Board was now examining did not really call for a change in Fund policies but rather for a clarification of how the Fund could and would be willing to apply them, as Mr. Hanemann had said. This was what Mr. Lieftinck's proposal did. It made clear that, when deficits of balance of payments could be essentially attributed to other causes than those under the control of a member and in particular not to fundamentally erroneous policies, the Fund's principles did not demand immediately complete corrective measures. This was a serious assurance that members whose policies were fundamentally sound could count on the Fund's financial assistance in any tranche.

With respect to the quantitative aspect of drawings, Mr. Toussaint recalled that Mr. van Campenhout had pointed out in a previous meeting that the problem could be taken care of by an increased use of the waiver clause. A reference to this could conceivably be inserted in Mr. Lieftinck's formula as one form of the liberal attitude which the Fund could adopt in appropriate cases.

Mr. Toussaint then turned to the other points of the proposed conclusions on which Mr. van Campenhout had some remarks. With respect to conclusion (1), he shared Mr. Waltzenegger's misgivings concerning the last sentence which enumerated the steps by which a fundamental solution could be found to the basic problems of countries relying on the proceeds of exports of primary products. This enumeration was not and could not be exhaustive, and it neglected important measures, in particular those which could be taken by the countries concerned themselves. Mr. Toussaint, therefore, suggested that the sentence be either dropped or substantially revised.

Mr. Toussaint then referred to paragraph (2) of the conclusions which indicated inter alia that the quotas of many countries were at present adequate from the point of view of financing export fluctuations. He felt that it should also be indicated somewhere, either in paragraph (2) or perhaps in paragraph (4), that the Fund's resources were also considered adequate at this time to enable the Fund to exert its proper action in this field.

Turning to conclusion (3), Mr. Toussaint pointed out that the introductory sentence could usefully be redrafted to indicate that already in the past the members' needs for compensatory financing had been given increasing attention by the Fund and that they could adequately be taken care of within the framework of the Fund's policies. The text would then add that two points could be particularly mentioned in that respect and thus introduce paragraph (3)(a) and (3)(b) redrafted as appropriate.

With respect to conclusion (3)(a), Mr. Toussaint pointed out that the text should be revised to emphasize the selective approach to the question of quota increases. Instead of saying that the Fund was now examining the quotas of the primary producing countries, the text could be amended to indicate that the Fund was prepared to consider requests for quota increases in appropriate cases.

Concerning conclusion (3)(b), Mr. Toussaint referred to his previous comments. Finally, he underlined that Mr. van Campenhout shared the views of the Directors who felt that any reference to affiliation of a possible new specialized agency to the Fund should preferably be dropped from paragraph (5) of the draft conclusions.

Mr. Skjaeveland said he had studied the revised report with great interest and he had also benefited very much from the elucidating discussions on the subject in the previous sessions and the present one. His latest approach to the document had been, in the light of the report on the second session of the Technical Working Group, to try and read the revised draft with the eyes of the recipient, that is, the UN Commission on International Commodity Trade. He felt confident that the Commission, like the Board, would find it a useful document, well written, and systematically well arranged. The main attention of the Commission would, naturally enough, be focused on those conclusions in the document that went beyond the normal limitations as set forth in the 1960 paper on the policies and procedures of the Fund.

In this respect, Mr. Skjaeveland continued, the Commission would find two conclusions which indicated a more positive attitude or constructive spirit than in the previous paper on the problem of compensatory financing. The first promising element the Commission would find in paragraph (3)(a) of the conclusions to the effect that the Fund was re-examining the quotas of the primary producing countries, in particular the small ones, in order to determine whether adjustments would be desirable, and the Commission would rightly interpret adjustments as increases. Some members might comment on the somewhat cautious formulation of this paragraph and raise the more general question whether in this era of cooperation and internationalization in the monetary field, increases in Fund quotas should not be regarded as a step, a minor one, toward the more ambitious, more sophisticated schemes which had been launched in recent years. Other members would explain that there were several other aspects to the problem of quota increases, and find comfort in the statement on page 17 that a moderate increase in the drawing facilities of the less developed countries in the Fund would probably not at present require quota increases from the developed countries.

The Commission, recalling the term "liberal" in its more limited context in the Fund's 1960 paper, Mr. Skjaeveland said, would probably consider the new version in paragraph (3)(b) a useful step in the right direction, although skeptics might comment on the amount of flexibility the term "liberal" implied. From the conclusions (4) and (5), one might presume, the Commission would conclude that the Fund, subject to certain conditions, considered itself in the best position to handle the problem of compensatory financing, and even without involving the intricate issue of automaticity in financing. In the event of competitive bidding, the latter point might prove decisive when the Fund offer was compared with the two automatic schemes submitted by the Technical Working Group.

Mr. Skjaeveland then added some personal comments on some of the conclusions. He had the impression that there was agreement in the Board on the first half of conclusion (1). The point of departure should be the more basic problems of the longer run. The views seemed to differ, however, with regard to the second half of the paragraph where indication was given of the solution of these problems. He agreed that a full presentation of the problem and possible solutions would be too voluminous, and not even required, but he thought nevertheless that it should be mentioned, for example, that the fundamental solution of these problems would "inter alia" depend on various measures.

It seemed to Mr. Skjaeveland that it would be advisable to use the same systematics in the preceding section V. In the present set-up the general basic problem was dealt with in the third paragraph on page 15. Would it not be advisable to transfer this part to the beginning of section V, or rather as a new second paragraph on page 14?

Although he could see the point made earlier in the discussions that conclusion (3)(b) might lead to exaggerated expectations, Mr. Skjaeveland felt inclined to support Mr. Garland's suggestion to keep at this stage the rather loose formulation as it was with its general qualification. He would hesitate to include more specific qualifications, in particular qualifications that would reflect on degrees of creditworthiness of individual groups, also from a public relations point of view. The saying that "in order to get a loan in a bank you will have to prove that you do not need it," might easily be switched to apply to Fund transactions too. The increased liberal attitude would, at least initially, have to be interpreted according to the merit of the case, and in this appraisal guidelines, such as indicated in Mr. Dale's analysis, could prove very helpful. A more liberal attitude of the Fund toward requests for drawings would also to some extent be contingent on whether or not the suggestions in conclusion (4) about additional resources would be adopted. In this paragraph, the Fund was virtually recommending that it should receive additional funds for its compensatory finance operations. The conditions were, however, according to conclusion (5), that such finance if arranged through the Fund should not be automatic.

Mr. Skjaeveland noted that the Fund's attitude to automaticity in compensatory financing in general was set forth in the first half of conclusion (5). It was carefully embalmed, but in essence it was somewhat negative. This general impression was somewhat modified by the second half of the paragraph where it was stated that it would not be desirable to arrange such compensatory financing with the Fund's resources, i.e., the issue was limited to the Fund proper. Furthermore, the last sentence in the paragraph seemed to admit that other international bodies might have views on automaticity in compensatory financing that differed from that of the Fund.

In the circumstances, and in view of the fact that a report was being submitted by the Technical Working Group to the CICT proposing two schemes which in principle were based on automaticity in compensatory financing, Mr. Skjaeveland said he personally, in spite of all the evidence provided at this end, would hesitate to endorse a conclusion which, like the first half of conclusion (5) seen isolated, could give the impression of an a priori ruling out of the potential applicability of some automaticity in compensatory financing. Admittedly, such automatic financing of export fluctuations would be a new special feature in international payments and, personally, he felt tempted to raise the question whether such a system like other more automatic payments procedures which had been applied previously, should not be given a "trial and error" period and also the benefit of the doubt during this period.

In conclusion, Mr. Skjaeveland said that in principle and in substance, subject to rephrasing of minor points, he was prepared to endorse the conclusions as presently formulated.

Mr. Dale said he wished at this time to add some remarks on conclusions (1), (3)(a) and (5) on which he had not commented in his statement at the previous session other than to say that he had no great difficulty with them. A number of Directors had referred to these conclusions and he therefore wished to state his own reactions. As regards conclusion (1), and particularly the final sentence enumerating the more basic problems for which a solution needed to be found, Mr. Dale said he would associate himself with Mr. Hudon and Mr. Skjaeveland. He felt it was both useful and desirable to list some of the longer-term steps that might be needed, but as Mr. Hudon had pointed out, this should be considered as merely illustrative. Mr. Dale also associated himself with Mr. Hudon's remarks on conclusion (3)(a). He had not read the paragraph as indicating that a very large-scale or complete revision of quotas was being considered, and consequently he would urge that it be retained substantially as it now stood, subject to some redrafting as might be indicated.

Mr. Dale then turned to conclusion (5) on which a large number of Directors had raised difficulties. They had felt that there should be no indication of Fund affiliation with any outside scheme or agency that might be established. It seemed to him that some of the difficulty might have arisen from the fact that the paragraph attempted to treat two problems as one. Most of the paragraph dealt with the desirability or undesirability of an automatic scheme for compensatory financing, and he felt that the paragraph should be limited to that issue. He would then put the last sentence, which referred to affiliation with another agency, in a separate paragraph appropriately revised. The alternatives were not whether there should be established a fully automatic scheme separate from the Fund or affiliated with it, but whether there was to be a separate scheme or not. For the Fund to say that the only alternative was a wholly automatic scheme would prejudice the issue and prejudge the outcome of negotiations which at best were at a very early stage. By transferring the last sentence of conclusion (5) to a new conclusion (6), the Fund would merely be saying that if governments chose to establish a separate scheme for compensatory financing then the question of affiliation would arise and should be examined in time. On the basis of the Fund's own consideration and what he understood to have been a shifting in viewpoint at the CICT Working Group's discussions in Geneva, conclusion (5) in the form he had just proposed should be retained. He saw no reason why the Fund should not conclude that full automaticity in or outside the Fund was undesirable; in fact, he did not believe that full automaticity was a probability in any event.

Mr. Hanemann also wished to add some comments in the light of the discussion so far. He thought Mr. Garland had excellently summarized what the Fund's main objectives in these discussions should be when he said they should be "to take the initiative, at a time when other alternative schemes seem to be losing their impetus and to help build up the image of a more positive and responsive Fund" and, secondly, "to provide for minimum interference with the present Fund framework of policy and to ensure that the problems of countries with fluctuating exports should be dealt with on a case-by-case basis and by a gradual accumulation of precedent" (Informal Session No. 62/4, 12/14/62).

In view of the remarks by some Directors on conclusion (1), Mr. Hanemann thought he should clarify his own position on this matter. He would have no definite objection to retaining a list of the measures considered necessary for a fundamental solution of the problem, but he felt very strongly that such a list should not convey the impression that the long-term measures were solely the problem of one group of countries. The list should, therefore, also cover those measures which the primary producing countries themselves should take within their own possibilities. As he had mentioned at the previous informal session, these measures included inter alia diversification of agriculture and industry, the development and installation of new techniques, the improvement of marketing policies, the finding of new markets, etc. If a list of measures were given it should, of course, be clearly indicated that it was not exhaustive.

As regards Table 1 and its inclusion in the report, which Mr. Dale and Mr. Anjaria had questioned, Mr. Hanemann said he thought it was helpful to have some statistical background for the discussion. He fully agreed that statistics could not solve the problem, but they did help to clarify what the situation was and what the magnitude of the problem was. While he admitted that Table 1 did not cover everything that had to be taken into account, he would prefer to retain it as an indication of the size of the compensatory financing problem.

Turning to the comments on conclusion (3)(b), Mr. Hanemann said he had the feeling that a solution of the Board's difficulties probably could be found in a combination of the different suggestions that had been put forward. He thought a statement along the lines that the Fund's attitude toward requests for drawings beyond the gold and first credit tranches that are related to balance of payments difficulties attributable to temporary causes beyond the control of the member will be "a liberal one" had a very positive aspect and should be retained in the final draft. He would also be inclined to keep the phrase "provided that the member itself is making reasonable efforts to solve its problems," but he would add the further proviso that the member should be prepared to work out in contact with the Fund basic policies consistent with the Fund's purposes which were aimed at a long-term solution of its problems. This would make it quite clear that the Fund's liberal attitude toward these countries with special difficulties had a counterpart in the willingness of the countries to cooperate with the Fund and follow the policies and purposes outlined in the Fund Agreement, and especially in Article I.

Mr. Hanemann said he had been especially interested in Mr. Dale's statement of what he thought the Fund's main technical criteria should be in judging drawing requests for compensatory financing. These were: (1) that the country concerned would have to have had in fact a reduction in total export proceeds and balance of payments difficulties attributable at least in part to an export shortfall, (2) that the difficulty would have to be found to be temporary in nature and therefore capable of correction or reversible within the near future, and (3) that the "compensable export shortfall" would have to be beyond the reasonable control of the country and attributable to outside forces. This, Mr. Hanemann thought, had been a real contribution to the discussion, for it made quite clear that the problem of compensatory financing with which the Fund dealt at present was limited to that part of the balance of payments difficulties which was not due to structural defects in or the internal policies of the country concerned but to conditions beyond its control. It was these special forces working on the primary producing countries from the outside that constituted the hard core of the problem for which a solution was now being sought in order that the Fund could give assurance that it wanted to do what it could for these countries within the framework of its Articles of Agreement.

Finally, with respect to conclusion (5), Mr. Hanemann said he still felt that it would be wiser if the Fund's report to the CICT omitted the last two sentences referring to an outside agency for automatic compensatory financing. All the proposals for a separate agency so far had been automatic compensation schemes, and what the Fund had to say in respect to affiliation with an outside agency would certainly be interpreted as relating to the proposals now under discussion. Therefore, he preferred to have the Fund take no position on the matter at this time.

Mr. Waïtzenegger wished to add a brief comment on conclusion (1) in the light of the suggestion of Mr. Dale and Mr. Hudon that the listing of measures needed for a fundamental solution be presented in such a way that they would be understood to be only illustrative. Mr. Waïtzenegger said he considered it useful to mention in the Fund's conclusions that the problem of compensatory financing contained wider issues than the short-term features with which the Fund could concern itself, and he would be prepared to look at an illustrative list along the lines suggested but he doubted that agreement could be reached even on that basis. Logically for him, the illustration of a problem or point should include the most important items. Therefore, unless the list were in very general terms, he was afraid it could not be agreed by all the Directors.

On a specific point in the present draft, Mr. Waïtzenegger added that he objected to the reference to an expanded flow of technical assistance from the developed to the less developed countries. He doubted that this problem was directly connected with the problem of compensatory financing and, therefore, he felt that it was out of place to mention it in the Fund's conclusion.

Mr. van Campenhout, who had now joined the meeting, said he would support Mr. Waïtzenegger's general position in regard to conclusion (1). However, if it was felt desirable for the Fund in an illustrative way to express some of the measures necessary for a fundamental solution, then Mr. Hanemann's point about the measures to be taken by the countries themselves should not be overlooked.

As regards conclusion (3)(b), Mr. van Campenhout said he was opposed to using the expression "reasonable efforts" in connection with drawings beyond the first credit tranche. These words described a particular tranche policy and, if they were used in relation to drawings beyond the first credit tranche, the ambiguity would arise whether the Fund's first credit tranche policy was to be applied to the new tranche. In fact, it was the use of the phrase "reasonable efforts" which was the cause of most of the ambiguity in the body of the staff's memorandum where he would suggest the use of the expression "appropriate effort" which did not have the specific meaning of "reasonable efforts."

Mr. van Campenhout said he still felt inclined to drop the last two sentences of conclusion (5) because he found it difficult to speak of affiliation with an agency about which nothing was known. This was a matter which the member governments would be discussing, and he was confident that they would have very much in mind that the Fund existed and whether a useful affiliation with a new agency should be recommended.

Mr. Saad said he agreed with the Directors who had misgivings about the final sentence in conclusion (1) and the incomplete list it contained. However, if it was felt desirable to include some examples of the kinds of measures needed for a fundamental solution, he would have no objection, provided it was clearly indicated that the list was merely illustrative.

Mr. Saad said he was mainly concerned about conclusion (3)(b) which was very ambiguous in its present form, and therefore should be redrafted. It was very clear that the Fund's policy on drawings had always been liberal in the past and, therefore, there should be no implication that the policy had not been. If it was felt necessary to comment on this aspect of the Fund's policy, then the report should say that the Fund would "continue to be liberal" in its attitude toward requests for drawings. Certainly, the Fund had followed a liberal attitude in considering requests from some of the countries that had elected him as, for example, in the emergency case of the United Arab Republic in early 1962 when the Board agreed to a drawing on the member's assurance of its intention to undertake a stabilization effort. This was a sound decision, for the Fund could not refuse to help a member in serious difficulty until after the causes of the member's situation had been analyzed and a corrective program had been devised.

Mr. Saad said he also had difficulty with the phrase "payments difficulties attributable to causes beyond the control of a member." One could argue that either nothing could be attributed to such causes or that everything could be. In any event, this had not been the Fund's policy in the past; the Fund had always been concerned about payments difficulties which the members could not handle with their own resources. The Fund allowed such a member to draw from the Fund and helped the country to work out a stabilization plan for the future; it did not argue with the member about why it had not taken certain measures in the past. Otherwise, it would be difficult to find any country that would be eligible to use the Fund's resources. It was his view, therefore, that conclusion (3)(b) should be revised in line with the Fund's present policy and should refer to payments difficulties which the member concerned could not deal with with available resources. Mr. Saad also objected to the proposal that drawings for compensatory financing be limited to 25 per cent of quota. An amount of that kind might help the member or it might not. Having in mind the public relations aspect of the Fund's report to the CICT, which several Directors had mentioned, he stressed that the report should contain language that would assure the world that the Fund intended to extend sufficient help in this important area and that it was not setting arbitrary limitations on the amount of that help. If the country had a genuine problem and satisfactory safeguards were given, the Fund should help to the extent that it could, limited only by the purposes and objectives set forth in the Articles of Agreement.

Mr. Saad added that he saw little purpose in conclusion (4) and would have no objection to dropping the whole paragraph. As regards conclusion (5), he agreed with the Directors who had objected to the last two sentences dealing with a matter which was not the concern of the Fund. Whether a new international agency was to be established or not, was for governments to decide. The Fund had to concern itself with matters within its own jurisdiction. If the Fund's views were requested, which had not yet been the case, it could then take a position, but, in any event, this would have to be taken up by the Board of Governors to which such matters had been reserved. Finally, with respect to conclusion (5), Mr. Saad said he did not like the statement in the second sentence that "it may well be against a country's genuine interest" if automatic finance were provided without exploration of the causes of the export decline. He would prefer that the sentence refer to the "interest of the international community as a whole," because the country itself should be in a position to know its own genuine interest.

Mr. Garland said he believed that conclusion (1) should be dealt with along the line taken by Mr. Saad. He added that he would like to see conclusion (3)(b) developed along the general line proposed by Mr. Klein, adding the idea that the Fund would continue to study possible detailed arrangements.

Mr. Lieftinck said he had little to add to what he had already said but he thought he should make some remarks in response to the observations in Mr. van Campenhout's statements, not because he disagreed with them but because he thought they had contributed in many respects to a clarification of his own position at the previous informal session. He wished to underline some of the elements that Mr. van Campenhout's statements had stressed. First, Mr. Lieftinck said he fully agreed that a shortfall of export earnings should always be considered in the framework of the overall balance of payments position of the country involved. The Fund was not primarily interested in a member's loss of income per se; what mattered to the Fund, was whether the member's balance of payments position was affected, that is, whether the income shortfall was reflected in the balance of payments. In this connection, he would clarify that he used the term "export shortfall" in the broader sense of the word which included not only earnings from exports but also earnings from services. In other words, both visible and invisible earnings were covered, but he would not include longer-term capital movements, which might have a counterbalancing effect.

Secondly, Mr. Lieftinck wished to underline what Mr. van Campenhout had said about the temporary character of the member's payments difficulties. Mr. Lieftinck fully agreed that the Fund's report should clearly indicate that they could not be isolated from the policies of the member. There could, of course, be temporary difficulties emanating completely from outside forces, but whether the difficulties would remain of a temporary character would, to a certain extent, and perhaps to a large extent, always be influenced by the policies of the member. Thirdly, Mr. Lieftinck wished to restate the Netherlands view that there should be a clear distinction between the conditions and criteria for drawings in the first credit tranche and drawings in the higher tranches. For the latter, a member should be expected to clearly demonstrate that it was meeting the purposes of the Fund by producing substantial evidence that it was pursuing policies to that effect.

Finally, Mr. Lieftinck said he was grateful to Mr. van Campenhout for his proposal with respect to the term "liberal" which he fully agreed should definitely include a more liberal use of the waiver clause in Article V, Section 4.

Mr. van Campenhout said he wished to add a comment on the public relations question mentioned by several of the Directors. An institution such as the Fund always had to be concerned with this problem, but it had to be kept in mind that there were both good and bad public relations. One thing that the Fund's policies and practices had achieved up to now was the interest other sources of finance had taken in the Fund's actions. It was his own personal experience, and he was confident that other Directors had had the same experience, that an increasing number of inquiries was being received from private bankers concerning the Fund's relationship with certain countries. The Fund's agreement to a drawing or stand-by created confidence because of the knowledge that the Fund's policies were being seriously pursued by the country in question. If the Fund should some day adopt a confused policy of semi-automatism, the benefit gained from its past policies and practices would disappear. To avoid this was his main concern in the present exercise.

In concluding the discussion the Chairman said the main area of difference on the Board still appeared to be related to parts (a) and (b) of conclusion (3). The staff would try to redraft the report in the light of the various comments and suggestions in the course of these informal discussions. He hoped that a new text on which the Directors would be able to agree would be ready for formal consideration by the Board around mid-January.

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

Mr. Jorge Del Canto

Room 807

(1) #3

CONFIDENTIAL

January 7, 1963

To: Members of the Executive Board

From: The Secretary

Subject: Executive Board Informal Session No. 62/4

The attached copy of the Secretary's Journal for Informal Session No. 62/4, held on December 14, 1962, is circulated for the information of the Executive Directors.

Att: (1)

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Department Heads
Division Chiefs

INTERNATIONAL MONETARY FUND

Secretary's Journal of Executive Board
Informal Session No. 62/4

10:00 a.m., December 14, 1962

Per Jacobsson, Chairman
F. A. Southard, Deputy Managing Director

Executive Directors	Alternate Executive Directors
J. J. Anjaria	
M. C. Bicalho	A. Coutinho
W. B. Dale	J. S. Hooker
J. M. Garland	F. C. Pryor
W. Hanemann	W. O. Habermeier
G. W. Klein	J. Urrutia
	J. Waïtzenegger
P. Lieftinck	H. M. H. A. van der Valk
D. B. Pitblado	R. H. Bonham Carter
	L. D. Hudon
P. Reina Hermosillo	C. E. Sansón
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K. Skjaeveland	L. Olofsson
Sumanang	A. Nikoi
	W. Tennekoon
B. Tann	I. S. Sun
A. van Campenhout	M. Toussaint

Roman L. Horne, Secretary
F. Hodel, Assistant Secretary

Also Present

African Department: Tun Wai. Asian Department: C. C. Liang. European Department: G. Ferras, Director; R. Evensen, C. L. Merwin, J. K. Rosenblatt. Exchange Restrictions Department: I. S. Friedman, Director; J. H. C. de Looper, U. Sacchetti, J. R. Thomas. Legal Department: J. Gold, General Counsel; F. Ballmann, J. G. Evans, A. S. Gerstein, P. Lachman, G. Nicoletopoulos. Middle Eastern Department: J. W. Gunter, Deputy Director; A. R. Bengur. Research and Statistics Department: J. J. Polak, Director; O. L. Altman, G. S. Dorrance, J. M. Fleming, R. R. Rhomberg, W. H. Taylor. Western Hemisphere Department: P. J. Brand, E. Laso. Office of the Treasurer: Y. C. Koo, Treasurer; R. Kroc. J. K. Horsefield, Chief Editor. W. P. Cooke, Personal Assistant to the Managing Director. G. Williams, Special Representative to UN. H. G. Hopkins, Information Office. Technical Assistants to Executive Directors: J. de Groote, L. Marini, Y. Mizoe, D. W. Wilson, A. Wright.

Executive Board
Journal - Informal Session No. 62/4
12/14/62

1. COMPENSATORY FINANCING OF EXPORT FLUCTUATIONS - FUND REPORT TO CICT

The Executive Board had an informal and preliminary exchange of views on a revised draft Fund report to the CICT on compensatory financing of export fluctuations (SM/62/94, Rev. 1, 11/27/62, and Cor. 1, 11/28/62).

In opening the discussion, the Chairman noted that the paper before the Board took into account the views expressed at the informal discussions on November 16, 1962 (Informal Sessions Nos. 62/1 and 62/2). He hoped there would be a further full and free exchange of views at the present session and that this would bring the Board closer to a decision. The Chairman also directed attention to the report of the Fund's observers to the second session of the Technical Working Group of the CICT (SM/62/104, 12/13/62) which indicated an expectation that the Fund would report on ways in which it might make an effective contribution in the field of compensatory financing. With this in mind, he hoped the present discussion could be limited to the narrow range of points which still appeared to be in question.

Mr. Dale observed that the paper on compensatory financing which was now before the Board was a helpful redraft of the paper considered in the last informal discussions of this subject. At a number of points, he regarded the present paper as a considerable improvement over the already fine paper before the Board at that time. He also believed that some of the crucial statements and conclusions now offered a basis on which a good deal of advance could be made in the present discussion. Certain of these conclusions needed to be discussed in detail and made more explicit, as he would indicate later.

Mr. Dale said he would begin his comments at the point where he began in his initial remarks on November 16 by indicating to the Board the present position of U.S. policy on compensatory financing. In those comments he had indicated that two of the U.S. conclusions which might be subject to reconsideration, depending on circumstances as they evolved, were: (1) That the need for facilities to provide compensatory financing for export fluctuations of the primary producing countries should be met by the establishment of a new and separately financed scheme; and (2) that it might be feasible for the Fund, by a suitable development of its policies and procedures, to meet the need for compensatory financing satisfactorily. The view of the U.S. Government on these points had not been changed in the interim between the November 16 discussion and the present one.

In assessing the context within which the Board should discuss the paper now before it, Mr. Dale said it might be well to take note of two events that had occurred in the period since the last discussion of compensatory financing. He believed these events were important in shaping the environment which should help determine the response which the Fund made to the request from the CICT for a report on what the Fund might undertake in the field of compensatory financing. First, the Working

Group of the Commission on International Commodity Trade which met in Geneva for some weeks had now completed its work and its report was concluded except for editorial changes. This meant, among other things, that the conclusions the Fund might reach in its own report would no longer be able to influence the work of the CICT Working Group, and this might indicate that the time pressure for conclusion of the Fund's consideration was in some degree reduced.

Much more important, however, Mr. Dale said, were several features of the conclusions reached by the CICT Working Group. In considering the question of full automaticity for a compensatory financing scheme, based solely on statistical factors, the Working Group's conclusions indicated that some doubt was expressed "as to whether export shortfalls should be compensated without any regard to the balance of payments as a whole or to the underlying causes." While this conclusion was apparently not unanimous, it was an important indication that complete automaticity in this matter was questionable. The CICT group also indicated, in discussing both the DIF proposal and the OAS scheme, that other lending institutions, especially the IMF, would no doubt take into account in their operations the borrowings under such a scheme. Thus the resources made available to the primary producing countries would not all represent net gain. Finally, the CICT group raised the question "whether effects broadly similar to those of an OAS scheme (not a DIF scheme), though without the feature of automaticity, might be achieved in another way with less cost and less danger of undesirable consequences, particularly through the IMF with improved facilities." This surely was an important conclusion for the Board to consider in the present discussion.

The second important event, Mr. Dale said, was the adoption by the UN General Assembly of the resolution for a conference by early 1964 on international trade and development. The resolution provided for discussion of international compensatory financing along with other aspects of the problems faced by primary producing countries. This was another indication of deep interest that something substantial be accomplished in the field of compensatory financing.

Turning to the paper before the Board, Mr. Dale said he wished to make several comments about the statistical indicators of the requirements for compensatory financing, particularly as they were provided by column 1 of Table 1 and with reference to the discussion on page 11 of the draft report. An adequate statistical representation must of course be based on historical facts, and those must necessarily be limited in their implications for the future. Beyond that he agreed with the observations on page 13 that arbitrary statistical criteria might produce data which did not take account of special circumstances so that the figures for particular countries should not be taken too seriously. The more he studied the alternative statistical formulations and calculations provided by the staff, the more he had concluded that many of them were enlightening but none of them was in any way conclusive. There was also one factor that was nearly, if not wholly, impossible to reflect statistically. It was certainly not desirable to compensate primary producing countries, or any others, for export shortfalls (even if they were short term) that were wholly the result of internal mismanagement. No judgment was reflected in the figures of Table 1 as to the extent to which the maximum financial requirements there indicated were in fact external in source or were attributable to actions of the countries themselves. He had noted, however, that in a number of the individual country cases where the maximum financial requirements shown were rather large, there was some reason to believe that more appropriate policies on the part of the countries concerned would have reduced the requirements substantially. This was indeed another way of saying that the wholly automatic approach to compensatory financing was not desirable.

On the whole, Mr. Dale said, he was persuaded that statistical formulations and calculations were useful and enlightening, if used with great care, but that none of them could have more than very limited validity. He added that none of this was meant to reflect on the excellent and very helpful statistical and analytical work of the staff. The difficulty with statistical representations of the problem lay in the complexity of the problem itself, not in the ability of the staff. On the whole, he would be inclined to reduce, rather than add to, the statistical information in Table 1--or even to question whether it should be included in the report at all. He did, however, accept the general over-all figures in Table 1 as a reasonable approximation to the size of the compensatory financing problem.

Turning to comments that bore more directly on what the Fund might be prepared to do in the field of compensatory financing, Mr. Dale said he had found it helpful to his own consideration to envisage five different cases of countries which might find themselves confronted with short-term export shortfalls beyond their own control. These, he would designate as Cases A through E. Case A was that of a primary producing country which had not drawn on the Fund. For such a country, the gold tranche drawing was available on a virtually automatic basis to compensate for export fluctuations or for other purposes in accordance with the Articles of Agreement. For such a case, within the financial limitations involved, there was clearly no need for a change in Fund policy on drawings. Case B involved a country whose position at the Fund was at the 100 per cent of quota mark. Such a country could draw through the first credit tranche on the basis of a showing of "reasonable efforts" to solve its payments problems which arose from short-term export fluctuations or from other sources. Again, the degree of automaticity was high enough not to present any reason why the Fund should alter its approach.

Case C, Mr. Dale continued, was that of a country whose currency holdings in the Fund stood at 125 per cent or more of its quota. Such a country when requesting a drawing because of balance of payments difficulties owing to short-term expor+ shortfalls would, under present policies, have to present substantial justification. Normally, a substantial stabilization program would have to be undertaken. Present policies, even if liberally interpreted, did not provide any specific arrangements for a drawing for compensatory financing purposes. Case D was that of a country having a stand-by arrangement with the Fund which involved stabilization undertakings satisfactory to the Fund. It might be supposed that these stabilization undertakings were being fully observed. Nonetheless, the provision for drawings from the Fund might not contemplate the resources needed in the event a short-term export shortfall of wholly external origin occurred. In such a case the country concerned could, of course, request an addition to the drawing arrangements under the stand-by and the situation could be handled under present policies, though they did not specifically provide for it. Case E was that of a country with a stand-by arrangement with the Fund where the undertakings underlying the stand-by were not fully being met but where an export shortfall occurred.

Mr. Dale noted that Cases C through E all involved difficulty and some ambiguity under present policies and under the statement in conclusion (3)(b) of the paper before the Board (SM/62/94, Rev. 1, p. 19, 11/27/62). Cases C and E were, in his judgment, the crucial ones. The question was, under the Fund's policies and practices as the Board was now considering them, would countries in the circumstances he had described as Cases C and E have greater or more liberal drawing facilities at the Fund than they had previously had? Unless that question could be answered in the affirmative, he thought it would be difficult to hold that the Fund had moved decisively to provide fully the need for compensatory financing.

Continuing, Mr. Dale said he believed that conclusion (3)(b) offered some advance on the attitude of the Fund toward compensatory financing. But that paragraph and the discussion on page 15 relating to it left considerable ambiguity. Did it meet the test of added facilities for compensatory financing that he had just outlined or did it not? To answer this question affirmatively, something along the following lines might be needed: (1) A country applying for a "compensatory financing" drawing would have to have had, in fact, a reduction in total export proceeds and balance of payments difficulties attributable at least in part to such export shortfall. Moreover, the difficulty would be found to be temporary in nature and could reasonably be expected to be corrected or reversed within the near future. (2) The country was making reasonable efforts to solve its problems. (3) The "compensable export shortfall" was beyond the reasonable control of the country concerned and was attributable, for example, to reductions of prices, and/or volumes taken, in international markets, on the one hand, or to uncontrollable natural phenomena, such as adverse weather, leading to crop failures, on the other.

In the third point, Mr. Dale noted that he had used the term "compensable export shortfall" and thought he should explain more fully what he intended to convey with this term. He meant to define "compensable export shortfall" so as to convey the thought that when export proceeds were reduced by comparison with the levels of other years, that reduction might be attributable to the joint or separate action of two causal factors: (1) conditions beyond the country's control; and (2) the effects of the country's own policies. He wished to find a formulation for the concept of "compensable export shortfall" which would make it clear that only that part of the total export shortfall which was beyond a country's control should be considered eligible for a "compensatory financing" drawing from the Fund. If it could be accepted that a formulation along these lines would be suitable for a Fund policy on compensatory financing, it would be necessary to limit the drawings that might be made under it. He was inclined to feel that a limit of 25 per cent of quota should be placed on such drawings.

Mr. Dale also observed that a question arose whether a "compensatory financing" drawing should have any effect on the decision of the Fund in the event the question arose of a waiver for Fund holdings beyond the 200 per cent of quota limit. It seemed to him that if the Fund was to make clear that drawings for compensatory financing purposes represented a net addition to its regular facilities, and was to give reasonable assurances to the affected countries, the amount of a compensatory financing drawing either already made or newly approved at any time should be considered prima facie justification for waiving the 200 per cent ceiling by an amount equal to the compensatory financing drawing which might be outstanding at any given time.

As to charges and repayment terms, Mr. Dale said he saw no compelling reason to believe that these should differ for compensatory financing drawings from the policies and approaches now in force for all drawings.

In concluding Mr. Dale said he had limited his remarks mainly to Fund drawing policy because that was, in his judgment, the heart of the matter as to Fund action on compensatory financing. As to other elements of the conclusions in the paper before the Board, he had no great difficulty, though he might wish to make further remarks later in the discussion.

Mr. Waitzenegger observed that the problem of compensatory financing, under active discussion by a number of international organizations at the present time, was of great significance for Fund members and the Fund as an institution. Much light had already been shed on this matter and it was certainly a privilege to hear the excellent comments of other Directors during the informal sessions of November 16 last, as well as the illuminating statement of Mr. Dale at the present session. Mr. Waitzenegger was convinced that this new round of discussions, based on the revised draft report, would further the understanding of Fund action. He also wished to take this opportunity to pay tribute to the staff for its work in the field of compensatory financing.

Mr. Waitzenegger noted that at its tenth session last May the United Nations Commission on International Commodity Trade had invited the Fund "in the light of the discussion during the tenth session to present, as soon as possible, a report as to whether and in what way the Fund might play an increased part in the compensatory financing of export fluctuations of primary exporting countries." This was a clear invitation to weigh the opinions expressed by the various delegations during the session. The Fund observers had reported that "discussions revolved around whether and to what extent" it was desirable to offset fluctuations in export receipts of primary producing countries and that strong support had been given to the idea of compensatory financing (SM/62/94, 11/8/62). The report of the Commission stated "that it was unanimously agreed that urgent action was needed to mitigate the impact on primary exporting countries of instability in their export earnings" and that "nearly all delegates agreed that additional arrangements for compensatory financing were called for." On the other hand, there were wide differences of opinion with respect to the means by which additional compensatory financing should be achieved. The Commission report indicated that "a thorough examination of the possibility of expansion of existing systems would be required before any new system of compensatory financing should be set up." It seemed evident that what really was in question was not the principle of compensatory financing but the form such financing should take. Thus, the Fund was faced with a distinct challenge, as Mr. Lieftinck had rightly pointed out (Informal Session No. 62/2, 11/16/62). The very existence of two elaborate schemes showed the seriousness of the problem. It was significant that the Technical Working Group, which met in Geneva in November 1962, recognized in its conclusions that the separate schemes "would be worthwhile only to the extent that they were more efficient than the types of assistance at the expense of which they might be established." Creating an institution with functions overlapping those of the Fund would reduce the Fund's ability to influence the policies of member countries and could defeat its basic purposes. Unnecessary duplication of technical and financial facilities must be avoided, and the more so because compensatory financing, which had to be considered in relation to a country's payments position, certainly fell under Fund responsibilities.

No doubt, Mr. Waitzenegger continued, the policies adopted by the Board had worked well on the whole, notwithstanding the fact that the procedures followed had not been exactly the ones contemplated at Bretton Woods. It was equally true that control by the Fund of the use of its resources was a powerful instrument, although not the only one at its disposal. Broadly speaking, the situations which the Fund had helped correct in the past were characterized mainly by two elements: a deficit in the balance of payments and an excessive internal demand which frequently caused the deficit. In those circumstances, the remedy was to make the assistance subject to the implementation of measures likely to reduce the demand. In the interest of its own development, a country under inflation must take decisive steps to restore financial stability. But there could be situations of a different nature where stringent policies were not of the same degree of relevance. The Fund was already an important source of compensatory financing, and it had shown its flexibility in some cases, such as that of the United Arab Republic. A thorough revision of its policy could certainly intervene without impairing the principles underlying the Bretton Woods Agreement. Mr. Waïtzenegger had no hesitation in saying that, in the framework of this Agreement and in the light of experience to date, the Fund could adopt a positive and constructive approach in the field of compensatory financing. Such a revision of its policies would in no way lessen the action which the Fund had directed toward establishment of sound policies since its inception.

Mr. Waïtzenegger pointed out that the staff had made two specific proposals in the revised draft report now under discussion (SM/62/94, Rev. 1, pp. 14 and 15, 11/27/62). First, quota adjustments could be envisaged for primary producing countries, particularly those with small quotas. Second, some liberalization of drawing policies could be considered. On the matter of quota increases, he would be very brief because he had covered the subject at length during the informal discussions on November 16. He wished again to recall that, at the end of 1959, the Board had concurred with the view that "members' quotas were adequate to provide its primary producing members with a supplement to liquidity which, in the majority of cases, should be sufficient, in conjunction with their own resources to enable them to deal with payments problems as are created by short-term fluctuations in exports." He wished also to repeat that the French authorities did not consider it possible to adjust quotas according to balance of payments requirements exclusively. The multipurpose functions of quotas were well known and so was the fact that no simple factor could be used to allocate quotas in a satisfactory manner. Two other points also had to be kept in mind. The first was the relationship between quotas in the Fund and subscriptions in the International Bank and its affiliates, to which other Directors had previously referred. He supported their views entirely. The second was the obligation of a member to subscribe one quarter of its quota increase in gold, referred to by the staff on page 14 of the revised report. This obligation was far from being negligible. The Fund had the discretion only to reduce the gold portion in the circumstances indicated in Article III, Section 4(a), namely, when the monetary reserves of the member country were less than its new quota. Naturally, the Fund could lessen the immediate impact of such payment by some special provision, as was done in the case of small countries in 1959. It remained that, in the end, the gold payment charge would burden the member; any other method for reducing or transferring the payment charge would not seem feasible. For all those reasons, it seemed neither necessary nor advisable to aim at some generalized action in the matter of quotas, even selectively limited to one or two categories as illustrated in the recent staff study (SM/62/95, 11/8/62). But individual adjustments could be envisaged in cases where there was true inadequacy.

In relation to compensatory financing, Mr. Waïtzenegger said he did not think that quota adjustments provided the proper solution if the Fund intended to adopt a constructive attitude. He was convinced that what really counted was the qualitative access to Fund resources much more than the quantitative elements of the problem. Therefore, the interesting staff proposal on drawing policies had to be analyzed carefully. To be authorized to draw under the proposed new rule, a member would fulfill two main requirements: first, its payments difficulties would have to be of a temporary character and attributable to causes beyond its control; second, the member would make reasonable efforts to solve its problems. These two conditions implied the exercise of judgment which was not an easy task. He did not contest, however, the necessity for the Fund to retain a large degree of appreciation, and he was ready to accept the first condition entirely. Therefore, his concern about the present proposal lay in other considerations.

First of all, Mr. Waïtzenegger said, the proposal was ambiguous. The condition relating to the member's economic policy could raise various interpretations, as he had already noticed in conversations with other Directors. The expression "reasonable efforts" could mean no more than a general policy in conformity with the main objectives of the Fund. But it could be interpreted equally as not modifying the principle according to which an increased degree of justification was required for new drawings. The wording used in the second paragraph of page 15 did not give assurance of a liberal attitude to primary exporting members. In its present form, the proposal would not remove the uncertainties on the part of countries about their ability to use the Fund's resources in adverse circumstances. Simpler and more readily understandable language would be far better.

Secondly, Mr. Waïtzenegger noted, there was no quantitative limit to drawings under the proposal. Assuming that the Fund's holdings of a member's currency stood at 125 per cent of the quota, would such a country be authorized to draw 2 or 3 tranches in accordance with the policy requirements laid down for the first credit tranche? Such uncertainty was again undesirable. Compensatory financing should meet only part of any export shortfalls, and it appeared that an amount corresponding to 25 per cent of the quota, coupled with a reasonable use of the member's reserves, would be sufficient in most cases. The question might well be raised as to whether the Fund would have sufficient resources to provide supplementary assistance to primary producing countries. In his opinion, by limiting the compensatory drawings to one tranche, there would be no reason to consider the present Fund resources inadequate, as had been clearly stated in the 1960 report on "Fund policies and procedures" (SM/60/14, Rev. 2).

Finally, Mr. Waïtzenegger said it was his view that the present proposal could shatter the existing policies which had successfully stood the test of practical application. Keeping in mind the special nature of the financing envisaged, it would be preferable to adopt a rule different from the policy applied in "ordinary drawings." In this respect, he fully appreciated the suggestion of some Directors, during the first informal session, that drawings up to one quarter of quota should remain separate from ordinary drawings in the application of tranche policies. Such a proposal could retain the useful concept of causes beyond the member's control, as well as the temporary character of the payments difficulties resulting from an export receipt shortfall. Since the Fund would have to determine the nature of the deficit and the duration of the difficulties, the drawing would not be automatic. From the viewpoint of the member's policies, no additional corrective measures would be required as a condition to compensatory drawing. In other words, the policy justification would be, so to say, "frozen" to the conditions required for the last drawing in the regular tranches. He doubted that this proposed revision of Fund procedures would present any serious difficulties technically. The wording should be carefully studied but psychologically such a proposal would be of great importance. As a complement, it would be useful for the Fund to mention its readiness to use its authority under Article V, Section 4, to waive the 200 per cent of quota limit.

Turning to part VII of the revised report containing the conclusions recommended by the staff, Mr. Waïtzenegger remarked that paragraph (1) rightly stressed that the provision of short-term credits by the Fund could not deal with the more basic aspects of declining export prices. It was evident that the longer-term problems were too broad and complex to be solved by a simple revision of Fund policies. They should be approached mainly by an organization of international markets on a commodity-by-commodity basis. Admittedly, this would be a long process but compensatory financing could, meanwhile, bring about an improvement over the present situation. The second sentence of paragraph (1) drew sufficient attention to the wider issues. On the other hand, the last sentence of the paragraph was incomplete and arbitrary in attempting to enumerate long-term measures systematically. This was quite natural as it was not possible to review them all in a few lines. Furthermore, the Fund had not been requested to take a position on those problems as they were the responsibility of other institutions, which had been studying them for a long time. In view of the debatable character of the paragraph's last sentence, on which he would not comment in detail now, he felt it would be more appropriate to delete it. He recalled that Mr. Plumptre had merely asked for the insertion of one or two paragraphs in the body of the report to place the problem of compensatory financing in a broader setting. This was continued in the third paragraph of page 15.

With respect to paragraph (3)(a) of the recommendations, which was identical with conclusion 2 of the first draft report despite many Directors' comments, Mr. Waïtzenegger said he was opposed to language which (1) conveyed the impression that a somewhat generalized and uniform approach was envisaged and (2) directly and exclusively linked the quotas to the needs of the countries in connection with balance of payments fluctuations. The inclusion of such a paragraph could imply a decision of broad scope which had not been fully discussed in the Board.

With respect to paragraph (5) of the conclusions, Mr. Waïtzenegger considered that the last two sentences did not represent any substantial progress over the former text which had created difficulties for many Directors. He was not in a position to go along with the new text, as it included a clear reference to an automatic compensatory scheme outside the Fund. The paragraph would gain greatly if it were limited to only the first two sentences, which explained the Fund's views on any automatic system.

In concluding, Mr. Waïtzenegger observed that the Fund had given evidence of its deep interest in the problems of its members and that the time had now come for it to show foresight and take action which would prove to be a real contribution in the field of compensatory financing. In view of the obviously widespread attention being given to the question, the Fund must give careful consideration to the public relations aspects of its report to the CICT. He agreed with Mr. Pitblado who had drawn the Board's attention to this point. The Fund's view should be stated clearly and constructively. Some progress had already been made, but further discussions would be necessary to attain that end. He sincerely hoped that the next few weeks would bring definite agreement by the Board.

Mr. Siglienti observed that so much ground had already been covered in the two earlier informal sessions on this matter, as well as in this meeting, that he would have little to add. But since he had not yet participated in the discussion he wished to take this opportunity to state his own personal position, thought it might in part repeat what other Directors had said. As far as the official Italian position was concerned, Mr. Siglienti referred to a number of official statements made on various occasions which had mentioned the problem of the primary producing countries and had stressed the interest that Italy had in finding a solution to this problem. The most recent of these statements was made by the Governor for Italy at the last Annual Meeting. It should be made clear, however, that Italy had not yet had an opportunity to reach any final conclusions on the merits of the various schemes currently under study, due in part to the fact that Italy was not represented in the CICT.

Speaking in his personal capacity, Mr. Siglienti said he wished first to state his agreement with the general conclusions of the two earlier discussions as they had been summed up in the closing remarks of the Chairman. Mr. Siglienti was convinced that a solution should and could be found within the Fund, and this was not because it was a question of the Fund's prestige, but for at least two good reasons. First, there was in general no lack of international institutions but, on the contrary, scope for better coordination and better exploitation of the existing ones. In addition, among the existing world-wide agencies, the Fund was the most appropriate and most competent to deal with the short-term aspect of the problem. He realized, of course, that short-term and long-term problems could not always be easily separated, but this was a difficulty that the Fund faced in other fields. It might well be that some countries believed that an increase in the number of agencies would result in more credits, but he thought the primary producing countries would eventually be the first ones to suffer from such a confusing situation, as described by Mr. Garland in the earlier discussions. In fact, Mr. Siglienti was glad to note that none of the Directors had spoken in favor of creating a new institution, and this also seemed to be the view held by the Working Group of the CICT, as Mr. Waitzenegger had mentioned.

Mr. Siglienti said he was even more opposed to a separate scheme which would function automatically, and he saw no need of repeating the staff's arguments against automaticity which he had found convincing. In general, the case against automaticity was very clear to him. Automatic formulae did not provide the right solution for the primary producing countries any more than they did for the industrialized countries. He added that he would hold the same view if the matter under discussion were a scheme on international liquidity.

In the light of these views, Mr. Siglienti said he still felt uneasy about that part of the staff's conclusions dealing with the establishment of a separate agency and its possible affiliation with the Fund, especially the last sentence in conclusion (5) (SM/62/94, Rev. 1, p. 19, 11/27/62). While the new version now under discussion avoided the impression that the establishment of such an agency was desirable, it still left the impression that the Fund was willing to accept cooperation with such an agency "obtorto collo," which was hardly encouraging for the future activity of both the Fund and of the new agency.

Ruling out any scheme outside the Fund, Mr. Siglienti said he would now briefly consider what action the Fund could take in connection with export fluctuations. The staff had examined two types of action, namely, in the field of quota increases and in the field of the Fund's drawing policies. He would be inclined to find a solution in adaptations of the drawing policies rather than in a general or selective or generalized selective increase in quotas. Mr. Waitzenegger had recalled the multi-purpose functions of quotas and the difficulty of either extending the quota increase to a large number of countries or limiting increases to a few countries. He shared Mr. Waitzenegger's opinion that increasing quotas did not offer a proper solution to the problems of the primary producing countries, and he was in general convinced that a case had not been made out in favor of an extended adjustment of quotas. Mr. Waitzenegger had elaborated on these points and Mr. Siglienti shared his misgivings.

As far as Fund drawing policy was concerned, Mr. Siglienti said he did not see much harm in extending to the first credit tranche the present policy for drawings in the gold tranche in favor of the primary producing member countries. This was not inconsistent with what he had said earlier about automaticity. Even the drawing rights in the gold tranche were not fully automatic under the present policy. The conditions of Article V, Section 3 had to be fulfilled and the benefit of doubt could be challenged.

If this policy were extended to drawings in the first credit tranche, the danger of automaticity pointed out by the staff would be removed by the very fact that the transaction would be a Fund transaction within the framework of the Fund Agreement. This was particularly true for the kind of danger pointed out in the revised draft report when it said "The total amount of short-term credit made available to a country by one agency or under one arrangement cannot be totally divorced from the amount made available on similar terms by another agency or under another arrangement by the same agency" (ibid., p. 8, para. 2). By extending this kind of automaticity to the first credit tranche the Fund would not be offering much more in practice than it offered at present, but it would be giving much firmer and more concrete assurance to the primary producing countries that compensatory financing was immediately available in a reasonable amount.

Mr. Siglienti added that he would have welcomed some more discussion by the staff of the "stand-by" or "near stand-by" approach mentioned on page 3 of the draft report. He did not know whether any detailed proposals had been submitted, but he suspected that the UN experts had in mind something other than a more extensive use of stand-by arrangements. He thought they might have had in mind that the Fund would reach the conclusion that a country or a group of countries was particularly affected by a decline in export receipts and the Fund would then issue a policy statement saying that these countries were eligible to draw on the Fund or apply for a stand-by arrangement with the Fund, that their requests would be handled liberally and that the Fund would be bound by its previous statement of policy. A fuller explanation of what the UN experts had in mind would have been most helpful.

As regards the conclusions in section VII of the draft report, Mr. Siglienti said he agreed with the first and second conclusions. The general tone had been improved and a more constructive contribution had been made on these points in the revised draft. He also had no difficulty with the conclusion set forth in paragraph (3)(a) which could be read in connection with the statements in paragraph (2). On the other hand, the statements in paragraph (3)(b) seemed to offer very little, and here an effort should be made to find a better solution. Mr. Lieftinck's proposed amendment, which had been circulated before the meeting, constituted only a minimum. If his point were omitted the report would convey the impression that the policies now followed with respect to drawings in the first credit tranche were not liberal, which of course was not true. Mr. Siglienti said he would even welcome mention in this paragraph that the Fund was extending to the first credit tranche the policies now followed with respect to the gold tranche.

Continuing with respect to the conclusions, Mr. Siglienti said he had no difficulty with paragraph (4), but he had great misgivings about paragraph (5), especially the last sentence. If it was felt desirable to retain the idea, he would at least change the order of the reasoning and start by saying that the Fund could not reach a decision on the question of affiliation with another agency until more was known about the nature and functions of such an agency. The report could then go on to say that at this stage the Fund did not believe that the setting up of a new agency was desirable. In conclusion, Mr. Siglienti said his own preference was to delete the last two sentences of the paragraph.

Mr. Lieftinck said he considered the new version of the draft report as a considerable improvement on the preceding one. He was also grateful for the additional statistical material supplied by the staff which he found greatly illuminating. At this time, he was not in a position to comment more than incidentally on the very important points contributed to the discussion by the previous speakers. He would wish to consider these more carefully.

With respect to the revised draft report before the Board, Mr. Lieftinck said he felt that the new text did not provide a sufficiently clear answer to the questions put to the Fund by the CICT. However, two things stood out clearly and, in his opinion, very satisfactorily. First, the Fund was not prepared to allow automatic drawings beyond the gold tranche to compensate for export shortfalls, not even in the case where the shortfalls were caused by conditions beyond the control of the member. This position was strongly and sufficiently motivated in the report. The second clear point was that the Fund would continue to be liberal with respect to drawings in the first credit tranche and would interpret its liberalism in terms of the well-known criterion which it had been applying to drawings in the first credit tranche, namely, that the country concerned should be making a reasonable effort to overcome its difficulties. But with respect to drawings in the higher tranches, the draft report was still somewhat ambiguous. On page 15, the report stated that "there is no need for the Fund to alter the policies and practices laid down for drawings of the second or further credit tranches." While there was an indication of the willingness of the Fund to show some flexibility in the application of its policies, it was stated as a matter of principle that there was no need to change the existing policies with respect to drawings in the higher tranches. However, the following wording of conclusion (3)(b) appearing on page 19 could lead to a completely different interpretation: "The Fund's attitude towards requests for drawings (beyond the gold tranche) that are related to payments difficulties attributable to causes beyond the control of the member will be a liberal one, provided that the member itself is making reasonable efforts to solve its problems." This could be interpreted to mean that with respect to payments difficulties attributable to causes beyond the control of the member the Fund would be ready to apply the condition now being applied to the first credit tranche. He could not agree that in the cases under consideration the condition now being applied to the first credit tranche would be applied to the higher tranches.

Another example of ambiguity between his interpretation of conclusion (3)(b) and other statements in the report, Mr. Lieftinck said, appeared on page 7 where it was said that "in the higher tranches, the Fund will therefore want to be satisfied that a sound set of policies is being followed." He felt that this was something different than the mere requirement that the member should be making reasonable efforts to solve its problems. It was clearly indicated on page 7 that even in those cases where the adverse development of export proceeds had been brought about predominantly by causes beyond the control of the member, sound policies were to be followed. This might be, and usually would be, corrective policies. The statement was made later on page 7 that "a need for corrective policies might arise either because the decline in exports appeared to foreshadow a lasting weakening of the country's balance of payments or because, though the export decline itself might be purely temporary and self-correcting, the country's monetary and financial policies were such as to provoke, sooner or later, balance of payments difficulties even under satisfactory export conditions." Mr. Lieftinck believed that these would not be rare cases but would more likely present themselves often. It was therefore his feeling that sound and, in many cases, corrective policies should be required and in more specific terms than expressed by the words "reasonable efforts."

Mr. Lieftinck said he, therefore, had great difficulty in going along with conclusion (3)(b) because he had the clear impression that it meant that with respect to drawings related to payments difficulties created or intensified by conditions beyond the control of the member the criteria for the first credit tranche would also be applied to the higher tranches. Accordingly, he had tried to indicate in the redraft of paragraph (3)(b) circulated before the meeting the position of the Netherlands Government as to what the Fund could do in the way of compensatory financing. His draft proposed that the Fund should have a liberal attitude toward requests for drawings beyond the gold and first credit tranches that are related to balance of payments difficulties caused by essentially temporary situations beyond the control of the member, "provided that the Fund is satisfied that the member is pursuing basic policies aimed at adjusting its total expenditures to the longer-run changes in its available resources." This text was not to be considered a final proposal but merely as an illustration of the present Netherlands position.

In explaining his proposal, Mr. Lieftinck said it was his view that any rewording of conclusion (3)(b) should make clear that there was no problem with respect to drawings covering only the first credit tranche, including those for compensatory financing. Therefore, his formulation referred only to drawings beyond the first credit tranche. Secondly, he had used the phrase "balance of payments difficulties" in place of "payments difficulties" because the Netherlands authorities felt that every request to the Fund for a drawing should be decided in the light of the member's balance of payments as a whole and not in the light of only one factor. Thirdly, Mr. Lieftinck said, he had tried to make clear that any specific policy of the Fund with respect to compensatory financing for export shortfalls should be linked to causes of an essentially temporary character. This specific point was not mentioned in the staff's draft, though he recognized that it might have been intended. Mr. Lieftinck went on to explain that he had retained the words "liberal one" because his authorities felt that there was reason to be forthcoming in cases where balance of payments difficulties arose from causes beyond the member's control,or at least predominantly from such causes. If Mr. Siglienti felt that the word "liberal" in this context might imply that the Fund's policies on drawings in the first credit tranche were not liberal at present, Mr. Lieftinck said he would have no objection to using the word "forthcoming" instead of "liberal."

The essential new element in his draft, Mr. Lieftinck said, was the proviso at the end. In the view of the Netherlands authorities, it was not sufficient that the member should be making reasonable efforts to solve its difficulties. They felt that in these cases the Fund should be satisfied that the member was pursuing basic policies aimed at adjusting its total expenditures to the longer-run changes in its available resources, which meant that the Fund should be satisfied that the country itself was prepared to adjust its policies to the longer-term trends in its balance of payments position. If the Fund were satisfied that that was the policy of the member, the Fund could be forthcoming and lenient in those cases where the member's balance of payments was affected substantially by a shortfall in export proceeds for reasons beyond its control. He felt that this explanation sufficiently clarified what the Netherlands authorities felt the Fund could do to meet the needs of members for compensatory financing of export shortfalls. He wished to add, however, that it was understood that the Fund's contribution would always be matched by a reasonable use of the member's own resources, which, of course, constituted an essential part of the Fund's general policy on the use of its resources.

Turning to the question of quota increases, Mr. Lieftinck said the Netherlands authorities felt that with respect to the primary producing countries, particularly the smaller ones, selective quota increases would certainly contribute to the assistance the Fund could make available under its drawing policies, as he had indicated. But they felt that the wording of conclusion (3)(a) was less adequate than that used in the body of the report, particularly the statement reading: "The Fund is now examining on a selective basis the quotas of the primary producing countries, in particular those of the countries with fairly small quotas, in order to determine whether adjustments would be desirable to make individual quotas more uniformly adequate to meet each country's needs in connection with export fluctuations as well as other balance of payments fluctuations" (SM/62/94, Rev. 1, p. 14, 11/27/62). He saw no good reason for not repeating this wording in conclusion (3)(a). With respect to the statements in the report on the quota proposals, Mr. Lieftinck thought there should be some clarification of the statement that "those receiving the increased quotas would be obliged to subscribe one quarter of the increase in gold, unless special arrangements were to reduce or postpone this burden" (ibid.). This could be interpreted in various ways. The interpretation he would favor, and which should be made clear, was that the Fund would be forthcoming in this respect in the same manner as it had in previous cases, such as where the Fund had allowed the member to spread its gold payment over a period of five years. If the statement in the report meant more than this, he would like clarification and would have to reserve his position on it.

As regards conclusion (4), Mr. Lieftinck said he had noted two references to the provision of "additional resources," and he wondered whether any suggestion was incorporated in the paragraph regarding a prospective need for an increase in the Fund's resources in order to more adequately meet the problem under discussion. In this connection he had noted that the report of the CICT Working Group would point out that "maximum indebtedness under Scheme 2 (including Australia and New Zealand) would have amounted to some $1.4 billion or roughly the same as under Scheme 1 which does not cover these two countries. On a comparable basis, the figure for Scheme 2 would have been close to $1.3 billion" (SM/62/104, p. 5, 12/13/62). This seemed to be the result of calculations made on the basis of drawing facilities which would be created if the OAS scheme was adopted. Mr. Lieftinck wondered whether the staff had any indication of what the maximum additional indebtedness to the Fund could amount to under the policies which were now being proposed under the conclusions and recommendations contained in the draft Fund report. He also asked what the maximum additional drawing on the Fund would amount to if Mr. Dale's suggestion for what in fact would amount to a free tranche for compensatory financing were agreed. Certainly the quantitative aspects, as well as the qualitative aspects of changes in policies, had to be considered, for the Fund should not adopt policies that would result in a considerable drain on its resources which might later result in further steps to increase its resources.

In this connection, Mr. Lieftinck said he had also noted that the CICT Working Group report would mention that under the OAS scheme repayments would at times fall due in years of shortfalls and that this could raise difficult problems of refinancing. The report would suggest that "effects broadly similar to those of an OAS Scheme (not a DIF scheme), though without the feature of automaticity, might be achieved in another way with less cost and less danger of undesirable consequences, particularly through the IMF with improved facilities" (ibid., p. 7). Here again, Mr. Lieftinck said he felt that, before coming to a final conclusion about any change in Fund policies, the Board should consider whether such action could create a situation for member countries where they could not repay the Fund within 3 to 5 years and where refinancing facilities would be necessary unless the Fund waived its present requirements. These were some of the wider implications of the proposed liberalization of the Fund's drawing policies, which the Board should keep in mind.

Finally, Mr. Lieftinck wished to associate himself with the position taken by Mr. Siglienti and Mr. Waftzenegger with respect to conclusion (5), particularly the last two sentences. While he was not yet prepared to take a final position on the matter, Mr. Lieftinck said he felt it would be wise at this time not to create the impression that the Fund was anxious to have a separate international agency established and would be pleased to be associated with it.

Mr. Garland welcomed the opportunity to express some further observations on the report which the Fund was to submit to the CICT. In general, he felt that the revised draft now before the Board represented a very useful improvement, both in its general content and in its manner of presentation, on the first draft which was discussed several weeks ago. Everyone recognized that the staff had been faced with a very difficult task in seeking to prepare a report which did reasonable justice to the various viewpoints which had been expressed around the table. It was understandable, therefore, that, at various points, the draft report bore some of the marks of compromise, and it must be expected that the full implications of the report could only be worked out in later discussions of the Board on particular cases.

Mr. Garland recalled that in his statement on November 16, he had expressed the hope that the next draft of the report would display a more positive attitude on the role of the Fund in compensatory finance, and he suggested that reference might be made in the next draft to the possibility of the Fund exploring ideas of the "special tranche" kind. He therefore welcomed the inclusion in the present draft of conclusion (3)(b), which indicated that the Fund's attitude toward requests for drawings relating to payments difficulties attributable to causes beyond the control of a member would be a liberal one, and he would not wish to suggest that an attempt should be made to include anything more definitive than this in the concluding section. He would also say at once that he would prefer the present text of conclusion (3)(b) to that which had been suggested by Mr. Lieftinck, although this did not mean he would be insensitive about applying Mr. Lieftinck's proviso to particular cases.

While he was in general agreement with the conclusions, Mr. Garland said he thought it would be useful to indicate in the report that the Fund was continuing to give consideration to its drawing policies in relation to balance of payments difficulties caused by export fluctuations. On pages 15 and 16 of the report there was some discussion of two alternative changes in Fund policies to which the Fund said it did not feel attracted. These alternatives, however, did not cover all the possibilities, and he believed there were some other alternatives which might be explored. His view was a purely personal one and he wished first to reiterate that he believed the main objectives of the Fund on this matter should be first, to take the initiative, at a time when other alternative schemes seemed to be losing their impetus and to help build up the image of a more positive and responsive Fund and, second, to provide for minimum interference with the present Fund framework of policy and to ensure that the problems of countries with fluctuating exports should be dealt with on a case-by-case basis and by a gradual accumulation of precedent.

Continuing, Mr. Garland said he might mention that he seemed to have been thinking along some lines very similar to those of Mr. Waftzenegger in his approach to these general objectives. He had been considering whether Fund members might be given the right to apply for a special credit tranche drawing if movements in their export proceeds satisfied certain approved statistical criteria. These statistical criteria would merely determine the right to make application for such a drawing. The application would then be considered by the Fund Board in exactly the same way as any other drawing application. To assist countries in determining whether they were entitled to make application for this special tranche drawing, the Fund might prepare periodically figures of export movements in terms of these statistical criteria. The only advantage of the special tranche drawing would be that it could be obtained without any tightening of any general drawing conditions, that is to say, that a member which already had drawn in the second tranche could obtain the special tranche drawing on second tranche conditions. There would be no marginal tightening of conditions as a result of a special tranche drawing. Countries, which might be entitled by reason of their current policies or the magnitude of their problems to draw more than one tranche, would not be limited to the special tranche. The repurchase provisions could be the same as for an ordinary drawing, although there could perhaps be an informal understanding that repurchase should be accelerated if the drawing member enjoyed a marked upswing in exports. A proposal along these lines would avoid some of the objections which had been levelled against the two alternative suggestions canvassed in the staff paper. The final judgment would be retained for the Fund. Drawings would not be automatic. There would be a minimum of interference with established policies. But the Fund would demonstrate its flexibility and give greater confidence to members that any prima facie case for compensatory financing would be carefully considered.

Mr. Garland believed that one of the most important considerations in this matter, at the present juncture, was that some additional initiative on the part of the Fund taken now might enable it to scotch the whole issue of a separate institution for compensatory finance. It must be remembered that some primary producing countries were quite satisfied with the present facilities which were available to them from the Fund for adding to their second line of reserves; in this group Australia might be particularly mentioned. Other primary producers, particularly those which were doubtful about the adequacy of the Fund's facilities, could be attracted to a rather more positive Fund proposal, at a time when alternative schemes seemed, at least for the moment, to be losing their impetus. From this point of view, the decisions being taken now, and in the next few months, were of considerable strategic importance. Therefore, he did not think that the Fund should exclude at this stage the possibility that some proposal of this general character might prove to be both feasible and desirable. In place of the cautionary comment that the Fund did not feel presently attracted to such proposals, the report should include some indication that possibilities of this kind would continue to be explored--or preferably the report might be redrafted in a more positive direction.

As to the conclusions, Mr. Garland said he found them generally acceptable. Conclusion (4) might be terminated at the end of the sentence reading "it would, therefore, in the opinion of the Fund, be preferable to provide such additional resources through the Fund." The remaining portion of that sentence did not seem to be necessary and indeed could be regarded as somewhat provocative.

Mr. Pitblado said that he, and his authorities, had found the revised draft report generally acceptable and he therefore had little to say on it. He noted that in the discussion so far a number of important suggestions primarily related to conclusion (3)(b) had been put forward, and would like to have an opportunity to reflect on these before commenting on them. While a number of diverse positions had been expressed, he had the feeling that an examination of the qualifications which the speakers had made to their basic positions would reveal a tendency to converge.

As regards the conclusions in the draft report, Mr. Pitblado said he would agree with Mr. Waitzenegger on the last sentence of conclusion (1) which had been inserted to meet a point that he and other Directors had made in the earlier informal sessions. The present draft suffered the disadvantage of arbitrary selection and, in particular, left out one or two thoughts which would have to be included in any full coverage of the subject. Mr. Pitblado said he would favor exclusion of the sentence and the substitution of some reference to the policies and work which needed to go on in other international institutions. With respect to conclusion (3)(b), he had a good deal of sympathy with the point of view and suggestions put forward by Mr. Dale on the way the Fund should proceed in cases where there were clear declines in export income attributable to external causes. The difficulty facing the Board, however, seemed to stem from the fact that the relatively extreme case was easy to express and in fact even easy to deal with under the Fund's present procedures. The ideal case would be one in which a country suffered a short-term shortfall in export earnings which could easily be made up in the future; the difficulty lay in the shaded cases where a shortfall in exports constituted one of many causes of the country's difficulties. He therefore agreed entirely with the view already expressed that the Fund should approach such a country in the round and not establish any automatic right for drawings which did not take account of the member's policies and actions. The thoughts and policies that should guide the Fund in dealing with individual cases could be expressed more or less restrictively, as mentioned in the different speeches so far in this session. His own thought was that they should be expressed less restrictively, both because that seemed to be most pragmatic as well as the direction which most Directors seemed to favor, and also for the reasons Mr. Garland had expressed that the Fund found itself in the position of wishing to find legitimate ways within the Fund mechanism to meet the problem and did not wish to give support to the idea that the problem should be handled on a new basis through another mechanism which would require the agreement of governments. What the Fund said in the draft report should be as liberal as possible without raising any false hopes. Whether it would be desirable or not to treat drawings on the Fund for compensatory financing on a special tranche basis with a special label, was a matter on which he would wish to reflect further. On the one hand, this would be good psychologically but, on the other hand, it might be taken as going beyond the median position which most Directors seemed to have in mind.

Finally with respect to conclusion (5), Mr. Pitblado said he agreed with those speakers who had expressed dislike for the last two sentences. If it was felt that the matter of a separate international agency should be dealt with, even though it was not clear that the Fund had been asked for its views, he believed it would be better to insert an appropriate paragraph in the body of the report in place of the present sentences in the final conclusion.

Mr. Hanemann said that, like other Directors, he had found the new draft report a valuable improvement on previous attempts to tackle the problem of compensatory financing of export fluctuations. He thought it was well to keep in mind that the Fund's report and studies on compensatory financing could not be directed to a full-fledged answer to all problems of the primary producing countries. It was only part of their balance of payments problems to which the Fund could direct its attention in this respect and certainly the Fund could not provide a solution of the manifold long-term problems. This came out more clearly in the present draft than in the previous papers. Quite rightly the new text drew attention to the fact that the objective of a satisfactory rising trend in export proceeds of the developing countries was of far broader dimensions than the provision of repayable credits to mitigate short-term export fluctuations. As far as the latter was concerned--and they were in essence the problem with which the Fund had to deal in its report--Mr. Hanemann observed that he felt it had been generally agreed in the previous informal discussions that automatic financing schemes did not provide the right solution of the difficulties which the primary producing countries faced in this respect.

Mr. Hanemann said he would concentrate his comments at this session on the conclusions of the draft report, though in doing so he might mention some points in the body of the report. With respect to conclusion (1), he associated himself with Mr. Waltzenegger and others who had pointed out that the formulation of the long-term problems and what would be involved in a fundamental solution of them was very incomplete. For example, nothing had been said about those measures which the primary producing countries themselves could take, though in other parts of the report and in the earlier discussions mention had been made of such problems as diversification in agriculture and industry, the development and introduction of new techniques, the improvement of marketing policies, etc. Having in mind the complexities of the problems and the difficulties involved in drafting an adequate statement of the various ways in which a long-term solution could be found, he wondered whether it was possible to sum them up adequately in a few lines. Perhaps it was therefore better to delete the final sentence of conclusion (1).

The main point of the conclusions, Mr. Hanemann noted, was set forth in paragraph (3), which opened with the statement that "members may be given further assurance that their needs in regard to compensatory financing will be more adequately taken care of by the following developments." It was his feeling that the Fund had already given a great deal of thought to the problem and had taken care of various needs for compensatory financing. For this reason, he had misgivings about language which could be interpreted as an indication by the Fund that it believed that what it had done was too little or too late. He would rather see language in which the Fund stressed what it had already done and what its policies really meant. This seemed especially desirable when the paper contained a statement that there was no need to alter the present policies. He agreed that there was no such need because the Fund's present policies were flexible and could be handled so flexibly that in using them and transferring them into individual decisions the needs of the countries concerned could be met adequately insofar as these needs arose from special balance of payments difficulties due to outside forces beyond their control. Since this was the limited character of the problem with which the Fund was now faced, it might be useful to have the introduction to paragraph (3) contain more definite statements on the Fund's role, as well as an expression of confidence that its resources and policies were adequate to deal with the problem which the CICT Working Group was considering.

Mr. Hanemann said the wording of conclusion (3)(a) had puzzled him because it differed from the language used on page 14 of the report and omitted four important words previously agreed, namely, "on a selective basis." In his opinion, it was essential to insert these words in the opening sentence of this conclusion. The rest of the paragraph ran along the same lines as conclusion (2) of the earlier draft, on which he had expressed serious misgivings. He felt, however, that language which would be acceptable to all Directors could be found because everyone seemed agreed that the quota question should be approached on a selective basis and with a view to determining whether or what adjustments could be made individually in those cases where present quotas by reference to appropriate tests appeared clearly inadequate to deal with the export fluctuations with which the countries with relatively small quotas might be faced.

Turning to conclusion (3)(b), Mr. Hanemann recalled that he had already expressed the opinion that the Fund's resources were adequate to meet the needs of member countries arising from export fluctuations due to outside forces and that the present drawing policies were wide enough to give assurance to these countries that the Fund was prepared to let them use its resources for this purpose, when necessary and appropriate, in a rather liberal way. In this respect, he thought there was a general consensus that the Fund should help these countries. It was, of course, easy to build up a theoretical example of a country which should receive the maximum assistance possible because its problems were due to outside forces and were temporary in character, and the country was following sound policies under conditions of stability. But these extreme cases were probably easier to conceive in theory than to find in practice. The Fund always had to face cases where judgments had to be made with respect to the extent to which a member's problems were due to its own policies and measures and the extent to which they were due to outside forces, and the Fund had to decide on the extent to which it could allow the country to use the Fund's resources so as not to go beyond the general purposes of the Fund as set out in Article I or without jeopardizing the revolving character of its resources. What was necessary now was to find language for conclusion (3)(b) which would express both these points so that the member countries could be assured that they would get help from the Fund, though at the same time being made aware that the Fund's help was not automatic and that the Fund could not use its resources without exploring the possible causes of the member's difficulties and the corrective policies the member country itself could take.

For these reasons, Mr. Hanemann continued, he had some sympathy for the new language proposed by Mr. Lieftinck because it clearly indicated that the Fund was prepared to be liberal with respect to drawings in the higher tranches, though at the same time indicating that there were limits to this liberality. As regards the other proposals and suggestions made in the course of the present discussion, Mr. Hanemann said his first and provisional reaction was that it might appear somewhat contradictory to take the position in the body of the report that an automatic solution was not desirable, and at the same time introduce in the conclusions elements of an automatic or quasi-automatic character to the way in which the Fund would deal with the problem of compensatory financing. This should be left to individual judgment based on the Fund's willingness and preparedness to give increased attention to these problems. In addition, he believed it would be useful to add to conclusion (3) a sentence containing the idea set forth on page 15 of the report where it was said that "it is the Fund's opinion that action along these two lines will go far towards meeting the needs of its member countries for a second line of reserves, on a repayable basis, to deal with payments difficulties due to export fluctuations." He would even go so far as to say that action along these lines would meet the needs of the member countries as far as these needs could be met by international institutions on a repayable basis. In his view, the Fund could express more confidence about what it could do in this field, and state flatly that it felt it could handle the member's needs with respect to short-term export fluctuations as far as these were essentially due to factors outside their control.

As regards conclusion (5), Mr. Hanemann associated himself with those who had proposed deletion of the last two sentences. What appeared in the first sentence of the paragraph was convincing and in line with the conclusions of all studies the Fund had made. The second sentence mentioned a consideration which had been referred to on page 8 of the report when it said "it is not particularly desirable and may be against the genuine interest of the country concerned if this finance is provided automatically." In addition, the body of the report referred to a second important consideration, namely, that the total amount of short-term credit made available to one agency could not be totally divorced from the amount made available on similar terms by another agency or under another arrangement by the same agency. He believed that a short resumé of this second consideration should be added to conclusion (5). The third sentence also contained only part of what the body of the report had to say about automatic compensatory financing. If the Board was not inclined to say more than had been suggested by the staff, he would prefer to leave out of the report the conclusion contained in the third sentence. With respect to the final sentence of conclusion (5), Mr. Hanemann associated himself with the other speakers who thought it would not be useful to mention the possibility of Fund affiliation with another new international agency. Such a sentence weakened all the argumentation in the body of the report on the limitations and deficiencies of an automatic mechanism. After all, it was now up to the member governments to decide what position to take with respect to special schemes outside the Fund. It might well be that the governments would decide that what was to be done with respect to short-term export fluctuations should be done within the Fund and along the line of the proposals being made by the Fund. Then the question of affiliation would not come up.

Mr. Hanemann then added some comments on specific points in the body of the draft report. He drew attention to the reference to a new column which had been added to Table 1 containing what the draft report called "a rather extreme assumption" (SM/62/94, Rev. 1, p. 13, 11/27/62). He considered Table 1 useful in coming to a judgment of the magnitude of the problem, but he had some misgivings about the inclusion of a column based on what was admitted to be a rather extreme assumption. However, he was open-minded on the matter.

With respect to page 14 of the report, Mr. Hanemann said he had the same question as Mr. Lieftinck on the sentence which mentioned the obligation to pay one quarter of the increase in quota in gold, unless special arrangements were to reduce or postpone this burden. He thought it would contribute to clarification if in this respect mention were made of the provisions of Article III, Section 4(a), and of the line taken with respect to the gold subscription at the time of the general quota increases in 1959.

Arrangements along this line could perhaps provide a solution, but it might raise expectations which would not come true if countries interpreted the sentence in question as meaning that there was a way of transferring the burden of a 25 per cent gold payment for a country that wished to request a quota increase.

Referring to the discussion of the Fund's possible actions along the line of selective quota increases and drawing policies as mentioned on pages 15 and 16, Mr. Hanemann observed that he had already spoken at length on these questions. He had one minor point, however, in connection with the paragraph mentioning "the pursuit of expansionary policies in the developed countries." He thought some clarification of what was meant by this expression was useful. He would prefer to use language like "the pursuit of policies conducive to stable growth."

In concluding, Mr. Hanemann directed attention to the sentence on page 17 which read "A moderate increase in the drawing facilities of the less developed countries in the Fund would probably not at present require quota increases from the developed countries." If, as he understood was the case, a moderate increase in the drawing facilities of the primary producing countries was in mind, increases in the quotas of the developed countries would not be required, and this should be clearly stated. In any event, as Mr. Lieftinck had suggested, it would be useful to have a clearer indication of the quantitative aspects of the Fund's preparedness with respect to individual quota adjustments and to the liberal use of its resources in order to mitigate the difficulties arising from export fluctuations.

Mr. Reina said he had read the revised version of the draft report on compensatory financing with a great deal of interest, and he thought that in many respects it represented a considerable improvement over the original paper. He would limit his remarks primarily to the proposed drawing policies of the Fund in connection with compensatory financing.

First, Mr. Reina said, he was pleased to note that in paragraph (1) of the conclusions the problem had been set forth in its proper context. The emphasis given to the longer-term aspects of the problem was quite appropriate. It seemed quite fitting for the Fund to recognize that the fundamental solution of the problem required not only the continuing application of sound developmental and financial policies on the part of the less developed countries, but also decisive measures by the developed countries in maintaining an expanding demand for the products of the less developed countries, in assuring these countries the fullest access to the markets for their products, in promoting agreement among producers and consumers of raw materials and foodstuffs, and in providing an expanded flow of financial and technical assistance to the less developed countries.

Mr. Reina believed that paragraph (3) of the conclusions should be strengthened by more concrete proposals with regard to the drawing policies of the Fund, in order to provide members with further positive assurances that their needs in regard to compensatory financing would be adequately met. In particular, it would be desirable to spell out paragraph (3)(b) in more concrete terms. One possibility, which he would enthusiastically support, would be to indicate that the Fund was prepared to make available to countries for this purpose an additional credit tranche over and beyond their existing drawing rights under present Fund policy. As a complement to this "liberalization" of policy, the Fund would be prepared, under appropriate conditions, to consider relaxation of the use of its waivers beyond 200 per cent of quota. Before granting part or all of this credit tranche, there would have to be a prior decision by the Fund on the individual situation, so as to determine whether and to what extent the export shortfall could be considered of a temporary character, predominantly beyond the control of the member. The decision would also involve conditioning the availability of this additional specific amount to the adequacy of the policies the member country was pursuing to solve its problems.

A situation in which adequacy of policies existed, Mr. Reina continued, might be characterized as one in which a member country was pursuing totally sound policies or policies that would meet the present Fund standard of substantial justification for drawings beyond the first credit tranche. Countries in such a situation would, of course, have access to Fund resources, not only for compensatory financing but also for general balance of payments purposes, even if transactions with the Fund were of a magnitude that would raise the Fund's holdings of the member's currency beyond 200 per cent of quota. In other words, in this instance the Fund would be prepared to use its powers under Article V, Section 4, to waive this limitation on the holdings of the member's currency.

Another situation that would have to be considered, Mr. Reina said, was that of a member country which was following reasonable policies but such policies did not quite meet the present strict standards for drawings beyond the first credit tranche. In this situation, the member country would have access to this special credit tranche on top of the gold and the first credit tranches, for which it supposedly qualified at present. This, of course, would be the case if the Fund's holdings of the member's currency were, at a given moment, 125 per cent of quota or less. He believed that this special credit tranche for a country in such a situation should be given even if the Fund's holdings of the member's currency were, at a given time, in the higher credit tranches, but in no case should the granting of this special credit tranche take it beyond 200 per cent of quota. This distinction was important so that countries that had drawn heavily on the Fund in the past and were still not pursuing totally sound policies would be given less liberal treatment than countries that all along had been pursuing quite adequate policies. This limitation would also serve as a further incentive for the countries concerned to change their policies from merely reasonable policies to totally sound policies. Consideration would also have to be given to a third type of situation where a country's policies could not even be termed reasonable. Such countries could not hope to get accommodation from the Fund beyond the gold tranche.

Mr. Reina stressed that in his opinion the decision of the Fund before granting this special assistance should be based not only on the adequacy of policy criterion, but also on whether and to what extent the member's export shortfall could be considered to be of a temporary character. For, if the export shortfall of a member country in a given year reflected a more permanent downward trend in its export proceeds arising from a continuing decline in prices, the provision of such assistance without the member taking corrective action at the time would only postpone the day of reckoning that would require even a more drastic readjustment at a later stage. In attempting to estimate a norm of exports, judgment should be based on an analysis of the causal factors at work, rather than by any mathematical formula based on the mere statistical magnitude of current and previous exports.

In concluding, Mr. Reina said that, if his proposal were to be agreed by the Board, it would have to be set forth in great detail in section V(2) of the paper dealing with drawing policies. In addition, the proposal ought to be summarized in concrete terms under paragraph (3)(b) of the conclusions. The spelling out of such a "liberalization" of Fund policies to meet the problem of compensatory financing would also be important to assure members that the problem could be effectively met by the Fund and that there was no need to resort to grandiose schemes that might in the end not provide a realistic answer to the problem and might, in the final analysis, weaken the Fund's sphere of influence in exchange and balance of payments matters.

In concluding the session, the Chairman observed that a number of suggestions had been made with respect to conclusion (3)(b) which would call for further consideration. The other suggestions were largely drafting points on which there seemed to be no great difference of opinion, if any. He was inclined to agree with Mr. Pitblado that, in the light of the qualifications the Directors had made in presenting their various points of view, the differences among them were probably less pronounced than they first appeared.

The Chairman noted that there were two categories of countries involved in the problem before the Board: those whose policies were on the whole satisfactory and those whose policies were not satisfactory. It was not difficult to deal with the first category; several Directors had pointed this out, and Mr. Lieftinck's redraft of conclusion (3)(d) represented a possible expression of that view. But the difficult category was made up of those countries which did not have satisfactory policies, such as the case of the United Arab Republic which had been before the Board early in 1962. In that case the Fund went beyond its normal policies. What was required of the member was the assurance of a serious intention to engage in a stabilization effort, and one sign of this was taken to be the member's willingness to receive a Fund mission to discuss seriously a stabilization program. Some wording of that kind could perhaps be incorporated in a redraft of conclusion (3)(b) because what a number of primary producing countries wanted was for the Fund to agree to specific conditions for drawings beyond the first credit tranche by members whose policies were such that they would not normally qualify for such drawings.

The Chairman then summarized the various suggestions that had been put forward concerning the qualifications for Fund assistance in compensatory financing. The first was that the Fund should judge the declines in export earnings as predominantly beyond the member's control. Secondly, the Fund would have to be satisfied that the declines were of a temporary character, and, thirdly, the Fund would have to be satisfied that the member was making reasonable efforts to solve its problems, as could be said to be the case with the United Arab Republic to which he had just referred. The fourth suggestion was that drawings for compensatory financing of export shortfalls should not exceed 25 per cent of quota.

The main question still to be considered, the Chairman said, related to the countries whose policies were not satisfactory at the time they requested Fund assistance. The report to the CICT should show not only that the Fund would like to help these countries but also that it was in a position to do so. In this connection, the public relations aspect of the report should not be overlooked. As he saw it the present exercise should produce something new so that others could see that a determined effort was being made by the Fund to be of assistance in this field. Perhaps this would be the best way to "scotch" other proposals, as one Director had suggested. It was clear that the major subject for further consideration was conclusion (3)(b), and he proposed that informal discussion of this be resumed on December 17.

FOR AGENDA

Mr. Jorge Del Canto

Room 807

(1)

SM/62/94
Revision 1
Correction

November 27, 1962

To: Members of the Executive Board

From: The Secretary

Subject: Compensatory Financing of Export Fluctuations

The memorandum SM/62/94 has been revised in the light of comments made by Executive Directors at the Informal Sessions of November 16th and is attached herewith, recast in the form of a draft Report to the Commission on International Commodity Trade. The redrafting affects particularly (a) the Introduction, (b) Section IV (from page 11 of SM/62/94, page 10 of the present paper), (c) Section V, and (d) Section VII, the Conclusions.

This matter is expected to be scheduled for consideration by the Executive Directors during the first half of December.

Att: (1)

Other Distribution:
Department Heads
Division Chiefs

INTERNATIONAL MONETARY FUND

The Compensatory Financing of Export Fluctuations of Primary Producing Countries

Draft Report by the International Monetary Fund

November 26, 1962

Introduction

At its tenth session held in Rome, in May 1962, the United Nations Commission on International Commodity Trade "invited the International Monetary Fund, in the light of the discussion during the tenth session, to present, as soon as possible, a report as to whether and in what way the Fund might play an increased part in the compensatory financing of export fluctuations of primary exporting countries, and to keep the Technical Working Group currently informed of the progress of its deliberations on the subject."

The present Report by the International Monetary Fund is presented in fulfillment of the invitation extended by the Commission on International Commodity Trade.

I. Previous Consideration of the Problem by the Fund

In 1960, in response to an earlier request by the Commission on International Commodity Trade, the Fund prepared a study explaining its policies and procedures bearing on the compensatory financing of fluctuations in foreign exchange receipts from the export of primary commodities.1/ The main points in this study may be briefly summarized as follows:

(1) The provision of foreign exchange to Fund members to assist in the compensation of short-term fluctuations in the balance of payments constitutes a legitimate use of Fund resources. Among such fluctuations are some that arise primarily from variations in export prices and proceeds. In order that balance of payments deficits from this cause should be suitable for financing by the Fund, however, the member's policies must be such as to enable it, with the financial assistance it obtains from the Fund, to overcome its difficulties within a reasonably short period of time.

1/ "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations," IMF Staff Papers, November 1960.

(2) It would be neither practicable nor desirable to make the amount of such assistance dependent on any automatic formula, or to provide any separate form of Fund assistance to deal with export fluctuations alone. This is because judgment is required to determine the extent to which export fluctuations are properly compensable in the light of the balance of payments as a whole, and the extent to which any compensation required should be provided by international means, and because if the Fund gave too much of its assistance automatically its ability to influence countries toward the adoption of appropriate policies would be seriously impaired. Requests for drawings for all purposes in accordance with the Articles of Agreement are, however, treated liberally in the gold tranche and the first credit tranche.

(3) Fund quotas, (as of end 1959) were considered adequate to provide for its primary producing members a supplement to liquidity which, in the majority of cases, should be sufficient, in conjunction with their own resources, to enable them to deal with payments problems created by short-term fluctuations in exports or in external receipts of the order experienced since World War II, provided they did their best to keep their incomes and costs adjusted to the longer run changes in their external purchasing power.

(4) There appeared, (as of the same date) to be no reason why shortage of resources should be a factor limiting the amount of assistance that the Fund would otherwise consider it desirable to give to its members.

(5) Consequently, it was concluded, "members of the Fund that are taking appropriate steps to preserve international financial stability and to maintain their balance of payments in equilibrium, taking good years with bad, and that are otherwise making satisfactory progress toward the fulfillment of the Fund's purposes, can anticipate with confidence that financing will be available from the Fund which, in conjunction with a reasonable use of their own reserves, should be sufficient to enable them to overcome temporary payments difficulties arising from export fluctuations."1/

II. Suggestions for Increased Compensatory Use of Fund Resources

Since the study summarized above was submitted to the United Nations in April 1960, the subject of compensatory financing has been actively considered within the framework of the United Nations and of the Organization of American States, in particular by the UN Expert Group which, in January 1961 reported on "International Compensation for Fluctuations in

1/ Op. cit., p. 4.

Commodity Trade," by the UN Commission on International Commodity Trade, and by the OAS Group of Experts on the Stabilization of Export Receipts which reported in April 1962.

In general, the international bodies in which the matter has been discussed have displayed understanding towards the Fund's policies on compensatory financing, as outlined above (including the restricted scope given to automatism in Fund transactions), and appreciation for the assistance which the Fund has been able to give under its present rules to primary exporting countries with export difficulties. However, certain suggestions have been made for changes in policy that would permit an enhancement of the Fund's compensatory role. Moreover, it has been argued that even if the Fund made a reasonable degree of progress in the direction indicated enough uncertainty would remain in the minds of governments as to their ability to draw on the Fund to justify the consideration of other possible international measures of compensatory financing. It has, therefore, been suggested that there is a need for some new financial institution, separate from though possibly affiliated to the IMF, to provide compensatory financing for export fluctuations in amounts or of a kind, or with a degree of automatism that is either not practicable, or not desirable, for the IMF. In pursuance of this line of thought, the above mentioned UN Expert Group worked out schemes, which have subsequently been elaborated by the UN Secretariat, for a Development Insurance Fund, while the OAS Expert Group has prepared a scheme on a loan basis for an International Fund for Stabilization of Export Receipts.

The following are the principal suggestions that have been made by UN or OAS Experts regarding the policies and practices of the IMF in the use of its own resources.

(a) Qualitative criteria for the use of Fund resources. The Commission for International Commodity Trade, at its session of May 1961, "considered that it would be desirable if the Fund would study the question whether the present criteria for the use of its resources are fully adapted to circumstances in which payments difficulties arise mainly from fluctuations in primary product markets."

(b) Stand-by or near stand-bys for compensatory financing. According to the Report of the UN Expert Group (p. 29) "Through the increased use of stand-by arrangements or consultative procedures the Fund should aim to clarify with interested members the conditions which would assure that the full use of the quota without waiver (Fund holdings of 200 per cent of a member's currency) or even more will be readily granted if it appears justifiable according to forecasts of commodity markets and other relevant considerations."

(c) Extension of gold-tranche criterion to later tranches. The following suggestion is contained in the Report of the UN Experts (p. 28). "In so far as drawings on the Fund are automatic, a country whose export proceeds fall has reliable access to a source of compensatory financing. At present only 25 per cent of a member country's quota comes close to being automatically available. Any significant increase in this percentage which the Fund could institute would be a valuable step towards providing compensatory financing to meet the needs of primary producing countries when threatened with the adverse impact of a decline in export proceeds."

(d) Automatic compensatory drawing rights in first credit tranche. In Appendix II of the Report of the UN Experts one of the Experts (M. L. Qureshi) suggested that "to offset fluctuations in the export proceeds of primary producing countries, compensatory drawings and repayments should be determined automatically by a formula. The fluctuations should be measured as a deviation from a trend which can be estimated on the basis of a moving average of three preceding years. A shortfall in export proceeds in any year should entitle the country concerned to draw from the Fund automatically up to, say, an amount which causes the Fund's holdings of the country's currency to equal 125 per cent of its quota---- Subsequently, when export proceeds are above the trend, the excess earnings should be used automatically to repay the earlier drawings." From the context it appears Mr. Qureshi had in mind full compensation of shortfalls as defined, up to the 125 per cent point, and subsequent repayment of the whole of any excess of export proceeds over trend.

(e) Automatic compensatory drawing rights additional to normal facilities. At the Special Meeting of the Organization of American States at Punta del Este, Chile advanced the proposal that Fund members affected by price declines in important export commodities should be enabled to draw from the IMF in amounts determined by the magnitude of the price decline in question relative to the average price of the preceding three years and by the volume of exports affected. Drawings under these special arrangements would be repaid when prices rose above the level of the three preceding years. The ability of members to make ordinary drawings would not be affected by the amounts outstanding under these special arrangements.

III. Automatism in the Use of Fund Resources

The proposals that have been advanced, whether for new compensatory financing institutions or for changes in the policies and practices of the IMF, are evidence that the assistance provided by the IMF under present policies is considered either insufficiently automatic in character or inadequate in amount to deal with the payments problems that arise from export fluctuations in primary exporting countries. The question of automatism of Fund operations is discussed in this section; that of the quantitative adequacy of members' access to the Fund in the next one.

The type of automatism envisaged in the various proposals that have been put forward--automatism of the "export compensatory" rather than the "all purpose" type--has two principal features:

(1) A mathematical formula is used to determine the question whether and to what extent exports in a particular year are to be considered so abnormally low as to require compensation, or so abnormally high as to permit the repayment of compensation received previously. No judgment would be made by the lending agency, in the light of any other information that might be available, as to whether, in a particular situation, the formula yields a reasonable estimate of normal exports.

(2) The lending agency, whether the Fund or a new agency, would make credit available to a country without question whenever the formula pointed to a statistical justification on export grounds alone. No regard would be paid to the over-all balance of payments need for such credit, to the likelihood that the country would be able, in the light of the policies it was pursuing, to repay the credits that were being granted or, in some proposals, to the amount the country has already borrowed. The country itself could, of course, refuse to take up credits to which it was entitled or could repay credits before maturity.

With regard to the first point, the assumption has been made virtually without question in the proposals now under consideration that when exports are below the average for, say, the three preceding years they can safely be assumed to be abnormally low so that compensation would be appropriate.1/

1/ In the various discussions resulting in the proposals for compensatory financing now before the CICT, a number of statistical indicators were considered prior to final agreement on the value of total exports. Suggestions to base compensation on exports of individual commodities, on export prices, on the terms of trade, or on exports of goods and services were examined; they were discarded, however, in favor of the statistically less complicated concept of total merchandise exports.

Statistical experiments recently made for a large number of primary producing countries over the post-war period suggest that this is by no means generally the case. The fact that exports in any given year have been lower than they were in preceding years is very often an indication of a downward trend which may well persist for some years to come. Export proceeds that look low in relation to those of preceding years may well appear in retrospect as rather favorable. It follows from this that automatic formulae based on past and current export data only can yield at best rather unsatisfactory estimates of the true trend of exports. In the absence of foreknowledge of future exports, the least inaccurate estimate of the normal level in any given year is likely to be one that attributes a great weight to the exports of the year itself. Even when this is done, however, the extent to which it is possible by means of compensation to bring export proceeds closer to their true norm or to reduce their instability is distinctly limited.1/

While great uncertainty must always attach to any attempt to estimate the medium-term trend or norm of exports, it is reasonable to assume that a better estimate could be made by the exercise of judgment based on an analysis of the causal factors at work than by any mathematical formula, however skillfully contrived, that is based on the mere statistical magnitude of current and previous exports.

As regards the second aspect of automatism, the fact that credit is to be granted irrespective of the general balance of payments situation or of the policies of the country receiving assistance, it is necessary to consider whether and to what extent such automatism (i) already exists and (ii) is desirable, within the Fund.

Under present Fund policies "members are given the overwhelming benefit of the doubt in relation to requests for transactions within the "gold tranche," that is, for drawings which do not increase the Fund's holdings of the currency beyond an amount equal to the member's quota. The Fund's attitude to requests for transactions within the "first credit tranche"--that is, transactions which bring the Fund's holdings of a member's currency above 100 per cent but not above 125 per cent of its quota--is a liberal one, provided that the member itself is making reasonable efforts to solve its problems. Requests for transactions beyond these limits require substantial justification. They are likely to be favorably received when the drawings or stand-by arrangements are intended to support a sound program aimed at establishing or maintaining the enduring stability of the member's currency at a realistic rate of exchange."2/

1/ Paper on "Export Norms and their Application to Compensatory Financing" in a forthcoming issue of IMF Staff Papers.

2/ 1962 Annual Report, page 31.

In the higher tranches, the Fund will therefore want to be satisfied that a sound set of policies is being followed. The Fund may have reached this conclusion before the question of a drawing arose, e.g. if it has a stand-by arrangement with the country in question. Assuming such policies are being followed, no change in them would be needed to meet payments difficulties that are due solely to temporary situations in foreign markets, or to such factors as a temporary crop fluctuation. The mere fact of a falling off in exports would not be taken as an indication that a corrective program was necessary or that the corrective program already envisaged required to be intensified. On the other hand, a need for corrective policies might arise either because the decline in exports appeared to foreshadow a lasting weakening of the country's balance of payments or because, though the export decline itself might be purely temporary and self-correcting, the country's monetary and financial policies were such as to provoke, sooner or later, balance of payments difficulties even under satisfactory export conditions. Recognition by the Fund of the need for corrective policies in either of the two circumstances mentioned above does not mean that the Fund will seize the occasion of a member country's financial plight to press for immediate adoption of the full range of what might be construed as "ideal" policies, for example, the elimination of all payments restrictions, the adoption of full currency convertibility at an effective par value, the abolition of all multiple rates, etc. Reference to the policies followed in regard to these matters by the many countries that are using the Fund in the second or higher credit tranches or that have stand-by arrangements permitting such use will dispel at once the notion of such an approach by the Fund. In accordance, however, with the purposes set out in Article I, which guide the Fund in all its actions, Fund assistance, at least beyond the gold tranche, should not be made available to any country that makes no effort to move towards the elimination of those aspects of its exchange and monetary policies, which are detrimental to its own interests in the long run, and very often in the short run as well.

The general case against providing compensatory credit without inquiry into general balance of payments need or into the policies of the country concerned has been argued at length in "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations" and these arguments have not in general been challenged. As suggested by the UN Experts, a country exposed to export fluctuations might feel more secure if it had access to resources on which it could draw without having to satisfy any international organization or lending government as to the type of domestic or international economic policy it was pursuing. Moreover, it is possible that the availability of international credit on an automatic basis at times when exports are low and the necessity of repaying such credit at times when exports are high would have some effect in inducing countries to attempt to keep their domestic expenditures and imports on an even keel on the basis of reasonable expectations as to the medium term trend of their exports and other receipts. These potential advantages, however, have to be weighed against the disadvantages of automatic credit geared to a single element in the balance of payments. In this connection it may be appropriate to mention two considerations in particular:

(1) Even a statistically accurate determination that exports in a particular year are below normal implies nothing at all as to the cause of the shortfall. The cause may be a decline in world demand or a crop failure brought about by a natural calamity. But the reason may also lie in inappropriate exchange rates, domestic inflation, government purchases for stockpile at prices above those prevailing in world markets, inadequate arrangements for the collection and transportation of crops or other shortcomings of national policy. When declines in exports occur a most careful consideration of their possible causes is indicated in order to determine whether some of them may not be open to remedial action by the country itself, so as to prevent export declines in the future if similar circumstances recur.

Thus, while it is desirable that countries have access to financial means to compensate for export fluctuations, it is not particularly desirable and may be against the genuine interest of the country concerned if this finance is provided automatically and without an exploration of the causes of the decline in exports and the measures that should be taken to improve exports in the future.

It should be pointed out in this connection that the benefits that a country may derive from reaching an understanding with the Fund as to the policies appropriate to its situation extend beyond the financial assistance obtained from the Fund itself. In such circumstances agreement with the Fund is likely to strengthen opinion abroad and at home regarding the country's creditworthiness, and thus to facilitate the attraction of capital from other sources, official as well as private.

(2) The total amount of short-term credit made available to a country by one agency or under one arrangement cannot be totally divorced from the amount made available on similar terms by another agency or under another arrangement by the same agency. It would be shortsighted to think that a country would be fully justified in borrowing a relatively large amount

on short-term for the compensation of an export shortfall with total disregard of the amount it had already borrowed on short-term on some other grounds. Prudent countries would themselves see to it that their total indebtedness did not exceed what they could reasonably expect to repay, and this would take into account all indebtedness of a similar character. It would seem to be dubious wisdom to set up the terms of lending of an international agency in such a manner as to put governments under internal pressure to borrow sums that they themselves might consider going beyond the bounds of prudence. If there are sensible limitations on total short-term borrowing, these limitations should be taken into account not only by the borrowing country itself but also in the policies of the international agency extending the credit.

IV. Quantitative Adequacy of IMF Drawing Facilities

The UN Expert Group responsible for producing "International Compensation for Fluctuations in Commodity Trade" calculated that 16 out of 46 primary producing countries experienced, over the years 1953 to 1959, cumulative shortfalls of exports, as compared with average annual exports over the three preceding years, of such magnitude that to compensate them fully would have compelled them, after using up 125 per cent of their IMF quotas, to dip into their own reserves to an extent exceeding one-third of end-1959 reserves.

The Experts did not offer an opinion as to whether these facilities, had they been available on an automatic basis, would have been adequate to meet to a reasonable extent the need for compensatory financing of export fluctuations. However, they pointed out that if only the 25 per cent of quota constituting the gold tranche (or the 50 per cent constituting the gold and first credit tranches) had been made available to meet the cumulative export shortfalls, over 20 (or 16, respectively) of the countries concerned would have had to draw down their reserves by more than 30 per cent to achieve full compensation. This, they implied, was insufficient, and even if a reasonable degree of progress were made by the Fund in extending the automatism of drawings in many cases the uncertainty of drawings would, they considered, offer a serious handicap to the object of continuity in development expenditure.

In a UN Secretariat Study (E/CN 13/43) of January 1962 it was calculated:

(a) that for the average primary exporting member of the IMF the average shortfall in export earnings (as compared with the mean of the previous three years' exports) over the period 1953 to 1960 slightly exceeded 50 per cent of its (1961) quota; but that in only half of the countries would drawings of up to 50 per cent of quota have sufficed to offset the average annual shortfall for years in which shortfalls occurred; and

(b) that if each primary exporting member had compensated 100 per cent of its export shortfalls by drawing on the IMF and had used 60 per cent of export excesses for repayment, up to a limit of cumulative net drawings of 50 per cent of quota, primary exporting members could have compensated in this way about one-third of their total shortfalls.

The authors of the study made it clear that their calculations were not intended to reflect on, or measure, the adequacy of the IMF as a means of assisting member countries, since usually reserves and other sources of credit could also be drawn upon and since IMF drawings are not limited to 50 per cent of quota.

The question of the quantitative adequacy of drawing facilities in the IMF to meet the needs for compensatory financing of export fluctuations is one of great difficulty, and no answer can be made to it without the help of many arbitrary suppositions. In arriving at these suppositions the following considerations are relevant:

(a) In the first place, as is generally recognized, IMF facilities are intended to be used in conjunction with national reserves, and other sources of finance.

(b) Again, account has to be taken of the fact that all these various forms of international liquidity are required to meet payments deficits arising, not only from export shortfalls but also from fluctuations in other items in the balance of payments, notably import fluctuations. These factors are, in fact, rather more important than export shortfalls in the causation of payments deficits. Moreover, reserves cannot safely be run down to zero even to meet the severest drains. On the other hand the various possible causes of deficit are unlikely to exercise their maximum effect simultaneously.

(c) In seeking to measure the probable need for compensatory financing of export shortfalls it is somewhat misleading to measure such shortfalls either from a 5-year moving average centered on the middle year, as was done in "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations" or from a moving average of the preceding three years as was done by the UN Experts and Secretariat, and by the OAS Experts. As has been pointed out in a staff paper 1/ the 5-year moving average centered on the current year, while it may be considered an "ideal" norm from which to measure export deviations, is not usable in practice since foreknowledge of the exports of future years is necessarily lacking. It would seem desirable, however, that the "practical" norm from which export deviations are measured should be close to this "ideal" norm insofar as the latter can be predicted in the light of existing knowledge. Such a prediction is perhaps best made by the exercise of judgment in the light of all relevant information. If, however, it is decided to define the practical norm by an automatic formula involving the exports of current and previous years, the formula, if it is not to diverge unnecessarily from the ideal norm, must give considerable weight to the current year's exports. Moreover, as was argued in "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations" the compensation of fluctuations should, in principle, be partial only. Accordingly a target level of availabilities should be chosen that is somewhat closer to actual exports than is the ideal norm. The result will be to increase still further the weight that should be given to the current year's exports in the calculation of the practical norm, or alternatively--what amounts to the same thing--deviations of actual exports from the practical norm should themselves be compensated only in part.

In Table 1 it has been assumed that drawings on the IMF or drafts on national reserves will be made to cover two thirds of shortfalls of actual exports with respect to a practical export norm defined as an average of exports in present and two previous years, with weights of 50 per cent on the present year and 25 per cent on each of the two previous years. It is assumed that two thirds of export surpluses with respect to this norm are used to repay drawings or reconstitute reserves. In order to ensure that countries with a downward long-term trend in exports do not indefinitely increase their claims on compensatory financing it is assumed that drawings are in any case repaid, or drafts on reserves made

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1/ "Export Norms and their Application to Compensatory Financing" to appear in a forthcoming issue of IMF Staff Papers.

good, in the fourth and fifth years of the drawing. The maximum net cumulative requirements for compensatory financing over the period 1951-61 on these assumptions 1/are shown for each primary exporting member of the Fund in column (1).

Columns (2), (3) and (4) present three alternative measurements of the means presently available to meet the requirements set forth in column (1). Column (2) shows one third of each country's potential external liquidity, defined as its unused potential drawing facilities with the Fund (through the fourth credit tranche) plus its gross reserves of gold and convertible currency, as of mid-1962. The assumption underlying this column is that one third of external liquidity is approximately what can be used to meet export fluctuations, the remainder being required for basic reserves and for other types of payments deficits insofar as these coincide with export shortfalls. Column (2) shows one half of the excess of each country's potential external liquidity, as of mid-1962, over a presumed minimum reserve equal to the value of one month's imports at the 1961 rate. Column (3) gives each member country's Fund quota as of mid-1962. The assumption underlying column (3) is that each member would be in a position to use up to one half of its quota for the purpose of financing export fluctuations and would match this amount by an equal use of its own reserves, so that the combined use of reserves and IMF resources would amount to 100 per cent of quota.

The problem of the adequacy of Fund resources (in conjunction with national reserves) in meeting needs for the compensatory financing of export fluctuations is approached differently in columns (2) and (3) on the one hand, and column (4) on the other. A comparison of column (1) with columns (2) or (3) affords a measure of the extent to which member countries might have been able to meet export fluctuations of a defined magnitude on the basis of their external liquidity as of a given moment of time (viz. mid-1962). A comparison of column (1) with column (4) affords a measure of the extent to which member countries could meet such fluctuations on the basis of their normal drawing power in the Fund, starting from a position in which drawings for the purpose of export compensation are zero and assuming that the member will have adequate independent reserves to use pari passu with drawings in the Fund. In all cases the need for financing is measured in relation to the experience of a particular decade (1951-61), and on the basis of specific assumptions regarding the degree of compensation. The comparisons with columns (2) and (3) would seem the more relevant in considering the need for adding to the resources available to countries for compensatory financing. The comparison with column (4) is the more relevant to a consideration of the adequacy of the quotas of individual countries.

1/ The assumptions are the same as those underlying Scheme 24 of Table 1 of DM/62/40, a scheme which yields export availabilities considerably closer to target and considerably smoother over time than those of Scheme 1 (the OAS Scheme).

It might be argued that in some countries parts of the reserves are virtually unusable, in that they are pledged against certain liabilities, or for other reasons. To some extent this factor is taken into account in the concept of minimum reserves underlying the calculations in columns (2) and (3). However, since no allowance has been made for this factor in column (4), column (5) has been added to show to what extent the compensatory financing of export fluctuations would be limited if countries' use of external liquidity for this purpose were to be limited to 50 per cent of Fund quotas--a rather extreme assumption in most cases.

The differences between the alternative measures of the means available for compensatory financing of export fluctuations shown in columns (2), (3), (4) and (5), and the computed requirements for such financing shown in column (1), are set forth in columns (6), (7), (8) and (9), respectively. It is remarkable that the incidence of "minus" signs in columns (6) and (7) is almost identical. One third of external liquidity as of mid-1962 would have been inadequate to cover maximum compensatory requirements in the case of only 9 countries out of 47.1/ One half of the excess of such liquidity over one month's imports would have been similarly inadequate in the case of 8 out of the same 9 countries, with the exception of Pakistan. A limitation of financing to 100 per cent of quota as shown in column (8) would again have restricted export compensation in only 9 cases.2/ Since these groups partially overlap, 16 member countries would have been limited by one or the other criterion, viz. Argentina, Bolivia, Chile, Colombia, Haiti, Indonesia, Iran, Iraq, Malaya, Panama, Pakistan, Sudan, Syria, Tunisia, Uruguay and Viet-Nam. The more stringent limitation of financing to 50 per cent of quota illustrated in columns (5) and (9) would result in "minus" signs in 10 countries other than those mentioned above.3/ In view of the necessarily somewhat arbitrary nature of the criteria employed in these calculations, and their uniform application to all countries regardless of special circumstances, the results for individual countries should not be taken too seriously. The calculations do, however, yield a general impression of the magnitude of the problem.

It should be added that, in a few countries with declining medium term trends over the 1951-61 period, such as Bolivia and Pakistan, limitation of the finance available for automatic compensation over that period would probably have exercised a beneficial effect through limiting the need for repayment at times when exports were low in relation to trend.

1/ Argentina, Bolivia, Chile, Colombia, Haiti, Indonesia, Iran, Pakistan and Syria.

2/ Iran, Iraq, Malaya, Panama, Sudan, Syria, Tunisia, Uruguay and Viet-Nam.

3/ Burma, Ceylon, Dominican Republic, El Salvador, Ghana, Honduras, Pakistan, Thailand, Turkey and UAR-Egypt.

V. Fund Action in Connection with Export Fluctuations

The Fund is exploring ways in which Fund drawings might be made to serve better the needs of primary producing countries in relation to export fluctuations, and intends to proceed along the following lines to provide further assurance that members' needs in this regard will be adequately taken care of, assuming that members themselves are making reasonable efforts to solve their payments problems.

(1) Quotas. The Fund is now examining on a selective basis the quotas of the primary producing countries, in particular those of the countries with fairly small quotas, in order to determine whether adjustments would be desirable to make individual quotas more uniformly adequate to meet each country's needs in connection with export fluctuations as well as other balance of payments fluctuations.

While any judgment as to the adequacy of quotas is in part dependent on the level of reserves that countries can be expected to maintain, Table 1 would seem to indicate that the quotas of many countries, taken in conjunction with a reasonable use of their own reserves, are at present adequate from this point of view. The quotas of some other countries, however, are rather clearly insufficient to meet the possible need for Fund assistance to deal with export fluctuations.

If the quotas of certain countries were increased, initially only those countries of whose currencies the Fund--both before and after the quota increase--held amounts equal to 75 per cent of quota would secure a pro rata increase in drawing facilities in all tranches. Countries with substantial drawings outstanding would initially receive additional drawing facilities in the higher tranches. However, on completion of repurchases they also would benefit from a proportionate increase in gold and early credit tranches. On the other hand, those receiving the increased quotas would be obliged to subscribe one quarter of the increase in gold, unless special arrangements were to reduce or postpone this burden.

Quota increases would help the countries concerned to meet more effectively payments difficulties of whatever nature, and not only those arising from export fluctuations. The need for quota increases would, therefore, have to take into account evidence other than that provided by Table 1 as well.

(2) Drawing policies. With regard to requests for drawings (beyond the gold tranche) that are related to payments difficulties attributable to causes beyond the control of the member the attitude of the Fund will be a liberal one, provided that the member itself is making reasonable efforts to solve its problems.

This is the rule laid down for drawings in the first credit tranche; while there is no need for the Fund to alter the policies and practices laid down for drawings of the second or further credit tranches, the Fund can be sufficiently flexible in the application of its policies to allow for difficulties of a predominantly external character in a member's payments problem. The Fund would, of course, have to decide in individual situations whether and to what extent the member's payments difficulties could be considered to be of a temporary character, predominantly beyond the control of the member. If in such cases the application of the Fund's policies would involve transactions of a magnitude that would raise the Fund's holdings of a member's currency beyond 200 per cent of its quota, the Fund would be prepared to use its power under Article V, Section 4 to waive this limitation on its holdings.

It is the Fund's opinion that action along these two lines will go far towards meeting the needs of its member countries for a second line of reserves, on a repayable basis, to deal with payments difficulties due to export fluctuations. The Fund is, of course, fully aware of the fact that the objective of a satisfactorily rising trend in the export proceeds of the developing countries is of far broader dimensions than the provision of repayable credit to mitigate short-term export fluctuations, and that measures in other fields--such as the pursuit of expansionary policies in the developed countries, liberal trade policies, the provision of aid, the diversification of agriculture and industry in the developing countries--are needed to make satisfactory progress towards this objective.

In deciding on this course of action the Fund has considered two alternative changes in its policies, to which it does not, however, feel attracted. They are briefly discussed in the two sections that follow.

(1) Drawings to be made available automatically on the basis of a statistical criterion of export shortfalls. Any attempt to graft a system of export automatism onto the Fund's normal system of drawings would give rise to difficulty and, probably, confusion. It would run counter to the Fund's policy of relating the granting of its assistance to the adoption of corrective programs wherever such programs are needed. It would also be confusing to the relationship between the Fund and individual members if the latter were entitled in certain circumstances, depending on the outcome of calculations of the type indicated earlier in this paper, to obtain

assistance from the Fund without regard to the member's observance of its understandings with the Fund. The problem would also arise of working out a body of rules to decide the manner in which repayments should be allocated as between "compensatory" and "ordinary" drawings.

(2) Increased all-purpose automatism. This type of automatism might be achieved, for example, by extending "gold tranche treatment" to drawings in the first credit tranche; the criteria now applicable to drawings in the first credit tranche might then be transferred to those in the second.

The existing gradations of automatism in the Fund's policies on the use of its resources, as set out on page 6 above, reflect certain broad considerations as to the Fund's relation with its members and its role in the world payments system. To be most effective with its members, the Fund's policies on drawings must neither be so exacting as to turn the Fund into a righteous bystander of history, nor so accommodating as to turn it into an accomplice of inflation. Steering between these extremes, the Fund's present policies allow virtual automatism in the gold tranche, apply relatively mild criteria for use of the first credit tranche, and apply increasingly severe criteria for use of higher tranches. As a result of these policies a country's gold tranche drawing rights on the Fund can for all practical purposes be included in the country's own reserves, whereas access to the Fund beyond the gold tranche represents increasingly "conditional" liquidity.

While the Fund's policies as to the degree of automatism of access to successive tranches are not frozen for all time, any alteration in them would call for justification. Experience indicates that many of the less developed primary producing countries have found it difficult to avoid inflation and hold on to their independent reserves (including their automatic drawing rights). From this point of view it would not seem desirable to increase the proportion of quota available on an automatic basis without regard to the cause of the payments deficit or the policies being pursued by the country.

VI. Comparison of New Proposals for Compensatory Financing with Possible Action by the Fund

Of the two schemes for setting up new compensatory institutions that have been suggested by expert groups, the Development Insurance Fund suggested by the UN Expert Group involves not only loans, but also grants, viz., insofar as insurance receipts of countries with relatively large shortfalls exceed the premiums paid by them, or insofar as contingent loans are cancelled when, because of a downward medium-term trend in export receipts, they have remained outstanding for a number of years. These features of the DIF scheme have no counterpart in anything the IMF could do with its own resources, and there is therefore no basis to compare a grant scheme with an expansion of the facilities provided by the Fund.

Such an expansion in Fund facilities can, however, be compared with proposals designed to provide facilities for compensatory financing on a repayable basis. While it is possible to construct, among the many variants of the DIF scheme, a scheme that would contain no grant element, it is probably more illuminating to make a comparison between the Fund on the one hand and the OAS scheme on the other hand. It may be sufficient to compare a number of the salient aspects, without attempting to cover in full all aspects of Fund transactions or all details of the present OAS proposal.

(a) Access to resources. Fund resources are available for balance of payments deficits arising from a broad variety of circumstances provided the Fund is satisfied that the member's policies are such as to give the Fund the assurance, in accordance with the Fund's tranche policy as set out above, that the member's use of the Fund will be temporary. In the OAS plan, access is limited to cases of export shortfalls below the statistical norm; in these circumstances access is automatic except that the proposal contains a procedure for suspending the right of access.

(b) Repayment. In the Fund, repayment is related to increases in a country's reserves, with an outside limit of three to five years. In the OAS proposal, repayment is related to the performance of exports compared to their norm, with repayment in any event in the fourth and fifth years.

(c) Contribution by underdeveloped countries. Quota increases in the Fund normally require a gold contribution of 25 per cent of the quota increase. In the OAS proposal the underdeveloped countries are expected to contribute one-third of the total resources put up.

(d) Contribution by developed countries. The OAS plan envisages a contribution from the developed countries in the order of magnitude of $1 billion. While initially much of this money would be made available on a stand-by basis only and would therefore not accrue to the less developed countries, it would no doubt prove necessary to seek legislative approval in the contributing developed countries for the full amount. A moderate increase in the drawing facilities of the less developed countries in the Fund would probably not at present require quota increases from the developed countries. The fact that action through the existing machinery of the Fund would not have legislative implications for the developed countries at this time might make it easier for them to obtain parliamentary approval for other measures aimed at giving aid to the less developed countries.

VII. Conclusions

(1) The Fund has given consideration to the question whether and in what way it ought to play an increased part in the compensatory financing of export fluctuations of primary exporting countries. In devoting attention to this matter, the Fund has been fully conscious of the fact that the provision of credit to deal with the balance of payments effects of export fluctuations represents in its essence only a useful alleviation of the short-term difficulties of the countries relying on the proceeds of exports of primary products, and does not purport to deal with the more basic problems of the longer run. The fundamental solution of thse problems will depend on the maintenance of an expanding demand by the developed countries for the products of the less developed countries; on trade policies in the developed countries that will assure the less developed countries the fullest access to the natural markets for their products; in appropriate cases on agreements among producers and consumers of raw materials and foodstuffs; and, finally, on an expanded flow of financial and technical assistance from the developed to the less developed countries.

(2) The provision of foreign exchange to its members to enable them to finance export fluctuations constitutes a legitimate use of Fund resources, and they have been drawn on frequently for this purpose. The quotas of many countries, taken in conjunction with a reasonable use of their own reserves, are at present adequate from this point of view, and there is room for members to make an increased use of the Fund for financing balance of payments deficits arising from export shortfalls. Within the framework of the present Fund's policies, with their desirable balance between automatic and conditional access to the Fund's resources, increased use could be made of the Fund's resources where necessary, for instance by a more extensive use of stand-by arrangements.

(3) Members may be given further assurance that their needs in regard to compensatory financing will be more adequately taken care of by the following developments.

(a) The Fund is now examining the quotas of the primary producing countries, in particular those of the countries with relatively small quotas, in order to determine whether adjustments would be desirable to make them more uniformly adequate to meet each country's needs in connection with export fluctuations as well as other balance of payments fluctuations.

(b) The Fund's attitude towards requests for drawings beyond the gold tranche ~~that are related to payments difficulties attributable to causes beyond the control of the member will be a liberal~~ one, provided ~~that the member itself is making reasonable efforts to solve its problems~~.

(4) Increased action by the Fund in the field of compensatory financing, whatever its form, will channel additional resources to the primary exporting countries on a temporary basis. Any other arrangement to provide additional resources on a loan basis would inevitably be similar in many respects to Fund drawings and repurchases. It would, therefore, in the opinion of the Fund, be preferable to provide such additional resources through the Fund, so that whatever were the Fund's policies from time to time on the use of its resources would apply to the whole of a country's access to the Fund as thus enlarged.

(5) The Fund has given extensive consideration to proposals for automatic compensation of export fluctuations on the basis of a statistical criterion of export shortfalls related to export values for recent years. It concludes that the compensation that can appropriately be achieved in this manner is distinctly limited and that it may well be against a country's genuine interest if automatic finance is provided without an exploration of the causes of the decline in a country's exports and the measures to be taken to improve exports in the future. For these and other reasons, it would not be desirable to arrange in the Fund, with the use of the Fund's resources, automatic compensatory financing of export fluctuations, with the loans and repayments determined on the basis of a formula. If, nonetheless, it were desired to provide such automatic compensatory financing, either on a loan basis or on an initial or contingent grant basis, by means of a separate international agency with its own resources, consideration should be given to the possible desirability, from the points of view of such an agency and the Fund, of affiliation of the agency to the Fund.

and the first credit tranche that are related to balance of payments difficulties caused by essentially temporary situations beyond the control of the member will be a liberal one, provided that the Fund is satisfied that the member is pursuing basic policies aimed at adjusting its total expenditure to the longer run changes in its available resources.

Table 1. Adequacy of External Liquidity to Finance Export Fluctuations

(Millions of U.S. Dollars)

	Max. Financial Requirements Indicated by 1951-61 Experience 1/	Assumed Limits of Finance Available				Excesses or Deficiencies (-) in Available Financing			
		1/3 of External Liquidity 2/	1/2 of Excess External Liquidity 3/	Fund Quota 4/	1/2 of Fund Quota 4/	(2)-(1)	(3)-(1)	(4)-(1)	(5)-(1)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Argentina	192.3	101.3	91.2	280.0	140.0	-91.0	-101.1	87.7	-52.3
Bolivia	18.8	9.1	10.4	22.5	11.2	-9.7	-8.4	3.7	-7.6
Brazil	130.8	206.6	249.2	280.0	140.0	75.8	118.4	149.2	9.2
Burma	20.5	56.5	75.7	30.0	15.0	36.0	55.2	9.5	-5.5
Ceylon	25.8	42.6	49.0	45.0	22.5	16.8	23.2	19.2	-3.3
Chile	54.8	35.0	28.0	100.0	50.0	-19.8	-26.8	45.2	-4.8
Colombia	79.5	66.7	76.8	100.0	50.0	-12.8	-2.7	20.5	-29.5
Costa Rica	5.8	10.0	10.6	15.0	7.5	4.2	4.8	9.2	1.7
Cyprus	4.5	22.9	29.6	11.2	5.6	18.4	25.1	6.7	1.1
Domin. Repub.	8.3	11.9	14.5	15.0	7.5	3.6	6.2	6.7	-0.8
dor	5.8	13.8	15.9	15.0	7.5	8.0	10.1	9.2	1.7
alvador	7.8	15.4	18.6	11.2	5.6	7.6	10.8	3.4	-2.2
Ethiopia	4.7	29.6	40.6	13.2 5/	6.6 5/	24.9	35.9	8.5	1.9
Ghana	21.8	75.4	96.8	35.0	17.5	53.6	75.0	13.2	-4.3
Greece	12.3	116.7	145.3	60.0	30.0	104.4	133.0	47.7	17.7
Guatemala	5.7	22.5	28.2	15.0	7.5	16.8	22.5	9.3	1.8
Haiti	7.3	5.3	6.6	11.2	5.6	-2.0	-0.7	3.9	-1.7
Honduras	7.0	7.9	8.8	11.2	5.6	0.9	1.8	4.2	-1.4
India	148.0	305.6	368.2	600.0	300.0	157.6	220.2	452.0	152.0
Indonesia	135.0	89.9	101.8	165.0	82.5	-45.1	-33.2	30.0	-52.5
Iran	289.7	96.4	119.6	70.0	35.0	-193.3	-170.1	-219.7	-254.7
Iraq	54.7	56.0	67.1	15.0	7.5	1.3	12.4	-39.7	-47.2
Jordan	2.7	20.8	26.4	8.0 5/	4.0 5/	18.1	23.7	5.3	1.3
Korea	8.1	72.5	96.2	18.8	9.4	64.4	88.1	10.7	1.3
Lebanon	3.3	64.1	81.8	6.8	3.4	60.8	78.5	3.5	0.1
Libya	1.7	36.3	48.2	11.0 5/	5.5 5/	34.6	46.5	9.3	3.8
Malaya	246.0	290.1	404.8	32.5 5/	16.2 5/	44.1	158.8	-213.5	-229.8
Mexico	60.2	185.6	231.1	180.0	90.0	125.4	170.9	119.8	29.8
Morocco	2.8	81.2	103.2	52.5	26.2	78.4	100.4	49.7	23.4
Nicaragua	3.4	12.9	16.2	11.2	5.6	9.5	12.8	7.8	2.2
Nigeria	15.8	80.0	94.1	50.0	25.0	64.2	78.3	34.2	9.2
stan	143.0	142.1	186.4	150.0	75.0	-0.9	43.4	7.0	-68.0
ma	1.8	10.3	9.4	0.5	0.2	8.5	7.6	-1.3	-1.6
Paraguay	4.0	5.0	5.9	11.2	5.6	1.0	1.9	7.2	1.6
Peru	11.0	42.2	43.8	32.5 5/	16.2 5/	31.2	32.8	21.5	5.2
Philippines	15.2	46.7	40.1	75.0	37.5	31.5	24.9	59.8	22.3
Saudi Arabia	4.2	114.3	158.9	55.0	27.5	110.1	154.7	50.8	23.3
Sudan	32.8	63.9	86.1	15.0	7.5	31.1	53.3	-17.8	-25.3
Syria	28.2	9.2	6.7	15.0	7.5	-19.0	-21.5	-13.2	-20.7
Thailand	24.8	175.7	243.4	45.0	22.5	150.9	218.6	20.2	-2.3
Tunisia	18.8	30.3	36.6	18.3 5/	9.2 5/	11.5	17.8	-0.5	-9.6
Turkey	51.3	85.9	107.6	86.0	43.0	34.6	56.3	34.7	-8.3
UAR - Egypt	77.8	77.9	89.3	90.0	45.0	0.1	11.5	12.2	-32.8
Uruguay	60.3	82.8	115.6	30.0	15.0	22.5	55.3	-30.3	-45.3
Venezuela	0	229.5	295.9	150.0	75.0	229.5	295.9	150.0	75.0
Viet-Nam	34.7	60.4	80.0	18.5 5/	9.2 5/	25.7	45.3	-16.2	-25.5
Yugoslavia	9.0	36.3	16.6	120.0	60.0	27.3	7.6	111.0	51.0
Total	2,101.8	3,453.1	4,276.8	3,203.3	1,601.4	1,351.3	2,175.0	1,101.5	-500.4

1/ As described on pages 11 and 12 of the text.

2/ A country's external liquidity is defined as its gold and convertible foreign exchange reserves plus its gross IMF position. Figures given are for mid-1962. A country's gross IMF position is the amount that it could still draw, as of a given date, if its justification were sufficient, without increasing the Fund's holdings of its currency above 200 per cent of its quota.

3/ Excess external liquidity (as of mid-1962) is defined as external liquidity (described in footnote 2) less average monthly imports (for 1961).

4/ Quotas given are for mid-1962.

5/ Quotas to be increased by annual installments, as follows: Ethiopia to $15 million; Jordan to $11.25 million; Libya to $15 million; Malaya to $37.5 million; Peru to $37.5 million; Tunisia to $22.5 million; and Viet-Nam to $22.5 million.

INTERNATIONAL MONETARY FUND

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Per Jacobsson, Chairman
F. A. Southard, Deputy Managing Director

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P. Lieftinck	H. M. H. A. van der Valk
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	A. Nikoi
	W. Tennekoon
	I. S. Sun
A. van Campenhout	

A. C. Frost, Acting Secretary
F. Hodel, Assistant Secretary

Also Present
African Department: J. V. Mládek, Acting Director; Tun Wai. European Department: E. Sturc, Deputy Director; W. A. Beveridge, R. Evensen. Exchange Restrictions Department: R. V. Anderson. Legal Department: J. Gold, General Counsel; H. Aufricht, A. S. Gerstein, G. Nicoletopoulos. Research and Statistics Department: J. J. Polak, Director; O. L. Altman, G. S. Dorrance, G. Lovasy, R. R. Rhomberg, A. S. Shaalan, W. H. Taylor. Western Hemisphere Department: J. Del Canto, Director. Office of the Secretary: J. W. Lang. Office of the Treasurer: R. Kroc. W. P. Cooke, Personal Assistant to the Managing Director. G. Williams, Special Representative to UN. Information Office: H. G. Hopkins. Technical Assistants to Executive Directors: J. de Groote, H. G. Heinrich, Y. Mizoe, P. Sundaram, D. W. Wilson.

Executive Board
Journal - Informal Session No. 62/2
11/16/62

1. Compensatory Financing of Export Fluctuations

The Executive Board continued its informal and preliminary exchange of views on a staff memorandum concerning compensatory financing of export fluctuations (SM/62/94, 11/8/62, and Informal Session No. 62/1, 11/16/62).

Mr. Lieftinck wished first to join the other Directors in paying tribute to the staff for its very helpful paper. He observed that previous speakers had pointed out that it had been less than three years ago when the Board had discussed the problem of compensatory financing and the question had been raised whether there was any need to revise the conclusions that had been reached at that time (EBM/60/10, Item 3, 3/18/60). Speaking personally in his individual capacity, Mr. Lieftinck said he felt that three years ago the Board could restrict itself to a statement of policy or clarification of existing policies in response to the question that had been put to the Fund. At the present time, however, the Fund was faced with an invitation to do more than that, and this meant that it was now faced with a distinct challenge. Certainly Mr. Dale's statement at the previous session left very little doubt about this.

Despite the shortness of the period that had elapsed since the last discussion, Mr. Lieftinck said he felt that the Board had to recognize the dynamics of the problem and face the fact that in many countries there was an increasing awareness of the seriousness of the problem and that in other agencies experts and responsible officials were intensively studying the matter. In addition, there were certain other factual developments that explained the inescapability of facing up to the problem. In many of the raw material producing countries--in fact, all over the world in the developing countries--aspirations were growing to improve living conditions and the adjustment of domestic income to downward movements in export income was becoming more and more difficult socially and politically. At the same time during the last three years the development efforts in a great number of countries had been markedly increased, and the authorities of these countries had felt that these efforts, genuinely undertaken to build for the future, were seriously affected by strong declines in export proceeds, especially where populations were rapidly increasing.

Another development, Mr. Lieftinck continued, was the building up of a certain fear in a number of primary producing countries that regional groupings of a preferential nature might increase their problems, give them less free access to free world markets, and lead to further declines in the prices of their products. Hence, there were a number of new factors which explained the urgency of the matter before the Board, and for that reason he welcomed the present discussion.

Mr. Lieftinck said he fully agreed with those Directors who had pointed out that the problem of fluctuations in export earnings was much too broad and complex to be solved entirely by some revision of Fund policies. But he believed it would be useful if the Fund, in replying to the invitation which it had received, pointed out that according to its Articles of Agreement the Fund had a task and should perform a function in this whole framework. This could be carried out first, by the promotion of domestic and balance of payments policies in the primary producing countries which might be helpful in overcoming the shocks to their economic structures resulting from declines in their export proceeds. At the same time, the Fund should never give up advocating liberal commercial and payments policies on the part of the more industrialized member countries. These two fundamental approaches should never be out of sight.

The question then arose, Mr. Lieftinck said, as to how the Fund in a more technical manner could be helpful through the use of its resources, and on this point he thought it would be worthwhile to underline again that the Fund could only be of assistance with respect to short-term fluctuations in the balance of payments of members where actual export income declines had occurred. This was a very severe restriction on what the Fund could do. He fully associated himself with the previous speakers who had pointed out that a large number of long-term problems were involved in the whole question and that it would be illusory to expect that the Fund could do more than alleviate on a short-term basis some of the painful consequences of the fluctuations in export earnings.

The staff paper, Mr. Lieftinck noted, had examined whether the drawing facilities of the Fund were adequate to meet at least the short-term problem, and he considered the discussion of this point one of the most important parts of the paper. He had been impressed by the approach of the staff and the effort it had made to indicate in what measure the Fund's drawing facilities should be sufficient to perform a legitimate function in this framework, but he would have liked to have seen a further elaboration of these considerations, especially those set out in paragraph (b) on page 11 and the statement that "on balance, therefore, it may not be unfair to assume that, say, one third of the total of potential IMF facilities and national reserves are available for the purpose of financing export fluctuations to the extent that these ought to be financed" (SM/62/94, p. 11, 11/8/62). This was a very important statement, and although he was quite prepared to accept the correctness of it on the authority of the staff, he would welcome some further explanation of how it had arrived at that conclusion. On the assumption that the statement was correct in a very general sense, it seemed clear that it might not apply to each individual case, and for that reason he had some hesitation in accepting Table 1 as fully supported by the facts. Mr. Plumptre and Mr. Anjaria thought the table had been based on a rather conservative approach. Mr. Lieftinck said it was his opinion that several cases where the minus signs appeared could be explained by very temporary noneconomic factors, and he would question whether the over-all approach of the availability of one third of potential IMF facilities and national reserves could be applied to all cases. Certainly, it would have to be applied with great caution. Nevertheless, he felt that one probably could conclude from the table that there were not too many cases in which the external liquidity available to member countries exporting primary products had been inadequate. But the fact that such a conclusion could be reached with respect to the past did not mean that it would have validity for the future. In this connection, it was noteworthy that in recent years in a number of raw material producing countries national reserves, accumulated in periods of favorable market conditions, had seriously declined. Therefore, the Fund should be cautious about basing its conclusions on Table 1.

Mr. Lieftinck said he was quite prepared to consider the present exercise along with other exercises designed to ascertain whether the range of use of the Fund's resources by its raw material producing members should be enlarged. This, in fact, was the only one of the four suggestions for Fund action which appealed to him. The staff's discussion and appraisal of these alternative suggestions formed another important part of the report (ibid., pp. 13-19). He had nothing to add to the discussion of the first alternative under which drawings would be made available automatically on the basis of a statistical criterion of export shortfalls. He also was not attracted by the second alternative concerning automatic drawings for balance of payments difficulties attributable to a temporary cause beyond the country's control. It would be very difficult to find in practice a pure case of this nature, for in a majority of the cases balance of payments difficulties probably resulted from a mixture of causes, one of which might well be a cause beyond the country's control. In this connection, Mr. Lieftinck remarked that he did not fully agree with Mr. van Campenhout that causes beyond the control of the member did not call for action by the member itself. Short of adequate foreign assistance to meet the balance of payments problem, such a country might be forced to adjust its income level and its imports to the decline in export prices even if the cause of the balance of payments difficulties was beyond its control. He would agree that if there were a pure case of the kind envisaged in the second alternative the Fund should do its utmost to be helpful within the maximum of its possibilities and its policies. But this did not mean that action by the member was not called for. He felt that the staff was correct in concluding that "any attempt to graft a system of export automatism onto the Fund's normal system of drawings would give rise to difficulty and, probably, confusion" (ibid., p. 14). The same comment could be made with respect to the third alternative under which "the existing automatic access would be extended over a larger area of the quota than that to which it now applies." Moving the criteria for the lower tranches into the higher tranches would mean greater automaticity, which he felt was not in line with the purposes of the Fund and the interests of its members.

Mr. Lieftinck then turned to the fourth alternative under which "members would be permitted larger access to the Fund resources without extending the range of automatism in any of the ways mentioned above." Two possibilities arose under this method, the first being an increase in the ceiling on drawings so that members could draw beyond 100 per cent of quota, and the second being selective quota increases. He felt that it was not necessary at this time to make a definite and final choice between these possibilities. Personally, he was open to either course. Both had advantages and disadvantages and perhaps some desirable combination of the two could be conceived. But he would stress that, if and insofar as quota increases on a selective basis should be considered, there should be no relaxation of the rule requiring 25 per cent of the increased quota to be paid in gold.

As regards the possibility of undertaking selective quota adjustments, Mr. Lieftinck thought the criteria for such action should be very carefully chosen. Like other Directors, he felt that the use of a formula based on one element in the balance of payments would be arbitrary and inadequate. For the time being he was inclined to join those Directors who had suggested that some adjustment of the Bretton Woods criteria might be preferable to all those suggested up to now. But, in this connection, he thought it important to bear in mind that Fund quotas were not unrelated to Bank subscriptions and that what might be desirable in the Fund might not be desirable in the Bank.

It seemed clear, Mr. Lieftinck continued, from the figures presented in SM/62/95 that member countries with quotas under $30 million and those with quotas in the range of $31-60 million had fallen behind in terms of the percentage of their actual quotas to their computed Bretton Woods formula quotas as compared with countries with quotas of over $60 million and with the ten industrialized members. As a first approach to the problem of the revision of quotas, Mr. Lieftinck said he could go along with some kind of solution on a selective basis and after careful study of each case on its merits. But he was also prepared to make an attempt to improve the position of the member countries with quotas under $60 million more generally by raising their existing quotas to a percentage of their computed Bretton Woods formula quotas which exceeded the percentage of the over $60 million quota group and the industrialized members. At present that percentage for the major industrial countries was 39.4 per cent and for the second highest group it was 55.3 per cent. He would be prepared to consider bringing the $31-60 million quota group up to 60 per cent and the group with quotas up to $30 million to 65 or 70 per cent. In that manner, the Fund could move on a selective basis but with some generalization in mind. It would give some redress and even some advantage to countries with quotas under $60 million. In concluding, Mr. Lieftinck said he was not making a specific proposal along these lines but had merely advanced the suggestion as a possible general approach to the problem of the smaller quotas.

Mr. Pitblado wished to add some observations on a purely personal basis. He welcomed the opportunity of hearing the views of other Directors and commended the staff for its excellent study. Mr. Pitblado said he would direct his remarks to the two issues now before the Fund: first, the views or report which the Fund could present to the CICT in response to its invitation, and, second, the actions which the Fund might consider taking within its own direct field which were related to the problem of compensatory financing. The very good staff paper now before the Board had been directed to the specific issues on which the Fund's views had been requested. Other speakers had drawn attention to the wider issues which lay behind the question of compensatory financing. The Board would have to consider whether in a report to another body in response to a specific request the Fund should state its views in a much broader setting. All of the Directors and the member governments were aware of the wider issues and were giving a great deal of attention to the broad problems in the relationship of the primary producing and exporting countries to the industrialized countries and to the wider issues of trade policy in all its aspects. These were matters which were very much within the purview of the Fund and within the ambit of its purposes and interests.

Turning to the paper itself, Mr. Pitblado said that one of its main virtues was that it had produced some very useful statistics--in fact, as Mr. Hanemann had said, the best statistics on the problem that had been produced so far. They gave a measure of the general scale of the problem of export fluctuations insofar as this could be separated from other aspects, and it matched them according to various criteria against the resources which had been available. Any criteria obviously were open to criticism.

Mr. Pitblado also felt that the staff arguments against automaticity were extremely cogent and that this led on logically to making out a strong case on merits against a separate automatic scheme for compensatory financing, since all the schemes advanced so far contained a complete or a great degree of automatism as an essential element. In his view these arguments were linked with the points which Mr. Klein and others had made, that the particular problem of compensatory financing was not the major problem with which the primary producing countries were confronted. Mr. Pitblado pointed out that he was speaking of a rather limited scheme with short-term purposes and one which was genuinely revolving. Any scheme designed to overcome the long-term problem, or which involved an element of long term, would have to be looked at in other contexts and in the light of the resources which could be made available for aid purposes through other institutions, such as IDA. But, examining a scheme for limited purposes, the staff paper made out a good case against automatism. He had been very impressed by the remarks of Mr. Mansour and Mr. Reina that a scheme financed mainly by countries trying to assist the developing countries might tie up finance which was needed for development. He hoped these arguments would be expressed cogently to the UN experts.

If the merits of an automatic compensatory scheme were dubious, Mr. Pitblado said, it was all the more important that the Fund should do all it could within its policies and purposes to meet the problem and seek to strengthen its capacity to help. The staff paper discussed two broad means of doing this: by a more liberal use of the Fund's existing resources and by an adjustment of some quotas. With respect to the quota problem, the figures submitted by the staff were, of course, open to question, but they did imply two general conclusions. The first was that there was a wide diversion in the adequacy of quotas between country and country in relation to their export fluctuations. This brought out the case for a selective approach to the question of quota adjustments. A case by case examination might, of course, lead to higher quotas for a number of members, though, as Mr. Lieftinck had pointed out, Fund quotas had to be considered in the light of Bank, IFC, and IDA subscriptions as well. The question of how to approach the matter was difficult, but he would be inclined to agree with Mr. Plumptre that a somewhat generalized selective approach would be desirable. Mr. Pitblado went on to say that he would not recommend that the criterion of export fluctuations be adopted as the main one for such an exercise, but, as others had suggested, he thought progress might be made by giving a somewhat different weighting to the elements in the Bretton Woods formula.

With respect to a liberalization of the Fund's policies on the use of its resources, Mr. Pitblado said it should be made clear that the Fund's present policies in fact met many of the considerations now under discussion and that these policies were being applied sympathetically. It might well be that some easement of the present policies on drawings in the various tranches could be worked out, but he would not favor establishing any new and special labels. From the point of view of the Fund and the country concerned there was a distinct advantage to looking at the problems in the round. Nevertheless, Mr. Pitblado felt that on both points, quotas and drawings policy, the Fund should be prepared to make serious studies to see what advances were possible.

Mr. Pitblado also drew attention to the need for careful consideration of the public relations aspect of any report the Fund might make to the CICT in view of the widespread interest in and importance attached to the matter of compensatory financing. The Fund's views should be stated clearly but in a manner which created an atmosphere of warmth toward its conclusions.

As regards the conclusions recommended by the staff, Mr. Pitblado said he did not entirely agree with the Directors who felt that paragraph (2) went too far at the present time. He thought the Board should be able to determine whether some fairly generalized selective adjustment of quotas could be undertaken at this time. He was prepared, however, to consider a redraft of paragraph (1) to take care of the points made by Mr. Hanemann and Mr. Waïtzenegger. Mr. Pitblado also agreed with other speakers that paragraph (4) regarding a new agency and Fund affiliation with it went too far. Only in the event that, despite the Fund's views on automatic compensatory schemes, a separate organization along these lines were to be established would it be appropriate for the Fund to discuss the question of affiliation with such an agency.

Mr. Caranicas said he also would speak purely personally. He thought Mr. Lieftinck had quite correctly pointed out that the conclusions which the Fund had reached on this matter three years ago had been in response to certain questioning, whereas at the present time the Fund had been invited to submit a statement of its views on compensatory financing to the CICT. There was no escape from the problem for there was a strong feeling that the Development Decade, which the 1960's had been designated by the United Nations, would not be successful unless a solution to the commodity problem were found, and the Fund had to consider the matter from this standpoint. There was a growing recognition in the world that international commodity trade problems were more of a secular than a short-term nature. Before an adequate solution could be found, there would have to be a correct diagnosis.

Mr. Caranicas observed that since the end of World War II the year-to-year fluctuations in external receipts had averaged between 9 and 12 per cent, and in some cases as high as 18 per cent. Though the degree of instability was not wide--it seemed moderate in comparison with the inter-war period--its effects were much more serious because of the prevailing political and social climate in many countries and were sufficient to endanger the development plans and programs of the primary producing countries. The time was now approaching when definite progress would have to be made in finding a solution to the commodity problem through projects, such as compensatory financing, to stabilize external receipts. Certainly the progress had been insufficient up to now. The various compensatory financing schemes that had been suggested might be useful in offsetting short-term fluctuations, pending adoption of longer-term solutions, but they did not get to the root of the evil and were even dangerous in that they increased the external indebtedness of the countries concerned. In this connection, it was of interest to note that the report of a Group of Experts set up by the Economic and Social Council ten years ago to study the subject of commodity trade and economic development had stated that, if undesirable repercussions of excessive fluctuations in primary commodity markets are to be minimized, "there is one broad alternative to the direct stabilization of prices by means of commodity agreements. This is to arrange for compensatory international flows of money in the event of sharp fluctuations in primary commodity markets. Such 'secondary' action, of course, by its very nature does not attack the root of the disturbances it compensates." This conclusion still held today.

Among the many studies that had been devoted to the problem since the drafting of the Havana Charter, Mr. Caranicas said, special importance had been attached to this report of the UN Group of Experts, which had also stated that the economic progress of the underdeveloped countries was affected by the prices they received for primary products and by the relation between these prices and the prices of the manufactured goods and services they bought abroad. He believed that if any lasting solution were to be found it would have to be in the field of prices. Efforts should be made to determine a fair price, which disregarded neither the interests of the consumer nor those of the producer, and which was closer to prices prevailing on protected markets than those quoted on the marginal international market. Such an approach should lead to an overhaul of policies in the direction of systems of protection and assistance for exports. A deliberate effort should also be made to raise prices to a level sufficient to meet production costs, to enable a certain amount to accrue to the exporting countries' ordinary budget revenue, and leave a margin for investment. An endeavor should be made to solve the problem commodity by commodity, in stages, and in accordance with flexible rules. In some cases, it might be possible to maintain the existing system, while establishing one or more compensation funds at the world or regional level, from which the producing countries would be indemnified when prices fell below a specified level.

Mr. Caranicas said he was not unaware of the objections and difficulties to which this argument might give rise. Certainly, there was no ideal solution for the commodity problem. But, short-term measures were no more than a palliative. Action should proceed along such lines as would eliminate the inequalities existing among primary producers by raising the prices of their products and restoring the terms of trade. Moreover, the raising of prices was bound up with the development of assistance to the peoples with inadequate purchasing power. Such a program was nothing more than the implementation of one of the ideas by which the 1953 UN Group of Experts had been guided.

A common commodity policy, Mr. Caranicas stressed, had to be developed along with a compensatory financing scheme, and such a common policy should cover three main points. It should be developed on a commodity-by-commodity basis, as exemplified by the Coffee Agreement, in order to correct long-term structural defects. It should also recognize the close relation between trying to reach a balance in demand and supply of individual commodities, on the one hand, and development planning and economic assistance, on the other. The policy should be world-wide in scope but should leave room for nondiscriminatory regional arrangements. Account also had to be taken of the complications created by the differing economies of the raw material producing countries and the varying degree of their dependence on one or two exports.

Turning to the draft report before the Board, Mr. Caranicas said he thought the staff had produced a very useful document. He preferred to have the conclusion set forth in paragraph (1) of the recommendations remain unchanged as it seemed from the discussion that some Directors thought that present quotas were adequate while others considered them inadequate. In this connection, he directed attention to the statement in the 1961 report of the UN Group of Experts on international compensation for fluctuations in commodity trade which said: "These are important conclusions, for they reveal our considered doubt whether the Fund's activities, present or likely, offer a complete answer to the need for measures to effect instability in the export trade of primary producing countries. This applies particularly to the underdeveloped countries in view of the special importance of maintaining continuity in their developmental expenditure. It is right, nevertheless, to stress our view that the Fund can and should play an increasing role in this form of compensatory financing." Mr. Caranicas stressed that, in his opinion, there was much room for improvement in the role the Fund was now playing, and that the statements in paragraph (4) of the recommendations should rather be broadened than diluted or eliminated. The world at large looked to the Fund for bold action in this field. As Mr. Lieftinck had said, a great deal had happened since the Fund had submitted its statement to the UN about three years ago. Attitudes and reactions could change in line with world developments. One only had to look at the developments in the Bank's lending policies and in its views toward operations in local currencies to see examples of great changes in policy. Similar startling shifts had occurred in the attitude of many countries toward the commodity problems. The United Kingdom and the United States, for example, had switched from their earlier policies of not joining the CICT, of which they were now members and were also active participants in several commodity agreements. Mr. Caranicas concluded by urging that the Fund move forward in the compensatory financing field and take the leadership in showing the way to some kind of effective scheme under its aegis.

Mr. Tennekoon said he had not planned to intervene in the present discussion because he had not yet received the views of the Governments that had elected Mr. Suzuki. But in view of some of the remarks made earlier he thought he would be failing his duty if he did not make a brief personal statement. Like the other speakers, he wished to pay tribute to the staff for its excellent paper. He had been prepared to go along with the conclusions recommended by the staff and would have remained silent had it not been for the suggestion to delete paragraph (2) which he regarded as very important.

Mr. Tennekoon recalled that at the previous session Mr. Dale had indicated that the United States' view was that any arrangement for compensatory financing should be world-wide in scope and not regional, should be addressed exclusively to short-term fluctuations, and closely tied to the Fund. If such an arrangement were to be closely tied to the Fund, Mr. Tennekoon continued, it would not make much sense to delete paragraph (2) because little could be achieved in the way of Fund assistance to the underdeveloped countries unless their quotas were increased. The quotas of these developing countries were far too small, in his opinion. The Bretton Woods formula gave great weight to the ability of a country to pay on the basis of its national income, but today the important criterion would seem to be its international trade. Small countries, like his own, depended on exports to a great extent for their income, and if these exports fetched low prices, or for some other reason the volume of exports dropped, the countries should be able to fall back on some institution to come to their rescue. These countries naturally looked to the Fund as a source for such help. The small developing countries, dependent on one or two export products were at the mercy of world markets; these countries did not determine the prices for their raw materials nor were they able to control the output which often depended on climatic conditions. They were thus often victims of circumstances beyond their own control and, realizing this, they were now doing their utmost to diversify their economies and become less dependent on the rest of the world.

But, Mr. Tennekoon said, this was a long-range process, and when sudden falls in the prices of their commodities occurred, then the country concerned either had to reduce or abandon its development work or go ahead with the programs and resort to deficit financing. In such a situation, the Fund would tell the country that it had taken the wrong course and, therefore, the Fund could not help the country. This was the reason why the small countries felt they should be assisted either by an increase in their quotas or through a more flexible and liberal policy with respect to the use of the Fund's resources. He found it difficult to understand why some Directors feared the use of the word "liberal" in this matter, and if the Fund was going to be more liberal it should say so. If members were assured that the Fund would follow a liberal line they would at least have the comfort that they could come to the Fund with their problems rather than abandon their whole development effort. It should be clearly understood that the developing countries were trying hard to get out of the difficulties they now found themselves in. Their viewpoint should be understood by the Fund, the Bank, and IDA to which the countries looked for help and guidance. In fact, without help from these institutions, there would be little hope for the successful outcome of the struggle now going on to build up these weak economies.

Mr. Tennekoon also referred to Mr. Lieftinck's remark about the concern of the primary producing countries about regional groupings. Mr. Tennekoon said he agreed that there was a certain amount of concern, but he thought it should be made clear that these countries were not opposed to regional groupings as such but they feared that as a result of such groupings the primary producing countries would be discriminated against, with the result that they would become poorer. It was to be hoped that in the negotiation of regional agreements the larger, developed countries would realize that the small countries were struggling to overcome inflation and stabilize their economies and that every assistance should be extended to them to improve their standards of living.

Finally, Mr. Tennekoon said he had been very interested in Mr. Anjaria's suggestion for a special tranche for Fund drawings by primary producing countries in certain circumstances. It seemed clear that it would be a great service to these countries if they could come to the Fund for help when they found themselves in payments difficulties through no fault of their own. He would be very interested in seeing how such a system could be worked out.

Mr. Sun wished first to commend the staff on its paper which presented a clear and comprehensive review of the problem. At this stage of discussion he wished only to add some general comments. He had no definite suggestions to offer to the technical questions raised in the paper. However, it seemed to him that the position taken by the Fund regarding the matter did not give an adequate answer to the problem of the primary producing countries which suffered from export fluctuations under circumstances beyond their control. The recommendations only went so far as to offer to accept the affiliation of a new agency to deal with the situation. Since compensatory financing of export fluctuations of primary commodities fell legitimately within the scope of the Fund's work, he thought that the creation of a new international body would neither simplify the functions of the Fund nor lighten the burden of the industrial members, but would probably come in conflict with the Fund's work. Complete automatism was indeed undesirable and impracticable. Each case should be handled on its own merits. However, it seemed to him that the Fund, with the industrial members now in a much stronger position, should exercise more liberal and lenient policies toward those members which were in real need due to export shortfalls. It might perhaps be possible to extend the Fund's present liberal policy in the first credit tranches to the second credit tranche in drawings or stand-bys for compensatory financing. The Fund had often made use of the waiver clause in Article V, Section 4.

In concluding, Mr. Sun said he doubted that this complicated problem would soon be solved satisfactorily and, therefore, further studies and deliberation would be helpful and desirable.

Mr. Dale recalled that to begin the discussion at the previous session he had spoken briefly about the position of American policy as it presently stood on the matter of compensatory financing. He wished now to express several initial conclusions that he had personally reached on the basis of the Board's discussion which he had found of outstanding quality and most enlightening. He would address himself principally to the conclusions recommended in the paper before the Board and within the framework in which they had been advanced by the staff. Several Directors had mentioned the importance of the tone, both in the paper as a whole and in the conclusions in particular. Mr. Garland had made an excellent statement on the importance of helping to create in the terms expressed to the CICT, and to the world at large, the impression that the Fund was doing its very best to be constructive within the limits of its Articles and established operating policies. Mr. Pitblado had referred to the importance of the public relations aspect of the Fund's report. Mr. Dale said he fully agreed with these comments. The Fund's report should describe the Fund's views and attitudes in a constructive and positive manner and at the same time be responsive to the problem and challenge that was now before it.

With respect to the conclusions set forth in paragraph (1) of the recommendations and the large number of suggestions for amending the staff's text, Mr. Dale said it seemed clear that the Board was still a long way from reaching agreement on any proposals that the Fund might be prepared to make to the CICT. It seemed important, however, that the Fund do its best to provide proposals that were specific, and indicate with some precision what it was prepared to do so that some meat could be put on the bones, as it were, of its indication of liberality and concern for the problem. For his own part, his initial, tentative conclusion was that the suggestion of a special tranche for countries experiencing difficulties due to fluctuating exports provided interesting material for study, and he would be willing to ask his Government to investigate it.

Referring to the comments on paragraph (2) of the conclusions, Mr. Dale said he found himself in agreement with Mr. Plumptre who had coined a most felicitous expression when he referred to a kind of "generalized selective" approach to the problem of the smaller quotas. Mr. Dale said it was his view that the concept expressed in paragraph (2) should be retained and that careful consideration should be given to the criteria used in considering any revision of quotas, either of the small quotas or others as well. In addition, he found himself in agreement with Mr. Plumptre's remark that Table 1 might have some limitations as to the extent to which it revealed fully the adequacy of the external liquidity available to member countries. In this connection, Mr. Reina had mentioned some reasons why the use of gross reserves figures might provide some limitations.

Mr. Dale said that paragraph (3) as it now stood provided no difficulty for him. On the other hand, it would add little unless it was supported by a strong and explicit statement of what the Fund was prepared to do.

With respect to paragraph (4) relating to Fund affiliation with whatever compensatory financing agency might emerge, Mr. Dale said he would join those who had expressed some concern about the text proposed by the staff in the sense that it might be interpreted as an indication of willingness on the part of the Fund to affiliate with any kind of agency that might emerge. On the other hand, he would be most reluctant to have a series of conclusions provided by the Fund which did not mention in an affirmative way the prospect of association with whatever agency might emerge. He would add parenthetically his personal judgment that, as to the issue of automaticity, intelligent, well-informed men of goodwill who studied the problem would almost certainly come to the conclusion that complete automaticity on the basis of a mere statistical formula was not possible in this field, and therefore he found himself somewhat less concerned than Mr. Pitblado about the nature of the kind of agency that might emerge.

Finally, Mr. Dale said he was in agreement with Mr. Plumptre on the usefulness of expressing clearly in the text and in the conclusions the limited relationship that compensatory financing schemes might have to the larger problem presented to the world by the difficulties of those countries which were so heavily dependent on a few commodities. He also agreed that the following four areas mentioned by Mr. Plumptre were very pertinent in this respect: the extent of economic growth and the level of economic activity in industrial countries, the general trade policies of those countries and others, the general field of international commodity agreements and the progress being made under them, and the capital and technical assistance being provided under bilateral and multilateral programs.

In concluding the discussion, the Chairman thanked the Directors for their interesting and constructive observations which the staff would take into account in redrafting the report with a view to arriving at a document which the Board members would find generally acceptable. There were a few points, however, on which most Directors seemed to agree at this stage. The first was that the problem of compensatory financing was only part of a wider problem, and the second was that the Fund's field was limited to short-term fluctuations in export earnings but that the long-term problems of trade policy, commodity agreements, etc., were of great importance. All speakers seemed to be agreed that in considering the question of adjustment of quotas the Fund should take a sympathetic attitude toward particular countries, but the question would have to be further explored, especially with respect to the criteria to be applied. The Directors also seemed to favor a liberal attitude to the use of the Fund's resources, and this attitude could, it was thought by several Directors, be fitted into the existing framework of the Fund's policies and practices. As regards the question of affiliation with a new international institution, the Chairman said he fully agreed that the Fund's position would depend upon the kind of agency that might be set up.

Finally, the Chairman said it was clear from the discussion that the Board felt that the Fund could and should do something in this field and that a positive and constructive report should be submitted to the CICT.

INTERNATIONAL MONETARY FUND

Secretary's Journal of Executive Board
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10:00 a.m., November 16, 1962

Per Jacobsson, Chairman
F. A. Southard, Deputy Managing Director

Executive Directors	Alternate Executive Directors
J. J. Anjaria	S. L. N. Simha
M. C. Bicalho	A. Coutinho
W. B. Dale	J. S. Hooker
J. M. Garland	F. C. Pryor
W. Hanemann	W. O. Habermeier
G. W. Klein	J. Urrutia
	J. Waitzenegger
P. Lieftinck	H. M. H. A. van der Valk
D. B. Pitblado	
A. F. W. Plumptre	L. D. Hudon
P. Reina Hermosillo	C. E. Sansón
	A. Mansour
	C. P. Caranicas
K. Skjaeveland	L. Olofsson
	A. Nikoi
	W. Tennekoon
B. Tann	I. S. Sun
A. van Campenhout	

A. C. Frost, Acting Secretary
F. Hodel, Assistant Secretary

Also Present

African Department: J. V. Mládek, Acting Director; Tun Wai. Asian Department: H. C. Murphy, Deputy Director; C. C. Liang. European Department: E. Sturc, Deputy Director; W. A. Beveridge, R. Evensen, P. Walter, A. C. Woodward. Exchange Restrictions Department: R. V. Anderson, S. Makdisi, K. Satow, W. J. R. Woodley. Legal Department: J. Gold, General Counsel; H. Aufricht, A. S. Gerstein, P. Lachman, G. Nicoletopoulos. Middle Eastern Department: J. W. Gunter, Deputy Director; A. R. Bengur. Research and Statistics Department: J. J. Polak, Director; W. R. Gardner, Deputy Director; O. L. Altman, G. S. Dorrance, G. Lovasy, R. R. Rhomberg, A. S. Shaalan. Western Hemisphere Department: J. Del Canto, Director; E. W. Robichek, Deputy Director; S. T. Beza, G. J. Clark, F. Vera. Office of Administration: P. Thorson, Director. Office of the Secretary: J. W. Lang. Office of the Treasurer: Y. C. Koo, Treasurer; R. Kroc, C. M. Powell. J. K. Horsefield, Chief Editor. W. P. Cooke, Personal Assistant to the Managing Director. G. Williams, Special Representative to UN. Information Office: J. Reid, H. G. Hopkins. Technical Assistants to Executive Directors: J. de Groote, H. G. Heinrich, Y. Mizoe, P. Sundaram, D. W. Wilson.

1. EXECUTIVE DIRECTOR

The Chairman welcomed Mr. Plumptre, Executive Director, to the Executive Board.

2. COMPENSATORY FINANCING OF EXPORT FLUCTUATIONS

The Executive Board began an informal and preliminary exchange of views on a staff memorandum dealing with compensatory financing of export fluctuations (SM/62/94, 11/8/62).

The Chairman noted that the staff paper was intended to serve as the basis for the preparation of a report which the Fund had been asked to submit to the Commission on International Commodity Trade for its meeting next April. In order to assure proper translation, circulation, and consideration by member governments, the Fund report would have to be ready at the latest by early January. He hoped that the present informal exchange of views would help to determine attitudes toward the paper so that it might be possible to agree on a report to go forward to the CICT by around the middle of December.

Mr. Dale began his remarks with an expression of appreciation to the staff for its excellent paper which he had found most helpful in clarifying the questions at issue in this discussion. He thought it might be useful by way of beginning the discussion if he would say a few words about United States policy on the matter of compensatory financing. Before doing that, however, he wished to stress that this matter, which had been under discussion for several years, was one in which the Fund had a deep and continuing interest, and it was his personal hope that in the not too distant future the Fund would be in a position to take action that would be recognized as a very real contribution to world arrangements in this field.

With respect to United States policy, Mr. Dale pointed out that there were three points on which that policy was rather well developed and settled. First, the United States authorities felt that any arrangement for compensatory financing should be world-wide in scope and not regional. It was their judgment that any attempt to establish a compensatory scheme on a regional basis would run afoul of a number of difficult and possibly irreconcilable problems. The second and very important point, which was discussed extremely well in the staff paper, was that such a scheme should address itself exclusively to short-term fluctuations and not to longer-term problems, such as the secular deterioration in the terms of trade of the primary producing countries. In that context it was the U.S. view that any compensatory financing scheme should cover only part of any short-term shortfall that might be determined to exist between actual exports and a trend line. Finally, the United States authorities felt very strongly that whatever scheme might be elaborated should be closely related to the Fund, making use of the Fund's technical resources, staff, and management.

In a number of other areas, Mr. Dale continued, the United States Government had reached certain tentative or initial policy conclusions, which were subject to further study, evaluation, and review. First, any compensatory financing scheme should be a separately funded arrangement in which all participants should provide contributions. The fund should be composed of convertible currencies, should be revolving in character, and should be subject to normal interest charges. Second, under such a scheme, credit extension to primary producing countries experiencing export shortfalls should be substantially automatic, but there should also be provision for consultation between such countries and the administering agency and for some discretionary authority on the part of this agency. The third tentative U.S. conclusion was that an appropriate revision or expansion of IMF activities directed toward compensatory financing would be one alternative which, substantively, would be capable of meeting the requirements. So far as possible, any such revision or expansion should be under arrangements that provided specifically for drawings to meet balance of payments difficulties stemming from short-term export fluctuations beyond the reasonable control of primary producing countries. Mr. Dale added that it was his personal feeling that, if such an extension of the Fund's activities could be developed, it would be a happy event for the Fund and for the entire free world.

Mr. Hanemann said he welcomed the opportunity to have an informal discussion of the staff paper on compensatory financing and he wished to join Mr. Dale in thanking the staff for a very competent piece of work and for its intensive studies on this complex subject. The staff paper now under discussion, as well as two Departmental Memoranda on statistical testing (DM/62/20 and DM/62/40), cast some light on many obscure details and clarified certain questions which perhaps had not been fully understood in previous discussions. The new papers represented a decided contribution to the consideration of the problem.

Turning to the memorandum under discussion (SM/62/94, 11/8/62), Mr. Hanemann observed that the staff had approached the various proposals that had been advanced from two different angles; first, from the standpoint of automaticity and, second, from the standpoint of the adequacy or inadequacy of external liquidity to finance export shortfalls. With respect to automaticity, he noted that the staff had considered both the type of automatism envisaged and the point that in the various schemes that had been put forward credits were to be granted irrespective of the over-all balance of payments situation of the country receiving assistance, of the policies it was pursuing, or the amount the country had already borrowed. Mr. Hanemann said he agreed in principle with all the staff arguments regarding the type of automatism and thought the staff had quite correctly concluded from its studies that "automatic formulae based on past and current export data only can yield at best rather unsatisfactory estimates of the true trend of exports" and that "the extent to which it is possible by means of compensation to bring export proceeds closer to their true norm or to reduce their instability is distinctly limited" (ibid., p. 6). These statements were particularly impressive because they were based on statistical tests and measurements which in their broad approach had not been equalled by any other studies. Therefore, he was fully prepared to associate himself with the comment on page 7 that "it is reasonable to assume that a better estimate could be made by the exercise of judgment based on an analysis of causal factors at work than by any mathematical formula, however skillfully contrived, that is based on the mere statistical magnitude of current and previous exports."

Mr. Hanemann also thought the staff had presented very useful comments on the second feature of automatism, namely, that credit should be granted irrespective of the general balance of payments situation or of the economic policies of the government requesting the credit. The staff had been right in pointing out in this connection that the Fund had never been rigid in the application of its policies on the use of its resources; in fact, it could even be said that over the last years the Fund had become increasingly liberal and generous in this respect. On the other hand, it had to be borne in mind that the Fund must operate within the provisions of its Articles of Agreement and had to be assured that adequate safeguards were maintained. This meant, as the paper stressed, that "Fund assistance, at least beyond the gold tranche, should not be made available to any country that makes no effort to move towards the elimination of those aspects of its exchange and monetary policies, which are detrimental to its own interests in the long run, and very often in the short run as well" (ibid., p. 8). Mr. Hanemann also fully concurred in the staff observation that with regard to the countries' access to financial means to compensate for export fluctuations "it is not particularly desirable and may be against the genuine interest of the country concerned if this finance is provided automatically and without an exploration of the causes of the decline in exports and the measures that should be taken to improve exports in the future" (ibid., p. 9). In addition, he thought the staff had been right to point out that "the total amount of short-term credit made available to a country by one agency or under one arrangement cannot be totally divorced from the amount made available on similar terms by another agency or under another arrangement by the same agency" (ibid.).

To sum up, with respect to automatism, Mr. Hanemann said he felt that the staff paper was a rather convincing demonstration that an automatic mechanism for compensatory financing could not produce the positive effects which had been erroneously attributed to them and that the extent to which those schemes could be effective was at best a very limited one. It might well be that automatic compensatory financing schemes might result in more disappointment than they would contribute to a solution of the problem of the countries concerned.

Mr. Hanemann felt that part IV of the memorandum, dealing with the quantitative adequacy of Fund drawing facilities, together with Table 1 on the adequacy of external liquidity to finance export fluctuations, constituted the most illuminating part of the paper and that it called for very careful study. It was his view that the assumptions which had been used in Table 1 were not unreasonable and that it was in some way encouraging to see that the measurement of the deficiencies in export financing on the basis of these assumptions revealed that the apprehensions about a general or widespread inadequacy of available financing for export fluctuations were not fully in line with the facts. Minus signs appeared in only a small number of cases in Table 1, and only in the cases of Iran and the Syrian Arab Republic was there a deficiency noted in both measurements used. As a first reaction, Mr. Hanemann said, he would be inclined to draw the following preliminary conclusions: first, it would not be in line with reality to assume that in the majority of cases available external liquidity was inadequate to finance export fluctuations and, second, that there were cases where there was an inadequacy, but these were special and individual cases and, therefore, it seemed neither necessary nor advisable to aim at some uniform action in this field. What really mattered, was to single out those cases in which the external liquidity was clearly inadequate to finance export fluctuations and in which special assistance, after careful review, seemed justified.

As regards part V of the paper which discussed and appraised various suggestions for Fund action, Mr. Hanemann said he felt that it was quite proper for the staff to have included this material as a basis for the Board's discussion, but he questioned whether it should be incorporated in a Fund report to another international agency. In many respects, he agreed with the staff's observations on the four categories of measures that had been appraised. With respect to the first, namely, that drawings would be made available automatically on the basis of a statistical criterion of export shortfalls, he was prepared to associate himself with the conclusion that "any attempt to graft a system of export automatism onto the Fund's normal system of drawings would give rise to difficulty and, probably, confusion" (ibid., p. 14). Mr. Hanemann also expressed agreement with the staff's comments on the second category under which drawings would be made available automatically after a Fund decision that the country's balance of payments difficulties were attributable to a temporary cause beyond its control. He concurred especially in the conclusion that it would appear preferable not to turn the Fund's flexibility of policy into a rule or procedure, "the application of which might, in many instances, raise difficult problems of policy and statistical judgment" (ibid., p. 15). In his view, the staff had also been right in its appraisal of the third category which would extend the existing automatic access to the Fund's resources over a larger area of the quota than that to which it now applied (ibid., pp. 15 and 16). He agreed with the staff that it did not seem desirable to increase the proportion of quota available on an automatic basis without regard to the cause of the payments deficit or the policies being pursued by the country.

As regards the fourth category under which members would be permitted larger access to Fund resources without extending the range of automatism, Mr. Hanemann said the staff had reached the same conclusion as he had when it said "Table 1 would seem to indicate that the quotas of many countries, taken in conjunction with a reasonable use of their own reserves, are at present adequate" (ibid., p. 16). It was this conclusion that made him feel that what was appropriate was a selective approach to ascertain the special cases where available external liquidity was inadequate to deal with the export fluctuations.

Mr. Hanemann said he also wished to comment on the staff recommendations as set forth in part VII of the report (ibid., pp. 19 and 20). In the first place, he had noted the omission of a short review of the useful observations on automatism which had appeared in the body of the report. What the Fund had to say about the limitations and disadvantages of an automatic system might be very important to the technical working group of the CICT. He therefore would prefer to have a paragraph added to the recommendations in which the observation and comments made on automatism would be summed up. With respect to paragraph (1) of the recommendations, Mr. Hanemann questioned whether the sentence reading "one of the important functions of the Fund is to provide to its members compensatory financing for export fluctuations" was in full harmony with the functions of the Fund as set out in Article I of the Articles of Agreement. He believed the statement might detract from the real purposes of the Fund, but this was not to say that the question of compensatory financing was not of great interest to the Fund. It might be preferable, in his view, to use the following language which had appeared in the Fund's study submitted to the CICT in 1960: "The provision of foreign exchange to Fund members to assist in the compensation of short-term fluctuations in the balance of payments constitutes a legitimate use of Fund resources."

Continuing, Mr. Hanemann said he concurred in the observations contained in the second sentence of the recommendation which read: "The quotas of many countries, taken in conjunction with a reasonable use of their own reserves, are at present adequate from this point of view, and there is room for members to make an increased use of the Fund for financing balance of payments deficits arising from export shortfalls." He would be willing, however, to go a step further and say that the Fund was prepared to continue to practice its drawing policies in a generous attitude, particularly with respect to the raw material producing countries concerned. The framework of the Fund's drawing policies was a wide one, and he wondered whether countries which felt they were exposed to special difficulties due to large export fluctuations should not be assured that the Fund was willing to let them use its resources when necessary and appropriate in a rather liberal way. This would not mean that the Fund should give up or substantially weaken its policies on the use of its resources which had so well stood the test of time. But he felt it could be made clearer in the report that the Fund was prepared to be as flexible as possible in the handling of the policies whenever this could be done without endangering the revolving character of the Fund's resources or its purposes as set out in Article I and when the individual situation justified it. In this connection, he had in mind the statement made by the Chairman of the Board of Governors at the 1962 Annual Meeting that "there is nothing in the Articles of Agreement or the policies of the Fund, as outlined in the Annual Report, that precludes the Executive Directors, when they deem it fit, from waiving any terms or conditions laid down in the Articles governing the use of the Fund's resources." Over the years, the Fund had in fact become increasingly liberal and generous, Mr. Hanemann said, and he would have no difficulty with a clearer statement on this point in a Fund report to the CICT working group.

Finally with respect to paragraph (1) of the recommendations, Mr. Hanemann wished to add some comments on the sentence reading "In addition, the adjustment of quotas could be considered in those cases where it was justified by the application of appropriate tests." He was personally prepared to accept this language because it was in line with his own view that all studies in this field pointed to a selective approach to the problem based on the merits of the individual cases. In making such a selective approach, it would, of course, be helpful if one could follow some general guiding line. But he had serious doubts that any of the formulae employed in the staff studies (SM/62/94, 11/8/62) could be used as such a guiding line and would produce satisfactory results. In studying the staff paper mentioned, he had the strong impression that the use of the formulae presented there would possibly produce as many problems as it would solve. Thus, he had not only grave doubts about a collective approach to the problem of quotas in connection with the question of compensatory financing, but also about any quota formula based on one economic factor. Despite the many deficiencies of the Bretton Woods formula, it was clear that it had one advantage in that it attempted to combine in one formula various elements of a country's economy. The attempt to base quotas on different economic factors should not be abandoned. A detailed consideration of this problem was, of course, a matter for discussion at another time. Insofar as the present discussion was concerned, he felt that the Fund report to the CICT Working Group should go as far, but no further than to indicate that the Fund was prepared to go into the question of quota adjustments for primary producing countries on a selective basis in cases where it seemed justified by the application of appropriate tests.

In view of the foregoing, Mr. Hanemann said he had serious misgivings about the insertion in the Fund's report of the following second recommendation of the staff: "The Fund is now examining the quotas of the primary producing countries, many of which are in the group of countries with small quotas, in order to determine whether adjustments would be desirable to make these quotas more uniformly adequate to meet each country's needs in connection with export fluctuations as well as other balance of payments fluctuations" (ibid., p. 20). This language seemed to convey the impression that a collective approach was aimed at.

With respect to paragraph (3) of the recommendations, Mr. Hanemann questioned the desirability of mentioning the Fund's general borrowing arrangements, which could be interpreted as an indication that a scheme along this line might be under consideration with respect to the financing of export fluctuations.

As regards the final staff recommendation, Mr. Hanemann said he had difficulty with the sentence reading "If it were desired to provide such automatic compensatory financing, either on a loan basis or on an initial or contingent grant basis, it might be advisable to establish a separate international agency for this purpose with its own resources." This could perhaps be interpreted as an indication that the Fund favored the establishment of such an institution. As against that he felt that the conclusions on the deficiencies and limitations of an automatic mechanism spelled out in the body of the report pointed clearly in the opposite direction. He also thought it would be inappropriate for the Fund to say, as proposed in the last sentence of paragraph (4), that "the Fund should be willing to accept the affiliation of such an agency." He questioned whether the affiliation of the Fund with such an agency might not lead to as much confusion and difficulty as had been mentioned on page 14 of the report with respect to the grafting of a system of export automatism onto the Fund's normal system of drawings. Therefore, he would be very hesitant about agreeing to a sentence in which the Fund stated its willingness to accept affiliation of an automatic compensatory financing agency.

Mr. Waitzenegger observed that the instability of exports of primary commodities was one of the most important and complex problems with which international institutions were confronted at the present time. He recalled that in May 1962, the United Nations Commission on International Commodity Trade had invited the Fund to present a report "as to whether and in what way the Fund might play an increased part in the compensatory financing of export fluctuations of primary exporting countries." The terms of reference assigned to the Fund were broader than in March 1959 when the Commission had invited the Fund "to inform the Commission about its policies and procedures." Previous reports were mainly of a descriptive nature. He welcomed the fact that the new draft report before the Board went further and presented a study of different means by which the Fund might better serve the needs of primary producing countries in relation to export fluctuations. The staff report was well presented and the reasoning did not raise any major objection. He differed, however, on some conclusions as he would explain later.

The question of quota increases, Mr. Waitzenegger continued, seemed to have received special emphasis in the staff report. His remarks would touch on this matter and deal with the report on compensatory financing, as well as the statistical analysis of the relative adequacy of quotas prepared by the staff (SM/62/95, 11/8/62, and Cor. 1, 11/13/62). In the draft report on compensatory financing (SM/62/94, p. 18, 11/8/62), the Board had been invited to take into account the data prepared by the staff on the adequacy of quotas. It was his view that a case had not been made in favor of quota adjustments, although he would agree that it was certainly justifiable to study this solution as a possible means of Fund action.

Mr. Waitzenegger said he had found Table 1, attached to the draft report on compensatory financing, very interesting. The staff had assumed that drawings on the Fund and use of national reserves would be made to cover two thirds of shortfalls of actual exports with respect to an export norm. The maximum cumulative requirements of 47 countries during a given period were indicated and they were compared with (1) one third of a country's reserves as of mid-1962 plus one third of its unused drawings on the Fund at the same date and with (2) two tranches of a member's quota, plus an equal amount drawn from its own reserves. It could be stressed that the criteria were conservative. The table showed that for each of the two measurements only 9 countries out of 47 would have presented deficiencies in available financing. The staff mentioned that, since these two groups partially overlapped, 16 member countries would have been limited by one or the other criterion. It would be normal as well to note that only two countries, Syria and Iran, would have been limited by the two criteria. For Iran, he wondered whether the results were not based on trade during 1952 and 1953, which was abnormally low due to the stoppage of oil exports.

Continuing with his analysis of Table 1, Mr. Waitzenegger noted that the staff had indicated that "the two measurements approach the problem of the adequacy of the Fund from a somewhat different angle." According to the report (ibid., p. 13), the second measurement, namely, one half of a country's quota plus an equal amount drawn from its own reserves, "is the more relevant one if the intention is to reconsider the quotas of individual countries from the point of view of their adequacy to meet export fluctuations." As he had stated earlier, this second measurement would have been a limiting factor in only nine cases: Iran, Iraq, Malaya, Panama, Sudan, Syria, Tunisia, Uruguay, and Viet-Nam. It was interesting to note that, again excepting Syria and Iran, the seven other countries were not using, and most of them had never used, the resources of the Fund. A stand-by arrangement had been granted to Uruguay in October 1962.

Mr. Waitzenegger said his doubts about quota adjustments were equally founded on reasons of a more general character. As pointed out in the Fund report on policies and procedures in relation to the compensatory financing of commodity fluctuations, members' quotas, as of the end of 1959, were considered "adequate to provide its primary producing members with a supplement to liquidity which, in the majority of cases, should be sufficient, in conjunction with their own resources, to enable them to deal with payments problems as are created by short-term fluctuations in exports." This view had been supported unanimously by the Executive Directors during the third quinquennial review of quotas in December 1960. He could not imagine that the situation had changed so radically since that time to now reach a different conclusion. Hence, he did not find any justification for an increase in quotas, even limited to one or more categories of member countries. Incidentally, in SM/62/95, the repartition of countries in four categories according to the size of their quotas was made, and could only be made, in an arbitrary manner. On the other hand, he doubted that selective quota increases could be decided on the basis of the tables before the Board, and he wondered how it would be possible to reject requests by other countries in the same category which would often be neighboring countries.

Mr. Waïtzenegger added that the French authorities did not consider it possible to adjust quotas according to balance of payments requirements exclusively. It was certainly unnecessary to recall the multipurpose functions of quotas. At Bretton Woods, quotas were considered as a key element of the Fund. It was understood that "the complex and to some extent conflicting functions of quotas made it inevitable that any formula that might have been used should be complex," as stated in Mr. Altman's article which appeared in the Staff Papers of August 1956 (p. 140). No single factor could be used to allocate quotas in a satisfactory manner. It was also clear that any new or adjusted quota must fit into the existing structure. Moreover, the size of a quota was one of the elements which determined the relative voice of a country in the management of the Fund. Piecemeal adjustments in response to the particular financial needs of members could only worsen an allocation of voting powers which was not now altogether satisfactory. For all those reasons, Mr. Waïtzenegger considered that increasing quotas, even on a selective basis, was not the proper way if the Fund intended to adopt a constructive approach vis-à-vis the problem of compensatory financing for primary producing countries. Either quota increases would be extended to a large number of countries, thus modifying the precarious structure which so far had been attained, or quota increases would be limited to few countries, leaving unsolved the problem of compensatory financing for some 70 other primary producing members.

The Board, of course, Mr. Waïtzenegger went on to say, could not preclude individual members from making special requests for quota increases under the Articles of Agreement. As a matter of fact, the Fund was presently confronted with two such requests. He recalled that at the meeting of the Committee of the Whole in December 1960 the Chairman had made the following statement: "In the examination of any such requests the Board would no doubt find it useful to have at its disposal up-to-date statistics. I would therefore suggest that the staff should produce a new survey, based on more up-to-date statistics, which would be available to the Board to help it examine such requests as may be received in the light of the special circumstances of each case, and also in relation to the general structure of quotas." This suggestion was included in the report of the Committee of the Whole to the Executive Board. As was then indicated by Mr. Southard, some discussion of the new survey would be useful in order to have a better basis on which to form a judgment of any requests for special increases in quotas that might be received. Mr. Waïtzenegger thought the data submitted in SM/62/95 were certainly an attempt--he hoped only a preliminary one--to provide some statistics in this respect.

The French authorities, Mr. Waïtzenegger continued, wished to have a re-examination of the policy on use of the Fund's resources with a view to adopting more flexible rules. Drawings in the gold tranche were practically automatic in the sense that members "can count on receiving the overwhelming benefit of the doubt" with respect to them. The French authorities would be prepared to support, in favor of the primary producing countries, extension to the "first credit" tranche of the present policy for drawings in the gold tranche and consequently to ease access to higher tranches of quotas as had been suggested in the staff report (ibid., p. 15) and, in fact, already applied in some cases. Furthermore, the Fund could, at its discretion, waive the provision according to which a member's drawing would not increase the Fund's holdings of its currency to more than 200 per cent of its quota.

Mr. Waïtzenegger noted that at the beginning of his statement he had mentioned that he had misgivings about the staff recommendations for the conclusions of the Fund report (ibid., pp. 19 and 20). The position taken in paragraph (1) seemed too negative with respect to possible Fund action. He would suggest deletion of the last sentence and substitution of a sentence reading: "Furthermore, Fund policies could be made more flexible, as it has been the case in the past, in favor of primary producing countries."

With respect to paragraph (4) and the reference in the last two sentences to the establishment of a separate international agency, Mr. Waïtzenegger stressed that this was a matter which was beyond the competence of the Fund. Furthermore, these sentences were in contradiction with paragraph (3), according to which, in the opinion of the Fund, it would be preferable to provide additional resources through the Fund, so that whatever were the Fund's policies from time to time on the use of its resources would apply to the Fund's total resources as thus enlarged. Therefore, he would propose deletion of these sentences.

Finally, with respect to the proposed conclusions, Mr. Waïtzenegger said that in view of his comments on the matter of quota increases, he could not endorse paragraph (2) of the staff recommendations.

In concluding, Mr. Waïtzenegger said he wished to stress that he sincerely hoped the Fund would adopt a realistic and constructive attitude on behalf of primary producing countries. If the Fund were to review its policy and make clear to members what this policy was, he thought that uncertainties would not remain with regard to their ability to draw on the Fund, and discussion of alternative means would no longer be justified. He was well aware that the Board would need a reasonable period of time to clarify all the issues involved. But it could be expected that an understanding on general lines of action could soon be reached. The Technical Working Group of CICT was meeting in Geneva and would probably be in session until early December. It would certainly be useful to transmit to this Group a Fund report including more encouraging conclusions than those contained in the draft report now under discussion.

Mr. Garland said that at this stage he did not propose to do more than offer some tentative observations on the papers which the staff had prepared. As these papers had been circulated only a week ago, it had not been possible to secure any indication of the views of the authorities in his constituent countries. Accordingly, his observations at this session should be regarded as no more than his own personal and preliminary reactions.

Looking in a general way at the problem of compensatory finance, Mr. Garland said he wished to emphasize that the unsatisfactory level of export receipts was the crux of the problem which had faced primary producing countries in recent years. Everyone was familiar with the substantial deterioration in the terms of trade of most primary producing countries over the last decade and it was therefore unnecessary for him to go into detail on that matter. He thought it was appropriate, however, to remind the Board that the fundamental problem of unsatisfactory export receipts of primary producing countries could only be remedied by action on such matters as world market prices, access to markets of the industrialized countries, and production policies in those countries. In other words, any arrangements that might be evolved in relation to compensatory finance could at best only alleviate the short-term problems, and it would be unfortunate if they should be regarded as a substitute for positive action to improve the longer-term trend in the terms of trade of primary producing countries. Nevertheless, although compensatory finance arrangements might be regarded as only a partial and second best solution, primary producing countries were naturally anxious to explore all possible measures which, especially in the absence of any real progress on more fundamental measures, might do something to alleviate the short-term payments problems which arose.

At the same time, Mr. Garland said, it had to be borne in mind that fluctuations in the export proceeds of primary producing countries were also a matter of considerable interest and concern to the more industrialized countries. Although the first impact of fluctuations in export proceeds had to be carried by the reserves of primary producing countries, it was obvious that imports also carried some part of the impact, usually after some time lag. These changes in external purchasing power could be very important to the industrialized countries, particularly as they affected imports of capital equipment--one of the most unstable groups of industry in industrialized countries. In short, there was a common interest among all members of the international community in reducing the impact of fluctuations in export incomes of primary producing countries.

One of the principal purposes of the Fund, Mr. Garland continued, was to make resources available to members to "help them correct maladjustments in their balance of payments." Compensatory finance was therefore a problem of primary interest to the Fund. Looking at the matter from the Fund standpoint, it was rather disturbing to find pressures emerging in recent years for the establishment of separate schemes to deal with the compensatory finance problem. The two schemes now being actively considered blurred a little the international image of the Fund.

At this stage, it would be premature to make any predictions as to whether governments might find either of these schemes acceptable. Even if neither of these particular schemes found acceptance in the near future, however, the Fund faced the danger that pressures in favor of such schemes would continue.

The implications for the Fund of the establishment of any separate scheme, Mr. Garland said, could be very important, and he would have liked to have seen more attention directed to this aspect in the staff paper. If a separate scheme were established, larger resources would probably be available, and the magnitude of the calls on the Fund for short-term finance would no doubt be reduced. It should not be overlooked, however, that the contributions by many countries to any separate scheme could easily involve indirect calls on Fund finance and that, especially in relation to the OAS scheme, the Fund could find itself in due course helping countries to meet some of their repayment obligations under that scheme. Generally too, there might be some rather invidious incompatibilities between an automatic and a discretionary scheme.

Mr. Garland said these considerations led him to think that the time had now come for the Fund to adopt a positive forward-looking attitude on this matter, and he hoped that the CICT would receive shortly, not only a report by the Working Group exploring the possibilities of DIF and OAS schemes, but also a Fund report which set out, as an alternative to such separate schemes, a concrete plan of action by the Fund.

Turning to the staff paper itself, Mr. Garland said he would regard the present draft as a very competent and careful piece of work. When the time came to consider the terms of a draft report to the CICT, he would hope that such a draft would adopt a positive attitude toward the possibility of the Fund playing a more active role in relation to compensatory finance. However, he would add that he was impressed by the arguments against the Fund relying on any formula in dealing with this problem, and he felt sympathy for the conclusion reached on page 7 that the exercise of judgment, based on an analysis of the causal factors at work, was to be preferred to any mathematical formula, however skillfully contrived.

Mr. Garland also endorsed recommendation (2) that the Fund should now examine the quotas of the primary producing countries in order to determine whether any adjustments would be desirable. Even a cursory study of the statistical material which had already been assembled seemed to suggest divergencies which represented a prima facie case for examination. At the same time he found himself in considerable sympathy with the suggestions put forward on page 15 of the document under categories (2) and (3), and he would not wish to exclude at this stage the possibility of the Fund developing along either of these two lines. His present feeling therefore was that the Fund report to CICT might include as a further conclusion a statement to the effect that the Fund was also examining the possibility of measures of the kind referred to in categories (2) and (3).

Mr. Garland believed that additional emphasis should be given to the flexibility of the Fund responses, and in this respect he was in sympathy with the remarks of Mr. Waitzenegger. The image which the Fund should present to members and international agencies should be one of willingness to respond to emerging difficulties and changing circumstances. He also liked Mr. Hanemann's suggestion that assurances should be given of liberal and generous use of Fund resources to primary producing countries faced with problems of export fluctuations.

In concluding, Mr. Garland said that generally the paper seemed to provide a satisfactory starting point for a report by the Fund on this matter. The Fund's report should be reasonably ample, and if it was changed from what was before the Board, it could be enlarged rather than reduced. The tone of the staff paper was somewhat firmer than the previous rather tentative approaches to this question, and he hoped that the Board would now support a more positive attitude and perhaps encourage the staff to be even firmer on the main points of its presentation.

Mr. van Campenhout said that his intervention in this discussion was, of course, based on a preliminary personal study of the papers submitted by the staff and without the benefit of the reactions of any Government. His remarks were tentative and certainly incomplete. He thought the staff was to be congratulated for the important research work it had done on the problem of "compensatory finance." He had read the present staff paper against the background of the two previous staff studies on the effects of an impressive number of plans for automatic compensatory financing. It was interesting to note that none of these plans seemed to be significantly effective, particularly when supported by extensive financial means.

Mr. van Campenhout said he generally agreed with the main conclusion of the present staff paper as summarized in the first recommendation, as well as with the trend of its argumentation. Emphasis was properly put on the fact that the Fund's policies on the use of its resources were as adequate for dealing with deficits in balance of payments due to a fall in export receipts as they were for other kinds of imbalance. There appeared to be no reason to establish special rules to deal with one particular type of deficit and no justification for increasing the degree of automatism in the access to the Fund's resources for dealing with the problem of export fluctuations. It was also noteworthy that as a whole the resources of the Fund were adequate and that most of the quotas of the countries exporting primary commodities were also appropriate. It seemed to him that paragraph (1) of the recommendation of the staff was sufficient, and he saw no need for the conclusion set forth in paragraph (2). Mr. Hanemann had adequately argued this point.

Mr. van Campenhout continued that these remarks did not mean that in appropriate cases the Fund should not give particular attention to fluctuations of exports, whether from the viewpoint of the use of its resources or from the viewpoint of the adequacy of particular quotas. This should go almost without saying as the relative importance of exports fluctuations depended in each case on the nature of the economy of the country concerned. While he agreed with Mr. Hanemann that the Fund should have a "liberal and generous" attitude to the problems affecting particular countries depending mostly on exports of primary products, he would hesitate to use this phraseology in the redraft of the Board's observations for the simple reason that its meaning was vague and might create undue expectations.

Mr. van Campenhout noted that the staff had enumerated four categories of measures by which countries could, conceivably, be given a larger or more automatic access to Fund resources (ibid., p. 13). The second one read as follows: "drawings would be made available automatically after a decision by the Fund that the country was experiencing balance of payments difficulties attributable to a temporary cause beyond the control of the member." In such cases, the Fund having to take a decision as to the temporary character of the deficit and on the fact that such deficit was beyond the control of the member, the drawing would not be automatic. But, after reaching these two conclusions, one could not see how, under the charter and the Fund's policies, financing could be refused, provided that the amount of assistance required did not go beyond the 25 per cent limitation provided for in Article V, Section 3. There would, therefore, be larger access to the Fund's resources if the suggestion examined by the staff meant that the Fund would be willing to waive the 25 per cent limitation of Article V, Section 3. He suggested that this might be an acceptable means to liberalize Fund policies. Mr. van Campenhout said he also was not a priori opposed to consider waiving, on an ad hoc basis, the 200 per cent limit provided by Article V, Section 3 for the use of the Fund's resources. This might be, in some cases at least, a better and more realistic solution to occasional inadequacies of quotas than permanent increases resulting from statistical formulae, the shortcomings of which were well known.

While he had no dispute with the substance of paragraph (3) of the recommendations and although he saw some merits in including it in the Fund's observations, Mr. van Campenhout said he had some doubt as to the wisdom of referring to an increase in Fund resources when the findings of the staff indicated that they were for the time being adequate.

As to the recommendation set forth in paragraph (4) Mr. van Campenhout said that, like others, he wondered whether the time was ripe to suggest affiliation of the Fund with some hypothetical agency, the usefulness of which was open to question. In any case, before considering this possibility it would be desirable to have more information on the nature of the agency as well as the degree of affiliation suggested.

Finally, Mr. van Campenhout suggested that consideration be given to adding two points to the recommendations of the staff: One would be the confirmation of the essence of the study made by the Fund for the Commission on International Commodity Trade in 1960, the findings of which were summarized on pages 2 and 3 of the present paper. The other one was the inclusion in the Fund report of the summary of the two previous studies made by the staff and to which he had referred at the beginning of his intervention.

Mr. Reina wished first to take this occasion to tell the Directors how gratifying it was for him to be part of the Fund's distinguished and able Board that bore such great responsibility in resolving the world monetary and payments problems. He looked forward to having a fruitful experience in working with the Directors over the course of the next two years. Mr. Reina also welcomed the opportunity to make a few remarks about the complex problem of compensatory financing of export fluctuations--a subject that had aroused a great deal of interest in the countries which he represented, and in the whole of Latin America, as well as other underdeveloped areas of the world. As a basis for discussion, the staff had submitted an excellent, and in many ways, illuminating report for which he congratulated the staff.

Mr. Reina said he was very much in favor of the basic idea of compensatory financing of export fluctuations for underdeveloped countries, and he gathered from the staff report that the Fund also was very much interested in this problem. He thought it should be recognized that the Fund, in providing assistance for general balance of payments purposes to these countries, had in a measure contributed to the financing of export fluctuations. He believed that the Fund could play an even more active role with regard to the solution of this problem. The problem of compensatory financing boiled down to finding an adequate way to support countries faced with sharp export fluctuations in a manner consistent with the basic objective of underdeveloped countries to have sustained economic growth with financial stability.

Mr. Reina said he shared the misgivings of the staff with regard to large automatic financing of export fluctuations. In the long run, large automatic financing could prove detrimental to the basic interests of these countries. However, he had some sympathy for the argument contained in the last part of the second paragraph on page 8 of the staff report, where it was mentioned that "it is possible that the availability of international credit on an automatic basis at times when exports are low and the necessity of repaying such credit at times when exports are high would have some effect in inducing countries to attempt to keep their domestic expenditures and imports on an even keel on the basis of reasonable expectations as to the medium-term trend of their exports and other receipts." Nevertheless, the arguments against large automatic credits presented by the staff, and the fact that the advantages just mentioned "have to be weighed against the disadvantages of automatic credit geared to a single element in the balance of payments" carried, in his opinion, a great deal of weight. He would stress, as was done in the staff paper, the necessity of examining the causes of the export shortfall before granting specific credits for compensatory purposes because, as pointed out by the staff, the reason for the shortfall might lie in inappropriate exchange rates, domestic inflation, or other shortcomings of national policy. This examination was essential for determining whether some of the reasons for the shortfall might or might not be open to corrective action.

The problem of whether countries could meet the financial requirements of export fluctuations through a reasonable use of their own resources, and a reasonable use of the Fund's resources, under present conditions, Mr. Reina said, raised, at least with regard to some countries, certain questions for him. It was his impression that many countries in Latin America were not in a position to make available, as suggested in the staff paper, either one third of their own reserves or the equivalent of 50 per cent of their quotas to meet this single element of balance of payments instability. The reason for this was that gross reserves of these countries (the concept used in Table 1 of the staff report) was not a true measure of short-term liquidity available to them. For one thing, in many cases, there were heavy short-term liability charges against these reserves, and some reserves were, in fact, pledged against the liabilities. For another thing, part of these reserves were generally maintained in gold, and, for some reason or other, countries were very reluctant to part with their gold holdings. In fact, he would venture to say that in many cases the available part of these gross reserves merely represented minimum working balances. He wished to emphasize that this applied only to certain countries in Latin America, while countries in other areas might be in an entirely different position. However, if there was at present insufficient general liquidity in underdeveloped countries, it could be argued that some liberalization of Fund policy, not only for compensatory financing but also for general balance of payments purposes, was called for with respect to these countries.

Turning to the steps he felt the Fund could take to more actively assist those countries facing sharp fluctuations in exports, Mr. Reina said there was some doubt as to whether the creation of a new institution, tying up a large amount of resources, was the most judicious way to use economic resources in tackling the problem, even without considering the matter of automaticity of credits. Whatever resources the developed countries would contribute might, as pointed out in the staff paper, be on a stand-by basis, and would, therefore, not effectively accrue to the less-developed countries. Employment of resources in this matter might hurt the chances of less-developed countries for obtaining commensurate assistance from the developed countries for investment purposes. It might be, therefore, that liberalization of certain aspects of Fund policy, together with selective increases in the quotas of underdeveloped countries, using appropriate criteria, might be one appropriate way to contribute to the solution of this problem. The liberalization of Fund policies to which he referred was described under point (2) on the alternative suggestions of Fund action (ibid., p. 15). That was, the setting aside for this purpose, up to a specified amount of quota that would be excluded from total drawings in the application of tranche policies. Or, as the staff put it, that the "increasing degree of justification at present required for new drawings as the amount of total drawings outstanding increases would under this scheme apply only to other drawings ("ordinary drawings") and would depend on the outstanding amount of ordinary drawings only." There would have to be a prior decision of the Fund in order to qualify for drawing for part or whole of this special tranche. As a complement to this new flexibility of policy, the Fund might wish to consider relaxation of the use of its waivers beyond 200 per cent. As noted by the staff, this flexibility of policy should not be turned into a rule or procedure. Taking this line of action would have, in his opinion, many definite advantages, and the Fund would thus make an even more positive contribution toward the solution of this very important problem. He was certain that the other Directors would want to discuss this proposal further, before making it part of the conclusions in a Fund report to the United Nations Commission on International Commodity Trade.

Mr. Plumptre started his remarks with a reference to Mr. Garland's point that the role to be played by compensatory finance was only part of a broader picture. The raw material producing countries were faced by continuing difficulties which had been accentuated in recent years by the downward drift in world prices for their products, or, in other words, the terms of trade had been running against them. Actions taken by the Fund must be seen as part of a broader international concern and willingness to deal with these continuing and somewhat accentuated problems. His only criticism of the staff paper, apart from the conclusions which he would mention later, was the lack of a paragraph or two which put the problem in its broader setting. He would have liked to have seen, for example, some discussion of the importance of maintaining high incomes and employment in the industrialized countries, of the need for appropriate commercial policies, of special commodity arrangements that might be worked out from time to time, as well as an appropriate reference to aid policies, both bilateral and multilateral. The draft report could be considerably strengthened in this way.

Apart from this, Mr. Plumptre said, he had found the staff paper excellent. He would not comment on it in great detail, but he wished to make it clear that his silence on certain points was to be interpreted as assent to them. He wished particularly to call attention to a few of the points included in the paper. The first and most important was the staff's discussion of automaticity which he had found both elegant and convincing. One could only conclude from it that insofar as external resources available to assist the raw material countries were limited they would not be best used by a resort to automaticity. On the contrary, one could see a continuing need for intelligence and judgment relating not to a single criteria but to the totality of the situation in which particular countries found themselves. Therefore, he found himself in full agreement with this part of the report.

Another point of great importance in the staff report, Mr. Plumptre said, was its emphasis that the positions of individual raw material producing countries differed among themselves. The resources available to some seemed to be reasonably adequate, while the resources available to others seemed to be inadequate. In this connection, he wished to say that, while he had found Table 1 interesting, he had the feeling that it underestimated the full extent of the problem now under discussion. He had the suspicion that there were in fact more countries which needed some particular attention on the compensatory financing side than were indicated by the few minus signs in the table.

Continuing, Mr. Plumptre said, this led him to the next point which he believed to be at the heart of the paper, namely, that there was a need for some generalized, selective approach to the problem. All the raw material producing countries were not in the same degree of need for additional compensatory financing, but there was an appreciable group which should be given special consideration in the Fund. If that was true, it would not seem to call for any change in the general rules of the Fund but for an adjustment of particular quotas. The question then arose whether this should be undertaken on an individual basis or, as he had already suggested, on a somewhat generalized basis. This led to the question mentioned by Mr. Hanemann of the criteria to be used and whether the adjustments should not be on a special, individual basis. Mr. Plumptre said it was his personal view that a somewhat generalized selective approach was called for and that some new or supplementary criteria should be used in the examination of individual quotas. He was not entirely satisfied with the criteria and formulae put forward in the staff's new study of quotas (SM/62/95, 11/8/62) and, like Mr. Hanemann, he kept leaning toward the Bretton Woods criteria. He hoped the staff would further exercise its ingenuity and consider whether some reweighting of the factors in the Bretton Woods formula closer to the present world situation might not be useful. It was true, of course, that the weighting of the particular indices in the Bretton Woods formula had been arbitrary and designed to meet the situation of individual countries at the time. Some reweighting of these factors might now yield a useful rule of thumb in relation to the problem with which the Fund was now confronted.

Finally, with respect to the conclusions of the report, which had been recommended by the staff, Mr. Plumptre said he was prepared to accept paragraphs (1), (2), and (3) substantially as they now stood. He saw no need for the deletions other Directors had suggested. Paragraph (2) seemed especially important because it told members and other interested bodies that the Fund was taking active steps along the lines it considered most appropriate to meet the particular situation. In fact, without a paragraph along these lines, other organizations which might see the paper would probably feel that the Fund was adopting a completely standpat attitude. Paragraph (2) was an important indication that the Fund was doing something.

Mr. Plumptre said his only quarrel with the recommendations related to paragraph (4) on which he shared the view of the previous speakers. If the report was right in what it said about automaticity, it would seem a grave mistake to include a paragraph enshrining the principle of automaticity. It might well be that an institution along the lines mentioned might come into being, and if it did, the Fund would have to examine its form to see whether it would be appropriate to associate with such an institution. But at this stage he was opposed to any indication that seemed to give credence and support to the concept of automaticity. He suggested that in place of the present text, the final conclusion might reproduce the Fund's views on compensatory financing as a part of the broader picture in which the Fund was playing its part along with other institutions and national governments.

In commencing his remarks, Mr. Mansour wished first to point out that all of the 15 countries which Mr. Saad represented depended on raw materials for their earnings of foreign exchange. Some of these countries had not yet come to the Fund for financial assistance, but others had and, in some cases, for substantial assistance. The problem of these countries was two-fold. There was the long-term problem of the deterioration in their terms of trade and the deterioration of their reserves partly as a result of this and partly as a result of stepped-up development plans. The problem also had its short-term aspects arising from unexpected fluctuations in world prices for raw materials. It was understandable that when the Fund had discussed its general borrowing scheme which would be of benefit to certain industrialized countries, the raw material producing countries should seek elucidation of how the Fund would try to meet their problems. They hoped for a more liberal attitude on the part of the Fund and prompter handling of their requests to the Fund.

Mr. Mansour said he had not yet received Mr. Saad's reactions to the staff paper under discussion, but he personally had found it very stimulating and he could go along with its main theme and approach and its analysis of the various compensatory schemes that had been suggested. But the paper had not, in his view, said enough about what the Fund was prepared to do for the countries which suffered sharp fluctuations in their export earnings. Basically, the main theme of the staff report was in line with the statement made by Mr. Saad in his opening statement as Chairman of the last Annual Meeting, to which Mr. Hanemann had already referred. This was that the Fund was the international agency competent to deal with the matter and the alternative schemes based on automatism, though seemingly attractive and dazzling, would not be as practical and useful to the countries themselves. Mr. Saad's statement had said:

> Among the difficulties faced by the developing countries as they press forward with development plans are inadequate and fluctuating export receipts. Indeed, with prices of primary commodities persistently weak, the inflow of development capital little more than offsets the weak trend of export earnings. The large number of developing countries which have sought help from the IMF is proof of the balance of payments difficulties that these countries are encountering. Many experts are today devoting considerable thought

and ingenuity to solving the attendant problems arising from price fluctuations of primary products and the tendency of some of these to decline markedly. These efforts are taking two complementary forms. One is to stabilize prices of major commodities, of which coffee is the most recent example. The other is financing of export fluctuations in the primary exporting countries. The IMF is an important source of compensatory financing. We have only to look at the magnitude of the drawings of primary producing countries in the last year or so, and the reasons for such drawings, to realize the importance of the Fund's compensatory role.

Various proposals for additional compensatory facilities have been made by expert groups under the aegis of both the United Nations and the Organization of American States. All of these proposals are under active study by those institutions and by the IMF. But one thing seems clear. There is nothing in the Articles of Agreement or the policies of the Fund, as outlined in the Annual Report, that precludes the Executive Directors, when they deem it fit, from waiving any terms or conditions laid down in the Articles governing the use of the Fund's resources. In this way, the Fund can offer its financial help in case of balance of payments difficulty arising from shortfalls in export receipts. As a matter of fact, this has been the practice in numerous cases. Even in instances where the need for a stabilization program was clear, the Fund, in emergency situations, has wisely extended its financial assistance first, and sucessfully negotiated the stabilization program later.

I am sure that with regard to the developing countries the Fund, without changing its Articles, can and will continue to adapt its policies to suit the particular case of each country. At the same time, it must be stressed that no scheme for use of the Fund's resources can be a substitute for the adoption of fiscal, monetary, and exchange policies which strengthen the balance of payments, permit a rebuilding of reserves, and encourage a larger inflow of capital.

Mr. Mansour thought it was encouraging to note that on the matter of international commodity agreements not only the primary producing countries but also many of the industrialized consumer nations were now receptive to widening the area covered by commodity agreements, but the world was still waiting to see concrete and real progress which could only be brought about if both producers and consumers kept supply in balance with demand. It was only in this area that lasting results could be achieved; compensatory financing was at best only a relief measure. For the proper balance to be reached, certain prerequisites were called for, foremost among which was the removal of all trade restrictions and discrimination, high duties, and excise taxes which limited consumption. Orderly intergovernmental cooperation among the producing countries was also badly needed in order to organize production and free it from artificial supports. In this respect, Mr. Saad had said:

> Closely linked with the question of shortfalls in export earnings of primary producing countries is that of commercial or trade policy. The less developed countries have had an increasingly smaller share of world trade. The trade gap between the industrial countries and the nonindustrial countries is constantly widening. The commercial policy of the industrial countries is of critical importance in this respect as they are bound for many years to be the principal markets of the developing countries. Major impediments to the exports of the developing countries still remain in many of the industrial countries, particularly in the field of agricultural and industrial raw materials. It is futile to encourage development and growth without making provision for expanding international markets for the products of this development and growth. Increased export capacity without access to foreign markets can only lead to frustration and bitterness. We are all aware that a number of developing countries are concerned with the implications for them of the formation of the Common Market in Europe. More rapid growth in the industrial countries is to the advantage of all. However, care must be taken that access to these growing markets is available to all of our member countries. Ways and means must be diligently sought to reconcile the objectives of the Common Market with the needs of other countries. It is encouraging that in the industrial countries there are wide sectors of the population and many responsible government officials who recognize the problems of the developing countries. There is room for greater international cooperation in these matters, and in this cooperation I am confident that our institutions can play a most useful part.

Mr. Mansour noted that Mr. Saad had also referred to the high indebtedness of the developing countries and the danger of a further piling up of their short-term debts. The terms suggested in the alternative schemes for automatic financing and equally automatic repayment created a still shorter-term borrowing than that under the Fund's policy, and this had its dangers for the developing countries in spite of its attractiveness to meet short-term needs. Mr. Mansour pointed out that at their last Annual Meeting many Governors had expressed a desire to see the Fund play a more active role in the field of compensatory financing. They seemed to have had in mind that the Fund would earmark one or two drawing tranches for such financing and label them as such. Psychologically, labels were popular and reassuring, and so long as the Fund had in the past granted assistance for this purpose and would continue to do so, there would be no harm in responding to this desire of so many Governors. Such a tranche or tranches could be integrated into the Fund's general policies on the use of its resources. He would suggest that this tranche be put after the first credit tranche and be treated under the same terms and conditions as now existed for drawings in the first credit tranche. He hoped the matter would receive serious study.

Continuing, Mr. Mansour said that in his view, if the Fund were satisfied as to the temporary nature of the shortfall in a member's export earnings and the member's potential ability to repurchase, Fund assistance should be forthcoming. In this connection, he had been interested in Mr. Dale's statement of the three points on which U.S. policy was now well established. Mr. Mansour said he fully agreed with the view that any compensatory scheme should be tied to the Fund and adapted to its policies and also endorsed the suggestion that any expansion in the use of the Fund's resources could be specifically addressed to the problem of fluctuating commodity exports. He believed that it would be useful to consider establishing closer and more active cooperation between the Fund and the CICT if the Fund were to extend its activities in the area mentioned. Such cooperation would be useful to both institutions. An arrangement for consultation and exchange of information could be devised. The CICT which administered the commodity agreements should be in a position to furnish the Fund with up-to-date data relating to conditions in world commodity markets and the extent to which any member requesting Fund assistance for compensatory financing had been affected by such conditions, as well as the actual standing and performance of that member in any commodity agreement to which it had adhered. Such information would help the Fund in assessing the amount of assistance warranted in the case and the degree of promptness with which it had to deal with the country's request. This kind of cooperation, Mr. Mansour said, was also necessary for the success of the Commodity Agreements which offered the only possible remedy for the problems arising from shortfalls in export earnings.

With respect to the views presented in the staff paper, Mr. Mansour said he agreed that any increased assistance from the Fund should be on a temporary basis and, while it was in the interest of a member to agree with the Fund on a stabilization program if needed, he thought the link suggested by the staff between compensatory drawings and a stabilization program should be qualified as only being necessary when the country asked for a drawing that would bring its use of the Fund's resources into the range where such a program was a prerequisite under the Fund's present policies.

Mr. Mansour also expressed interest in the reference in the staff paper to an adjustment of small quotas to make them adequate to the needs of the small countries which depended on primary products for their export earnings. He thought the suggestion was useful, and he hoped the new staff study on quotas would help the Board to reach a decision along these lines.

Turning to the recommendations of the staff Mr. Mansour said he could go along with the substance of paragraph (4) that "it would not be desirable to arrange in the Fund, with the use of the Fund's resources, automatic compensatory financing of export fluctuations, with loans and repayments determined on the basis of a formula." He thought it would be useful, however, for the Fund to stress to the CICT that an "automatic" formula for drawing had never been considered an appropriate arrangement in the Fund, even in the case of drawings in the gold tranche, and that members had accepted the concept of being given the overwhelming benefit of the doubt in this area. It should also be stressed that the Fund's policy on drawings in the first credit tranche provided almost the same assurance and promptness of action, and that drawings for compensatory financing could be treated the same way.

Finally, Mr. Mansour said he thought the last two sentences of paragraph (4) dealing with the possibility of the Fund accepting affiliation with a new agency providing automatic compensatory financing raised serious questions which needed further study on the detailed terms and conditions for such financing, as well as of the objectives of such a new agency, and whether or not they would run parallel with the Fund's basic objectives.

In concluding, Mr. Mansour observed that, while the Fund's total resources amounted to the equivalent of around $20 billion, its real objectives were far more important than its financial operations. Another agency granting automatic financing on the basis of a formula without adequate safeguards could defeat the basic purposes of the Fund. It was therefore to be hoped that any new independent agency that might be established would not have this result. It was important to bear in mind that the real problem for the raw material producing countries was the long-term one of deterioration in the terms of trade and that the incidental problem was that of price fluctuations. Any scheme to finance these fluctuations should have the all important objective of helping these countries to take the necessary corrective measures. Any objective effort to solve the problem of fluctuations in raw material export earnings, and the deterioration in the terms of trade of the primary producing countries, would have to take into account the hard facts of the present world situation.

Mr. Klein said that, as Mr. Mansour had very aptly put it, the main problem with which the so-called primary producing countries were faced, and which made their proceeds from exports inadequate for their fast development, was not in general the short-term fluctuations of their export income. The paper which the Board was now considering concerned itself only with such short-term fluctuations which, of course, in keeping with the fundamental purposes of the Fund, all related to monetary problems in the narrower sense of the concept and consequently to short-term changes in liquidity.

Among the developing countries, Mr. Klein noted, enormous expectations had been built up in relation to this scheme of compensatory financing of export fluctuations, but this was so because these countries hoped that such compensatory financing would solve their basic problems which were connected with the long-term development of their exports. He believed, therefore, that the recommendations, which would be adopted as the official opinion of the Fund to be communicated to the Technical Working Group of the Commission on International Commodity Trade, should contain a reference to this important fact, in order to forestall the mistaken impressions either that, if a scheme were adopted to iron out short-term fluctuations this would contribute effectively to solve the basic problems of periodic international illiquidity in these countries, or that such fundamental solutions were being denied them if the conclusion were reached that an automatic compensatory financing scheme was not advisable.

Mr. Klein observed that the fundamental problems had been referred to by a number of speakers, especially by Mr. Garland, Mr. Plumptre, and Mr. Mansour. These problems should be attacked from both ends; the markets of the industrial world should be free and open to these products and excessive domestic high cost production of the same commodities should be reduced and eventually eliminated. This was a point which should be made again and again, and the Fund should endorse it with all its authority as both the Board and the Managing Director had done frequently in the past. But corrective action was also needed at the other end, that is to say, in the primary producing countries themselves. And here he believed that rather sweeping generalizations would be made if the Fund spoke of primary products without making distinctions and qualifications. There were, for example, agricultural countries whose exports proceeds depended to a large extent upon changeable--sometimes periodically changeable--weather conditions. There were also countries which exported minerals, and here the fluctuations seemed to be determined mainly by the price formation in the importing markets. There were countries which produced food and animal feeds for which there should be a permanent and increasing demand in the world, given the present trend in population growth. But many of the possible markets did not have the means to buy such products at world market prices and on a cash basis in considerable amounts. Of other agricultural products, such as coffee, one might venture the opinion that they were at present produced on an excessive scale for any possible world demand even if all kinds of import barriers, which at present narrowed their markets, were suppressed. There were other cases in which the insufficient export proceeds of a country were linked to the state of the technique applied to their main products. Certain commodities were produced at present on a much larger scale because of considerably improved techniques and consequently their price per unit had dropped. Those countries which were not applying the same advanced techniques and had not increased their output of such a commodity found, of course, that their export income was dwindling. One might say that, while in the case of manufactured goods progress might show in improved qualities of the finished article rather than in price, in the case of primary commodities, progress might just show in a reduction of unitary price reached through improved technique. It was clear that a number of different devices might help the primary producing countries to improve their position, namely, diversification of production, introduction of new techniques, adequate financing of infrastructure which would improve production or marketing policies aimed at reducing cost, etc. Many of these devices would be effective only in the long run and very little would be achieved by smoothing out the short-term fluctuations. He thought it should be said that the staff was increasingly helping the primary producing countries to see where the real problems lay and what could be done in the exporting countries to contribute to their solution.

Continuing, Mr. Klein noted that the staff paper was concerned with the short-term fluctuations and it would seem--no doubt--most useful if these could be altogether obliterated. But this led to the fact that the dividing line between short-term fluctuations and long-term trends was not as neat as it appeared in retrospective statistical surveys. In particular, it was quite possible that fluctuations, which would not have been more than short-term ripples, worked themselves into long-term trends because timely corrective action had been omitted. It was for that reason that he personally was diffident of automatic devices which would mechanically iron out such differences. In many cases, the price mechanism would help to take that kind of action which would prevent such an unfortunate development. That markets could be lost through a year or two of a mistaken policy was illustrated by the Argentine experience, the country having in such a way lost its world markets for linseed of which it was the dominant producer. In this particular instance, such an outcome was not the consequence of short-term fluctuations but it adequately showed that the wrong policy pursued during a very short period could have a far reaching permanent effect. It was for that reason, in his opinion, very positively in the interest of the primary producing countries that compensatory financing should not be automatic, but should be subject each time to the thorough analysis of a competent staff. He believed that, as Mr. Plumptre had put it, in the matter of automatism the staff paper was very cogent, exhaustive and convincing, and he had few additional remarks to offer. One was that the Fund was at present--in fact always--broad-minded and understanding in its assessment of balance of payments difficulties due to short-term (and even to longer-term) fluctuations in export proceeds. The second was that the additional resources which might be mobilized in order to finance these short-term fluctuations might not help the country receiving the aid but only the Government in office at the time the credit was granted, while a succeeding Government might be laboring hard under the weight of the repayment obligations.

With regard to the paper itself, Mr. Klein said he had taken it so far as an internal document and not as one that was intended to be adopted as the official opinion of the Board to be communicated to the public. Therefore, he had not read it with a view to weighing each word, but he thought there would be further opportunities to do this after the present meeting.

With regard to the solutions within the reach of the Fund to help primary producing countries to cope more effectively with such short-term fluctuations, Mr. Klein thought that the most adequate would be to relax the Fund's policy to stop at the fourth credit tranche and to permit drawing, if this appeared warranted, beyond the amount which would bring the Fund's holdings of the currency of the country concerned to the

200 per cent mark. He would not have difficulties either in admitting a relaxation of the present requirements in the first credit tranches, though he would point out that at present most of the countries within the area which he represented would not be helped much by such a relaxation, unless of course the envisaged further credit tranche were considered as the first one, taking precedence as to treatment over the other credit tranches already granted.

Mr. Anjaria said it was not clear to him at what stage of the present UN consideration of the problem the Fund would be expected to state finally where it stood on the matter, but it appeared from the paper before the Board that the time schedule was very tight. Viewing the problem from a general standpoint, it had to be recognized, as Mr. Klein had said, that a scheme for financing purely short-term fluctuations in export earnings would not meet the demands and expectations of the developing countries, for what they wanted was an automatic source of assistance when their export earnings went down. It seemed desirable that any Fund report on the matter should state that, while the Fund fully appreciated the problem, the Fund itself was limited in what it could do because its resources could only be used on a short-term basis and for a diversity of balance of payments needs. This should be clearly stated because otherwise the Fund might be considered as not being seized of the problem, or, perhaps, not prepared to act. As other speakers had mentoned, the problem was a very complex one. To confine the role of the Fund or any other institution that might be created to assistance for purely short-term fluctuations, would provide no solution for the longer-term problem of the terms of trade of the primary producing countries. But, it was also not clear what the short-term problem was as distinct from the longer-term problem. In practice it was very difficult to distinguish between short- and long-term fluctuations in export earnings, and in his view a great deal more thought would have to be given to the problem.

Turning to the staff paper under discussion, Mr. Anjaria said he would have no objection to its being made available to the CICT Working Group, but if it was to be considered as a declaration of the views of the Fund the formulation of some of its arguments and conclusions would have to be changed. The report would have to be more detailed; it might have to be drafted in less technical terminology; and it should spell out the successive stages by which the Fund would move from the present situation to that which was envisaged. As it now stood, the paper mainly highlighted the present policies of the Fund. While this was desirable, it led to the conclusion that the Fund felt that it was already liberal and generous in its policies and probably could do little more, and that another institution might be needed, though this was not clear. Though the staff paper presented a fair statement of where the Fund now stood, it did not--perhaps it could not--indicate where precisely the Fund should or would come out.

Mr. Anjaria said he had been pleased to hear Mr. Dale's statement that the United States authorities felt that any arrangement for compensatory financing had to be world-wide in scope and that it should be closely related to the Fund. Speaking personally, Mr. Anjaria said he felt that in any approach to the problem the Fund should be placed at the center, for he doubted that any other agency could do the job as efficiently as the Fund. He also felt that the work of the Fund itself could not but be hampered by the establishment of another agency which would operate in a field, which though not identical, would be closely related. At this stage the Fund could, understandably, not make any commitment regarding its readiness to accept affiliation of another agency; that matter would have to be examined further. In any event a statement of willingness to have an affiliated agency should at least contain the proviso that the terms and conditions of such an institution would have to be satisfactory to the Fund.

In urging the Fund to take a more positive approach to the problem than appeared in the draft report, Mr. Anjaria recalled the Managing Director's reference in his statement at the 1962 Annual Meeting to new initiatives on the part of the Fund with respect to the developing countries. Mr. Anjaria said he felt that there was a widespread expectation on the part of the people in these countries that some clear initiative would now be taken by the Fund. While he was fully aware of the difficulties mentioned by Mr. Hanemann and Mr. Waftzenegger, Mr. Anjaria thought the Fund report should make clear, as suggested by Mr. Plumptre and Mr. Garland, that the problem was a wider one than the Fund alone could solve. He would agree also with the staff view that the Fund could not accept the rule of automaticity in respect of any assistance it provided.

At the same time, Mr. Anjaria urged that the paper indicate more positively that among the possibilities being considered was a readjustment of small quotas, though it should be made clear that the question of Fund quotas in general went beyond the immediate issue under consideration, and that these quotas were based on diverse considerations. He had great sympathy with Mr. Plumptre's suggestion regarding a generalized selective approach to the problem in respect of the quotas in the two lowest brackets. In this connection, Mr. Anjaria said he also shared the view that Table 1 seemed to present a more soothing picture than the realities warranted. Certainly an analysis of external liquidity in relation only to exports was a limited approach and, however appropriate it might be in this particular context, no room should be left for any assumption that the problem could be judged solely in relation to one item in the balance of payments. If the table was to be used in a Fund report, it should be pointed out that the table was not intended to reveal the over-all situation with respect to the adequacy of liquidity or the adequacy of individual Fund quotas. Mr. Anjaria said he agreed with Mr. Hanemann and Mr. Waftzenegger on the matter of Fund quotas in general and would stress that their relation to the compensatory financing needs of some countries could not be considered in isolation.

But on the question of a more liberal use of the Fund's resources, Mr. Anjaria thought some concrete decisions could be taken as, for example, extending to drawings in the first credit tranche the same terms and conditions as now applied to gold tranche drawings. Such a modification of policy would require substantive discussion in terms of the various needs of members and the liquidity of the Fund. He felt, however, that such liberalization would probably not be sufficient and that the Fund might also have to set up a special tranche available to primary producing countries. He recognized the practical difficulties of a separate tranche for which the criteria might differ from those for normal drawings, but he assumed that the rationale for such a special tranche was the fact that the shortfall in export earnings was recognized as being due to factors beyond the country's control. If so, monetary and fiscal policies would not have the same relevance as in normal drawings. In any event, he thought that the Fund should examine if there was need for, and if some way could be found to establish, a tranche available on somewhat more liberal terms than were now applicable.

Finally, with respect to the staff's recommendations concerning the conclusions of the Fund report, Mr. Anjaria said he agreed with other Directors that some of the wording of paragraph (1), especially the first sentence, would have to be revised. He also felt that a statement should be added to indicate what proportion of the compensatory financing field was already covered or likely to be covered by the Fund, and what would still remain to be covered. The idea that the Fund was doing very little in the field should be erased, and the role of the Fund even within its present policies should be presented in more concrete terms. Mr. Anjaria added that it was his hope that the conclusions would state more categorically that the Fund was studying the small quotas and was preparing to consider a more favorable realignment on its drawing tranches to assist in the problem of shortfalls in export earnings.

In conclusion, Mr. Anjaria again stressed that it must be recognized that any scheme for compensatory financing of fluctuations in export earnings would at best provide only a partial solution to the problem. Perhaps a separate new institution or some new financing device, similar to the Fund's general borrowing arrangement, might be necessary. If so, the Fund should be willing and prepare itself to cope with such a development.

It was agreed to continue the discussion at another session later in the day.

ALBERT C. FROST
Acting Secretary

FOR AGENDA

Mr. Jorge Del Canto

Room 807

(1)

SM/62/94

November 8, 1962

To: Members of the Executive Board

From: The Secretary

Subject: Compensatory Financing of Export Fluctuations

In connection with the request made by the Commission on International Commodity Trade that the Fund "present, as soon as possible, a report as to whether and in what way the Fund might play an increased part in the compensatory financing of export fluctuations of primary exporting countries," the staff has prepared the attached memorandum. It is intended that this memorandum would serve as the basis for the preparation of the Fund's report after discussion by the Executive Board.

The Technical Working Group of the Commission on International Commodity Trade is now meeting in Geneva and the Fund's representatives at this meeting are being provided with copies of the memorandum so that they will be kept abreast of the work being pursued in the Fund. In their contact with the Technical Working Group the Fund's representatives will be fully aware that the attached document is a staff memorandum, and their use of it will be guided accordingly. They will make it clear that the views of the Fund will be made available in due course, after the Executive Board has completed consideration of this matter.

Att: (1)

Other Distribution:
Department Heads
Division Chiefs

INTERNATIONAL MONETARY FUND

Research and Statistics Department

The Compensatory Financing of Export Fluctuations
of Primary Producing Countries

Prepared by the Research and Statistics Department

Approved by J. J. Polak

November 8, 1962

Introduction

At its tenth session held in Rome, in May 1962, the United Nations Commission on International Commodity Trade "invited the International Monetary Fund, in the light of the discussion during the tenth session, to present, as soon as possible, a report as to whether and in what way the Fund might play an increased part in the compensatory financing of export fluctuations of primary exporting countries, and to keep the Technical Working Group currently informed of the progress of its deliberations on the subject."

At the same session, the Commission also set up a Technical Working Group, consisting of the representatives of ten countries,

> "(a) to examine--in the light of the views expressed and the conclusions reached during the tenth session of the Commission, of the documentation available to that session and of the assistance that the International Monetary Fund can provide to primary exporting countries to overcome the problem of short-term fluctuations in their export earnings--the scheme for a [Development Insurance Fund] submitted by the United Nations Group of Experts and the scheme of compensatory financing for fluctuations in export receipts drawn up by the Organization of American States and submit its considered views to the eleventh session of the Commission together with the text of a draft agreement, including any necessary variants, for the purpose of illustrating a specific mechanism for compensatory financing and for the purpose of facilitating decisions by governments on this subject."

....
....

"(c) To report in good time to enable the Commission, at its eleventh session in 1963 to make recommendations to the Economic and Social Council on these questions. The report should be in the hands of the Secretary General before 12 January 1963 so that it may be distributed to Member Governments by 23 February 1963."

At its session in July 1962, the Economic and Social Council of the United Nations approved the work program of the Commission on International Commodity Trade relating to compensatory financing.

I. Previous Consideration of the Problem by the IMF

In 1960, in response to an earlier request by the Commission on International Commodity Trade, the Fund prepared a study explaining its policies and procedures bearing on the compensatory financing of fluctuations in foreign exchange receipts from the export of primary commodities.1/ The main points in this study may be briefly summarized as follows:

(1) The provision of foreign exchange to Fund members to assist in the compensation of short-term fluctuations in the balance of payments constitutes a legitimate use of Fund resources. Among such fluctuations are some that arise primarily from variations in export prices and proceeds. In order that balance of payments deficits from this cause should be suitable for financing by the Fund, however, the member's policies must be such as to enable it, with the financial assistance it obtains from the Fund, to overcome its difficulties within a reasonably short period of time.

(2) It would be neither practicable nor desirable to make the amount of such assistance dependent on any automatic formula, or to provide any separate form of Fund assistance to deal with export fluctuations alone. This is because judgment is required to determine the extent to which export fluctuations are properly compensable in the light of the balance of payments as a whole, and the extent to which any compensation required should be provided by international means, and because if the Fund gave too much of its assistance automatically its ability to influence countries toward the adoption of appropriate policies would be seriously impaired. Requests for drawings for all purposes in accordance with the Articles of Agreement are, however, treated liberally in the gold tranche and the first credit tranche.

1/ "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations." IMF Staff Papers, November 1960.

(3) Fund quotas, (as of end 1959) were considered adequate to provide for its primary producing members a supplement to liquidity which, in the majority of cases, should be sufficient in conjunction with their own resources to enable them to deal with payments problems created by short-term fluctuations in exports or in external receipts of the order experienced since World War II, provided they did their best to keep their incomes and costs adjusted to the longer run changes in their external purchasing power.

(4) There appeared, (as of the same date) to be no reason why shortage of resources should be a factor limiting the amount of assistance that the Fund would otherwise consider it desirable to give to its members.

(5) Consequently, it was concluded, "members of the Fund that were taking appropriate steps to preserve international financial stability and to maintain their balance of payments in equilibrium, taking good years with bad, and that were otherwise making satisfactory progress toward the fulfillment of the Fund's purposes, could anticipate with confidence that financing would be available from the Fund which, in conjunction with a reasonable use of their own reserves, should be sufficient to enable them to overcome temporary payments difficulties arising from export fluctuations."1/

II. Suggestions for Increased Compensatory Use of Fund Resources

Since the study summarized above was submitted to the United Nations in April 1960, the subject of compensatory financing has been actively considered within the framework of the United Nations and the Organization of American States, in particular by the UN Expert Group which, in January 1961 reported on "International Compensation for Fluctuations in Commodity Trade," by the UN Commission on International Commodity Trade, and by the OAS Group of Experts on the Stabilization of Export Receipts which reported in April 1962.

In general, the international bodies in which the matter has been discussed have displayed understanding towards the Fund's policies on compensatory financing, as outlined above (including the restricted scope given to automatism in Fund transactions), and appreciation for the assistance which the Fund has been able to give under its present rules to primary exporting countries with export difficulties. However, certain suggestions have been made for changes in policy that would permit an enhancement of the Fund's compensatory role. Moreover, it has been argued that even if the Fund made a reasonable degree of progress in the direction

1/ Op. cit., p. 4.

indicated enough uncertainty would remain in the minds of governments as to their ability to draw on the Fund to justify the consideration of other possible international measures of compensatory financing. It has, therefore, been suggested that there is a need for some new financial institution, separate from though possibly affiliated to the IMF, to provide compensatory financing for export fluctuations in amounts or of a kind, or with a degree of automatism that is either not practicable, or not desirable, for the IMF. In pursuance of this line of thought, the above mentioned UN Expert Group worked out schemes for a Development Insurance Fund which have subsequently been elaborated by the UN Secretariat, while the OAS Expert Group has prepared a scheme for an International Fund for Stabilization of Export Receipts on a loan basis.

The following are the principal suggestions that have been made by UN or OAS Experts regarding the policies and practices of the IMF in the use of its own resources.1/

(a) Qualitative criteria for the use of Fund resources. The Commission for International Commodity Trade, at its session of May 1961, "considered that it would be desirable if the Fund would study the question whether the present criteria for the use of its resources are fully adapted to circumstances in which payments difficulties arise mainly from fluctuations in primary product markets."

(b) Stand-by or near stand-bys for compensatory financing. According to the Report of the UN Expert Group (p. 29) "Through the increased use of stand-by arrangements or consultative procedures the Fund should aim to clarify with interested members the conditions which would assure that the full use of the quota without waiver (Fund holdings of 200 per cent of a member's currency) or even more will be readily granted if it appears justifiable according to forecasts of commodity markets and other relevant considerations."

(c) Extension of gold-tranche criterion to later tranches. The following suggestion is contained in the Report of the UN Experts (p. 28). "In so far as drawings on the Fund are automatic, a country whose export proceeds fall has reliable access to a source of compensatory financing. At present only 25 per cent of a member country's quota comes close to being automatically available. Any significant increase in this percentage which the Fund could institute would be a valuable step towards providing compensatory financing to meet the needs of primary producing countries when threatened with the adverse impact of a decline in export proceeds."

1/ This section of the paper has been reproduced, for convenience, from SM/62/34.

(d) Automatic compensatory drawing rights in first credit tranche. In Appendix II of the Report of the UN Experts one of the Experts (M. L. Qureshi) suggested that "to offset fluctuations in the export proceeds of primary producing countries, compensatory drawings and repayments should be determined automatically by a formula. The fluctuations should be measured as a deviation from a trend which can be estimated on the basis of a moving average of three preceding years. A shortfall in export proceeds in any year should entitle the country concerned to draw from the Fund automatically up to, say, an amount which causes the Fund's holdings of the country's currency to equal 125 per cent of its quota---- Subsequently, when export proceeds are above the trend, the excess earnings should be used automatically to repay the earlier drawings." From the context it appears Mr. Qureshi had in mind full compensation of shortfalls as defined, up to the 125 per cent point, and subsequent repayment of the whole of any excess of export proceeds over trend.

(e) Automatic compensatory drawing rights additional to normal facilities. At the Special Meeting of the Organization of American States at Punta del Este, Chile advanced the proposal that Fund members affected by price declines in important export commodities should be enabled to draw from the IMF in amounts determined by the magnitude of the price decline in question relative to the average price of the preceding three years and by the volume of exports affected. Drawings under these special arrangements would be repaid when prices rose above the level of the three preceding years. The ability of members to make ordinary drawings would not be affected by the amounts outstanding under these special arrangements.

III. Automatism in the Use of IMF Resources

The proposals that have been advanced, whether for new compensatory financing institutions or for changes in the policies and practices of the IMF, are evidence that the assistance provided by the IMF under present policies is considered either insufficiently automatic in character or inadequate in amount to deal with the payments problems that arise from export fluctuations in primary exporting countries. The question of automatism of Fund operations is discussed in this section; that of the quantitative adequacy of members' access to the Fund in the next one.

The type of automatism envisaged in the various proposals that have been put forward--automatism of the "compensatory" rather than the "all purpose" type--has two principal features:

(1) A mathematical formula is used to determine the question whether and to what extent exports in a particular year are to be considered so abnormally low as to require compensation, or so abnormally high as to permit the repayment of compensation received previously. No judgment would be made by the lending agency, in the light of any other information that might be available, as to whether, in a particular situation, the formula yields a reasonable estimate of normal exports.

(2) The lending agency, whether the Fund or a new agency, would make credit available to a country without question whenever the formula pointed to a statistical justification on export grounds alone. No regard would be paid to the over-all balance of payments need for such credit, to the likelihood that the country would be able, in the light of the policies it was pursuing, to repay the credits that were being granted or, in some proposals, to the amount the country has already borrowed. The country itself could, of course, refuse to take up credits to which it was entitled or could repay credits before maturity.

With regard to the first point, the assumption has been made virtually without question in the proposals now under consideration that when exports are below the average for, say, the three preceding years they can safely be assumed to be abnormally low so that compensation would be indicated.1/ Statistical experiments recently made for a large number of primary producing countries over the post-war period indicate that this is by no means generally the case. The fact that exports in any given year have been lower than they were in preceding years is very often an indication of a downward trend which may well persist for some years to come. Export proceeds that look low in relation to those of preceding years may well appear in retrospect as rather favorable. It follows from this that automatic formulae based on past and current export data only can yield at best rather unsatisfactory estimates of the true trend of exports. In the absence of foreknowledge of future exports, the least inaccurate estimate of the normal level in any given year is likely to be one that attributes a great weight to the exports of the year itself. Even when this is done, however, the extent to which it is possible by means of compensation to bring export proceeds closer to their true norm or to reduce their instability is distinctly limited.2/

1/ In the various discussions resulting in the proposals for compensatory financing now before the CICT, a number of statistical indicators were considered prior to final agreement on the value of total exports. Suggestions to base compensation on exports of individual commodities, on export prices, on the terms of trade, or on exports of goods and services were examined; they were discarded, however, in favor of the statistically less complicated concept of total merchandise exports.

2/ C.f. "Statistical Testing of Alternative Schemes of Compensatory Financing" DM/62/40.

While great uncertainty must always attach to any attempt to estimate the medium-term trend or norm of exports, it is reasonable to assume that a better estimate could be made by the exercise of judgment based on an analysis of the causal factors at work than by any mathematical formula, however skillfully contrived, that is based on the mere statistical magnitude of current and previous exports.

As regards the second aspect of automatism, the fact that credit is to be granted irrespective of the general balance of payments situation or of the policies of the country receiving assistance, it is necessary to consider whether and to what extent such automatism (i) already exists and (ii) is desirable, within the Fund.

Under present Fund policies "members are given the overwhelming benefit of the doubt in relation to requests for transactions within the "gold tranche," that is, for drawings which do not increase the Fund's holdings of the currency beyond an amount equal to the member's quota. The Fund's attitude to requests for transactions within the "first credit tranche"--that is, transactions which bring the Fund's holdings of a member's currency above 100 per cent but not above 125 per cent of its quota--is a liberal one, provided that the member itself is making reasonable efforts to solve its problems. Requests for transactions beyond these limits require substantial justification. They are likely to be favorably received when the drawings or stand-by arrangements are intended to support a sound program aimed at establishing or maintaining the enduring stability of the member's currency at a realistic rate of exchange."1/

In the higher tranches, the Fund will therefore want to be satisfied that a sound set of policies is being followed. The Fund may have reached this conclusion before the question of a drawing arose, e.g. if it has a stand-by arrangement with the country in question. Assuming such policies are being followed, no change in them would be needed to meet payments difficulties that are due solely to temporary situations in foreign markets, or to such factors as a temporary crop fluctuation. The mere fact of a falling off in exports would not be taken as an indication that a corrective program was necessary or that the corrective program already envisaged required to be intensified. On the other hand, a need for corrective policies might arise either because the decline in exports appeared to foreshadow a lasting weakening of the country's balance of payments or because, though the export decline itself might be purely temporary and self-correcting, the country's monetary and financial policies were such as to provoke, sooner or later, balance of payments

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1/ 1962 Annual Report, page 31.

difficulties even under satisfactory export conditions. Recognition by the Fund of the need for corrective policies in either of the two circumstances mentioned above does not mean that the Fund will seize the occasion of a member country's financial plight to press for immediate adoption of the full range of what might be construed as "ideal" policies, for example, the elimination of all payments restrictions, the adoption of full currency convertibility at an effective par value, the abolition of all multiple rates, etc. Reference to the policies followed in regard to these matters by the many countries that are using the Fund in the second or higher credit tranches or that have stand-by arrangements permitting such use will dispel at once the notion of such an approach by the Fund. In accordance, however, with the purposes set out in Article I, which guide the Fund in all its actions, Fund assistance, at least beyond the gold tranche, should not be made available to any country that makes no effort to move towards the elimination of those aspects of its exchange and monetary policies, which are detrimental to its own interests in the long run, and very often in the short run as well.

The general case against providing compensatory credit without inquiry into general balance of payments need or into the policies of the country concerned has been argued at length in "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations" and these arguments have not in general been challenged. As suggested by the UN Experts, a country exposed to export fluctuations might feel more secure if it had access to resources on which it could draw without having to satisfy any international organization or lending government as to the type of domestic or international economic policy it was pursuing. Moreover, it is possible that the availability of international credit on an automatic basis at times when exports are low and the necessity of repaying such credit at times when exports are high would have some effect in inducing countries to attempt to keep their domestic expenditures and imports on an even keel on the basis of reasonable expectations as to the medium term trend of their exports and other receipts. These potential advantages, however, have to be weighed against the disadvantages of automatic credit geared to a single element in the balance of payments. In this connection it may be appropriate to mention two considerations in particular:

(1) Even a statistically accurate determination that exports in a particular year are below normal implies nothing at all as to the cause of the shortfall. The cause may be a decline in world demand or a crop failure brought about by a natural calamity. But the reason may also lie in inappropriate exchange rates, domestic inflation, government purchases for stockpile at prices above those prevailing in world markets, inadequate arrangements for the collection and transportation of crops or other

shortcomings of national policy. When declines in exports occur a most careful consideration of their possible causes is indicated in order to determine whether some of them may not be open to remedial action by the country itself, so as to prevent export declines in the future if similar circumstances recur.

Thus, while it is desirable that countries have access to financial means to compensate for export fluctuations, it is not particularly desirable and may be against the genuine interest of the country concerned if this finance is provided automatically and without an exploration of the causes of the decline in exports and the measures that should be taken to improve exports in the future.

It should be pointed out in this connection that the benefits that a country may derive from reaching an understanding with the Fund as to the policies appropriate to its situation extend beyond the financial assistance obtained from the Fund itself. In such circumstances agreement with the Fund is likely to strengthen opinion abroad and at home regarding the country's creditworthiness, and thus to facilitate the attraction of capital from other sources, official as well as private.

(2) The total amount of short-term credit made available to a country by one agency or under one arrangement cannot be totally divorced from the amount made available on similar terms by another agency or under another arrangement by the same agency. It would be shortsighted to think that a country would be fully justified in borrowing a relatively large amount on short-term for the compensation of an export shortfall with total disregard of the amount it had already borrowed on short-term on some other grounds. Prudent countries would themselves see to it that their total indebtedness did not exceed what they could reasonably expect to repay, and this would take into account all indebtedness of a similar character. It would seem to be dubious wisdom to set up the terms of lending of an international agency in such a manner as to put governments under internal pressure to borrow sums that they themselves might consider going beyond the bounds of prudence. If there are sensible limitations on total short-term borrowing, these limitations should be taken into account not only by the borrowing country itself but also in the policies of the international agency extending the credit.

IV. Quantitative Adequacy of IMF Drawing Facilities

The UN Expert Group responsible for producing "International Compensation for Fluctuations in Commodity Trade" calculated that 16 out of 46 primary producing countries experienced, over the years 1953 to 1959, cumulative shortfalls of exports, as compared with average annual exports over the three preceding years, of such magnitude that to compensate them fully would have compelled them, after using up 125 per cent of their IMF quotas, to dip into their own reserves to an extent exceeding one-third of end-1959 reserves.

The Experts did not offer an opinion as to whether these facilities, had they been available on an automatic basis, would have been adequate to meet to a reasonable extent the need for compensatory financing of export fluctuations. However, they pointed out that if only the 25 per cent of quota constituting the gold tranche (or the 50 per cent constituting the gold and first credit tranches) had been made available to meet the cumulative export shortfalls, over 20 (or 16, respectively) of the countries concerned would have had to draw down their reserves by more than 30 per cent to achieve full compensation. This, they implied, was insufficient, and even if a reasonable degree of progress were made by the Fund in extending the automatism of drawings in many cases the uncertainty of drawings would, they considered, offer a serious handicap to the object of continuity in development expenditure.

In a UN Secretariat Study (E/CN 13/43) of January 1962 it was calculated:

(a) that for the average primary exporting member of the IMF the average shortfall in export earnings (as compared with the mean of the previous three years' exports) over the period 1953 to 1960 slightly exceeded 50 per cent of its (1961) quota; but that in only half of the countries would drawings of up to 50 per cent of quota have sufficed to offset the average annual shortfall for years in which shortfalls occurred; and

(b) that if each primary exporting member had compensated 100 per cent of its export shortfalls by drawing on the IMF and had used 60 per cent of export excesses for repayment, up to a limit of cumulative net drawings of 50 per cent of quota, primary exporting members could have compensated in this way about one-third of their total shortfalls.

The authors of the study made it clear that their calculations were not intended to reflect on, or measure, the adequacy of the IMF as a means of assisting member countries, since usually reserves and other sources of credit could also be drawn upon and since IMF drawings are not limited to 50 per cent of quota.

The question of the quantitative adequacy of drawing facilities in the IMF to meet the needs for compensatory financing of export fluctuations is one of great difficulty, and no answer can be made to it without the help of many arbitrary suppositions.

(a) In the first place, as is generally recognized, IMF facilities are intended to be used in conjunction with national reserves, and other sources of finance.

(b) Again, account has to be taken of the fact that all these various forms of international liquidity are required to meet payments deficits arising, not only from export shortfalls but also from fluctuations in other items in the balance of payments, notably import fluctuations. These factors are, in fact, rather more important than export shortfalls in the causation of payments deficits. Moreover, reserves cannot safely be run down to zero even to meet the severest drains. On the other hand the various possible causes of deficit are unlikely to exercise their maximum effect simultaneously. On balance, therefore, it may not be unfair to assume, that, say, one third, of the total of potential IMF facilities and national reserves are available for the purpose of financing export fluctuations to the extent that these ought to be financed.

(c) In seeking to measure the probable need for compensatory financing of export shortfalls it is somewhat misleading to measure such shortfalls either from a 5-year moving average centered on the middle year, as was done in "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations" or from a moving average of the preceding three years as was done by the UN Experts and Secretariat, and by the OAS Experts. As has been pointed out in DM/62/20 and DM/62/40 the five year moving average centered on the current year, while it may be considered an "ideal" norm from which to measure export deviations, is not usable in practice since foreknowledge of the exports of future years is necessarily lacking. It would seem desirable, however, that the "practical" norm from which export deviations are measured should be close to this "ideal" norm insofar as the latter can be predicted in the light of existing knowledge. Such a prediction is perhaps best made by the exercise of judgment in the light of all relevant information. If, however, it is decided to define the practical norm by an automatic formula involving the exports of current and previous years the formula, if it is not to diverge unnecessarily from the ideal norm, must give considerable weight to the current year's exports. Moreover, as was argued in "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations" the compensation of fluctuations should, in principle, be partial only. Accordingly a target level of availabilities should be chosen that is somewhat closer to actual exports than is the ideal norm. The result will be to increase still further the weight that should be given to the current year's exports in the calculation of the practical norm, or alternatively--what amounts to the same thing--deviations of actual exports from the practical norm should themselves be compensated only in part.

In Table 1 it has been assumed that drawings on the IMF or drafts on national reserves will be made to cover two thirds of shortfalls of actual exports with respect to a practical export norm defined as an average of exports in present and two previous years, with weights of 50 per cent on the present year and 25 per cent on each of the two previous years. It is assumed that two thirds of export surpluses with respect to this norm are used to repay drawings or reconstitute reserves. In order to ensure that countries with a downward long-term trend in exports do not indefinitely increase their claims on compensatory financing it is assumed that drawings are in any case repaid or drafts on reserves made good in the fourth and fifth year of the drawing. The maximum net cumulative requirements for compensatory financing over the period 1951-61 on these assumptions 1/ are shown for each primary exporting member of the IMF in column (1). They are compared with (A) one third of the country's potential external liquidity, defined as its unused potential drawing facilities with the IMF plus its reserves as of mid-1962 [column (2)] and (B) the member's quota as of the same date [column (3)].

The assumption underlying the use of the quota figure is that the member would be willing to use up to 50 per cent of its quota for the purpose of financing export fluctuations while matching this amount by an equal use of its own reserves.

The difference between the availabilities as indicated under (A) and (B) and the computed requirements are shown in absolute amounts in columns (4) and (5), and expressed in percentages in columns (6) and (7). From

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1/ The assumptions are the same as those underlying Scheme 24 of Table 1 of IM/62/40, a scheme which yields export availabilities considerably closer to target and considerably smoother over time than those of Scheme 1 (the OAS Scheme).

the distribution of "minus" signs in these columns it will be seen that one third of potential external liquidity as of mid-1962 would have been a limiting factor on export compensation in only 8 cases out of 46 1/ and 100 per cent of quota would have been a limiting factor in only 9 cases.2/ Since these two groups partially overlap, 15 member countries would have been limited by one or the other criterion, viz. Argentina, Bolivia, Chile, Colombia, Indonesia, Iran, Iraq, Malaya, Panama, Pakistan, Sudan, Syria, Tunisia, Uruguay and Viet-Nam.

It will be noted that the two measurements approach the problem of the adequacy of the Fund from a somewhat different angle. The first measurement indicates the extent to which individual countries are or were able to meet export fluctuations of a certain assumed size on the basis of the amount of their reserves at a particular moment of time, the size of their Fund quota, and the extent to which this quota had already been used. The second measurement, on the other hand, is related to the quota only, although it assumes that the member will have adequate own reserves to use pari passu with drawings on the Fund. The first measurement would seem to be the more relevant one if one considers the question whether there is a need for supplementary resources for compensatory financing. The second measurement is the more relevant one if the intention is to reconsider the quotas of individual countries from the point of view of their adequacy to meet export fluctuations.

V. Discussion and Appraisal of Alternative Suggestions for Fund Action

In view of the desire that has been expressed that the Fund explore ways in which Fund drawings might be made to serve better the needs of primary producing countries in relation to export fluctuations, a variety of means could be conceived by which these countries could be given larger, or more automatic, access to Fund resources than they now have.

Four categories of measures together with an appraisal of their means are distinguished, namely, those under which:

(1) drawings would be made available automatically on the basis of a statistical criterion of export shortfalls;

(2) drawings would be made available automatically after a decision by the Fund that the country was experiencing balance of payments difficulties atrributable to a temporary cause beyond the control of the member;

1/ Argentina, Bolivia, Chile, Colombia, Haiti, Indonesia, Iran and Syria.
2/ Iran, Iraq, Malaya, Panama, Sudan, Syria, Tunisia, Uruguay and Viet-Nam.

(3) the existing automatic access would be extended over a larger area of the quota than that to which it now applies;

(4) members would be permitted larger access to Fund resources without extending the range of automatism in any of the ways mentioned above.

"Automatism" and "automatic access" as used in this and subsequent sections of this memorandum are convenient terms for referring to the "overwhelming benefit of the doubt" which members receive in respect of "gold tranche" drawings. A member has to represent "need" under Article V, Section 3(a)(i), and this would presumably preclude drawings in cases in which shortfalls were so compensated by other shifts in the balance of payments that there was no actual or prospective payments deficit.

(1) A system might be conceived under which all members, or all primary exporting countries, would be entitled to draw within the gold tranche and the first and second credit tranches, to cover a proportion of export shortfalls from a practical norm based on present and past exports. For reasons expressed in DM/62/20 and DM/62/40 the practical norm should be one giving a substantial weight to the current year. The repayment system of these "compensatory drawings" could be the same as for ordinary Fund drawings, or additional repayments might be made automatically out of export receipts in excess of norm. That is, countries might be obliged to repay each year the greater of the following (a) a given proportion of any export excess, or (b) whatever is due under Article V, Section 7, or under repayment obligations in accordance with the Fund's three to five year policy in the fourth and fifth years.

A scheme of this sort would have little or no effect unless it applied at least through the second credit tranche. In the gold tranche and, in many instances, in the first credit tranche, members with export shortfalls would be in a position and would probably prefer, to make ordinary drawings rather than drawings geared to export proceeds for which repayment provisions might be more onerous than for ordinary drawings.

Any attempt to graft a system of export automatism onto the Fund's normal system of drawings would give rise to difficulty and, probably, confusion. It would run counter to the Fund's policy of relating the granting of its assistance to the adoption of corrective programs wherever such programs are needed. It may also be confusing to the relationship between the Fund and individual members if the latter were entitled in certain circumstances, depending on the outcome of calculations of the type indicated earlier in this paper, to obtain assistance from the Fund without regard to the member's observance of its understandings with the Fund. The problem would also arise of working out a body of rules to decide the manner in which repayments should be allocated as between "compensatory" and "ordinary" drawings.

(2) Drawings related to payments difficulties attributable to causes beyond the control of the member might, up to a specified amount, say one quarter of quota, be excluded from total drawings in the application of tranche policies. That is to say the increasing degree of justification at present required for new drawings as the amount of total drawings outstanding increases would under this scheme apply only to other drawings ("ordinary drawings") and would depend on the outstanding amount of ordinary drawings only. It would be up to the Fund to decide in individual situations whether and to what extent the member's payments difficulties could be considered of temporary external origin and would therefore qualify for drawing of part or whole of this special tranche.

An arrangement of this nature would be less open than the fully automatic arrangement described under (1) to the objection that assistance might be made available in circumstances where, in the Fund's judgment, the deficit was not likely to prove temporary in character. The arrangement would be in line with what the Fund had, on one or two occasions, done in situations that were rather clearly of an emergency nature; and the Fund has, more generally, in the application of its tranche policies taken into account the extent to which member countries were subject to unfavorable export conditions. It would appear preferable, however, not to attempt to turn this flexibility of policy into a rule or procedure, the application of which might, in many instances, raise difficult problems of policy and statistical judgment.

(3) If it were desired to extend the Fund's automatism in general, gold tranche treatment might also be given to drawings in the first credit tranche, and the criteria now applicable to drawings in the first credit tranche might then be transferred to those in the second. This form of "all-purpose automatism" might be confined to members with a record of especially high export fluctuations (judged relative to a centered five year moving average), or to primary exporting countries.

The existing gradations of automatism in the Fund's policies on the use of its resources, as set out at page 7 above, reflect certain broad considerations as to the Fund's relations with its members and its role in the world payments system. To be most effective with its members, the Fund's policies on drawings must neither be so exacting as to turn the Fund into a righteous bystander of history, nor so accommodating as to turn it into an accomplice of inflation. Steering between these extremes, the Fund's present policies allow virtual automatism in the gold tranche, relatively mild criteria for use of the first credit tranche, and increasingly severe criteria for use of higher tranches. It follows from these policies that a country's gold tranche drawing rights on the Fund can for all practical purposes be included in the country's own reserves, whereas access to the Fund beyond the gold tranche represents increasingly "conditional" liquidity.

While the Fund's policies as to the degree of automatism of access to successive tranches are not frozen for all time, any alteration of these policies would call for justification. Experience indicates that many of the less developed primary producing countries have found it difficult to avoid inflation and hold on to their independent reserves (including their automatic drawing rights). From this point of view it would not seem desirable to increase the proportion of quota available on an automatic basis without regard to the cause of the payments deficit or the policies being pursued by the country.

(4) Quota increases might be granted to those countries whose quotas, by reference to appropriate statistical yardsticks, would appear to be insufficient to deal with the export fluctuations that they are likely to encounter.

While any judgment as to the adequacy of quotas is in part dependent on the level of reserves that countries can be expected to maintain, Table 1 would seem to indicate that the quotas of many countries, taken in conjunction with a reasonable use of their own reserves, are at present adequate from this point of view. The quotas of some other countries, however, are rather clearly insufficient to meet the possible need for Fund assistance to deal with export fluctuations.

If the quotas of certain countries were increased, initially only those countries of whose currencies the Fund--both before and after the quota increase--held amounts equal to 75 per cent of quota would secure a pro rata increase in drawing facilities in all tranches. Countries with substantial drawings outstanding would initially receive additional drawing facilities in the higher tranches. However, on completion of repurchases they also would benefit from a proportionate increase in gold and early credit tranches. On the other hand, those receiving the increased quotas would be obliged to subscribe one quarter of the increase in gold, unless special arrangements were to reduce or postpone this burden.

Quota increases would help the countries concerned to meet more effectively payments difficulties of whatever nature, and not only those arising from export fluctuations. The need for quota increases would, therefore, have to take into account evidence other than that provided by Table 1 as well.

A result somewhat similar to quota increases could be achieved by a general policy decision on the part of the Fund to raise the limit, in terms of percentage of quota, of the extent to which the Fund would be willing to grant assistance to a certain group of members, e.g., those whose quotas had been judged to be particularly low. This limit is now 125 per cent of the member's quota and the figure of 100 per cent of a member's quota has been exceeded in a few exceptional cases only. The Fund has the legal power to waive this limitation. To raise it by 25 per cent of quota is in some respect equivalent to a quota increase of one-fourth. One disadvantage of proceeding by this route rather than that of quota increases in appropriate cases would be that the latter procedure makes it more feasible to take into account the divergence in the adequacy of present quotas. The two methods mentioned differ in a number of other respects too: quota increases provide increased drawing rights over the entire unused range of the quota, and hence in general on less stringent conditions and at a lower interest cost to the member. As against this, quota increases have normally required gold payment to the Fund. They also have an impact on members' voting and other rights and privileges.

It is a basic principle of the Fund mechanism that countries' quotas in the Fund are adjusted from time to time in the light of recent information on a country's need to use the Fund's resources and, in particular as regards the industrial countries, of its ability to contribute resources to the Fund. The Articles of Agreement provide for a quinquennial review of quotas (Article III, Section 2). The next such review is to take place in 1965.

In 1958, the Fund initiated a large scale increase in quotas which was not completed until well into 1959. As a general rule, quotas were increased by 50 per cent but there were many instances of larger increases. Countries with small quotas were given the option of requesting increases well above 50 per cent, and many primary producing countries with large quotas also received increases of up to 100 per cent of their previous quotas. Since that time the Fund has approved a number of requests for further quota increases.

In recent weeks the staff has, at the request of the Board, undertaken a statistical analysis of the relative adequacy of the quotas of the less developed countries, in particular those with small quotas (SM/62/95). In considering that information the Board will no doubt also want to take into account the data prepared by the staff on the adequacy of countries' access to the Fund from the point of view of export fluctuations, as provided in this memorandum.

VI. Comparison of New Proposals for Compensatory Financing with Possible Action by the Fund

Of the two schemes for setting up new compensatory institutions that have been suggested by expert groups, the Development Insurance Fund suggested by the UN Expert Group involves not only loans, but also grants, viz. insofar as insurance receipts of countries with relatively large shortfalls exceed the premiums paid by them, or insofar as contingent loans are cancelled when, because of a downward medium-term trend in export receipts, they have remained outstanding for a number of years. These features of the DIF scheme have no counterpart in anything the IMF could do with its own resources, and there is therefore no basis to compare a grant scheme with an expansion of the facilities provided by the Fund.

Such an expansion in Fund facilities can, however, be compared with proposals designed to provide facilities for compensatory financing on a repayable basis. While it is possible to construct, among the many variants of the DIF scheme, a scheme that would contain no grant element, it is probably more illuminating to make a comparison between the Fund on the one hand and the OAS scheme on the other hand. It may be sufficient to compare a number of the salient aspects, without attempting to cover in full all aspects of Fund transactions or all details of the present OAS proposal.

(a) Access to resources. Fund resources are available for balance of payments deficits arising from a broad variety of circumstances provided the Fund is satisfied that the member's policies are such as to give the Fund the assurance, in accordance with the Fund's tranche policy as set out above, that the member's use of the Fund will be temporary. In the OAS plan, access is limited to cases of export shortfalls below the statistical norm; in these circumstances access is automatic except that the proposal contains a procedure for suspending the right of access.

(b) Repayment. In the Fund, repayment is related to increases in a country's reserves, with an outside limit of three to five years. In the OAS proposal, repayment is related to the performance of exports compared to their norm, with repayment in any event in the fourth and fifth year.

(c) Contribution by underdeveloped countries. Quota increases in the Fund normally require a gold contribution of 25 per cent of the quota increase. In the OAS proposal the underdeveloped countries are expected to contribute one-third of the total resources put up.

(d) Contribution by developed countries. The OAS plan envisages a contribution from the developed countries in the order of magnitude of $1 billion. While initially much of this money would be made available on a stand-by basis only and would therefore not accrue to the less developed countries, it would no doubt prove necessary to seek legislative approval in the contributing developed countries for the full amount. A moderate increase in the drawing facilities of the less developed countries in the Fund would probably not at present require quota increases from the developed countries. The fact that action through the existing machinery of the Fund would not have legislative implications for the developed countries at this time might make it easier for them to obtain parliamentary approval for other measures aimed at giving aid to the less developed countries.

VII. Staff Recommendations

It is recommended that the Fund convey the following observations as the conclusions of its Report.

(1) One of the important functions of the Fund is to provide to its members compensatory financing for export fluctuations. The quotas of many countries, taken in conjunction with a reasonable use of their own reserves, are at present adequate from this point of view, and there is room for members to make an increased use of the Fund for financing balance of payments deficits arising from export shortfalls. Within the framework of the present Fund's policies, with their desirable balance between automatic and conditional access to the Fund's resources, increased use could be made of the Fund's resources where necessary, for instance by a more extensive use of stand-by arrangements. In addition, the adjustment of quotas could be considered in those cases where it was justified by the application of appropriate tests.

(2) The Fund is now examining the quotas of the primary producing countries, many of which are in the group of countries with small quotas, in order to determine whether adjustments would be desirable to make these quotas more uniformly adequate to meet each country's needs in connection with export fluctuations as well as other balance of payments fluctuations.

(3) Increased action by the Fund in the field of compensatory financing, whatever its form, will channel additional resources to the primary exporting countries on a temporary basis. Any other arrangement to provide additional resources on a loan basis would inevitably be similar in many respects to Fund drawings and repurchases. It would, therefore, in the opinion of the Fund, be preferable to provide such additional resources through the Fund, so that whatever were the Fund's policies from time to time on the use of its resources would apply to the Fund's total resources as thus enlarged. This was the procedure followed when, under the Fund's General Borrowing Arrangements, additional resources were marshalled "to forestall or cope with an impairment of the international monetary system."

(4) For the reasons indicated above, it would not be desirable to arrange in the Fund, with the use of the Fund's resources, automatic compensatory financing of export fluctuations, with loans and repayments determined on the basis of a formula. If it were desired to provide such automatic compensatory financing, either on a loan basis or on an initial or contingent grant basis, it might be advisable to establish a separate international agency for this purpose with its own resources. The Fund should be willing to accept the affiliation of such an agency, if the countries establishing it were to decide that affiliation with the Fund would ensure the most effective and economical operation of the agency.

Table 1. Adequacy of External Liquidity to Finance Export Fluctuations

	Max. Financial Requirements Indicated by 1951-61 Experience 1/	Available by Using (A) 2/ 1/3 of External Liquidity	Available by Using (B) 3/ Total Fund Quota	Excesses or Deficiencies (-) in Available Financing: In Million US $ (A) (2)-(1)	In Million US $ (B) (3)-(1)	In % of Requirements (A) (4) as % of (1)	In % of Requirements (B) (5) as % of (1)
	<---------- (Millions of U.S. dollars)				----------->		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Argentina	192.3	101.3	280.0	-91.0	87.7	-47	46
Bolivia	18.8	9.1	22.5	-9.7	3.7	-52	20
Brazil	130.8	206.6	280.0	75.8	149.2	58	114
Burma	20.5	56.5	30.0	36.0	9.5	176	46
Ceylon	25.8	42.6	45.0	16.8	19.2	65	74
Chile	54.8	35.0	100.0	-19.8	45.2	-36	82
Colombia	79.5	66.7	100.0	-12.8	20.5	-16	26
Costa Rica	5.8	10.9	15.0	5.1	9.2	88	159
Cyprus	4.5	7.5	11.2	3.0	6.7	67	149
Dom.Republic	8.3	11.9	15.0	3.6	6.7	43	81
Ecuador	5.8	13.8	15.0	8.0	9.2	136	159
El Salvador	7.8	15.4	11.2	7.6	3.4	97	44
Egypt	77.8	77.9	90.0	0.1	12.2	0	16
Ethiopia	4.7	29.6	13.2 4/	24.9	8.5	530	181
Ghana	21.8	75.4	35.0	53.6	13.2	246	61
Greece	12.3	116.7	60.0	104.4	47.7	849	388
Guatemala	5.7	22.5	15.0	16.8	9.3	295	163
Haiti	7.3	5.3	11.2	-2.0	3.9	-27	53
Honduras	7.0	7.9	11.2	0.9	4.2	13	60
India	148.0	305.6	600.0	157.6	452.0	106	305
Indonesia	134.8	89.9	165.0	-44.9	30.2	-33	22
Iran	289.7	96.4	70.0	-193.3	-219.7	-67	-76
Iraq	54.7	56.0	15.0	1.3	-39.7	2	-73
Jordan	2.7	20.8	8.0 4/	18.1	5.3	670	196
Korea	8.1	72.5	18.8	64.4	10.7	795	132
Lebanon	3.3	64.1	6.8	60.8	3.5	1,842	106
Libya	1.7	36.3	11.0 4/	34.6	9.3	2,035	547
Malaya	246.0	290.0	32.5 4/	44.0	-213.5	18	-87
Mexico	60.2	185.6	180.0	125.4	119.8	208	199
Morocco	2.8	81.2	52.5	78.4	49.7	2,800	1,775
Nicaragua	3.4	12.9	11.2	9.5	7.8	279	229
Nigeria	15.8	80.0	50.0	64.2	34.2	406	216
Pakistan	143.0	142.1	150.0	-0.9	7.0	-1	5
Panama	1.8	10.3	.5	8.5	-1.3	472	-72
Paraguay	4.0	5.0	11.2	1.0	7.2	25	180
Peru	11.0	42.2	32.5 4/	31.2	21.5	284	195
Philippines	15.2	46.7	75.0	31.5	59.8	207	393
Saudi Arabia	4.2	114.3	55.0	110.1	50.8	2,621	1,209
Sudan	32.8	63.9	15.0	31.1	-17.8	95	-54
Syria	28.2	9.2	15.0	-19.0	-13.2	-67	-47
Thailand	24.8	175.7	45.0	150.9	20.2	608	81
Tunisia	18.8	31.3	18.3 4/	12.5	-0.5	66	-3
Turkey	51.3	85.9	86.0	34.6	34.7	67	68
Uruguay	60.3	82.8	30.0	22.5	-30.3	37	-50
Venezuela	0	229.5	150.0	229.5	150.0		
Viet-Nam	34.7	60.4	18.5 4/	25.7	-16.2	74	-47
Yugoslavia	9.0	36.3	120.0	27.3	111.0	303	1,233
Total	2,101.6	3,439.5	3,203.3	1,337.9	1,101.7	64	52

1/ As described on page 12 of text.

2/ Alternative (A) measures amounts available as 1/3 of the country's gold and foreign exchange reserves as of mid-1962 plus 1/3 of its total tranche position in the Fund as of the same date. A country's total tranche position is the amount that it could draw, if its justification were sufficient, without increasing the Fund's holdings of its currency above 200 per cent of its quota.

3/ Alternative (B) measures amounts available by Fund quotas as of mid-1962, on the assumption that the member uses half its quota matched by an equal amount drawn from its own reserves.

4/ Quotas to be increased by annual installments, as follows: Ethiopia to $15 million; Jordan to $11.25 million; Libya to $15 million; Malaya to $37.5 million; Peru to $37.5 million; Tunisia to $22.5 million; and Viet-Nam to $22.5 million.

1) [illegible] [illegible]
Cong. King

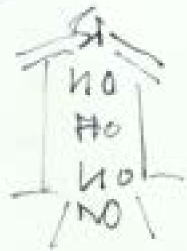
2) Gold : [illegible] Cuba

3) hello company

4) [illegible] [illegible]

5) go down to see Walter [illegible]

Send [illegible] see gin?



NOW

NEIN
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Mr. Del Canto

Kie

October 31, 1962

MEMORANDUM

TO: The Managing Director

FROM: J. J. Polak

SUBJECT: Compensatory Financing and Quota Increases

I attach two memoranda prepared in this department for transmission to the Executive Board. The first memorandum deals with compensatory financing and is intended to form the basis, after Board discussion, for a report from the Fund to the Commission on International Commodity Trade on the Fund's action in the field of, and attitude towards, the compensatory financing question.

The report analyzes the issues, presents strong arguments against mixing automatic compensatory financing techniques with the Fund's tranche policies and, as a result of a statistical analysis, comes out in favor of selective quota increases.

The quota paper consists mainly of some simple tables comparing present quotas with various yardsticks. It focuses mainly on the countries with small quotas but presents data for other countries for reasons of comparison. The evidence presented in this paper also points strongly towards selective quota increases. Any system of proportionate increases, whether it were limited to the small quotas or not, would tend to perpetuate the very real discrepancies in the adequacy of present quotas.

The two papers thus point essentially to the same conclusion and it would be helpful if they went to the Board at about the same time and if the Board considered one issue in connection with the other.

I also attach a brief memorandum from Mr. Altman bringing the conclusions of the two papers together. It shows that the countries appear to have inadequate quotas from the compensatory financing point of view would be among the ones that show up with unusually low quotas in the quota paper.

Attachments

cc: Deputy Managing Director
Mr. Southard
Mr. Gold
Mr. Friedman
Area Department Heads

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

Mr. Jorge Del Canto

Room 807

(1) #7

DM/62/40

INTERNATIONAL MONETARY FUND

Research and Statistics Department

Statistical Testing of Alternative Schemes of Compensatory Financing

October 22, 1962

The object of this paper is to apply certain statistical tests and measurements to the scheme for an "International Fund for Stabilization of Export Receipts" prepared by an Expert Group of the Organization of American States, and to 136 alternative schemes arrived at by applying quantitative or qualitative variations to one or more of the features of the OAS scheme and thereby to contribute to a general understanding of the working of compensatory mechanisms. With the aid of an electronic computer, the schemes in question have been applied to the export movements of 48 primary producing countries over the period 1951-1961 inclusive. The results of the tests and measurements are presented in Table 1, and analyzed in subsequent Tables.

Description of Tests and Measurements

The principal test applied is a measure of the closeness of fit of export availabilities, under whatever scheme is in question, to a target level of such availabilities, as compared with the closeness of fit of such availabilities to the target level in the absence of any compensatory scheme. By "export availabilities" is meant the actual value of exports plus any borrowings permitted, less any repayments required, under the scheme. In the absence of any scheme, availabilities will, of course, equal actual exports. The test is, in fact, a ratio of the standard percentage deviation of actual from target export availabilities for all years and countries, to the standard percentage deviation of actual exports from the same target, and is described as a "target deviation ratio."1/ For any given country and year the five year moving average of the country's exports, centered on the year in question, is taken as the "ideal export norm."2/ The target level of export availabilities for that country and year is a figure that lies between the actual exports and the ideal norm in such a way as to diverge

1/ Since these standard deviations cannot be calculated for 1960 and 1961, the deviation ratios shown at column 8 and 9 of Table 1 apply only to the nine years 1951 to 1959.

2/ C.f. DM/62/20, p. 2.

from actual exports by two thirds, and from the ideal norm by one third, of the difference between actual exports and the norm. The thought underlying this definition of target availabilities is that variations in actual exports carry with them inevitably certain variations in the need, and effective demand, for imports. For this reason, the degree of compensation aimed at should be only partial. The target chosen for export availabilities represents an attempt to compensate two thirds of the deviations of actual exports from the ideal export norm. A fuller discussion of the considerations underlying the degree of compensation arrived at is given at Appendix A.

Target deviation ratios based on a target compensation of two thirds are shown at column 8 of Table 1. Column 9 of Table 1 shows deviation ratios with respect to a target level of export availabilities that coincides with the ideal norm or five year moving average. These deviation ratios, based on a target compensation of 100 per cent, are shown merely for purposes of comparison with column 8.

It may be asked why the target level of availabilities for any year should be based on a five year moving average centered on that year. There is, of course, something arbitrary about any such norm. However, a centered five year moving average provides as fair a version as can be found of what most people would regard as the medium-term trend of exports and effects a reasonable smoothing out of short-term fluctuations. The inclusion in the average of exports of years following, as well as of those preceding, the year in question is the only way to ensure an appropriate equality of surpluses and deficits with respect to the norm, which would appear to be desirable if compensatory receipts based on deficits are to be balanced by compensatory repayments based on surpluses. The inclusion of five rather than any other number of years in the average thus centered appears to bring about an approximate balance of deficits and surpluses within the sort of period--three to five years--that might be considered appropriate for the purpose of compensatory lending.

The degree of approximation of actual to target export availabilities does not, however, supply a fully satisfactory criterion of the excellence of a compensation scheme. As is pointed out below, movements in all the norms that are in practice available for the purpose of defining compensable export deviations, based as they necessarily are on formulae relating to past and present years' exports only, tend to lag behind the movements in the ideal norm. For this reason, movements in actual availabilities under the various schemes also tend to lag behind movements in target availabilities. Changes in the schemes whereby availabilities are made to conform more closely to the timing of target availabilities well beyond a certain point involve some diminution in the smoothness of the actual availabilities. A certain degree of smoothing out of availabilities, however, is part of what is sought in a compensation scheme. Therefore in column 11 of Table 1 a measure of the "smoothness" of availabilities, relative to the need for availabilities, has been supplied to provide an auxiliary, though subordinate, criterion of excellence to that provided by the target deviation ratio.

This "smoothness ratio," as the measure in question might be called, consists in the standard percentage deviation of actual availabilities from a centered five year moving average of availabilities (corrected for the deviation of the target availabilities from the ideal norm), divided by the standard percentage deviation of exports from the ideal norm (similarly corrected).1/

In addition to these tests of closeness of fit, data are presented in column 12 of Table 1 showing the maximum total indebtedness of borrowing countries in the aggregate outstanding at the end of any year from 1951 to 1961 under the various schemes. Since the maxima in 1953 or 1954 reflect the rather abnormal conditions prevailing in the early years of the period--when exports were falling after the post-Korean boom--and since by these dates the repayment features of some of the schemes had not yet had time to exercise their effect on total indebtedness, data are also given in column 13 regarding the amount of total indebtedness outstanding under each scheme at the end of 1958, a year when indebtedness under most schemes was at its second highest level, and under some schemes at its highest level.

1/ The formula for the smoothness ratio is as follows:

$$\sqrt{\frac{\sum_{r=1}^{s}\left(\frac{a_r - m_r}{n_r}\right)^2}{\sum_{r=1}^{s}\left(\frac{x_r - m_r}{n_r}\right)^2}}$$

where a represents the deviation of availabilities from the centered five year moving average of availabilities, x the deviation of exports from the centered five year moving average of exports, m the deviation of target availabilities (based on a target compensation of two thirds) from the ideal export norm, n the ideal export norm, r the country-year in question, and s the number of countries times the number of years included in the calculation. Since a cannot be calculated for 1951 or 1952, the smoothness ratios shown at column 11 of Table 1 apply only to the seven years 1953 to 1959.

Nature of the ~~Sc~~hemes Examined

All the schemes examined are based on the OAS proposal for an International Fund for Stabilization of Export Receipts, in the sense that each scheme shares all features of the OAS proposal other than those explicitly mentioned in Table 1; with respect to the latter it may or may not differ from that proposal. It is assumed that the reader is familiar with the OAS proposal, which appears as Scheme No. 1 in Table 1.1/

Three features of the OAS Scheme have been subjected to variation;

(a) the weights assigned to the current and previous years in determining the current year's export norm, deviations from which on the part of actual current exports define the entitlement of each Category A country to borrow from, or its obligation to repay indebtedness to, the Stabilization Fund,2/

(b) the proportion which each country's maximum permitted cumulative indebtedness under the scheme bears to the amount of its average exports over the three preceding years, and

(c) the provisions governing the repayment of indebtedness under the scheme.

As regards (a), the OAS Scheme calculates the (practical) export norm for any year as an arithmetic mean of actual exports in the three preceding years. Alternative assumptions are made in Table 1, under which the present year is introduced into the norm and given a weight of one third, 45 per cent, 50 per cent, 55 per cent, 60 per cent, 65 per cent, 70 per cent and 75 per cent, respectively, the first and second preceding years being given equal or approximately equal weights (which necessarily decline as the weight given to the current year increases). It will be observed that the weights in all cases sum to 100 per cent. This is not a necessary feature of the weighting system. Indeed, a very slightly closer approximation to target availabilities might have been obtained had the weights been allowed to sum to 101 per cent so as to allow for the general upward trend in export receipts over the period in question. It was found, however, that this improvement in fit was obtained at the cost of a disproportionately large increase in the maximum outstanding indebtedness, resulting from the increased entitlement to borrow combined with the diminished obligation to repay, and it was decided to discard schemes involving weights exceeding 100 per cent.

1/ Report on Meetings and Proposals of Group of Experts of the Organization of American States on the Stabilization of Export Receipts, SM/62/33.

2/ Such "practical" export norms, used in the actual operation of the compensation schemes, are to be distinguished from the "ideal" norm (e.g., in the form of a five year moving average centered on the current year) on which is based the "target" in terms of which the schemes are evaluated.

In general, it has been assumed that borrowings and repayments, insofar as they are automatic, and subject to the limits imposed, constitute two thirds of any shortfalls or excesses of actual exports as compared with the export norm as determined by the various weighting systems mentioned above. In other words, the compensation ratio applicable to deviations from the "practical" norm has been kept at two thirds as in the original OAS Scheme. So long as the compensation ratio applies equally to surpluses and deficits there is no point in varying it experimentally, since the effects of a change in the compensation ratio are exactly the same as those of a change in the weight assigned to the current year, as compared with other years, in the determination of the export norm. Thus it makes no difference to either borrowings or repayments whether the weights assigned to the present and two preceding years' exports in the formula determining the practical export norm are 0, 40 per cent and 60 per cent with a compensation ratio of 40 per cent, or if the weights are 50 per cent, 20 per cent and 30 per cent with a compensation ratio of 80 per cent or if the weights are 60 per cent, 16 per cent and 24 per cent, with a compensation ratio of 100 per cent.1/ The higher the compensation ratio the higher must be the weight assigned to the current year in the determination of the practical norm.

In some ways it might be more elegant to assume a compensation ratio of 100 per cent in all schemes and adjust the weight in the current year accordingly, or to assume a zero weight on the current year's exports in all schemes and adjust the compensation ratio accordingly. However, to assume a two thirds compensation ratio has the advantage not only of facilitating comparison with the OAS Scheme, which had such a ratio, but also of corresponding to the target degree of compensation of two thirds (with respect to deviations from the ideal norm) that is implicit in the definition of the target level of availabilities. Roughly speaking, we may say that the partial compensation with respect to export deviations from the practical norm provided in the compensation ratio reflects the partial compensation with respect to deviations from the ideal norm aimed at in the target availabilities, while the weight assigned to the current year in the practical norm affects the extent to which the latter approximates the ideal norm.

In certain schemes, while the borrowing ratio has been kept at two thirds, the repayment ratio has been assumed to be 100 per cent.

1/ More generally, it makes no difference to either borrowings or repayments whether there are weights on the present and two preceding years of a, b, and c, respectively, with a compensation ratio of x, or weights of $x(a-1) + 1$, xb, and xc respectively, with a compensation ratio of unity, or, again, weights of zero, $\frac{b}{1-a}$, and $\frac{c}{1-a}$ respectively, with a compensation ratio of $x(1-a)$.

As regards (b), the limit of the cumulative indebtedness beyond which a country is not permitted to contract new indebtedness under the OAS Scheme is 20 per cent of average exports over the preceding three years. One set of alternative scheme has also been examined under which the limit is one third of such average exports and another in which there is no limit.

As regards (c), six alternative repayment systems have been considered:

(1) R.S. 1 is based on an interpretation of the Articles of Agreement of the International Fund for Stabilization of Export Receipts (the OAS Scheme). All borrowings are assumed to take place (in the form of interim credits) in the calendar year for which the borrowing entitlements accrue. Automatic repayments on stabilization credits are likewise assumed to take place--or are treated as if they took place--in the calendar year for which the repayment obligation accrues, the earliest stabilization credits being repaid first. Such part of any stabilization credit as remains unpaid in the first and second calendar year following the year in which the borrowing took place, is assumed to be converted into a deferred credit in the course of the third calendar year, and in that year no repayment, automatic or otherwise, takes place with respect to those credits, though if there have been later stabilization credits any automatic repayment obligations will be applied to them. Deferred credits are repaid in two equal installments occurring in the fourth and fifth calendar years after the orignal borrowing.

(2) R.S. 2 is the same as R.S. 1, except that stabilization credits are not converted into deferred credits until the end of the third calendar year following the year in which and with respect to which the borrowing took place. Automatic repayment obligations are applied to the repayment of outstanding credits in the third, as well as the first and second calendar years following the year of borrowing, and only what remains unpaid at the end of the third calendar year is repaid in installments in the fourth and fifth years. (This is thought to be what the authors of the OAS plan intended to achieve.) Total repayment in any year then equals the total amount of any five year old (deferred) credits outstanding, plus half the amount of any four year old (deferred) credits outstanding plus <u>either</u> the maximum automatic repayment obligation (two thirds of the export excess) <u>or</u> the total amount of stabilization credits outstanding, whichever is the less.

(3) R.S. 3 is the same as R.S. 2, except that automatic repayment obligations are applied, in the first instance, to the repayment of any four year old (deferred) credits before being applied to the repayment of any subsequent (stabilization) credits. Compulsory repayments are made on any five year old (deferred) credits and also any four year old (deferred) credits to the extent that less than one half of the latter has been repaid out of automatic repayments. Total repayments in any year will equal total outstanding five year old deferred credits, plus an amount that equals the maximum automatic repayment obligation, save that it may not fall short of half the amount of four year old deferred credits outstanding nor exceed the total amount of credit outstanding of a maturity of four years or less.

(4) R.S. 4 is the same as R.S. 2, except that stabilization credits are not converted into deferred credits until the end of the fourth calendar year following the year of borrowing, and that the amounts so converted are repaid in two equal installments in the fifth and sixth years. The amount repaid in any year will then be all of any six year old credits, half of any five year old credits and an amount equal to either the maximum automatic repayment obligation or the total stabilization credits outstanding (four years old or less) whichever is the less.

(5) R.S. 5 is an entirely automatic system of repayment without any compulsory repayments. But while borrowing entitlements amount to only two thirds of any export shortfalls, repayment obligations amount to 100 per cent of any export excesses. Repayments are applied to outstanding credits in the order in which they were contracted.

(6) R.S. 6 is the same as R.S. 5, except that repayment obligations amount to only two thirds of any export excesses.

Evaluation of Schemes

The results presented in Table 1 and subsequent Tables relate to the performance of the various schemes considered, for all countries taken together or in the average country. This synoptic view enables us to reach broad conclusions regarding the effects of varying certain features of the compensatory arrangements though a close appraisal of the schemes would call for an examination of the results country by country. The following appear to be the main conclusions to be drawn from the Tables.

(1) The extent to which any of the schemes bring export availabilities closer to target is limited. This would be true even if the target had aimed at a 100 per cent compensation, rather than a two thirds compensation, of deviations from the ideal norm: the deviation ratios with respect to the two targets are indeed rather similar in order of magnitude. Some of the variants examined have deviation ratios in excess of unity, showing that availabilities under these schemes deviate from target more than do actual exports, i.e., more than availabilities in the absence of any scheme whatsoever. The deviation ratio of the OAS Scheme as drafted (Scheme No. 1) is as high as .92 and the lowest deviation ratio for any scheme is no lower than .77. This implies that only 23 per cent of the deviations of actual exports from target availabilities would be cut out by the scheme in question (Scheme No. 132). These figures, however, may give too negative an impression. It should be borne in mind that none of the schemes purport to do anything to improve export availabilities during years where there are neither automatic borrowing entitlements nor repayment obligations--e.g., in years of generally rising exports prior to any shortfalls. Roughly, 40 per cent of all country-years fall in this category. A deviation ratio corrected for this factor can be roughly estimated by taking one and two thirds of the deviation ratio as given in the Table and subtracting two thirds. The corrected deviation ratio for the OAS Scheme would then amount to .86 and that for the scheme with the

lowest ratio would be .62 (implying that, in those years for which the schemes affect the level of availabilities at all, some 38 per cent of deviations from target are eliminated).

(2) All the schemes examined enhance the smoothness of export availabilities. This follows from the fact that all the smoothness ratios are below unity. The smoothness ratios vary from almost .87 in the OAS Scheme as drafted (Scheme No. 1) to .66 (Scheme No. 129). In the latter case, deviations in availabilities from their own moving average are reduced by one third for all country-years, i.e., by more than one half for those country-years for which the schemes affect the level of availabilities at all.

(3) The schemes examined vary considerably with respect to the maximum total indebtedness involved, from $2,770 million in the case of Scheme No. 129 to $590 million in the case of Scheme No. 92. A similar range between the different schemes is found with respect to the 1958 peak of indebtedness. There is no clear inverse correlation, as one might at first sight expect, between the expensiveness of a scheme and the extent to which it achieves a close approximation to target. On the contrary, by and large, the more expensive schemes are further from target than the less expensive. It will be possible to get a closer insight into this relationship after the effects of varying specific features of the schemes have been examined. As has already been observed, the maximum level of indebtedness occurs in most schemes in 1953 or 1954, because of the heavy borrowing in 1952 and 1953. In these schemes, there is a secondary peak in 1958. In some schemes, however, the 1958 peak is the absolute maximum.

(4) Perhaps the most striking of the conclusions which emerge from a perusal of Table 1 is the extent to which the inclusion of a weight for the current year in the formula determining the practical export norm, and the raising of that weight, not only reduce the volume of outstanding indebtedness occasioned by the scheme, but also, up to a point, improve the fit of actual to target availabilities. It is noteworthy that these effects appear whatever the degree of limitation on each country's cumulative indebtedness and whatever the repayment system adopted, though as can be seen from Table 2, they are more pronounced where the limits on indebtedness are wide than where they are narrow. There is, of course, some weight for the current year's exports that permits the closest approximation of actual to target availabilities. (If the weight on the current year were to rise to 100 per cent there would, in effect, be no compensation at all and the deviation ratio would rise to unity.) The level of this weight can only be determined by trial and error; it depends to some extent on the other features of the scheme. It appears to be higher for schemes with low debt limits and compulsory repayments than for schemes without such limits and such repayments. Naturally, too, it is higher the nearer target availabilities are to actual exports, e.g., higher for our target that seeks to compensate two thirds of export deviations from the ideal norm, than it would for a target incorporating the aim of 100 per cent compensation. In almost all cases, however, the weight for the current year's export that gives the closest approximation of actual to target availabilities is to be found within the range from 50 per cent to 75 per cent. When it is borne in mind that after the practical norm

has been determined only two-thirds of any deviations are subject to compensation it will be clear that, in the schemes that best approximate target availabilities, actual availabilities will fluctuate to a very considerable extent with exports. In such schemes the peak level of total indebtedness is generally less than $1,200 million.

The reason why "optimal" weights for current exports are so large is partly because, as was shown in a previous paper,1/ a considerable weight in any formula for determining a practical norm on the basis of past and current data only has to be given to the current year's exports if that norm is to approximate as closely as possible a moving average centered on the current year, and partly because, for schemes that involve debt limits and compulsory repayments, any addition to the weight on the current year reduces the importance of these restrictive factors, and the irregularities in the flow of export availabilities to which they give rise. Thus, for example, a high weight on the current year, by reducing the amount of compensation paid during a year of shortfall, may reduce the compulsory repayments that will be necessary four or five years later, which may also be years of shortfall, or may make it possible to compensate later severe shortfalls that would otherwise have had to remain uncompensated owing to the operation of the limit. Broadly speaking a 50 per cent weight on the current year is necessary to make the practical norm a good predictor of the ideal norm; higher weights are rendered desirable only by the need to mitigate the consequences of the limit and compulsory repayments.

The circumstance that the deviation ratio is more sensitive to changes in the weight assigned to the current year when debt limits are low than when they are high or non-existent is associated with the fact, discussed below, that such limits tend to improve the fit when the weight on the current year is low and to worsen it when that weight is high.

(5) The effect of the weighting system on smoothness of availabilities is different from its effect on the closeness of availabilities to target. Broadly speaking, among schemes that are without limits on indebtedness or compulsory repayments the smoothness of availabilities will be the higher the greater the number of years' exports entering into the formula for the

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1/ DM/62/20, "A Comparison of Formulae for Determining Export Norms," by J. Marcus Fleming, R. R. Rhomberg and Lorette Boissonneault.

practical norm and the more equal the weights assigned to these years.1/ Among schemes that involve both limits and compulsory repayments, however, those resulting in the smoothest trend of availabilities have fairly high weights (one third or one half) on the current year--though not so high as the weights of the schemes that show the best fit of availabilities with respect to target. The effect, therefore, of introducing smoothness as an auxiliary criterion of the relative excellence of schemes will be slightly--but only slightly--to reduce the optimal weight attached to the exports of the current year in the determination of the practical norm, as compared with what it would have been on the criterion of closeness to target alone.

(6) Repayment systems have been arranged in Table 1 in order of diminishing reliance on compulsory repayments and increasing reliance on automatic repayments. Broadly speaking, it can be said that the greater the reliance on automatic and the less on compulsory repayments the more closely will actual availabilities approximate to target availabilities (and the greater will be the smoothness of the availabilities) but the larger also will be the maximum levels of aggregate indebtedness and hence the amount of resources required by the scheme.2/ The data shown in column 8 of Table 1, on the one hand, and column 12 on the other, understate the influence that variations in the automaticity of the repayment system are likely to exercise in the longer run on the deviation ratio and on the maximum aggregate indebtedness, respectively. The influence on the deviation ratio is understated because for the first four years of the nine year period under examination no deferred payments could occur under any of the repayment systems and therefore no difference could appear in the availabilities arising under the different repayments systems with the exception of R.S. 5 (where automatic repayments amount to 100 per cent of export excesses, as compared with 66 per cent in other schemes). For this reason column 10 has been added to the table showing the average deviation ratios under the various schemes for the years 1955-59 only, though the shortness of the period makes for some irregularity

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1/ It is not clear why the smoothness of availabilities under scheme 129 is greater than under scheme 130. One would have expected approximate equality in the smoothness ratios in the two cases.

2/ From column 12 of Table 1 R. S. appears to involve lower aggregate indebtedness than R.S. 4. This, however, is because of the atypical character of maxima occurring in 1953 and 1954 which took place too early in the period to be affected by compulsory repayments under any scheme. In 1958, the year of the secondary maximum under both schemes, R.S. 5 involves higher aggregate indebtedness than does R.S. 4.

in the results. The influence of repayment systems on the maximum amount of outstanding indebtedness has likewise been understated because for many of the schemes the maximum indebtedness occurs in the year 1954, at a time when--except for R.S. 5--the influence of the differences between the repayment systems had not yet come into play. A sounder idea of the importance of this influence can be obtained by noting the difference that a change in the repayment system makes not to the highest aggregate level of indebtedness but to the level of indebtedness in 1958 which for some schemes is the highest and for others the second highest.

As can be seen from Table 3 the influence of the degree of automatism of the repayment system both on the fit of actual to target availabilities and on the level of aggregate indebtedness will be the greater the wider are the country debt limits, and--where debt limits are wide or non-existent1/--the less is the weight assigned to the current year's exports in the determination of the export norm. Both wide limits and low weights on the current year tend to increase the amounts borrowed and the amounts due for repayment, and thus give the repayment mechanism greater scope to exercise its influence on aggregate indebtedness. Inasmuch as automatism tends to improve the fit of availabilities it is natural that whatever gives automatism a greater quantitative effect on repayments will also enhance its beneficial effect on the fit.

(7) The widening, or removal, of the limits on the indebtedness of individual countries always has the effect of increasing the aggregate amount of indebtedness contracted at peak years (Table 4B). This effect is much more important when the weight assigned to the current year's exports in the definition of the practical norm is low than when it is high, since a high weight on the current year itself tends to keep the indebtedness of individual countries from attaining the limits. The effect of widening the limits is also more important when repayment is on a more automatic than when it is on a less automatic basis.

The effect of varying the limits on the fit of actual to target availabilities cannot be expressed so simply (Table 4A). When the weight assigned to the current year's exports in the determination of the practical norm is high (45 per cent and upwards) a widening of the limits tends to improve the fit. When no weight at all is assigned to the current year's exports, a widening of the limits markedly worsens the fit, to the point at which availabilities diverge more from the target than do unadjusted exports. Where a weight of one third is assigned to current year's exports

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1/ Where debt limits are narrow the influence exercised by the weighting of the present year on the effectiveness of automaticity is not uniform.

the influence of the limits is doubtful. A complete removal of all limits produces a better fit than either a 20 per cent or a 33 per cent limit but an expansion of the limit from 20 per cent to one third will be clearly beneficial only where the repayment system is entirely automatic. The conclusion is that, when current year's exports receive a low weight the norm is so distorted that it is better, as well as cheaper, to have a limit on each country's indebtedness.

This conclusion is slightly modified when account is taken of the effect on smoothness of availabilities. Expansion of the debt limit fairly generally tends to increase smoothness; but even here, for schemes on which the current years exports receive a zero weight in the definition of the practical norm a widening of the limit from 20 per cent to one third tends rather to reduce than to increase smoothness.

(8) It would seem of interest to extract from the set of 137 schemes, a short list of schemes which give the "best" results (in a sense to be defined) for a given "cost" or, to put the same thing in another way, have the lowest cost for a given degree of "excellence."

In this paper we have used two criteria of excellence a measure of closeness of fit to target availabilities (the deviation ratio) and a measure of smoothness of availabilities (the smoothness ratio). We have also two measures of cost, the maximum indebtedness outstanding at any time from 1951 to 1961, and the indebtedness outstanding at end-1958. For the purpose of compiling the short list of schemes a composite criterion of excellence has been calculated in which the deviation ratio is given twice the weight of the smoothness ratio, and a composite measure of cost in which maximum indebtedness and end-1958 indebtedness are given equal weights.

All schemes other than those included above the line in Table A are, by these composite criteria, <u>both</u> "inferior" to <u>and</u> "more expensive" than at least one of the schemes included in the list.

Table A

No. of Scheme	Deviation Ratio	Smoothness Ratio	Maximum Indebtedness	1958 Indebtedness	Repayment	Limit	Weight on Current Yrs. Exports
132	.772	.706	1460	1460	RS 6	None	50
133	.773	.723	1310	1310	RS 6	None	55
134	.777	.741	1170	1170	RS 6	None	60
106	.795	.726	1120	1080	RS 5	None	55
107	.794	.739	1000	960	RS 5	None	60
80	.799	.756	1040	890	RS 4	None	60
108	.802	.759	870	840	RS 5	None	65
81	.808	.778	910	780	RS 4	None	65
109	.813	.781	750	720	RS 5	None	70
82	.820	.800	780	670	RS 4	None	70
100	.834	.811	620	600	RS 5	1/3	70
28	.833	.805	780	530	RS 2	None	70
101& 110	.834	.811	620	600	RS 5	1/3=None	75
74	.836	.828	650	550	RS 4	1/3	75
20	.851	.833	650	440	RS 2	1/3	75
11	.876	.859	610	440	RS 2	20%	75
Scheme No. 1 (OAS)	.923	.868	1360	1310	RS 1	20%	0

All the schemes listed above the line show a closer approximation to the target, as well as a greater smoothness (in relation to need), than OAS Scheme No. 1, and all but the "best" scheme (No. 132) cost less, than the OAS Scheme No. 1. All the listed schemes attach a high--usually a very high weight--to the current year's exports in defining the practical export norm, and those which show a relatively close fit of availabilities to target, and great smoothness have wide or no debt limits. Those showing the best fit have neither debt limits nor compulsory or special repayments.

If schemes without debt limits and with repayment system 6 were excluded from consideration the top ten schemes and the twelfth scheme, would disappear from the list; and there would be no additions. Scheme No. 100 is the best of all the schemes with limits and with repayment systems other than R.S. 6.

If, in addition to schemes without debt limits and schemes with repayment system 6, all schemes with weights on the current year's exports exceeding 50 per cent were excluded from consideration we would have a completely different short list of schemes as shown in Table B.

Table B

No. of Scheme	Deviation Ratio	Smoothness Ratio	Maximum Indebtedness	1958 Indebtedness	Repayment	Limit	Weight on Current Yrs. Exports
96	.848	.775	1170	1160	RS 5	1/3	50
69	.857	.787	1220	1090	RS 4	1/3	50
87	.868	.791	1040	1030	RS 5	20%	50
60	.876	.794	1080	980	RS 4	20%	50
33	.884	.802	1080	840	RS 3	20%	50
6	.885	.799	1080	800	RS 2	20%	50
Scheme No. 1 (OAS)	.923	.868	1360	1310	RS 1	20%	0

The schemes appearing above the line on this list all give the highest "permissible" weight, viz. 50 per cent, to the current year's exports; and they are all closer to target, smoother (in relation to need), and cheaper than the OAS Scheme No. 1.

Appendix A

The objective of a compensatory financing scheme is to supply participating countries with additional foreign exchange resources at times of falling export receipts in order to make it unnecessary for them to restrict imports and other foreign payments to the level of current foreign exchange earnings. This, however, does not mean that the compensation should equal the full amount of the reduction in exports, since imports of goods and services will themselves tend to decline as a result of the fall in exports. Similarly, countries should not be required to repay past credits under the scheme to the full extent of a rise in exports, since part of the additional foreign exchange earnings will be absorbed by the expansion of imports which are induced by the increase in exports.

The purpose of this appendix is to assess the extent to which foreign exchange payments would tend to fluctuate with fluctuations in exports as a result of the normal economic mechanism of underdeveloped countries and, consequently, the extent to which these countries would be able to absorb available resources for compensatory financing of export fluctuations when exports decline, and to repay loans contracted for this purpose when exports recover, without drastic changes in their economic and financial organization.

The table attached to this appendix brings together a certain number of ratios from which, in the last column, an estimate is made of the ratio of the change in foreign expenditure (M', the prime used to indicate a concept wider than imports alone) to the change in exports (X) which is considered to be the autonomous variable. With the help of these figures a judgment is made as to the time pattern of foreign expenditure induced by export fluctuations.

Exports affect foreign expenditure in the first place through the remission abroad of profits of the export industry, in particular where this industry is conducted by foreign companies. A related item in the case of foreign oil companies are royalities paid aborad. The ratio of investment income paid abroad to exports (x_p) is shown in column (5). This ratio runs as high as about 40 per cent for some oil countries and is in the order of 15 to 20 per cent for a number of other countries.1/

1/ The figures used for investment income paid abroad represent the total of this balance of payments entry and may for a few countrie s include significant out payments of interests or profits of nonexport industries. This is probably most important for countries such as Australia and South Africa.

A second "cut" is taken out of export income by government taxation levied directly on exports. The ratio of these taxes to exports is indicated as t_x in column (4). The tax figures for this have been derived from the detailed government receipts information provided in the UN Statistical Yearbook. The ratio is quite large for oil producing countries but also for a number of other countries, in particular the underdeveloped countries of the Commonwealth. Since in some countries corporate or other income taxes are levied almost entirely on the export industry, the proceeds of these taxes have been included in the figure for taxes on exports alternatively (a) to the extent of one half, or (b) in full.

The balance of the original export value represents private domestic income from exports and this is spent and respent, except insofar as it "leaks out" by way of taxation, imports, or private saving.

An estimate of the ratio (t_y) of taxes (other than taxes on exports) to income is shown in column (3). In the further use of this ratio it is assumed that all nonexport taxes fluctuate proportionately to income, which is probably an overestimation of their degree of flexibility.

The ratio of imports to income (m) is shown in column (2). The figure used here is the average propensity to import, limited to goods. Allowance has not been made for the imports of services and for any difference between the marginal and the average propensity to import. The former adjustment would certainly, and the latter probably, raise the ratio computed in column (6).

No data are available on the response of private saving and private investment to changes in income. The calculation in column (6) has been made on the assumption that the private marginal propensity to spend (1-s) in the countries concerned equals unity. An alternative calculation in column (7) is based on the assumption that the private marginal propensity to spend equals 0.95, a figure which would almost certainly be a low estimate for most underdeveloped countries.1/

As far as the government is concerned, however, the assumption has been made that its marginal propensity to spend in the short run equals zero, i.e., that declines in tax receipts lead to equal government deficits and increases in tax receipts to equal surpluses. It may be assumed that governments would like to operate at least to this extent in a compensatory

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1/ For some evidence on this see J. J. Polak, An International Economic System, University of Chicago Press, 1953.

manner, although they may in fact in many cases not have been financially able to follow such a policy. The assumption 1/ does not, however, represent the maximum degree of stabilization that the government could practice. The government might raise government expenditures (or lower its rate of taxation) when exports and incomes decline and contract expenditure (or raise tax rates) when exports and incomes rise. Few underdeveloped countries, however, dispose of the institutional arrangements that would permit them to do this (and indeed many developed countries have found it difficult in practice to follow a policy of this nature) except where they run commodity schemes of their export products in such a manner as to achieve these additional compensatory effects.

Applying the assumptions made above we come to the computed effect in column (6) along the following lines. The initial impact on private domestic income of a change in exports will be equal to the amount of the export change multiplied by the coefficient $(1-x_p-t_x)$. Allowing then for the leak through imports and "income" taxes, this sum will give rise, according to standard multiplier theory, to a total effect on imports equal to $\frac{m}{m+t_y+s}$ times the original impact and a total effect on nonexport taxes equal to $\frac{t_y}{m+t_y+s}$ times the original impact.

Adding in also the direct impact on foreign expenditures of profits remitted abroad the total effect of a change in exports on foreign expenditure is as follows:

$$\frac{\Delta M'}{\Delta X} = \frac{m(1 - x_p - t_x)}{m + t_y + s} + x_p \text{ .}$$

It will be seen from column (6) that the ratios are narrowly concentrated, with 40 per cent falling in the range of .50 to .59. Perhaps most surprising is the fact that the oil countries do not typically fall outside of this range. This is attributable to the fact that the oil countries do not only remit large profits abroad, but also have a much higher ratio of export taxes levied than do other countries; the effects of these two unusually high ratios approximately cancel out in the result.

1/ A second assumption about government policy is implicit in the computation shown in the attached table. It is assumed that the monetary authorities keep the quantity of money in circulation constant by offsetting the effect of fluctuations in "availabilities" on the money supply through variations in central bank credit.

The alternative computation in column (7) assumes a marginal propensity to spend of 0.95 rather than of unity. Recomputation of the figures in column (6) with this allowance yields corrected ratios that are typically about .05 lower. The difference approaches .10 for a few countries; but two of these, India and Pakistan, are clearly countries where the private marginal propensity to spend is likely to be higher than .95.

The ratios in columns (6) or (7) show the changes in imports between an initial equilibrium situation and the final equilibrium which is re-established eventually after a change in exports. During the year in which the change in exports occurs the induced change in imports would be much smaller. Moreover, since imports adjust with a lag to an equilibrium level which itself fluctuates with exports, the adjustment will always remain incomplete. Using the average ratios of imports to income, of export taxes to exports, etc. for all countries listed in the Appendix table, and assuming that imports and income tax collections lag three months behind the receipt of income, one can determine the time pattern of imports produced by a regular cyclical movement of exports. Export cycles with a duration of three to four years result in import fluctuations whose amplitude is approximately one third of the amplitude of the underlying export fluctuations.

It is obviously impracticable to tailor the provisions of an international compensatory scheme to the precise time pattern with which each country's imports react to changes in its exports. The data given in this Appendix, nevertheless, suggest that for many primary producing countries foreign expenditures fluctuate on the average by as much as one third of the fluctuations of exports, even in the absence of variations in exchange control measures. This conclusion, it must be remembered, is based on the assumption that government expenditures and the money supply remain roughly constant in the face of export fluctuations. If government expenditures were to vary with the changes in tax collections that are induced by variations in exports, or if a similar influence of exports on domestic economic activity were allowed to occur through induced changes in the money supply, the effect of export changes on imports would be more pronounced and the scope for compensatory export financing would be correspondingly reduced. On the other hand, if domestic financial policies were to offset part of the impact of export changes on economic activity and thus on imports, international compensatory action could be more extensive. For reasons given earlier it would seem, however, that unless countries are in a position to revamp their internal financial system in the direction of much greater offsetting of the domestic effects of export fluctuations, they would not be able to use safely a compensatory scheme that finances more than two thirds of the short-term fluctuations in their exports.

Ratios Relevant to the Computation of Export Fluctuations
(Figures for 1959 or nearest year available)

Country	Imports / Income	General Taxes / Income	Export Taxes / Exports	Investment Income Paid Abroad / Exports	Computation $\frac{\Delta M'}{\Delta X}$	Alternative Computation
	m	t_y	t_x	x_p		
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Argentina	.15	.11	0	.06	.60	.51
Australia	.17	.24	0	.16	.50	.46
Burma	.23	.20	.02	.04	.55	.50
Ceylon a)	.37	.14	.25	.04	.55	.50
b)	.37	.12	.31	.04	.53	.48
Chile a)	.11	.15	.17	.16	.43	.39
b)	.11	.12	.34	.16	.42	.37
Colombia	.15	.11	0	.11	.61	.53
Costa Rica	.30	.15	.03	.06	.66	.60
Ecuador	.13	.12	.04	.16	.56	.49
El Salvador	.20	.11	.09	.03	.61	.53
Ghana a)	.22	.07	.30	.06	.54	.47
b)	.22	.07	.33	.06	.51	.44
Greece	.22	.19	0	.02	.56	.50
Guatemala	.21	.14	.10	.05	.56	.50
Honduras	.19	.10	.03	.05	.64	.55
India	.07	.07	.03	.06	.49	.38
Israel	.25	.30	0	.23	.58	.55
Malaya a)	.41	.16	.12	.05	.65	.60
b)	.41	.14	.15	.05	.65	.60
Mexico	.12	.08	.13	.20	.60	.52
New Zealand	.20	.30	0	.05	.43	.40
Pakistan	.08	.12	0	.04	.44	.36
Peru a)	.25	.15	.11	.17	.61	.56
b)	.25	.10	.22	.17	.60	.55
Portugal	.25	.15	.01	.02	.62	.55
South Africa	.26	.17	0	.19	.68	.63
Spain	.10	.14	0	.03	.45	.37
Sudan	.17	.11	.08	.01	.55	.46
Thailand	.19	.12	.05	.03	.58	.50
Venezuela	.24	.09	.45	.23	.47	.44
Average 1/	.20	.15	.08	.09	.56	.49

Frequency distribution of ratios in column (6)

.40 to .49	6
.50 to .59	10
.60 to .70	10

Notes:

Cols (2) and (3). Income: in some cases GNP has been used. The calculation leading to column (6) however, is independent of the income figures used.

Col. (3). General taxes: government revenue less export taxes.

Col. (4). Taxes levied on exports, oil royalties and, as indicated (a) one half or (b) all of income taxes (assuming these to represent mainly taxes on exports in the countries concerned).

Col. (5). It was assumed that the balance of payments data on investment income paid abroad reflect the profits on exports remitted abroad.

Col. (6). Change in foreign payments ($\Delta M'$ = imports and investment income) attributable to a change in exports. Formula used:

$$\frac{\Delta M'}{\Delta X} = \frac{m(1 - x_p - t_x)}{m + t_y} + x_p$$

Col. (7). Alternative computation:

$$\frac{\Delta M'}{\Delta X} = \frac{m(1 - x_p - t_x)}{m + t_y + 0.05} + x_p$$

1/ For Ceylon, Chile, Ghana, Malaya and Peru the ratio's shown under a) have been used.

Table 1. Tests and Measurements
(Schemes in Operation, 1951-61)

Scheme No.	Repayment Provisions	Limit	Weights t	Weights t-1	Weights t-2	Weights t-3	Deviation Ratio 1951-59 2/3 Compensation Target	Deviation Ratio 1951-59 100% Compensation Target	Deviation Ratio 1955-59 2/3 Compensation Target	Smoothness Ratio 1953-59	Billion dollar Total Indebtedness Maximum	(Year)	End-1958
1	RS 1	.20	0	1/3	1/3	1/3	.923	.929	.966	.868	1.36	(1954)	1.31
2	RS 1	.20	1/3	1/3	1/3		.905	.863	.887	.826	1.29	(1953)	1.04
3	RS 2	.20	0	1/3	1/3	1/3	.921	.911	.961	.830	1.36	(1954)	1.29
4	RS 2	.20	1/3	1/3	1/3		.905	.908	.887	.799	1.29	(1953)	1.03
5	RS 2	.20	.45	.28	.27		.891	.906	.883	.797	1.15	(1953)	.87
6	RS 2	.20	.50	.25	.25		.885	.907	.884	.799	1.08	(1953)	.80
7	RS 2	.20	.55	.23	.22		.884	.909	.890	.809	1.00	(1953)	.73
8	RS 2	.20	.60	.20	.20		.881	.912	.890	.820	.92	(1953)	.66
9	RS 2	.20	.65	.18	.17		.873	.912	.869	.828	.82	(1953)	.58
10	RS 2	.20	.70	.15	.15		.870	.914	.863	.843	.73	(1954)	.52
11	RS 2	.20	.75	.13	.12		.876	.921	.860	.859	.61	(1954)	.44
12	RS 2	1/3	0	1/3	1/3	1/3	.980	.916	1.113	.837	1.90	(1954)	1.46
13	RS 2	1/3	1/3	1/3	1/3		.926	.902	.987	.801	1.53	(1953)	1.11
14	RS 2	1/3	.45	.28	.27		.881	.890	.898	.788	1.30	(1954)	.93
15	RS 2	1/3	.50	.25	.25		.869	.888	.874	.793	1.22	(1954)	.86
16	RS 2	1/3	.55	.23	.22		.857	.888	.846	.796	1.10	(1954)	.79
17	RS 2	1/3	.60	.20	.20		.853	.892	.839	.805	.98	(1954)	.70
18	RS 2	1/3	.65	.18	.17		.856	.901	.840	.821	.86	(1954)	.61
19	RS 2	1/3	.70	.15	.15		.848	.903	.849	.822	.75	(1954)	.53
20	RS 2	1/3	.75	.13	.12		.851	.910	.864	.833	.65	(1954)	.44
21	RS 2	None	0	1/3	1/3	1/3	1.191	.934	1.347	.744	2.69	(1954)	1.77
22	RS 2	None	1/3	1/3	1/3		.891	.862	.965	.725	1.73	(1954)	1.17
23	RS 2	None	.45	.28	.27		.840	.861	.895	.728	1.43	(1954)	.97
24	RS 2	None	.50	.25	.25		.827	.863	.875	.734	1.30	(1954)	.88
25	RS 2	None	.55	.23	.22		.820	.869	.860	.748	1.17	(1954)	.79
26	RS 2	None	.60	.20	.20		.819	.876	.852	.762	1.04	(1954)	.70
27	RS 2	None	.65	.18	.17		.824	.886	.849	.784	.91	(1954)	.61
28	RS 2	None	.70	.15	.15		.833	.896	.853	.805	.78	(1954)	.53
29	RS 2	None	.75	.13	.12		.851	.910	.864	.833	.65	(1954)	.44

Table 1. (Cont'd.) Tests and Measurements
(Schemes in Operation, 1951-61)

Scheme No.	Repayment Provisions	Limit	Weights t	t-1	t-2	t-3	Deviation Ratio 1951-59 2/3 Compensation Target	Deviation Ratio 1951-59 100% Compensation Target	Deviation Ratio 1955-59 2/3 Compensation Target	Smoothness Ratio 1953-59	Billion dollar Total Indebtedness Maximum	(Year)	End-1958
30	RS 3	.20	0	1/3	1/3	1/3	.928	.916	.978	.842	1.36		1.34
31	RS 3	.20	1/3	1/3	1/3	0	.907	.910	.892	.804	1.29		1.07
32	RS 3	.20	.45				.890	.907	.881	.801	1.15		.90
33	RS 3	.20	.50				.884	.907	.880	.802	1.08		.84
34	RS 3	.20	.55				.882	.910	.886	.813	1.00		.76
35	RS 3	.20	.60				.881	.913	.890	.824	.92		.69
36	RS 3	.20	.65				.874	.913	.872	.834	.82		.60
37	RS 3	.20	.70				.872	.916	.866	.849	.73		.54
38	RS 3	.20	.75				.877	.923	.863	.865	.61		.45
39	RS 3	.33	0	1/3	1/3	1/3	.978	.917	1.109	.836	1.90		1.53
40	RS 3	.33	1/3	1/3	1/3	0	.921	.901	.974	.800	1.53		1.15
41	RS 3	.33	.45				.880	.891	.896	.793	1.30		.96
42	RS 3	.33	.50				.869	.889	.872	.798	1.22		.90
43	RS 3	.33	.55				.857	.889	.845	.803	1.10		.82
44	RS 3	.33	.60				.854	.894	.840	.812	.98		.73
45	RS 3	.33	.65				.857	.902	.842	.827	.86		.64
46	RS 3	.33	.70				.849	.904	.850	.830	.75		.55
47	RS 3	.33	.75				.850	.911	.862	.842	.65		.45
48	RS 3	None	0	1/3	1/3	1/3	1.153	.914	1.253	.707	2.69		1.87
49	RS 3	None	1/3	1/3	1/3	0	.874	.855	.923	.730	1.73		1.22
50	RS 3	None	.45				.829	.857	.867	.737	1.43		1.00
51	RS 3	None	.50				.819	.861	.853	.745	1.30		.91
52	RS 3	None	.55				.814	.868	.843	.759	1.17		.82
53	RS 3	None	.60				.814	.875	.840	.774	1.04		.73
54	RS 3	None	.65				.821	.886	.841	.795	.91		.64
55	RS 3	None	.70				.832	.897	.849	.816	.78		.55
56	RS 3	None	.75				.850	.911	.862	.842	.65		.45

Table 1. (Cont'd.) Tests and Measurements
(Schemes in Operation, 1951-61)

Scheme No.	Repayment Provisions	Limit	Weights t	Weights t-1	Weights t-2	Weights t-3	Deviation Ratio 1951-59 2/3 Compensation Target	Deviation Ratio 1951-59 100% Compensation Target	Deviation Ratio 1955-59 2/3 Compensation Target	Smoothness Ratio 1953-59	Billion dollar Total Indebtedness Maximum	(Year)	End-1958
57	RS 4	.20	0	1/3	1/3	1/3	.919	.911	.956	.833	1.40	(1958)	1.40
58	RS 4		1/3	1/3	1/3		.904	.908	.884	.804	1.29	(1953)	1.21
59	RS 4		.45	.28	.27		.886	.905	.869	.797	1.15	(1953)	1.04
60	RS 4		.50	.25	.25		.876	.903	.859	.794	1.08	(1953)	.98
61	RS 4		.55	.23	.22		.871	.904	.856	.801	1.00	(1953)	.91
62	RS 4		.60	.20	.20		.868	.906	.855	.810	.92	(1953)	.83
63	RS 4		.65	.18	.17		.865	.908	.847	.822	.82	(1953)	.73
64	RS 4		.70	.15	.15		.863	.911	.844	.838	.73	(1954)	.65
65	RS 4		.75	.13	.12		.870	.918	.843	.854	.61	(1954)	.55
66	RS 4	1/3	0	1/3	1/3	1/3	.969	.911	1.087	.837	1.90	(1954)	1.69
67	RS 4		1/3	1/3	1/3		.901	.890	.925	.789	1.53	(1953)	1.39
68	RS 4		.45	.28	.27		.869	.883	.865	.783	1.30	(1954)	1.17
69	RS 4		.50	.25	.25		.857	.882	.841	.787	1.22	(1954)	1.09
70	RS 4		.55	.23	.22		.849	.884	.823	.794	1.10	(1954)	.99
71	RS 4		.60	.20	.20		.842	.886	.806	.797	.98	(1954)	.89
72	RS 4		.65	.18	.17		.844	.894	.805	.811	.86	(1954)	.78
73	RS 4		.70	.15	.15		.836	.897	.817	.815	.75	(1954)	.67
74	RS 4		.75	.13	.12		.840	.905	.835	.828	.65	(1954)	.55
75	RS 4	None	0	1/3	1/3	1/3	1.137	.895	1.216	.708	2.70	(1954)	2.27
76	RS 4		1/3	1/3	1/3		.858	.843	.881	.719	1.73	(1954)	1.49
77	RS 4		.45	.28	.27		.813	.846	.824	.721	1.43	(1954)	1.23
78	RS 4		.50	.25	.25		.802	.650	.810	.728	1.30	(1954)	1.12
79	RS 4		.55	.23	.22		.798	.858	.802	.741	1.17	(1954)	1.00
80	RS 4		.60	.20	.20		.799	.866	.801	.756	1.04	(1954)	.89
81	RS 4		.65	.18	.17		.808	.877	.806	.778	.91	(1954)	.78
82	RS 4		.70	.15	.15		.820	.889	.817	.800	.78	(1954)	.67
83	RS 4		.75	.13	.12		.840	.905	.835	.828	.65	(1954)	.55

Table 1. (Cont'd.) Tests and Measurements
(Schemes in Operation, 1951-61)

Scheme No.	Repayment Provisions	Limit	Weights: t	Weights: t-1	Weights: t-2	Weights: t-3	Deviation Ratio 1951-59: 2/3 Compensation Target	Deviation Ratio 1951-59: 100% Compensation Target	Deviation Ratio 1955-59: 2/3 Compensation Target	Smoothness Ratio 1953-59	Billion dollar Total Indebtedness: Maximum	(Year)	End-1958
84	RS 5	.20	0	1/3	1/3	1/3	.917	.907	.950	.847	1.48	(1958)	1.48
85	RS 5		1/3	1/3	1/3		.900	.902	.851	.814	1.26	(1958)	1.26
86	RS 5		.45	.28	.27		.876	.896	.826	.794	1.11	(1953)	1.10
87	RS 5		.50	.25	.25		.868	.895	.822	.791	1.04	(1953)	1.03
88	RS 5		.55	.23	.22		.865	.897	.827	.796	.97	(1953)	.96
89	RS 5		.60	.20	.20		.862	.899	.828	.802	.89	(1953)	.89
90	RS 5		.65	.18	.17		.857	.901	.817	.809	.79	(1953)	.78
91	RS 5		.70	.15	.15		.854	.904	.813	.820	.70	(1953)	.70
92	RS 5		.75	.13	.12		.862	.912	.817	.838	.59	(1953)	.59
93	RS 5	.33	0	1/3	1/3	1/3	.950	.897	1.041	.848	1.87	(1958)	1.87
94	RS 5		1/3	1/3	1/3		.902	.884	.905	.807	1.49	(1953)	1.48
95	RS 5		.45	.28	.27		.860	.874	.825	.778	1.26	(1953)	1.25
96	RS 5		.50	.25	.25		.848	.873	.803	.775	1.17	(1953)	1.16
97	RS 5		.55	.23	.22		.840	.875	.787	.778	1.06	(1953)	1.05
98	RS 5		.60	.20	.20		.834	.879	.774	.782	.95	(1958)	.95
99	RS 5		.65	.18	.17		.836	.887	.775	.795	.84	(1958)	.84
100	RS 5		.70	.15	.15		.829	.891	.791	.797	.72	(1953)	.72
101	RS 5		.75	.13	.12		.834	.899	.814	.811	.62	(1953)	.60
102	RS 5	None	0	1/3	1/3	1/3	1.159	.903	1.270	.790	2.65	(1954)	2.38
103	RS 5		1/3	1/3	1/3		.866	.841	.881	.730	1.67	(1953)	1.60
104	RS 5		.45	.28	.27		.814	.841	.812	.715	1.37	(1953)	1.32
105	RS 5		.50	.25	.25		.801	.845	.793	.717	1.25	(1953)	1.20
106	RS 5		.55	.23	.22		.795	.852	.782	.726	1.12	(1953)	1.08
107	RS 5		.60	.20	.20		.794	.860	.778	.739	1.00	(1953)	.96
108	RS 5		.65	.18	.17		.802	.872	.783	.759	.87	(1953)	.84
109	RS 5		.70	.15	.13		.813	.884	.794	.781	.75	(1953)	.72
110	RS 5		.75	.15	.12		.834	.899	.814	.811	.62	(1953)	.60

Table 1. (Cont'd.) Tests and Measurements
(Schemes in Operation, 1951-61)

Scheme No.	Repayment Provisions	Limit	Weights t	t-1	t-2	t-3	Deviation Ratio 1951-59 2/3 Compensation Target	Deviation Ratio 1951-59 100% Compensation Target	Deviation Ratio 1955-59 2/3 Compensation Target	Smoothness Ratio 1953-59	Billion dollar Total Indebtedness Maximum	(Year)	End-1958
111	RS 6	.20	0	1/3	1/3	1/3	.899	.901	.903	.816	1.65	(1958)	1.65
112	RS 6		1/3	1/3	1/3		.883	.897	.825	.788	1.54	(1958)	1.54
113	RS 6		.45	.28	.27		.865	.894	.811	.782	1.37	(1958)	1.37
114	RS 6		.50	.25	.25		.857	.893	.806	.782	1.28	(1958)	1.28
115	RS 6		.55	.23	.22		.854	.895	.806	.790	1.19	(1958)	1.19
116	RS 6		.60	.20	.20		.851	.897	.806	.799	1.09	(1958)	1.09
117	RS 6		.65	.18	.17		.851	.901	.807	.814	.96	(1958)	.96
118	RS 6		.70	.15	.15		.851	.905	.810	.830	.85	(1958)	.85
119	RS 6		.75	.13	.12		.860	.913	.816	.848	.72	(1958)	.72
120	RS 6	.33	0	1/3	1/3	1/3	.914	.882	.951	.798	2.18	(1958)	2.18
121	RS 6		1/3	1/3	1/3		.864	.870	.823	.763	1.82	(1958)	1.82
122	RS 6		.45	.28	.27		.840	.869	.785	.763	1.53	(1958)	1.53
123	RS 6		.50	.25	.25		.831	.869	.769	.769	1.41	(1958)	1.41
124	RS 6		.55	.23	.22		.826	.872	.760	.778	1.28	(1958)	1.28
125	RS 6		.60	.20	.20		.823	.877	.752	.785	1.15	(1958)	1.15
126	RS 6		.65	.18	.17		.827	.885	.758	.800	1.02	(1958)	1.02
127	RS 6		.70	.15	.15		.823	.890	.779	.806	.88	(1958)	.88
128	RS 6		.75	.13	.12		.829	.859	.805	.822	.73	(1958)	.73
129	RS 6	None	0	1/3	1/3	1/3	1.087	.862	1.086	.659	2.77	(1958)	2.77
130	RS 6		1/3	1/3	1/3		.815	.820	.765	.683	1.95	(1958)	1.95
131	RS 6		.45	.28	.27		.779	.829	.732	.695	1.60	(1958)	1.60
132	RS 6		.50	.25	.25		.772	.835	.729	.706	1.46	(1958)	1.46
133	RS 6		.55	.23	.22		.773	.845	.732	.723	1.31	(1958)	1.31
134	RS 6		.60	.20	.20		.777	.855	.741	.741	1.17	(1958)	1.17
135	RS 6		.65	.18	.17		.790	.868	.757	.766	1.02	(1958)	1.02
136	RS 6		.70	.15	.15		.805	.882	.778	.791	.88	(1958)	.88
137	RS 6		.75	.13	.12		.829	.899	.805	.822	.73	(1958)	.73

Table 2

A - Decline in Deviation Ratio (for 33.3% Target) as Weight on Current Year's Exports Rises from Zero (a) to 75%, (b) to the Optimal Weight (Magnitude of Optimum Weight)

	20% Limit			1/3 Limit			No Limit		
	(a)	(b)		(a)	(b)		(a)	(b)	
R.S. 2	.045	.051	(70%)	.129	.132	(70%)	.340	.372	(60%)
R.S. 3	.051	.056	(70%)	.128	.129	(70%)	.300	.336	(55%-60%)
R.S. 4	.049	.056	(70%)	.129	.133	(70%)	.297	.339	(55%)
R.S. 5	.055	.063	(70%)	.116	.121	(70%)	.325	.365	(60%)
R.S. 6	.039	.048	(60%-70%)	.085	.091	(60% and 70%)	.258	.315	(50%)

B - Decline in (a) Maximum Total Indebtedness, (b) Total Indebtedness at 1958 Peak as Weight on Current Year's Exports Rises from Zero to 75%
($ Million)

	20% Limit		1/3 Limit		No Limit	
	(a)	(b)	(a)	(b)	(a)	(b)
R.S. 2	750	850	1,250	1,020	2,040	1,330
R.S. 3	750	890	1,250	1,080	2,040	1,420
R.S. 4	790	850	1,250	1,140	2,050	1,720
R.S. 5	890	890	1,250	1,270	2,030	1,780
R.S. 6	930	930	1,450	1,450	2,040	2,040

Table 3. Effect of Changes in Repayment System

A - Deviation Ratios: 33.3% Target, 1955-59

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Weight on Current Year's Exports	Country Debt Limit	R. S. 2	3	4	5	6	(3) less (5)	(5) less (7)
0	20%	.961	.978	.956	.950	.903	.005	.053
0	1/3	1.113	1.109	1.087	1.041	.951	.026	.136
0	None	1.347	1.253	1.216	1.270	1.086	.131	.130
1/3	20%	.887	.892	.884	.851	.825	.003	.059
1/3	1/3	.987	.974	.925	.905	.823	.062	.102
1/3	None	.965	.923	.881	.881	.765	.084	.116
45%	20%	.883	.881	.869	.826	.811	.014	.058
45%	1/3	.898	.896	.865	.825	.785	.033	.080
45%	None	.895	.867	.824	.812	.732	.071	.092
50%	20%	.884	.880	.859	.822	.806	.025	.053
50%	1/3	.874	.872	.841	.803	.769	.033	.072
50%	None	.875	.853	.810	.793	.729	.065	.081
55%	20%	.890	.886	.856	.827	.806	.034	.050
55%	1/3	.846	.845	.823	.787	.760	.023	.063
55%	None	.860	.843	.802	.782	.732	.058	.070
60%	20%	.890	.890	.855	.828	.806	.035	.049
60%	1/3	.839	.840	.806	.774	.752	.033	.054
60%	None	.852	.840	.801	.778	.741	.051	.060
65%	20%	.869	.872	.847	.817	.807	.022	.040
65%	1/3	.840	.842	.805	.775	.758	.035	.047
65%	None	.849	.841	.806	.783	.757	.043	.049
70%	20%	.863	.866	.844	.813	.810	.019	.034
70%	1/3	.849	.850	.817	.791	.779	.032	.038
70%	None	.853	.849	.817	.794	.778	.036	.039
75%	20%	.860	.863	.843	.817	.816	.017	.027
75%	1/3	.864	.862	.835	.814	.805	.029	.030
75%	None	.864	.862	.835	.814	.805	.029	.030
B - Total Indebtedness - 1958 Peak: $ Billion								
0	20%	1.29	1.34	1.40	1.48	1.65	-.11	-.25
0	1/3	1.46	1.53	1.69	1.87	2.18	-.23	-.49
0	None	1.77	1.87	2.27	2.38	2.77	-.50	-.50
1/3	20%	1.03	1.07	1.21	1.26	1.54	-.18	-.33
1/3	1/3	1.11	1.15	1.39	1.48	1.82	-.28	-.43
1/3	None	1.17	1.22	1.49	1.60	1.95	-.32	-.46
45%	20%	.87	.90	1.04	1.10	1.37	-.17	-.33
45%	1/3	.93	.96	1.17	1.25	1.53	-.24	-.36
45%	None	.97	1.00	1.23	1.32	1.60	-.26	-.37
50%	20%	.80	.84	.98	1.03	1.28	-.18	-.30
50%	1/3	.86	.90	1.09	1.16	1.41	-.23	-.32
50%	None	.88	.91	1.12	1.20	1.46	-.24	-.34
55%	20%	.73	.76	.91	.96	1.19	-.18	-.28
55%	1/3	.79	.82	.99	1.05	1.28	-.20	-.29
55%	None	.79	.82	1.00	1.08	1.31	-.21	-.31
60%	20%	.66	.69	.83	.89	1.09	-.17	-.26
60%	1/3	.70	.73	.89	.95	1.15	-.19	-.26
60%	None	.70	.73	.89	.96	1.17	-.19	-.28
65%	20%	.58	.60	.73	.78	.96	-.15	-.23
65%	1/3	.61	.64	.78	.84	1.02	-.17	-.24
65%	None	.61	.64	.78	.84	1.02	-.17	-.24
70%	20%	.52	.54	.65	.70	.85	-.13	-.20
70%	1/3	.53	.55	.67	.72	.88	-.14	-.21
70%	None	.53	.55	.67	.72	.88	-.14	-.21
75%	20%	.44	.45	.55	.59	.72	-.11	-.17
75%	1/3	.44	.45	.55	.60	.73	-.11	-.18
75%	None	.44	.45	.55	.60	.73	-.11	-.18

Table 4. Effect of Changes in Debt Limit
A - Deviation Ratios: 33.3% Target: 1951-59

	Weight on Current Year's Exports	Country Debt Limit	R.S. (2)	R.S. (3)	R.S. (4)	R.S. (5)	R.S. (6)
(1)	0	20%	.921	.928	.919	.917	.899
(2)	0	1/3	.980	.978	.969	.950	.914
(3)	0	None	1.191	1.150	1.137	1.159	1.087
(4) (1) less (2)			-.059	-.050	-.050	-.033	0.015
(5) (2) less (3)			-.211	-.172	-.168	-.209	-.173
(6)	1/3	20%	.905	.907	.904	.900	.883
(7)	1/3	1/3	.926	.921	.901	.902	.864
(8)	1/3	None	.891	.874	.858	.866	.815
(9) (6) less (7)			-.021	-.014	.003	-.002	.019
(10) (7) less (8)			.035	.047	.043	.036	.049
(11)	45%	20%	.891	.890	.886	.876	.865
(12)	45%	1/3	.881	.880	.869	.860	.840
(13)	45%	None	.840	.829	.813	.814	.779
(14) (11) less (12)			.010	.010	.017	.016	.025
(15) (12) less (13)			.041	.051	.056	.046	.061
(16)	50%	20%	.885	.884	.876	.868	.857
(17)	50%	1/3	.869	.869	.857	.848	.831
(18)	50%	None	.827	.819	.802	.801	.772
(19) (16) less (17)			.016	.015	.019	.020	.026
(20) (17) less (18)			.042	.050	.055	.047	.059
(21)	55%	20%	.884	.882	.871	.865	.854
(22)	55%	1/3	.857	.857	.849	.840	.826
(23)	55%	None	.820	.814	.798	.795	.773
(24) (21) less (22)			.027	.025	.022	.025	.028
(25) (22) less (23)			.037	.043	.051	.045	.053
(26)	60%	20%	.881	.881	.868	.862	.851
(27)	60%	1/3	.853	.854	.842	.834	.823
(28)	60%	None	.819	.814	.799	.794	.777
(29) (26) less (27)			.028	.027	.026	.028	.028
(30) (27) less (28)			.034	.040	.043	.040	.046
(31)	65%	20%	.873	.874	.865	.857	.851
(32)	65%	1/3	.856	.857	.844	.836	.827
(33)	65%	None	.824	.821	.808	.802	.790
(34) (31) less (32)			.017	.017	.021	.021	.024
(35) (32) less (33)			.032	.036	.036	.034	.037
(36)	70%	20%	.870	.872	.863	.854	.851
(37)	70%	1/3	.848	.849	.836	.829	.823
(38)	70%	None	.833	.832	.820	.813	.805
(39) (36) less (37)			.022	.023	.027	.025	.028
(40) (37) less (38)			.015	.017	.016	.016	.018
(41)	75%	20%	.876	.877	.870	.862	.860
(42)	75%	1/3	.851	.850	.840	.834	.829
(43)	75%	None	.851	.850	.840	.834	.829
(44) (41) less (42)			.025	.027	.030	.028	.031
(45) (42) less (43)			.000	.000	.000	.000	.000

Table 4. (Cont'd) Effect of Changes in Debt Limit
B - Total Indebtedness: Maximum: $ Billion

	Weight on Current Year's Exports	Country Debt Limit	R.S. (2) and (3)	R.S. (4)	R.S. (5)	R.S. (6)
(1)	0	20%	1.36	1.40	1.48	1.65
(2)	0	1/3	1.90	1.90	1.87	2.18
(3)	0	None	2.69	2.70	2.65	2.77
(4) (2) less (1)			.54	.50	.39	.53
(5) (3) less (2)			.79	.80	.78	.59
(6)	1/3	20%	1.29	1.29	1.26	1.54
(7)	1/3	1/3	1.53	1.53	1.49	1.82
(8)	1/3	None	1.73	1.73	1.67	1.95
(9) (7) less (6)			.24	.24	.23	.28
(10) (8) less (7)			.20	.20	.18	.13
(11)	45%	20%	1.15	1.15	1.11	1.37
(12)	45%	1/3	1.30	1.30	1.26	1.53
(13)	45%	None	1.43	1.43	1.37	1.60
(14) (12) less (11)			.15	.15	.15	.16
(15) (13) less (12)			.13	.13	.11	.07
(16)	50%	20%	1.08	1.08	1.04	1.28
(17)	50%	1/3	1.22	1.22	1.17	1.41
(18)	50%	None	1.30	1.30	1.25	1.46
(19) (17) less (16)			.14	.14	.13	.13
(20) (18) less (17)			.08	.08	.08	.05
(21)	55%	20%	1.00	1.00	.97	1.19
(22)	55%	1/3	1.10	1.10	1.06	1.28
(23)	55%	None	1.17	1.17	1.12	1.31
(24) (22) less (21)			.10	.10	.09	.09
(25) (23) less (22)			.07	.07	.06	.03
(26)	60%	20%	.92	.92	.89	1.09
(27)	60%	1/3	.98	.98	.95	1.15
(28)	60%	None	1.04	1.04	1.00	1.17
(29) (27) less (26)			.06	.06	.06	.06
(30) (28) less (27)			.06	.06	.05	.02
(31)	65%	20%	.82	.82	.79	.96
(32)	65%	1/3	.86	.86	.84	1.02
(33)	65%	None	.91	.91	.87	1.02
(34) (32) less (31)			.04	.04	.05	.06
(35) (33) less (32)			.05	.05	.03	.00
(36)	70%	20%	.73	.73	.70	.85
(37)	70%	1/3	.75	.75	.72	.88
(38)	70%	None	.78	.78	.75	.88
(39) (37) less (36)			.02	.02	.02	.03
(40) (38) less (37)			.03	.03	.03	.00
(41)	75%	20%	.61	.61	.59	.72
(42)	75%	1/3	.65	.65	.62	.73
(43)	75%	None	.65	.65	.62	.73
(44) (42) less (41)			.04	.04	.03	.01
(45) (43) less (42)			.00	.00	.00	.00

INTERNATIONAL MONETARY FUND

October 26, 1962

TO : Mr. Paul J. Brand

FROM: E. Walter Robichek

I have read the attached paper and told Marcus Fleming that I felt it gave complete and lucid coverage to this complex subject. I was told that WHD's reactions were needed before the close of business tonight, mainly, I suppose, because Marcus Fleming is going to Geneva this week end.

However, it might take a few days longer before the paper is issued. If you can spare the time, I would, therefore, very much like you to read it as soon after your return as possible and pass on to J.J. Polak any comments you may have.

Attachment

INTERNATIONAL MONETARY FUND

Nov. 7, 1962

Walter:

Since I was back in Washington for ~~onl~~y less than a week and had to draft a report on the IA-ECOSOC meeting, I did not have a chance to study the attached paper. However, prior to my previous trip to the OAS meeting, I took with me an earlier--and apparently less complete--draft on this subject, which J.J. Polak had given me and which I read. I had no serious difficulty with that earlier version.

Paul J. Brand

Attachment

Paul J. Brand

INTERNATIONAL MONETARY FUND

October 26, 1962

TO : Mr. Paul J. Brand

FROM: E. Walter Robichek EWR

I have read the attached paper and told Marcus Fleming that I felt it gave complete and lucid coverage to this complex subject. I was told that WHD's reactions were needed before the close of business tonight, mainly, I suppose, because Marcus Fleming is going to Geneva this week end.

However, it might take a few days longer before the paper is issued. If you can spare the time, I would, therefore, very much like you to read it as soon after your return as possible and pass on to J.J. Polak any comments you may have.

Attachment

Office Memorandum

TO : Mr. Walter Robichek

DATE: Oct. 25, 1962

FROM : J. Marcus Fleming JMF

SUBJECT : Draft Paper on "The Compensatory Financing of Export Fluctuations of Primary Producing Countries"

Here is the latest version of a draft policy paper for the Board on Compensatory Financing. The note is still under revision but Mr. Polak would like to get it, or something very much like it, to the Managing Director if possible by the week-end.

Mr. Jorge Del Canto

Room 807

(1)

SM/62/85

September 26, 1962

To: Members of the Executive Board

From: The Secretary

Subject: Commission on International Commodity Trade - Technical Working Group

Attached for the information of the Executive Directors is a report on the first session of the Technical Working Group of the Commission on International Commodity Trade held in New York, September 5-14, 1962.

Att:(1)

Other Distribution:
Department Heads
Division Chiefs

Report on the First Session of the
Technical Working Group of the Commission on International
Commodity Trade held in New York September 5 to 14, 1962

September 25, 1962

In accordance with the decision taken by the Commission on International Commodity Trade at its tenth session held in May 1962 a Technical Working Group composed of representatives of Argentina, Australia, Brazil, Ceylon, France, Mali, Pakistan, Sweden, the United Kingdom and the United States was set up (see SM/62/44) with the following terms of reference:

(a) To examine - in the light of the views expressed and the conclusions reached during the tenth session of the Commission, of the documentation available to that session and of the assistance that the International Monetary Fund can provide to primary exporting countries to overcome the problem of short-term fluctuations in their export earnings - the scheme for a DIF submitted by the United Nations Group of Experts and the scheme of compensatory financing for fluctuations in export receipts drawn up by the Organization of American States and submit its considered views to the eleventh session of the Commission together with the text of a draft agreement, including any necessary variants, for the purpose of illustrating a specific mechanism for compensatory financing and for the purpose of facilitating decision by Governments on this subject.

(b) To inquire, in the light of the studies already carried out on this subject by the United Nations and by other international organizations, whether and to what extent a scheme for compensatory financing can be adapted for offsetting the long-term declines in export receipts of primary exporting countries and the deterioration in their terms of trade; and to consider what guidance could be given to the Commission for its work relating to the other necessary measures for remedying the long-term situation.

The Group held its first meeting at U.N. headquarters in New York from September 5 to 14; it elected Mr. Goran Ryding of Sweden as its Chairman and Mrs. O.E.B. Gunewardene of Ceylon as Vice-chairman. Messrs. J.J. Polak, J. Marcus Fleming and Miss G. Lovasy of the Research Department and Messrs. G. Nicoletopoulos and F. Ballmann of the Legal Department attended at various times as observers for the Fund.

The meeting was devoted mainly to preparing a tentative outline for the Report to be presented to the Commission and to providing guidance to the Secretariat with respect to material required for the next meeting of the Group, scheduled tentatively for early November 1962, in Geneva.

The draft outline for the Report provides for a description and appraisal of (a) existing and (b) proposed means for compensatory financing. The former include the use of domestic reserves and resort to the IMF under its present practices and policies. The latter refer to the Development Insurance Fund (DIF) proposed by the U.N. Group of Experts and the International Fund for Stabilization of Export Receipts proposed by the Group of Experts of the Organization of American States; it is envisaged that a subsection entitled "Revision of Fund Policies and Practices" may also be included here, if the report which the IMF was requested by the CICT to prepare[1] becomes available before the Group has concluded its deliberations. It is further intended, in accordance with the terms of reference, to present draft articles of agreement accompanied by explanatory material which will permit comparison of the essential features of the proposed plans mentioned above. The Secretariat was asked to prepare draft articles based on the DIF proposal so as to facilitate comparison with the scheme proposed by the OAS. The Group also requested statistical analysis of the two schemes as proposed and of a number of variants of these schemes. The IMF staff is cooperating with the U.N. Secretariat in its preparatory work.

1/ See SM/62/44, p. 9.

SM/62/44

Mr. Jorge Del Canto

Room 807

(1) #1

June 1, 1962

To: Members of the Executive Board

From: The Secretary

Subject: Meetings on International Commodity Trade - Report by Fund Observers

Attached for the information of the Executive Directors is a report by Fund staff observers on the Joint Session of the Commission on International Commodity Trade and the FAO Committee on Commodity Problems and on the Tenth Session of the Commission on International Commodity Trade held in Rome, May 7 to 23, 1962.

Att: (1)

Other Distribution:
Department Heads
Division Chiefs

INTERNATIONAL MONETARY FUND

Joint Session of the Commission on International Commodity Trade and the FAO Committee on Commodity Problems and on the Tenth Session of the Commission on International Commodity Trade, held in Rome, Italy, May 7 to 23, 1962

Report by Fund Staff Observers

May 31, 1962

I. Joint Session

The joint session of the CICT and CCP opened on May 7 and was concluded on May 14. Miss Gertrud Lovasy, and, in the later stages, Mr. J. Marcus Fleming attended as Fund observers. (EBD/62/55)

Following the opening of the session with statements by Mr. B. R. Senn, Director-General of the FAO and Mr. Philippe de Seynes, UN Under-Secretary for Economic and Social Affairs, Mr. Henri Janton of France was elected chairman of the joint session and Mr. Hector Bernardo of Argentina and Mr. Evgeny S. Shershnev of the U.S.S.R. were elected as first and second vice chairman.

The agenda covered three items of substance: (1) Prospective production of and demand for primary products; (2) National Marketing Boards and Stabilization Funds and (3) International compensatory financing as applied to individual commodities.

Prospective production of and demand for primary products

The discussion centered primarily on a report prepared by the FAO: "Agricultural Commodities, Projections for 1970."1/ Projections were mainly based on population and income growth in individual countries and on trends in yields, acreage and animal numbers. Effects of changes in prices and in agricultural policies were not taken into account.

1/ E/CN.13/48.

With respect to foodstuffs, the Report concluded that shortages and malnutrition in low income countries would remain a major problem by 1970. In some other areas accumulation of agricultural surpluses would continue. With respect to raw materials growing competition with synthetic products would exert a depressing influence on prices. Demand in industrial countries both for foodstuffs and raw materials was expected to rise rather slowly and export receipts of the less developed countries were not expected to increase substantially in the course of the 'sixties.

There was general agreement that extension of food aid by high income surplus countries could assist in narrowing the gap between consumption levels in these and in the less developed countries. However, the final solution would have to be sought in acceleration of growth in agricultural production and national income in low income areas. As regards the unfavorable prospects for export earnings of primary producing countries, the ultimate solution to that problem was held to consist in diversification of output and exports, including industrialization and gradual development of exports of manufactures. Industrial countries could contribute to alleviate the situation by reducing trade barriers to agricultural imports, especially those from tropical zones. Some delegates urged that international measures be taken to raise or at least to maintain prices for agricultural products.

A second paper, submitted by the UN Secretariat 1/ dealt with demand projections for non-ferrous metals and for energy products (coal and petroleum) for the years 1965, 1970 and 1975. That paper which is part of a larger study on world economic trends being prepared by the UN, placed main emphasis on problems of definition and method rather than on actual quantitative forecasts. There was general agreement that the work on projection was very useful and should be continued.

International compensatory financing in relation to individual commodities

Discussions were based on a study prepared by the UN Secretariat 2/ which applied the mechanisms of the Development Insurance Fund (DIF) proposed by the group of experts 3/ to individual commodities. The results of the

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1/ "Prospective Demand for Non-Agricultural Commodities: Problems of Definition and Projection Methodology" E/CN.13/49.

2/ "A Development Insurance Fund for Single Commodities" E/CN.13/45.

3/ "International Compensation for Fluctuations in Commodity Trade" UN publication, Sales No.61.II.D.3.

study suggested that application of the scheme on a single product basis did not offer a promising approach. If participation were confined to countries exporting the particular commodity, the result, in most cases, would be to transfer funds between low income countries. Participation of importing countries, on the other hand would simply be a particular, though hardly the most desirable, form of extending aid to exporting countries. An alternative scheme under which transfers would be made from importers to exporters of individual products, or vice versa, according as prices were below or above a national trend price might prove more promising but presented various practical difficulties.

Most delegates agreed that a DIF scheme applied to export proceeds for individual commodities was subject to serious limitations and did not offer a practicable or desirable solution. Serious doubts were also expressed with respect to the alternative of compensating price fluctuations. It would prove difficult, if not impossible to find a generally acceptable standard for measuring price deviations. A number of delegates also objected to a scheme which, in case prices exceed such standard, would involve transfers from low to high income countries. Some delegations thought, however, that these difficulties could be overcome; even if the scheme under consideration might not be suitable some other form of compensatory financing applicable to price fluctuations could be found. A large number of delegates expressed preference for an approach not limited to individual commodities.

II. CICT Session

The tenth session of the Commission on International Commodity Trade opened on May 15 and was concluded on May 23. Mr. O. Dias Carneiro of Brazil was re-elected as chairman, and Messrs. Janton (France) and Lew (Federation of Malaya) as vice chairmen. The following countries were members of the Commission: Argentina, Australia, Belgium, Brazil, Bulgaria, Ceylon, Czechoslovakia, Ecuador, the Federation of Malaya, France, Madagascar, Mali, New Zealand, Pakistan, Peru, Sweden, the U.S.S.R., the United Kingdom, the United States and Uruguay. Mr. J. J. Polak, Mr. J. Marcus Fleming and Miss Gertrud Lovasy of the Research Department and Mr. George Nicoletopoulos of the Legal Department attended as Fund observers. (EBD/62/55)

The main item under consideration, in addition to the customary review of the situation in commodity trade was that of the compensatory financing of the export fluctuations of primary exporting countries.

Review of the situation in international commodity trade

The review indicated that export receipts of primary exporting countries increased by only 2 per cent from 1960 to 1961; the volume of exports advanced by 4 per cent but the continued decline in prices for primary products adversely affected receipts from trade. Prices of manufactured goods, on the other hand, were slightly higher in 1961 than the year before and the terms of trade of primary producing countries continued to deteriorate.

Short run factors including a decline in the consumption of some raw materials have affected trade in some commodities. The continued downward drift in the price level of primary products indicated, however, a more persistent imbalance between supply and demand. It was indicated that the causes of imbalance--and hence the appropriate remedies--varied for different commodities. In cases, e.g. coffee and cocoa, where the nature of the crop was largely responsible for the existing difficulties, concerted action affecting volume and prices of exports might provide a solution. In a number of primary products imports would benefit from any reduction in artificial incentives given to agricultural production in industrial countries. The problem was particularly difficult for commodities affected by the development of synthetics; action to support their prices would tend to reduce further their share in the market.

The U.S. delegation pointed to the considerable progress made toward implementing, in cooperation with other governments, a program intended to improve conditions in world commodity trade. Steps had been taken to set up a comprehensive agreement designed to deal with the severe problem presented by the large surplus production of coffee. Developments on the cocoa market, where some danger signals had appeared, were being kept under close review and the desirability of working toward a formal agreement concerning cocoa was being examined. With respect to the tin market, momentarily affected by acute shortage, the U.S. Government had had discussions with the Tin Council; possible accession to the existing agreement and utilization of U.S. excess stocks to supplement supplies so as to prevent further resort to substitutes was being considered. The problem arising for natural rubber from the expansion of output and consumption of the synthetic product would be studied, by the end of May, in a symposium on the future of both products.

The main concern of most other speakers was the persistent deterioration in the terms of trade of primary producing countries, largely resulting from the continuing decline in the prices received for their exports. Reference was made to the causes of the adverse development and the need for providing solutions to the long-term problems facing primary producing countries was emphasized.

Compensatory financing of export fluctuations

The Commission had before it a report on "Stabilization of Export Proceeds Through a Development Insurance Fund" (E/CN.13/43) prepared by the Secretary General for the purpose of elaborating the insurance scheme first put forward in the report "International Compensation for Fluctuations in Commodity Trade" (E/3447) which had been prepared by a group of UN Experts in early 1961 and discussed at the 9th session of the Commission. The report of the Group of Experts appointed by the Organization of American States to consider the Stabilization of Export Receipts was also circulated to the Commission for information.1/

Broadly speaking discussions revolved around whether and to what extent it was desirable to offset fluctuations in the export receipts in primary exporting countries by compensatory financing and, if so, what form such financing should take. Should it be achieved by extending the activities of the IMF or should some additional mechanism be created either along the lines of the Social Insurance Scheme suggested by the UN Experts--a scheme involving a mixture of grants and loans--or in the form of short-term credits of a fully reimbursable character as proposed by the OAS Expert Group?

In considering compensatory measures to offset short-term fluctuations most delegates referred to the present and potential role of the IMF. The Fund representative presented a brief statement on Fund policies and on transactions with primary producing countries which have greatly increased in recent years; he also expressed the Fund's interest in discussions and developments on the subject of compensatory financing.2/

The debate in the Commission, while showing much support for the general idea of compensating shortfalls in primary producing countries export receipts, indicated wide differences of opinion with respect to the means by which this should be achieved. The attitude of some countries towards the various possible solutions was more clearly defined than at the previous sessions of the Commission, but few countries were prepared to commit themselves definitely to one or the other approach.

1/ The nature of the proposals put forward by the OAS Experts and the UN Experts have been analyzed in some detail in SM/62/33 and SM/62/34 respectively.

2/ The statement by the Fund's observer is attached as Annex I.

Mr. Blumenthal, the U.S. Deputy Assistant Secretary of State for Economic Affairs, referred to the serious consideration given to compensatory financing by the U.S. Government and the exploratory work done in this field. In the U.S. view the assistance given by the IMF might usefully be supplemented by a mechanism providing credits in the case of export shortfalls. The U.S. Government had come to the tentative conclusion "that a general basically automatic compensatory financing scheme ... may be both desirable and feasible." Of the two approaches before the Commission the U.S. expressed a preference for the type proposed by the Experts of the OAS, partly because, after the initial contributions, it would be automatic and self-financing. It would, moreover, lend itself readily to coordination to the closely related activities of the IMF.

Among the other industrial members of the Commission, Sweden gave strong support to the UN Insurance Scheme. Proposals for legislation now before the Swedish Parliament envisaged the possibility of Sweden's participation in a compensatory financing scheme. The United Kingdom expressed itself as opposed to the idea of compensating receipts in export shortfalls as such. Compensatory financing had to take account of a country's over-all payments position and should not be linked to changes in any single component. Not only the DIF proposal but even in practice the OAS proposal would be likely to involve an element of aid distributed on criteria that were not necessarily the most desirable. The difficulties caused to primary producing countries because of primary shortfalls in their earnings might best be met by greater recourse to the IMF rather than by setting up a new body. France was not in favor either of the UN Insurance Scheme or of the OAS proposal since neither of the two approaches offered a solution of the problem of declining export prices. This problem would have to be approached by an organization of international markets on a commodity-by-commodity basis. If there had to be compensatory financing the delegate for France appeared to prefer that it should be on a commodity-by-commodity basis or on a regional basis. Short-term fluctuations in general exports could be met by drawing on the IMF and in this connection the IMF could 'perhaps pursue a more flexible and somewhat more automatic policy.' Belgium also pointed to the actual role of the Fund in providing financing for export shortfalls and stressed the need for finding a solution to the longer-term problems.

In general the less developed primary producing countries, with Pakistan and Brazil taking the lead, emphasized the need for compensatory financing. Most of the primary producing countries, however, laid great emphasis on the need for seeking solutions for the longer-term problems as well as for that of short-term fluctuations; some, notably Argentina, suggested that compensatory financing might be developed in such a way as to even out longer-term as well as cyclical fluctuations. This consideration lead most of these countries to express a preference for the grant-cum-loan proposals of the UN Experts over the pure credit proposals of the OAS Experts. The provision under the UN Insurance proposals that repayment obligations might be remitted after a certain period would to some extent assist countries faced with persistent declines in prices and stagnation of export receipts. Some of the support expressed by Latin American countries for the OAS scheme appeared to be based partly on the judgment that, as compared with the Insurance Fund proposal, this scheme had more prospects of acceptance on the part of industrial countries whose contributions would be essential. The United States, with the support of New Zealand, urged the importance of separating the problems of short-term fluctuations and longer-term trend and of confining compensatory financing to the former of these problems.

In spite of the divergencies of view expressed in the course of the debate the Commission was able to agree on the following summary of its findings, concisely expressed in the following extract from its report.

"It was unanimously agreed in the Commission that urgent action was needed to mitigate the impact on primary exporting countries of instability in their export earnings. Nearly all delegates agreed that additional arrangements for compensatory financing were called for. A majority of delegations held that the establishment of a new system was needed. In the view of some other delegations, a thorough examination of the possibility of expansion of existing systems would be required before any new system of compensatory financing should be set up. If such a mechanism were created, it should, in the opinion of most delegations, deal with fluctuations in export proceeds as a whole rather than with the proceeds of single commodities, should be established on a world-wide rather than on a regional or other restricted geographical basis, and should be basically automatic in its functioning. The view was expressed by some delegations that the need for compensatory measures could be obviated by appropriate action to remove the basic causes of instability."

As regards future action it was clear that some further investigation was called for before governments would be prepared to commit themselves to definite positions on the subject. At the suggestion of the U.S. delegation the Commission agreed on a two-pronged approach. (1) Setting up of a Technical Working Group composed of governmental experts, with which the IMF would be closely associated, whose primary job would be to examine the schemes for new compensatory institutions bearing in mind the assistance that the Fund can provide, and (2) a request to the Fund itself to prepare a report on any possible expansion in its own role with respect to compensatory financing. This request (see p. 9 below) is couched in general terms. In answer to this request, the Fund could confine itself to a restatement of its policies with respect to its own resources (revised as necessary in the light of recent developments); it could make proposals with respect to changes in its policies designed to provide additional arrangements for compensatory financing; it could take account of the proposals for setting up new compensatory institutions and comment on its own possible relation to any new institutions; or it could do some combination of these things.

The Commission expressed the desire that the Fund's report might be available "as soon as possible." These words implied some hope that the Working Group would, at some stage of its work, be able to take account of the Fund's report. It would in any event be expected that the Fund's report would be available for consideration by the Commission at its next session in May 1963, which would require completion of the report early in 1963.

The conclusions of the Commission are set forth below in the language of the Commission's Report.

"The Commission while conscious of the urgent need for measures to offset fluctuations in the export earnings of primary exporting countries, felt that it was not in a position to recommend acceptance of any particular measure without a further study of the various schemes suggested in this connection. Consequently, it considered it necessary to study in greater detail systems of compensatory financing to mitigate the effects of short-term fluctuations in export earnings and at the same time to intensify examination of the necessary measures for remedying the unsatisfactory long-term trend in the export earnings of the primary exporting countries and the deterioration in their terms of trade.

"It accordingly decided, subject to the approval of the Economic and Social Council, to set up a Technical Working Group composed of the representatives of the following Member Governments: Argentina, Australia, Brazil, Ceylon, France, Mali, Pakistan, Sweden, U.K., U.S. It further suggested that the Member Governments of the Technical Working Group should be invited to appoint as their representatives experts with special knowledge of commodity problems and of compensatory financing arrangements.

"The terms of reference to the Technical Working Group would be as follows:

(a) To examine, in the light of the views expressed and the conclusions reached during the tenth session of the Commission, of the documentation available to that session and of the assistance that the International Monetary Fund can provide to primary exporting countries to overcome the problem of short-term fluctuations in their export earnings, the scheme for a DIF submitted by the United Nations Group of Experts and the scheme of compensatory financing for fluctuations in export receipts drawn up by the Organization of merican States and submit its considered views to the eleventh session of the Commission together with the text of a draft agreement including any necessary variants for the purpose of illustrating a specific mechanism for compensatory financing and for the purpose of facilitating decision by Governments on this subject.

(b) To inquire, in the light of the studies already carried out on this subject by the United Nations and by other international organizations, whether and to what extent a scheme for compensatory financing can be adapted for offsetting the long-term declines in export receipts of primary exporting countries and the deterioration in their terms of trade; and to consider what guidance could be given to the Commission for its work relating to the other necessary measures for remedying the long-term situation.

(c) To report in good time to enable the Commission at its eleventh session in 1963 to make recommendations to the ECOSOC. The report should be in the hands of the Secretary General before 12 January 1963 so that it may be distributed to Member Governments by 23 February 1963.

"The Commission expressed the wish that the representatives of the International Monetary Fund should be associated with the Technical Working Group's deliberations. It also expressed the wish that observers from the International Bank for Reconstruction and Development, the United Nations Food and Agriculture Organization and the General Agreement on Tariffs and Trade should be present at these deliberations.

"The Commission invited the International Monetary Fund, in the light of the discussion during the tenth session, and after consideration of the questions involved, to present, as soon as possible, a report as to whether and in what way the Fund might play an increased part in the compensatory financing of export fluctuations of primary exporting countries, and to keep the Technical Working Group currently informed of the progress of its deliberations on the subject.

"The Commission expresses the hope that the Technical Working Group will be able to hold its first session shortly after the thirty-fourth session of the Economic and Social Council."

Annex I

Statement on Compensatory Financing Before the Commission on International Commodity Trade, 132nd Meeting, 18 May 1962 by Mr. J. J. Polak, Observer from The International Monetary Fund

Since this Commission met a year ago, a great deal of interesting and important work has taken place on the subject compensatory financing of export fluctuations. The proposals based on insurance payments and premiums and on contingent loans, that were presented to this Commission by an Expert Group in 1961, have been elaborated in a thorough report by the U.N. Secretariat. Under the auspices of the OAS another Expert Group has produced, in great precision and detail, a different approach to the problem, based on the provision and repayment of credit on an automatic basis.

The Fund has been following these developments with the greatest interest. As the Managing Director of the Fund stated at ECOSOC last month, "they form part of the efforts evident in many quarters to find ways of meeting the needs of the less developed countries." The primary producing countries constitute some four-fifths of the total Fund membership, and a very large share of Fund activities consists of working out with these countries programs of action in the financial field that will benefit the development of their productive resources. In performing this task the Fund has necessarily become aware of the unsettling effects that fluctuations in export proceeds can have for these countries. The Fund has also been interested in these various proposals because some of the functions of the new institutions contemplated are rather closely related to the Fund's own functions.

The members of this Commission will recall that, at an early stage of its deliberations on the subject of compensatory financing, the Commission requested from the Fund a report on its policies in this field. This report, entitled "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations" was submitted to this Commission in the spring of 1960. It stated in considerable detail the policies applicable to the use of the Fund's resources for the compensation of export fluctuations, and these policies were restated by Fund representatives at subsequent meetings of this Commission and of the Expert Group.

Briefly speaking, the Fund's policies on the use of its resources by a member are related to a country's quota in the Fund. Drawings that do not exceed the first 25 per cent of this quota, the so-called "gold tranche," are given "the overwhelming benefit of any doubt," which means that they are virtually automatic. The Fund's attitude towards drawings falling within the next 25 per cent of the quota, the so-called "first credit tranche," is a liberal one, provided that the member itself is also making reasonable efforts to solve its problems. Requests for drawings beyond these limits, i.e., in the higher tranches require substantial justification, in the form of a sound program to establish or maintain the enduring stability of the country's currency at a realistic rate of exchange.

The Fund has made it clear that it considers the provision of foreign exchange to assist in the compensation of short-term fluctuations in export proceeds a legitimate use of Fund resources, not only in the earlier but also in the higher quota tranches. As was stated in our 1960 paper "members of the Fund that are taking appropriate steps to preserve internal financial stability and to maintain their balance of payments in equilibrium, taking good years with bad, and that are otherwise making satisfactory progress toward the fulfillment of the Fund's purposes can anticipate with confidence that financing will be available from the Fund, which, in conjunction with a reasonable use of their own reserves, should be sufficient to enable them to overcome temporary payments difficulties arising from export fluctuations.

In applying these principles the Fund has in many actual cases given sympathetic consideration to the difficulties of countries whose payments problems have been occasioned or aggravated by crop failures or other export fluctuations of a genuinely short-term character. While the Fund will, as indicated, want to be assured (increasingly as drawings reach into higher tranches) that the drawing member adopt policies adequate to enable it to overcome its payments difficulties, it is clear that no additional corrective policies are required to the extent that a member's balance of payments deficit is due to temporary factors of the nature just mentioned. In discussing with the member its program to attain payments equilibrium the Fund always takes account of adverse factors of a genuinely temporary character. It would, of course, be clear that a country experiencing a declining export trend, say because of the existence of large surplus stocks overhanging the market for its major commodity, could not plan on a continuing payments deficit while relying on short-term credits to stave off its difficulties.

In 1961 the Fund's transactions with primary producing countries have been larger than in any previous year; 22 countries drew a total of $979 million. Repayments by primary producing countries were $350 million, leaving a net increase in Fund transactions outstanding with the nonindustrial countries of about $630 million. The total amount outstanding of Fund drawings by the primary producing countries has, indeed, shown a persistent tendency to increase from around one quarter billion dollars in the early 1950's to about $1.5 billion at the end of 1961.

The causes which led to the use of Fund's resources were manifold and (as we indicated to this Commission on earlier occasions), the evidence does not suggest declines in export proceeds as the single main cause of the balances of payments difficulties of the countries assisted. Frequently, these difficulties were closely related to increases in imports associated with excessive internal credit expansion. In a number of countries, however, a faltering in export receipts contributed to, or was the main factor responsible for, the underlying payments problem. Among the countries that used the Fund in 1961 where export shortfalls or stagnating exports have added to the difficulties, were Argentina, Australia, Brazil, Colombia, Nicaragua, Honduras, Ecuador, Turkey, the Philippines, Indonesia, Ceylon and the UAR.

At the present time, 28 primary producing countries have drawings outstanding from the Fund; three others are entitled to draw between 50 and 100 per cent of their quotas under stand-by arrangements. In all, 19 countries, all but one primary producing, have open stand-by arrangements with the Fund which, if fully drawn, would raise the outstanding drawings of many of these countries to the equivalent of three-quarters of their quotas or their full quotas and, in two instances to 125 per cent of quotas. In agreeing to drawings of such magnitudes compared to countries' quotas, the Fund has in recent years made frequent use of the special provision under which net drawings by a country may be allowed to exceed 25 per cent of its quota in a year.

In several cases, a stand-by has been arranged in anticipation of payments difficulties arising from export shortfalls; Syria, where exports were adversely affected by poor crops, has recently made such an agreement.

In general the Fund's policies with respect to compensatory financing have been treated with understanding both by the Group of Experts under Sir John Crawford's chairmanship and by this Commission. A number of suggestions have been made by the Experts and by the Commission for certain modifications and developments in that policy. The Fund has taken note of these suggestions and is continuing to give consideration to them. In considering these matters, the Fund will of course bear in mind the proposals for action in this field by other institutions.

This Commission has various proposals before it, whose common objective is to supply compensatory financing on a more or less automatic basis. As I stated before, the Fund has been following these matters with great interest in the past; it is ready to participate actively in any subsequent international discussions of these or other proposals for compensatory financing.

EBD/62/73

Mr. Jorge Del Canto

Room 807

(1)

May 24, 1962

To: Members of the Executive Board

From: The Acting Secretary

Subject: Compensatory Financing of Export Fluctuations

Attached are the key paragraphs on the above subject (subject to possible minor changes in wording) of the report of the 10th Session of the Commission on International Commodity Trade as agreed in Rome on May 23.

A full report by the staff team attending this meeting will be submitted later.

Att: (1)

Other Distribution:
Department Heads
Division Chiefs

Compensatory Financial Measures to Offset
Fluctuations in the Export Income of Primary
Producing Countries

/Paragraphs 1 through 4 Introductory/

5. It was unanimously agreed in the Commission that urgent action was needed to mitigate the impact on primary exporting countries of instability in their export earnings. There was general agreement, also, with the view that additional arrangements for compensatory financing were called for. A considerable number of delegations held that the establishment of a new system was needed. In the view of some other delegations, a thorough examination of the possibility of expansion of existing systems would be required before any new system of compensatory financing should be set up. If such a mechanism were created, it should, in the opinion of most delegations, deal with fluctuations in export proceeds as a whole rather than with the proceeds of single commodities, should be established on a world-wide rather than on a regional or other restricted geographical basis, and should be basically automatic in its functioning. The view was expressed by some delegations that the need for compensatory measures could be obviated by appropriate action to remove the basic causes of instability.

/Paragraphs 6 through 13 explain positions of countries/

Conclusion

14. The Commission while conscious of the urgent need for measures to offset fluctuations in the export earnings of primary exporting countries, felt that it was not in a position to recommend acceptance of any particular measure without a further study of the various schemes suggested in this connection. Consequently, it considered it necessary to study in greater detail systems of compensatory financing to mitigate the effects of short-term fluctuations in export earnings ... .

15. It accordingly decided, subject to the approval of the Economic and Social Council, to set up a Working Party ... .

16. The terms of reference of the Working Party would be as follows: (a) To examine, in the light of the views expressed and the conclusions reached during the tenth session of the Commission, of the documentation available to that session and in the light of the assistance that the International Monetary Fund can provide to primary exporting countries to overcome the problem of short-term fluctuations in their export earnings, the scheme for a DIF submitted by the United Nations Group of Experts and the scheme of compensatory financing for fluctuations in exports receipts

drawn up by the Organization of American States and submit its considered views to the eleventh session of the Commission together with a draft agreement for the purpose of illustrating a specific mechanism for compensatory financing and for the purpose of facilitating decision by Governments on this subject. (c) To report in good time to enable the Commission to take a decision on these questions at its eleventh session in 1963.

17. The Commission expressed the wish that the representatives of the International Monetary Fund should be associated with the Working Party's deliberations. It also expressed the wish that observers from the International Bank for Reconstruction and Development, the United Nations Food and Agriculture Organisation and the General Agreement on Tariffs and Trade should be present at those deliberations.

18. The Commission invited the International Monetary Fund, in the light of the discussion during the tenth session, and after consideration of the questions involved, to present, as soon as possible, a report as to whether and in what way the Fund might play an increased part in the compensatory financing of export fluctuations of primary exporting countries, and to keep the Working Party currently informed of the progress of its deliberations on the subject.

19. The Commission expresses the hope that the Working Party will be able to hold its first session shortly after the thirty-fourth session of the Economic and Social Council.

May 3, 1962

A Comparison of Formulae for Normal Exports

by J. Marcus Fleming, R. R. Rhomberg and Lorette Boissonneault

Introduction

In recent years, a number of proposals have been made for arrangements whereby short-term fluctuations in the export receipts of primary producing countries would be automatically offset, in whole or in part, by international transfers in the form of grants, loans and repayments, or by insurance transactions.

It is an essential feature of all of these schemes, and indeed of any conceivable scheme of compensatory financing, that compensable fluctuations in exports be defined in terms of the deviations of actual exports from some normal level. Moreover, if positive and negative deviations are to come into approximate balance over an appropriate period, two conditions must be fulfilled:

(a) The norm itself from which the deviations are measured must move with, though more gradually than, the movement in actual exports, and the shorter the period within which an approximate balance between positive and negative deviations is to be attained, the more responsive the norm must be to the movements in actual exports.

(b) The norm should, ideally, reflect not only the actual exports of the more or less recent past but also those of the more or less imminent future. Otherwise, if the movement in actual exports has a persistent tendency in one direction, the movement in the norm will lag continuously behind that in actual exports so that, if the persistent trend is upwards, positive deviations of actual exports from the norm will predominate, while if the trend is downwards, negative deviations will be the rule.

In "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations"1/ a five year moving average of exports centered on the middle year is taken as the statistical definition of normal exports. The norm thus reflects the influence of exports up to two years before and two years after the year to which it relates. This definition seems--from the charts annexed to the present paper--to result in deviations that correspond reasonably well with what economists usually have in mind when they speak of short-term export fluctuations. We shall call this the "ideal" norm.2/

As a basis for schemes of compensatory financing any such norm is "ideal" only on the assumptions (a) that payments to and from countries under the schemes are based on deficits and surpluses of actual relative to normal exports, and (b) that to the extent that import needs vary with exports such deficits and surpluses will remain uncompensated.

Any attempt, however, to compensate or offset by financial means export fluctuations measured in relation to the "ideal" norm, thus defined, runs into the difficulty that its value for any year cannot be derived from export data

1/ IMF Staff Papers, November 1960.

2/ Other definitions of the "ideal" norm are, of course possible. For the reasons given, however, any plausible definition would have to reflect in some way the influence of future, as well as of past, years.

that are already established at the time when the estimation has to be made. For practical purposes, therefore, the norm for any year has to be estimated on the basis of data relating to the same or previous years. Indeed, it has usually been assumed that such "practical" norms can be based on data relating only to previous years and not to the year for which the norm is calculated. This, however, seems to be an unnecessary restriction. It is certainly true that the data must relate to periods prior to the time of estimation, but when the ultimate purpose is to measure compensable variations the estimation of the norm may well take place after the year to which the norm relates. In any event any estimate of a compensable variation involves estimating not only the norm but also the actual level of exports for the year in question, and whatever estimate is made for the actual year can and should be used also in the calculation of the norm. If a preliminary estimate of actual exports for any year is made on a partially forecast basis before the end of that year, the same preliminary estimate can be used in calculating the norm, and this will reduce the effect of any errors in estimating actual exports on the measurement of the compensable variation.

The question arises of how to assess the relative merits of alternative methods of estimating the "practical" norm. In a general sense, it would seem that the more closely such a norm approximates the "ideal" norm the more satisfactory it will be. This opens up the possibility of a statistical testing of alternative "practical" norms in terms of their closeness of fit, as determined by least squares regression, to the "ideal" norm. However, it must be borne in mind that the "ideal" norm has been chosen as such by reason of a complex of qualities--notably smoothness and approximate balancing of shortfalls and excesses within a fairly short period of years, etc.--which are difficult to measure or even to define precisely, and it is quite possible as we shall see, that the result of one formula may deviate slightly less, in a statistical sense, from the "ideal" norm than another, and yet constitute on the whole a less satisfactory "practical" norm.

In the present paper, therefore, we seek to evaluate alternative formula for determining "practical" norms partly by comparing their closeness of fit to the "ideal" norm (as defined) and partly by comparing their movements on time charts relative to the movements of actual exports and of the "ideal" norm, respectively.

Estimates of export norms by governments for the purpose of determining appropriate national policies, or even by international organizations for the purpose of advising their members on policy or for the purpose of providing compensatory credit on a discretionary basis, can be made on the basis of a combination of quantitative and qualitative information relating to the circumstances of the particular country. In such cases it may be helpful, if only as a stage in the process of arriving at a "practical" norm, to combine relevant statistical data for immediately preceding years (including for certain purposes the current year) in dynamic (forecasting) formulae derived by statistical regression from data relating to a considerable number of years. For such purposes, the formulae can be tailormade to fit the circumstances of each country and may differ, as regards both the determining variables and the relative weights assigned to them, from country to country. Moreover, though the actual exports of immediately preceding years will always bulk large in the estimation of export norms, data reflecting other economic magnitudes likely to affect future exports e.g. domestic cost trends or the level of economic activity in other countries might well find a place in such calculations.

The situation is altered--and the scope for accurate estimation considerably narrowed--when the formula sought is one designed to be of service in connection with a multinational scheme for compensatory financing. For this purpose there is need of a formula of a type that is recognizably uniform as between countries, and that can be applied to an individual case both quickly and without resort to potentially controversial statistical manipulations.

The present paper deals exclusively with formulae deemed to be sufficiently simple in concept and uniform in character to be acceptable in connection with an international scheme. These formulae are tested for their relative degree of approximation to "ideal" export norms as defined above. The approximation can never be as close in the case of formulae applied uniformly to all countries as in that of formulae tailormade to suit the circumstances of individual countries. It is hoped to review formulae of the latter type in a subsequent paper.

The relationships tested

Practical norms have been calculated for 43 countries over the period 1951-61 according to a variety of formulae. In all of these the "practical" export norm, $\bar{x}$, is expressed as a weighted sum of actual exports, x, in the current year and in preceding years, i.e.

$\bar{x}_t = a_o x_t + a_1 x_{t-1} + a_2 x_{t-2}$ etc. where the subscript signifies the year to which the variable refers and a_o, a_1, a_2 etc. are constant coefficients. These formulae fall into two main classes:

A. Those in which the coefficients a_o, a_1, a_2, etc., measuring the extent to which the "practical" norm for year t is influenced by the actual exports of years t, t-1, t-2 etc. respectively, are determined a priori; and

B. Those in which the coefficients a_o, a_1, a_2 etc. are determined by least squares regression on the "ideal" norm, N_t (defined as a 5-year moving average centered on the middle year), i.e. the coefficients are so chosen as to minimize the percentage discrepancy between $\bar{x}_t$ and N_t.

Of the "practical" norms so calculated a few have been charted, while a somewhat larger selection has been included in Table 2 and a still larger selection in the Appendix Table.

In one type of Category A formula, equal weights are given to the exports of such years as are included. Thus, in the cases set forth in Table 2 the "practical" export norm of any year is equal respectively, to

(1) the actual exports of the current year $[\bar{x}_t = x_t]$,

(2) the actual exports of the preceding year $[\bar{x}_t = x_{t-1}]$,

(3) the 'unweighted' (i.e. equally weighted) mean[1] of the exports of the two preceding years [$\bar{x}_t = \frac{1}{2}(x_{t-1} + x_{t-2})$],

(4) the 'unweighted' mean of the exports of the three preceding years [$\bar{x}_t = \frac{1}{3}(x_{t-1} + x_{t-2} + x_{t-3})$],

(5) the 'unweighted' mean of the current year and preceding year, [$\bar{x}_t = \frac{1}{2}(x_t + x_{t-1})$],

(6) the 'unweighted' mean of the current year and two preceding years [$\bar{x}_t = \frac{1}{3}(x_t + x_{t-1} + x_{t-2})$].

Norms based on the 'unweighted' means of longer periods of years than those shown above show a poorer approximation to the "ideal" mean and are generally less satisfactory than those set forth above.[2]

Table 2 also shows

(7) a particular unequally weighted mean of the current year and the two previous years [$\bar{x}_t = \frac{1}{2}x_t + \frac{1}{4}x_{t-1} + \frac{1}{4}x_{t-2}$]. This particular formula is not, strictly speaking, of an a priori character, since it is a conscious approximation to one of the formulae arrived at by least squares regression.

A second type of Category A formula is also shown in Table 2, namely one in which the "practical" export norm for any year is equal to

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1/ The term "mean" signifies that the coefficients sum to zero.
2/ For "unweighted" means covering 4 years, see Appendix Table.

(8) a figure arrived at by extrapolating a straight line trend fitted (by least squares) to actual exports over the preceding six years, and

(9) the value for the current year of a straight line trend fitted to actual exports over a six year period ending in the current year.

Trends for longer or shorter periods than those shown here yield "practical" norms that approximate less closely to the "ideal" norms than those based on the six year trends (See Appendix Table). As is demonstrated in the Appendix, norms arrived at by trend fitting as at (8) and (9) above can be expressed as weighted means of actual exports in the six years ending, respectively, in the preceding year and in the current year, with unequal coefficients or weights. They, therefore, belong, where we have put them, in Category A.

For each "practical" norm of Category B, the coefficients expressing the influence on the "practical" norm for any year of actual exports in the several preceding or current years have been arrived at by a single least squares regression calculation including all countries. More precisely, the coefficients are such as to minimize the average <u>percentage</u> discrepancy between $\bar{x}_t$ and M_t for all 43 countries and all the years covered in the calculation in question. Of the "practical" export norms of Category B, four are included in Table 2 viz. those expressing the "practical" norm for any year as a weighted sum of actual exports in

(1) the two preceding years,

(2) the three preceding years,

(3) the current year and the preceding year, and

(4) the current year and two preceding years.

In all these cases, the regressions have been calculated (to permit comparison) over the same period, 1951 to 1959 inclusive. Formulae including a larger number of previous years' exports could have been--and some have been--calculated (See Appendix Table). With each addition of a year to the formula the 'fit' between $\bar{x}_t$ and N_t necessarily improves. But with each such additional year the number of years that can be included in the regression calculation declines and one can feel less and less confident of the validity of the results. As can be seen from the Appendix Table, the closeness of fit does not in fact increase very materially even when the number of years' exports included rises from 3 to 7. It has therefore been decided to stop short in Table 2 at the former figure.

Table 1 sets forth the coefficients or weights assigned by regression analysis under the various Category B formulae to actual exports in each of the years covered by the formula.

Table 1. Coefficients by which Actual Exports in Each of the Years Covered by the Formula is Multiplied to Yield a "Practical" Export Norm for the Current Year

Formula	t	t-1	t-2	t-3
B.1	* *	.64	.38	* *
B.2	* *	.63	.33	.07
B.3	.54	.46	* *	* *
B.4	.47	.28	.26	-

It will be noted that all the coefficients are positive, and that the later the year the higher and more positive they are. (These features are not necessitated by the nature of the calculation.) For formulae including year t-4, the regressions yielded coefficients for that year that were both small in magnitude and statistically of low significance. In general the coefficients add to more than unity, and the further back in time is the average year covered by the formulae, the higher is the sum of the coefficients. In this way, the general upward trend in the exports of the 43 countries is reflected in the calculation.

Coefficients for Category B formulae have been worked out by regression analysis not only for the period 1951-59 but also for overlapping sub-periods. As is shown in the Appendix the coefficients arrived at for the various formulae are remarkably stable in the various sub-periods.

Table 2. Extent of Discrepancy Between Practical Export Norm (on alternative definitions) and the Ideal Export Norm (defined as a centered 5-year moving average of actual exports) for 43 Primary Producing Countries

Estimate based on:	Percentage Standard Deviation[1/] 1951-59	1955-59
A - A Priori Formulae		
(1) Current year's exports	11.4	9.0
(2) Preceding year's exports	12.5	10.1
(3) Preceding 2 years' exports, equal weights	11.1	9.0
(4) Preceding 3 years' exports, equal weights	12.9	10.6
(5) Current year's and preceding year's exports: equal weights	7.6	6.2
(6) Current year's and preceding 2 years' exports: equal weights	6.9	6.1
(7) Current year's and preceding 2 years' exports: weights 50:25:25	6.3	5.6
(8) Trend of 6 preceding years extrapolated to current year	...	10.8
(9) Current year's value of trend of 6 years ending in current year	...	6.2
B - Formulae with Coefficients Based in Regression		
(1) Preceding two years' exports	10.4	8.6
(2) Preceding three years' exports	10.3	8.6
(3) Current year's and preceding years' exports	7.6	6.1
(4) Current year's and preceding 2 years' exports	6.1	5.4

1/ Root mean square percentage deviation of "practical" norm from "ideal" norm.

In Table 2 the standard percentage deviation of the various "practical" norms from the "ideal" norm is shown not only for the period 1951-59 as a whole, but also for the sub-period 1955-59.[1/] This has been done largely to facilitate comparison between the results shown for formulae A.8 and

1/ The category B formulae for which standard deviations are shown for the sub-period 1955-59 have the coefficients arrived at by regression for that sub-period, not for the period 1951-59.

A.9 (which are not available for the earlier part of the period) and those shown for other formulae, but it also shows the stability of the ranking of the different practical norms with respect to the magnitude of the deviation in question, a fact that is brought out even more convincingly in the Appendix Table where standard deviations are given for various sub-periods. The general decline in the standard deviation in successive sub-periods results from the greater stability of export earnings as the disturbances following the Korean War were left behind.

Evaluation of the tests

(1) Formulae that give a substantial weight to the current year's exports in the computation of the "practical" norm fit the "ideal" norm more closely than those that exclude the current year.

(2) As follows from the nature of the mathematical process involved, formulae for which the coefficients or weights are assigned by least squares regression yield a better fit than those in which weights are assigned *a priori*. The reason why the results of formula A.7 are close to those of B.4 is that the weights of the former were specifically chosen as an approximation to those of the latter. On the other hand, the results of A.5 ~~B.5~~ are close to those of B.3, because the least squares coefficients of the latter happen to be close to the equal weights of the former.

(3) Among the formulae using "unweighted" means, a closer fit to the "ideal" norm is obtained by using the exports of the preceding two years (A.3 ~~B.3~~) than by using the exports of the preceding three years (A.4 ~~B.4~~). This

is not surprising in view of the definition the "ideal" norm itself which gives weight to the last preceding and second last preceding years but not to the third last preceding year.

(4) Similar considerations help to explain the fact that formula A.6 gives a closer fit than formula A.5. However, the fact that formulae A.7 and B.4 give a closer fit than formula A.4 (i.e. the fact that a better fit is obtained when the current year is given a specially large weight) does not follow from the definition of the "ideal" norm, but indicates that the current year is a better predictor of the years immediately following than are past years.

(5) the 'unweighted' arithmetic mean of the previous 3 years (A.4) lies, in general, further from the "ideal" norm, and the 'unweighted' arithmetic mean of the previous 2 years, (A.3) lies only slightly closer to that norm than does the current level of actual exports (A.1). This does not mean that A.3 and A.4 fluctuate more widely than A.1. On the contrary, such moving averages of several years' exports necessarily pursue a smoother course than do the exports of a single year. Their wider deviation from the "ideal" norm results from the fact that where the long-term trend of exports is upward (downward) the "practical" norms A.3 and A.4 may lie for extended periods substantially below (above) the "ideal" norm.

(6) The percentage standard variation of the"practical" with respect to the "ideal" norm is, for the closest fitting of the "practical" norms (A.7 and B.4), 50 to 51 per cent less than that of the "practical" norm with the poorest fit, (A.4), and 45 to 47 per cent less than that of current actual exports.

(7) Even for the "practical" norm showing the closest fit to the "ideal" norm, (B.4) the average deviation over the 1951-59 period is more than 6 per cent, and of the *a priori* norms other than A.7, those showing the closest fit have an average deviation for the same period of 7 to 7½ per cent.

Comments on the Charts

The Charts annexed to this paper show, for 43 primary producing countries, the movements over the period 1950-61, of four different "practical" norms, together with actual exports and (up to 1959) the "ideal" norm. The four "practical" norms selected for charting are not confined to those that best fit the "ideal" norm but include some of those most frequently considered as practical norms in connection with schemes of compensatory financing, together with some that show a better approximation to the "ideal" norm. They are, running from top to bottom of the Charts:

A.4 Preceding three years' exports: equal weights,

A.3 Preceding two years' exports: equal weights,

A.6 Current year's and preceding 2 years' exports: equal weights, and

B.4 Current year's and preceding 2 years' exports: weights determined by least squares regression.

Examination of the Charts illustrates certain features of the different "practical" norms that are not revealed by the single statistical measure of percentage standard deviation from the "ideal" norm, discussed in the previous section.

Thus it is clear that where the long-term trend in actual exports is definitely upwards or downwards the deviations of actual exports from the "practical" norm are in all cases predominantly negative or positive, respectively. This is, of course, the more serious the greater (up to a point) is the average length of time between the years on whose exports the "practical" norm for the current year is based and the current year itself, i.e. the higher are the weights given to the more distant preceding years.

The "practical" norms all lag to some extent behind actual exports. Here, again, the lag is the longer the higher are the weights given to the more distant preceding years. Of the formulae illustrated in the Charts, the lag is greatest for the scheme shown in the top panel of the Chart (A.4). In this case, the average lag (of 2 years) appears to correspond roughly to half the length of the average export cycle in many countries and in those countries the "practical" norm therefore appears to move countercyclically to actual exports. This is an undesirable feature of any norm that is to be used as a basis for compensatory financing.

Though the "practical" norm (A.3) shown in the second top panel of the Charts fits the "ideal" norm more closely than does that (A.4) shown in the top strip, its movements are more abrupt and it is doubtful whether on balance it is superior to A.3 for purposes of compensatory financing. A similar objection could be brought against the "practical" norm shown in the bottom panel (B.4), as against that shown in the second bottom panel (A.6). In this case, however, it is arguable that the disadvantage of lesser smoothness is outweighed by the advantage of better timing in the movements of the norm, and hence a better balance of surpluses and deficits of actual exports with respect to the norm.

Conclusion

As we have seen, the merits of different formulae for arriving at a "practical" export norm for the purpose of compensatory financing cannot be assessed by any single measure. However, a very important measure would appear to be the smallness of the deviation of the "practical" norm in question for an "ideal" norm defined as a centered 5-year moving average of actual exports. Judged by this test as well as by other characteristics, such as smoothness, promptness of response to changes in long-term trend, etc. formulae that give weight to the current year and the two preceding years appear to be preferable to those giving no weight to the current year. As the weight assigned to the current year's exports rises above one third the "practical" norm will move still closer to the "ideal" norm, but with some loss of smoothness.

Appendix

This appendix sets out the procedure by which the standard deviations given in Table 2 of the text and in Table A of the Appendix have been computed and the methods by which the coefficients in Table 1 of the text and in Table B of the Appendix have been derived.

The normal level of exports, or the "ideal norm", N, for country j at time t is defined as the centered 5-year moving average of exports, x:

$$N_{jt} = \frac{1}{5}\left(x_{j,t+2} + x_{j,t+1} + x_{j,t} + x_{j,t-1} + x_{j,t-2}\right).$$

A particular "practical norm", $\bar{x}$, of the form

$$(1)\quad \bar{x}_{jt} = a_0 x_t + a_1 x_{t-1} + \ldots + a_n x_{t-n}$$

will differ from the value of the ideal norm for the country and year in question by a discrepancy or "error", U_{jt}. The criterion of goodness of fit which has been chosen in this study; uses these deviations expressed as fractions of the respective values of the ideal norm ($u_{jt} = U_{jt}/N_{jt}$).

This procedure makes the errors for different countries comparable and permits an evaluation of the closeness with which a particular practical norm approximates to the ideal norm on the average for all countries and for all years included in the computation. The measure of the average discrepancy given in Table 2 of the text is the standard deviation (the root-mean square) of the "errors" u_{jt} ($j=1, 2, \ldots, 43$; $t = 1951, 1952, \ldots, 1959$).

Since this procedure does not distinguish between the errors for different countries and for different years, the notation may be simplified accordingly. We write u_i for the difference between the two norms expressed as a fraction of the ideal norm,

$$u_i = \frac{N_i - \bar{x}_i}{N_i} = 1 - \frac{\bar{x}_i}{N_i}$$

where the subscript i runs over all countries and all years. We can write

$$(2)\quad u_i = 1 - a_o X_{io} - a_1 X_{i1} - a_2 X_{i2} - \ldots - a_n X_{in}$$

where X_{io} stands for the ratio of the exports of the country and the year to which i refers to the respective ideal norm, and X_{i1}, X_{i2}, ..., X_{in}, stand for the corresponding ratios of the country's exports in the first, second, ..., n-th, preceding year to the ideal norm of the current year; a_o, a_1, ..., a_n are as given in equation (1).

To determine the root mean square deviation for any chosen practical norm we compute

$$\sqrt{\frac{\sum_{i=1}^{m} u_i^2}{m}}$$

where m is the number of countries (in the present study 43) multiplied by the number of years for which the computation is carried out (for instance, 9 years in the case of the period 1951-59). These calculations are facilitated by obtaining the expression Σu_i^2 from equation (2) in terms of the coefficients a_k ($k = 0, 1, \ldots, n$) and of the sums of squares, and the sums of the cross-products of the X_{ik} ($i = 1, 2, \ldots, m$; $k = 0, 1, \ldots, n$). Having obtained these moments once, the goodness of fit of any (linear) practical norm can be derived by substituting the numerical weights of this norm, including zeros where applicable, into the expression for Σu_i^2. For instance, for the practical norm that gives equal weights to the preceding three years we would have $a_0 = 0$, $a_1 = 0.33$, $a_2 = 0.33$, $a_3 = 0.33$, $a_4 = 0$, $a_5 = 0$, ..., $a_n = 0$, and Σu_i^2 would be given by

$$(3)\quad \Sigma u_i^2 = m - 2(a_1\Sigma X_{i1} + a_2\Sigma X_{i2} + a_3\Sigma X_{i3} - a_1a_2\Sigma X_{i1}X_{i2} - a_1a_3\Sigma X_{i1}X_{i3} - a_2a_3\Sigma X_{i2}X_{i3}) + a_1^2\Sigma X_{i1}^2 + a_2^2\Sigma X_{i2}^2 + a_3^2\,\Sigma X_{i3}^2 \quad .$$

In order to find the set of weights, a_k^*, which will minimize the root mean square deviation for a practical norm which takes account of a given number, n', of current or past years' exports, we set the first derivative of Σu_i^2 with respect to each of the weights equal to zero and obtain n' equations of the form

$$\frac{\partial \Sigma u_i^2}{\partial a_k} = 2\Sigma\,(1 - a_0X_{i0} - \ldots - a_{n'}X_{in'})\,(-X_{ik}) = 0$$

$$(k = 0, 1, \ldots, n')$$

which are similar to the so-called normal equations of standard least-squares regression procedure. These n' equations can be solved for the n' values of a_k^*:

$$\left\{a_k^*\right\} = \left[\sum_i X_{ik}X_{ij}\right]^{-1} \left\{\sum_i X_{ik}\right\}$$

$$(k = 0, 1, \ldots, n';\quad j = 0, 1, \ldots, n')$$

where braces enclose column vectors and the square brackets contain the matrix of the second moments around the origin of the X_{ik}. It follows from the method of their derivation that these "optimal" weights, a_k^*, yield the smallest possible percentage deviation between the ideal norm and the practical norm for the period over which they have been fitted. Appendix Table B shows the weights a_k^* which were computed for the different subperiods. Optimal weights have been derived for three overlapping subperiods, 1951-55, 1953-57, and 1955-59, in addition to the computations for the full period 1951-59. It is seen that the optimal weights remain fairly stable from one fitting period to another. The standard errors of these weights have been found to range from 0.01 to 0.06. The weights that apply to the current year and to the two preceding years are generally at least 5 to 10 times as large as their standard errors.

Another type of practical norm mentioned in the text is the extrapolation of a straight-line trend fitted over the preceding θ years. For instance, if $\theta = 6$, we compute a trend equation from the exports of years 1 to 6 and make the extrapolated value for year 7 our practical norm for that year; similarly, extrapolation to year 8 of a trend equation fitted to years 2 to 7 gives the norm for year 8, and so forth. Alternatively, the practical norm can be defined as the trend value for the current year computed from a trend equation fitted to the export data for the current and the $\theta - 1$ preceding years.

While this method appears at first blush to be quite different from the one discussed previously, it can easily be reduced to similar terms. The practical norm may be expressed as a linear function of the θ preceding years' exports with coefficients which are given by the standard regression procedure of fitting a linear trend.

In fitting a trend line to θ observations of a variable y we get the equation

$$y_t = c_0 + c_1 t$$

where $c_0 = \dfrac{\Sigma t^2\ \Sigma y_t - \Sigma t\ \Sigma y_t t}{\theta\ \Sigma t^2 - (\Sigma t)^2}$ and $c_1 = \dfrac{\theta\ \Sigma y_t t - \Sigma t\ \Sigma y_t}{\theta\ \Sigma t^2 - (\Sigma t)^2}$

all summations being from 1 to θ. The extrapolation one year beyond the fitting period is

$$y_{\theta+1} = c_0 + c_1 (\theta + 1).$$

The proportional deviation of the ideal norm from the practical norm, defined as the extrapolated value of the straight-line trend over the preceding θ years, is then

$$(4)\quad u_i = 1 - [A_\theta + \theta B_\theta]\, X_{i1} + [A_\theta + (\theta - 1)B_\theta]\, X_{i2} + \ldots + [A_\theta + B_\theta]\, X_{i\theta}$$

where $A_\theta = \dfrac{\Sigma t^2 - (\theta + 1)\ \Sigma t}{\theta\ \Sigma t^2 - (\Sigma t)^2}$ and $B_\theta = \dfrac{\theta\ (\theta + 1) - \Sigma t}{\theta\ \Sigma t^2 - (\Sigma t)^2}$; $(t = 1, 2, \ldots, \theta)$.

For any given trend period θ, say, a 6-year trend, A_θ and B_θ are given constants and the coefficients of the X's in (4) are given coefficients. From the moments of the X's and a formula analogous to (3) the percentage standard deviations for different moving trends can be immediately derived without actually fitting the individual trend equations.

This approach to the problem shows that the moving-trend extrapolation method of determining the practical norm is merely one of an indefinitely large number of possible weighting schemes of the past θ export values. Such a set of weights can never be superior to the set a_k^* ($k = 1, 2, \ldots, \theta$), which is derived by minimizing Σu_i^2, and it could be equally good only by coincidence. The weights implied by the various moving trend methods of defining a practical norm are given in Appendix Table A where they can be compared with the corresponding optimal weights determined by least-squares and with the *a priori* weights that have been considered.

Appendix Table A. Extent of Discrepancy Between Practical Export Norm (on alternative definitions) and the Ideal Export Norm (defined as a centered 5-year moving average of actual exports) for 43 Primary Producing Countries

	Practical Norm: Weights applied to exports of period								Percentage Standard Deviation 1/			
	t	t-1	t-2	t-3	t-4	t-5	t-6	t-7	1951 1959	1951 1955	1953 1957	1955 1959
(1)	1.0								11.4	12.8	9.3	9.0
(2)		1.0							12.5	14.2	10.6	10.1
(3)	.5	.5							7.6	8.5	6.7	6.2
(4)		.5	.5						11.1	12.8	10.1	9.0
(5)*	.54	.46							7.6	8.5	6.6	6.1
(6)*		.64	.38						10.4	11.7	9.2	8.6
(7)	.33	.33	.33						6.9	7.6	6.5	6.1
(8)		.33	.33	.33					12.9	14.6	12.1	10.6
(9)	.5	.25	.25						6.3	6.7	5.6	5.6
(10)		.5	.25	.25					11.7	13.1	10.7	9.6
(11)*	.47	.28	.26						6.1	6.5	5.6	5.4
(12)*		.63	.33	.07					10.3	11.5	9.2	8.6
(13)	.25	.25	.25	.25					9.3	10.3	8.9	7.9
(14)		.25	.25	.25	.25				--	--	14.5	12.6
(15)**	.7	.4	.1	-.2					9.2	10.4	7.9	7.2
(16)**		1.0	.5	0.0	-.5				--	--	14.6	13.8
(17)*	.47	.28	.26	0.0					6.1	6.5	5.6	5.4
(18)*		.72	.28	.06	-.04				--	--	9.2	8.6
(19)**	.6	.4	.02	0.0	-.2				--	--	6.7	6.6
(20)**		.8	.5	.2	-.1	-.4			--	--	13.1	11.5
(21)*	.52	.30	.22	.04	-.06				--	--	5.4	5.3
(22)*		.73	.40	-.05	-.03	-.06			--	--	9.0	8.3
(23)**	.52	.38	.24	.10	-.05	-.19			--	--	6.4	6.2
(24)**		.67	.47	.27	.07	-.13	-.33		--	--	10.8	10.7
(25)*	.51	.31	.23	.04	-.03	-.07			--	--	5.3	5.2
(26)*		.65	.38	.06	.06	-.08	-.07		--	--	--	8.2
(27)**	.46	.36	.25	.14	.04	-.07	-.18		--	--	--	6.6
(28)**		.57	.43	.29	.14	0.0	-.14	-.29	--	--	--	11.4
(29)*	.48	.33	.23	.04	-.02	-.06	-.01		--	--	--	5.2
(30)*		.65	.38	.06	.06	-.08	-.07	0.0	--	--	--	8.2

1/ Root mean square percentage deviation of "practical" norm from "ideal" norm.

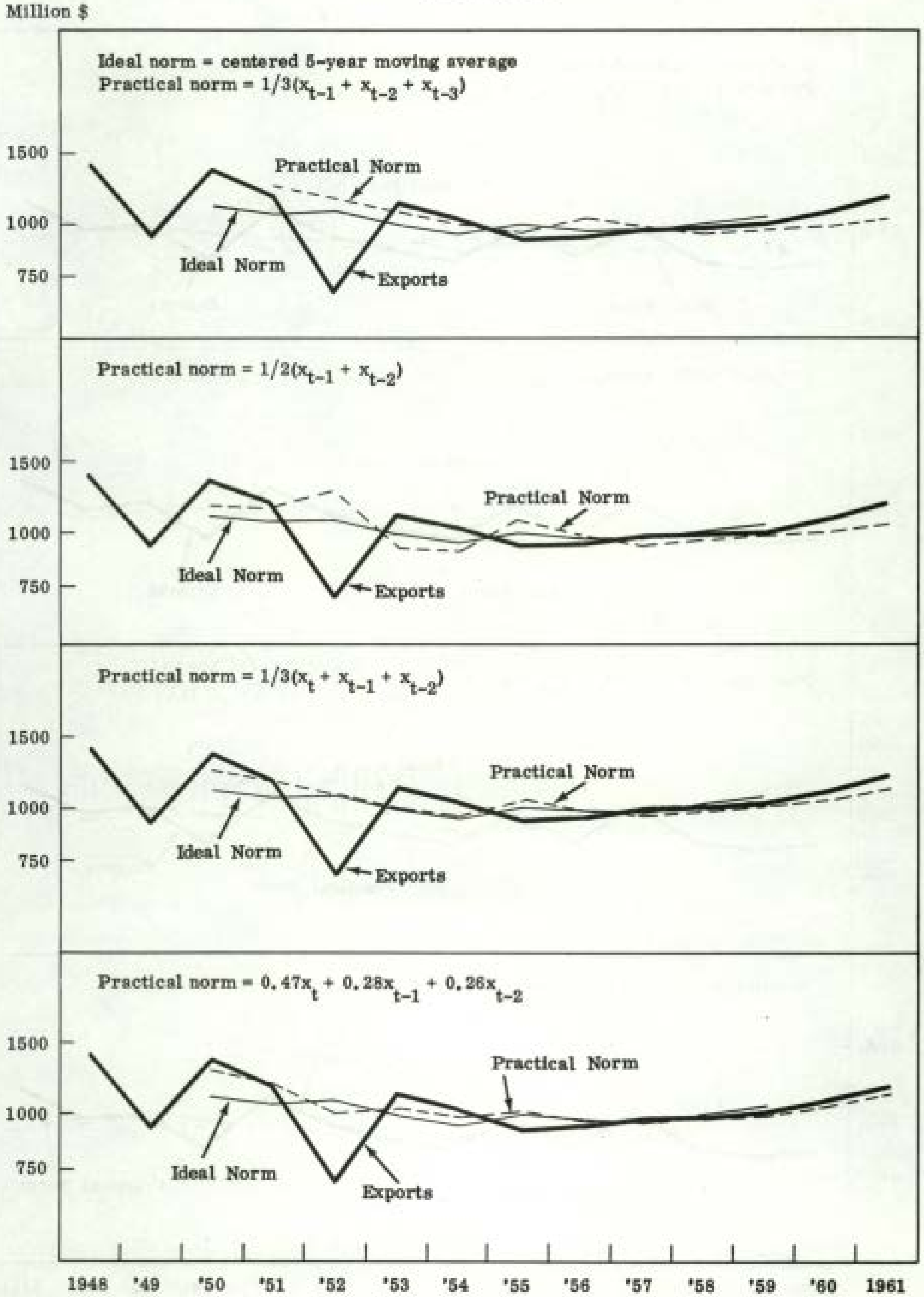
* Weights determined by regression. The weights given above refer to the period 1951-59 or the first subperiod for which the calculation could be made. The regression weights for the other subperiods are shown as Appendix Table B below.

** Weights implied by the extrapolation from moving trends. See discussion in the Appendix.

Appendix Table B. Weights Determined by Regression

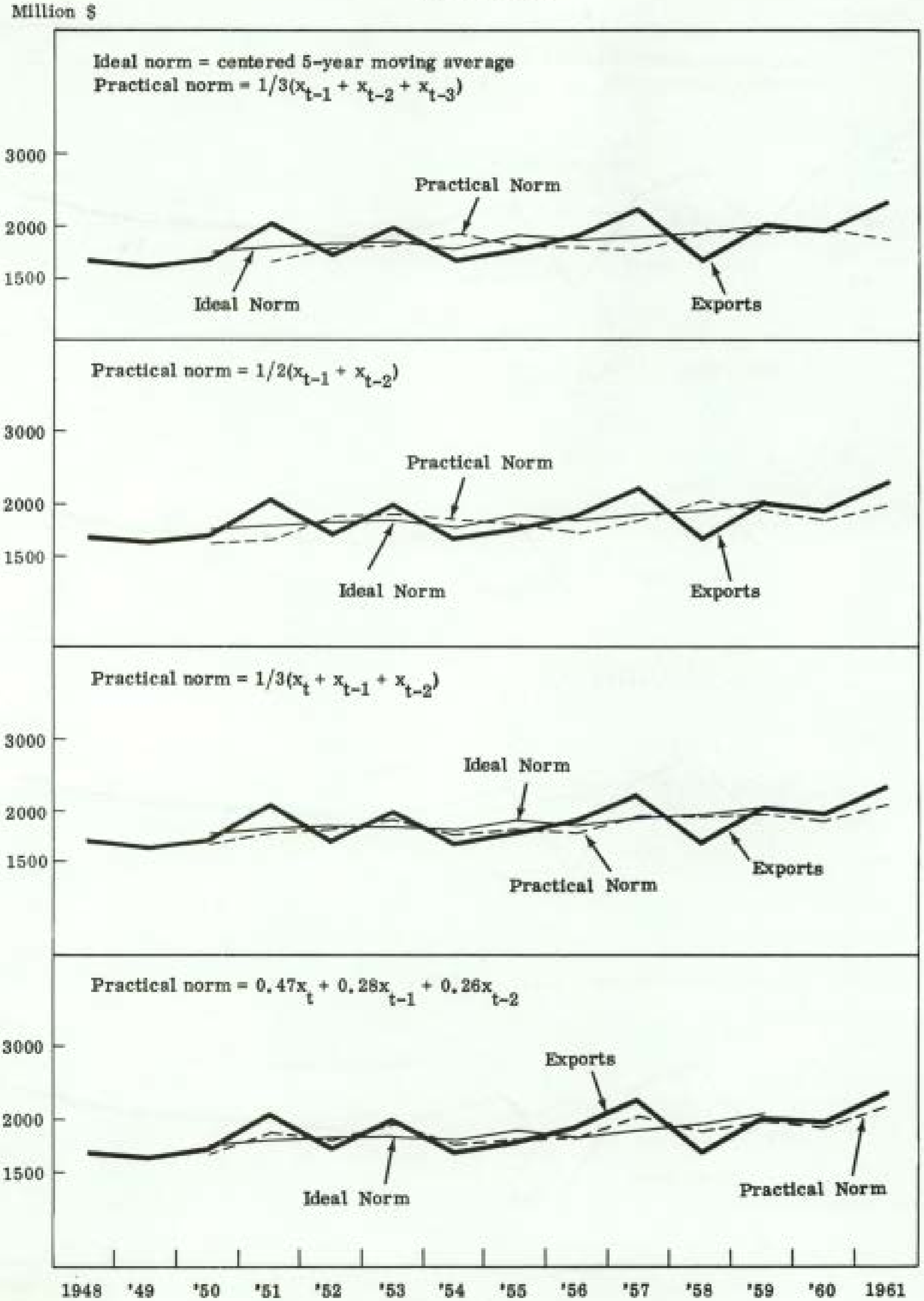
Number of Weights	Line of Table A	Fitting Period	Regression weights applied to exports of year							
			t	t-1	t-2	t-3	t-4	t-5	t-6	t-7
2 years	(5)	1951-59	.54	.46						
		1951-55	.55	.45						
		1953-57	.55	.45						
		1955-59	.55	.46						
	(6)	1951-59		.64	.38					
		1951-55		.64	.40					
		1953-57		.72	.30					
		1955-59		.65	.36					
3 years	(11)	1951-59	.47	.28	.26					
		1951-55	.48	.26	.28					
		1953-57	.51	.29	.22					
		1955-59	.49	.31	.21					
	(12)	1951-59		.64	.31	.07				
		1951-55		.63	.33	.07				
		1953-57		.62	.31	.12				
		1955-59		.71	.28	.03				
4 years	(17)	1951-59	.47	.28	.26	0.0				
		1951-55	.48	.26	.27	.02				
		1953-57	.51	.29	.22	0.0				
		1955-59	.49	.32	.23	-.02				
	(18)	1953-57		.72	.28	.06	-.04			
		1955-59		.65	.36	.01	-.01			
5 years	(21)	1953-57	.52	.30	.32	.04	-.06			
		1955-59	.49	.31	.24	.03	-.05			
	(22)	1953-57		.73	.29	.06	.01	-.08		
		1955-59		.67	.37	.04	.06	-.12		
6 years	(25)	1953-57	.51	.31	.23	.04	-.03	-.07		
		1955-59	.48	.33	.24	.04	-.02	-.06		
	(26)	1955-59		.65	.38	.06	.06	-.08	-.07	
7 years	(29)	1955-59	.48	.33	.25	.04	-.02	-.06	-.01	
	(30)	1955-59		.65	.38	.06	.06	-.08	-.07	0.0

ARGENTINA



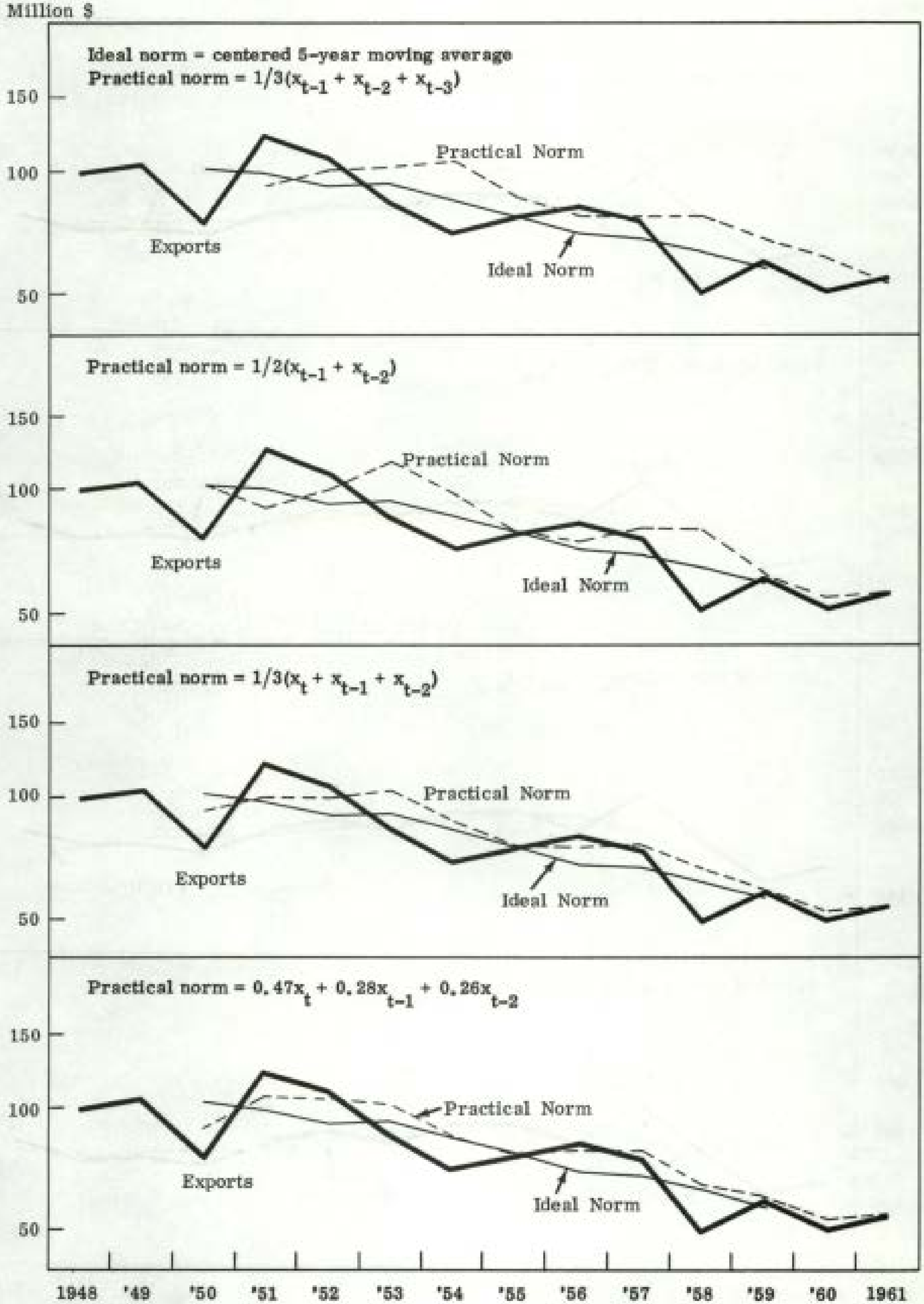
Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
Practical Norm
Ideal Norm
Exports
Practical norm = $1/2(x_{t-1} + x_{t-2})$
Practical Norm
Ideal Norm
Exports
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
Practical Norm
Ideal Norm
Exports
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
Practical Norm
Ideal Norm
Exports
1500
1000
750
1948
'49
'50
'51
'52
'53
'54
'55
'56
'57
'58
'59
'60
1961

AUSTRALIA



Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
3000
2000
1500
Practical Norm
Ideal Norm
Exports
Practical norm = $1/2(x_{t-1} + x_{t-2})$
3000
2000
1500
Practical Norm
Ideal Norm
Exports
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
3000
2000
1500
Ideal Norm
Practical Norm
Exports
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
3000
2000
1500
Exports
Ideal Norm
Practical Norm
1948
'49
'50
'51
'52
'53
'54
'55
'56
'57
'58
'59
'60
1961

BOLIVIA



Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
150
100
50
Practical Norm
Exports
Ideal Norm
Practical norm = $1/2(x_{t-1} + x_{t-2})$
150
100
50
Practical Norm
Exports
Ideal Norm
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
150
100
50
Practical Norm
Exports
Ideal Norm
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
150
100
50
Practical Norm
Exports
Ideal Norm
1948
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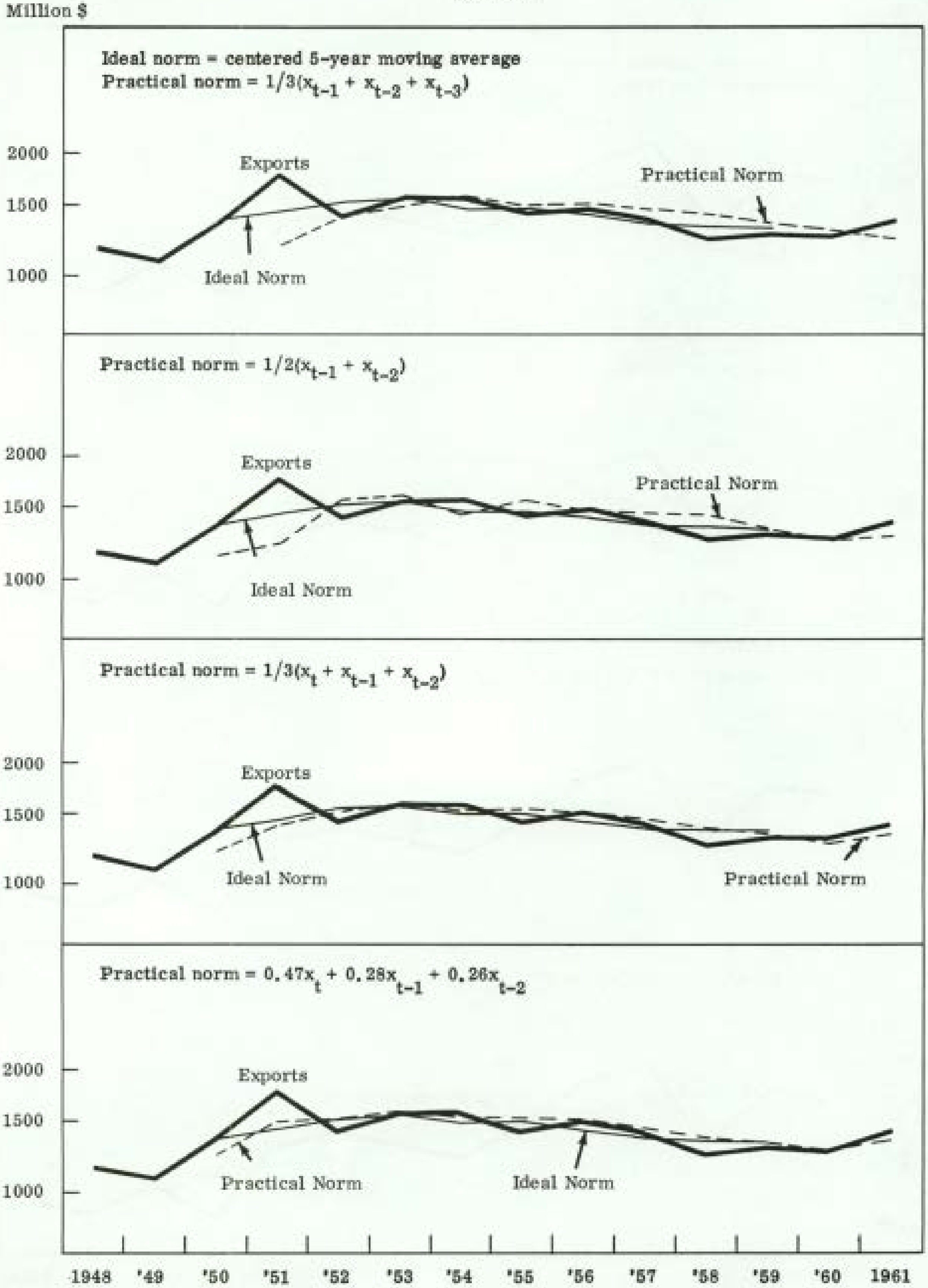
BRAZIL


Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
2000
1500
1000
Exports
Practical Norm
Ideal Norm
Practical norm = $1/2(x_{t-1} + x_{t-2})$
2000
1500
1000
Exports
Practical Norm
Ideal Norm
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
2000
1500
1000
Exports
Ideal Norm
Practical Norm
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
2000
1500
1000
Exports
Practical Norm
Ideal Norm
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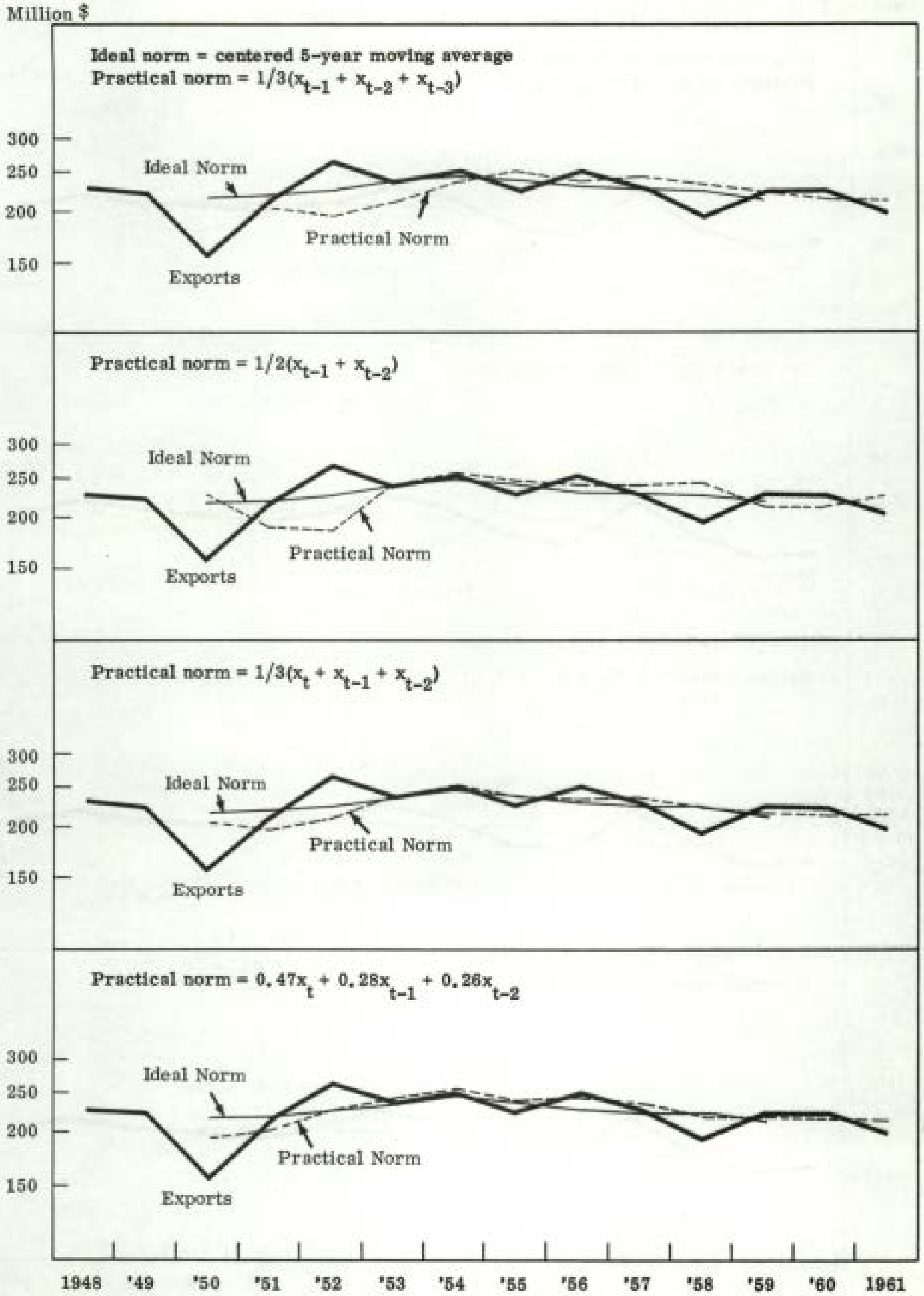
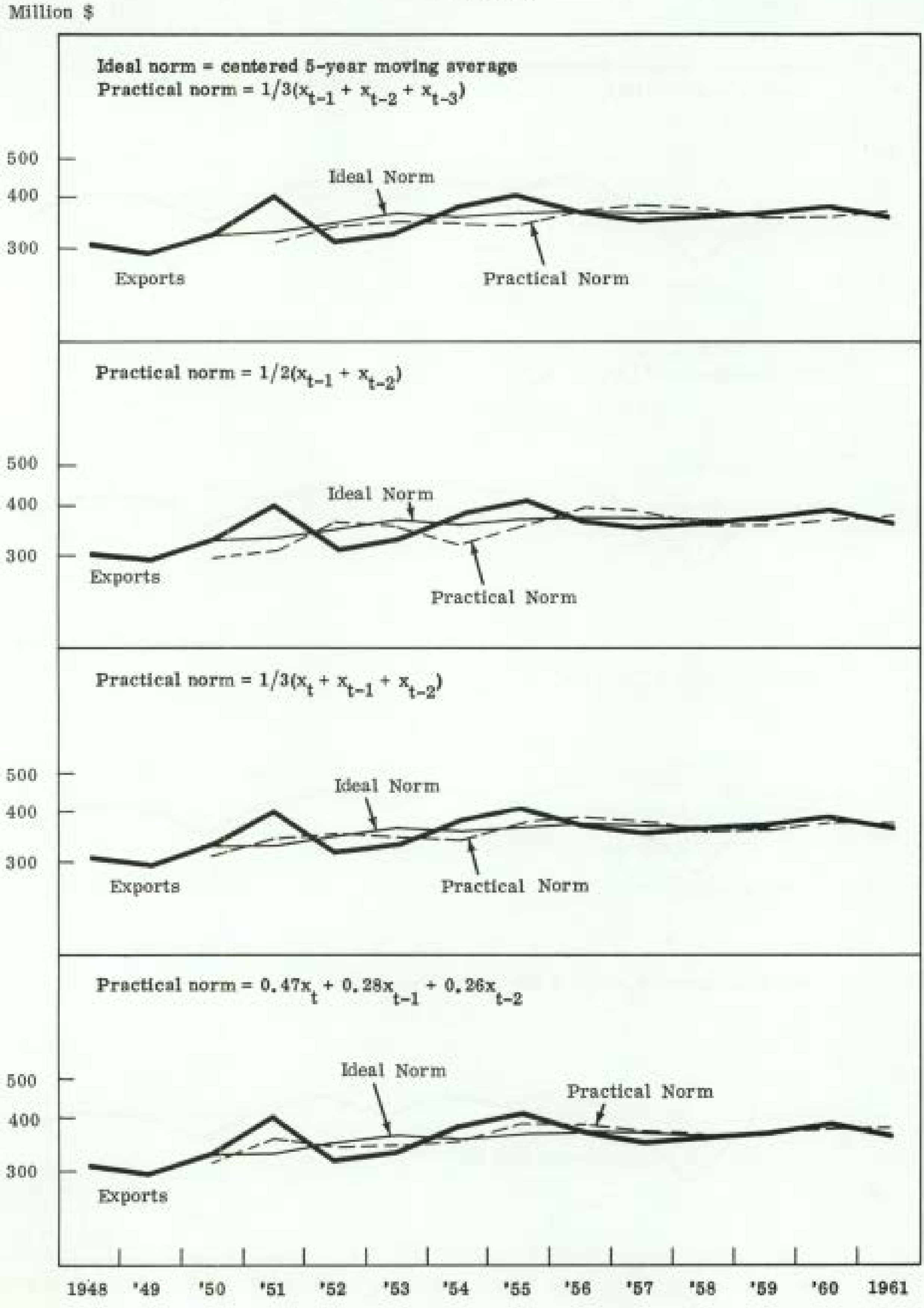
1961

BURMA



Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
300
250
200
150
Ideal Norm
Practical Norm
Exports
Practical norm = $1/2(x_{t-1} + x_{t-2})$
300
250
200
150
Ideal Norm
Practical Norm
Exports
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
300
250
200
150
Ideal Norm
Practical Norm
Exports
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
300
250
200
150
Ideal Norm
Practical Norm
Exports
1948 '49 '50 '51 '52 '53 '54 '55 '56 '57 '58 '59 '60 1961

CEYLON


Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
500
400
300
Ideal Norm
Exports
Practical Norm
Practical norm = $1/2(x_{t-1} + x_{t-2})$
500
400
300
Ideal Norm
Exports
Practical Norm
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
500
400
300
Ideal Norm
Exports
Practical Norm
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
500
400
300
Ideal Norm
Practical Norm
Exports
1948
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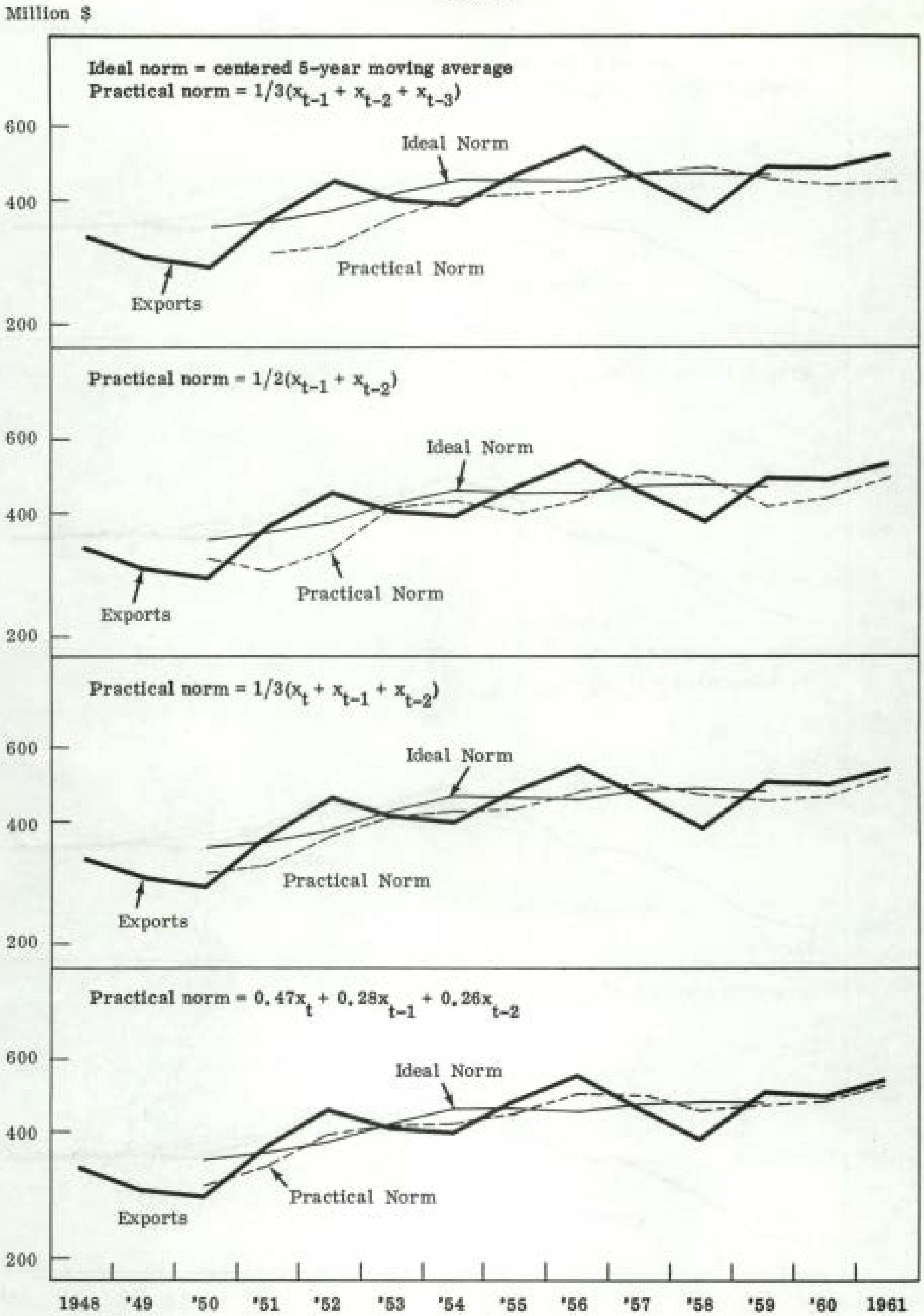
1961

CHILE


Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
Ideal Norm
Practical Norm
Exports
Practical norm = $1/2(x_{t-1} + x_{t-2})$
Ideal Norm
Practical Norm
Exports
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
Ideal Norm
Practical Norm
Exports
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
Ideal Norm
Practical Norm
Exports
600
400
200
1948
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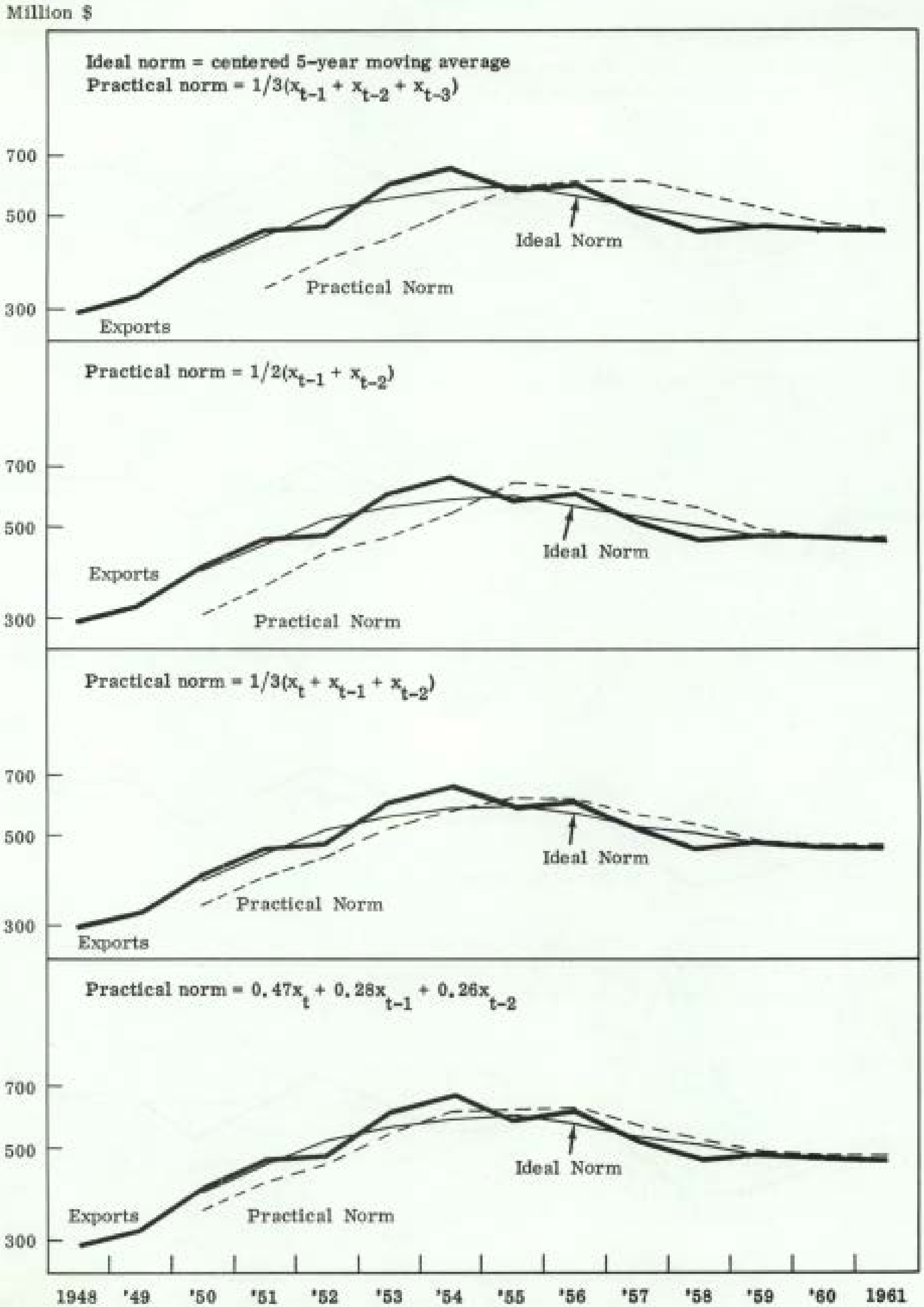
'60
1961

COLOMBIA



Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
700
500
300
Ideal Norm
Practical Norm
Exports
Practical norm = $1/2(x_{t-1} + x_{t-2})$
700
500
300
Ideal Norm
Exports
Practical Norm
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
700
500
300
Ideal Norm
Practical Norm
Exports
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
700
500
300
Ideal Norm
Exports
Practical Norm
1948
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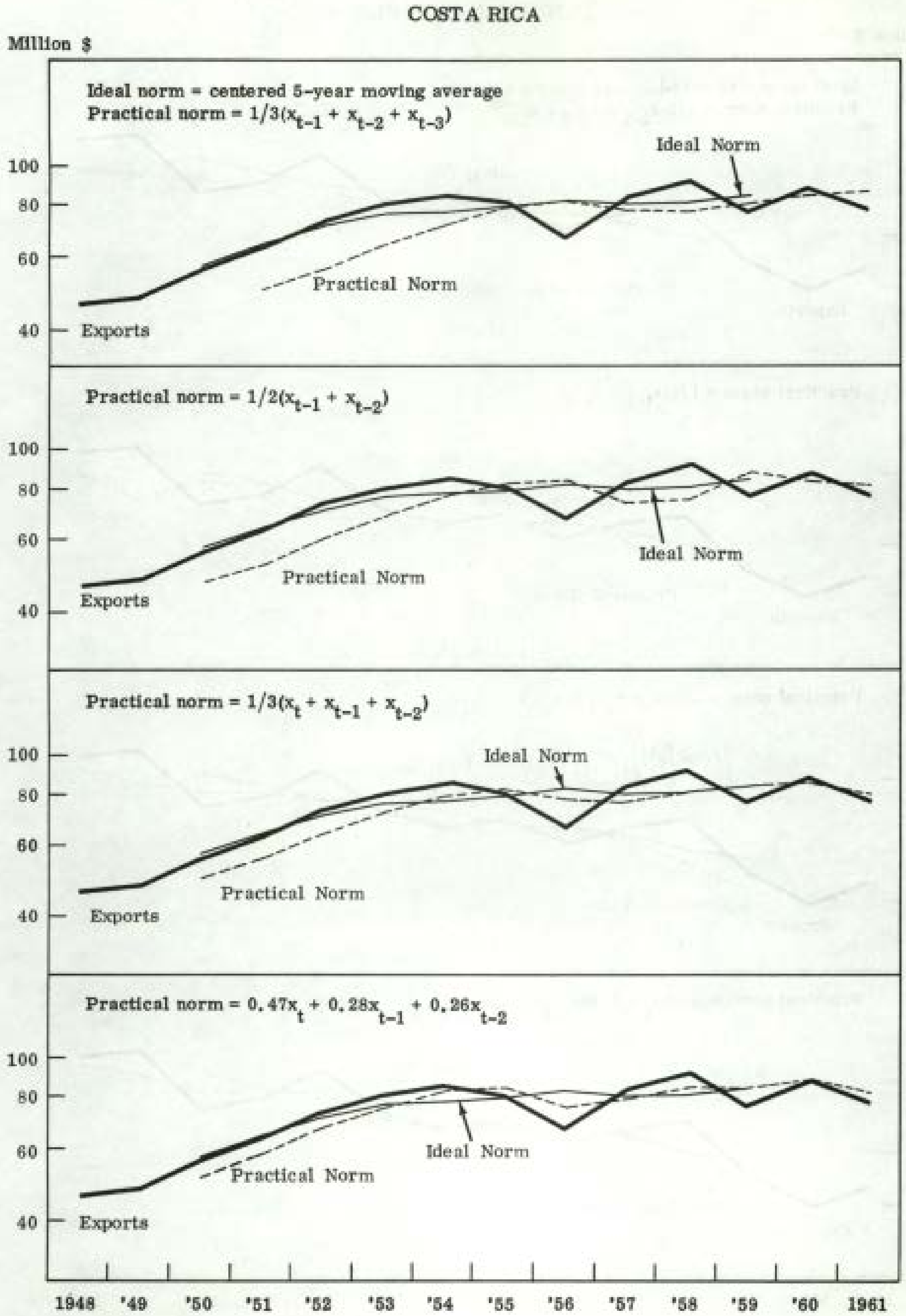
'60
1961


COSTA RICA
Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
Ideal Norm
Practical Norm
Exports
Practical norm = $1/2(x_{t-1} + x_{t-2})$
Ideal Norm
Practical Norm
Exports
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
Ideal Norm
Practical Norm
Exports
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
Ideal Norm
Practical Norm
Exports
100
80
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1948
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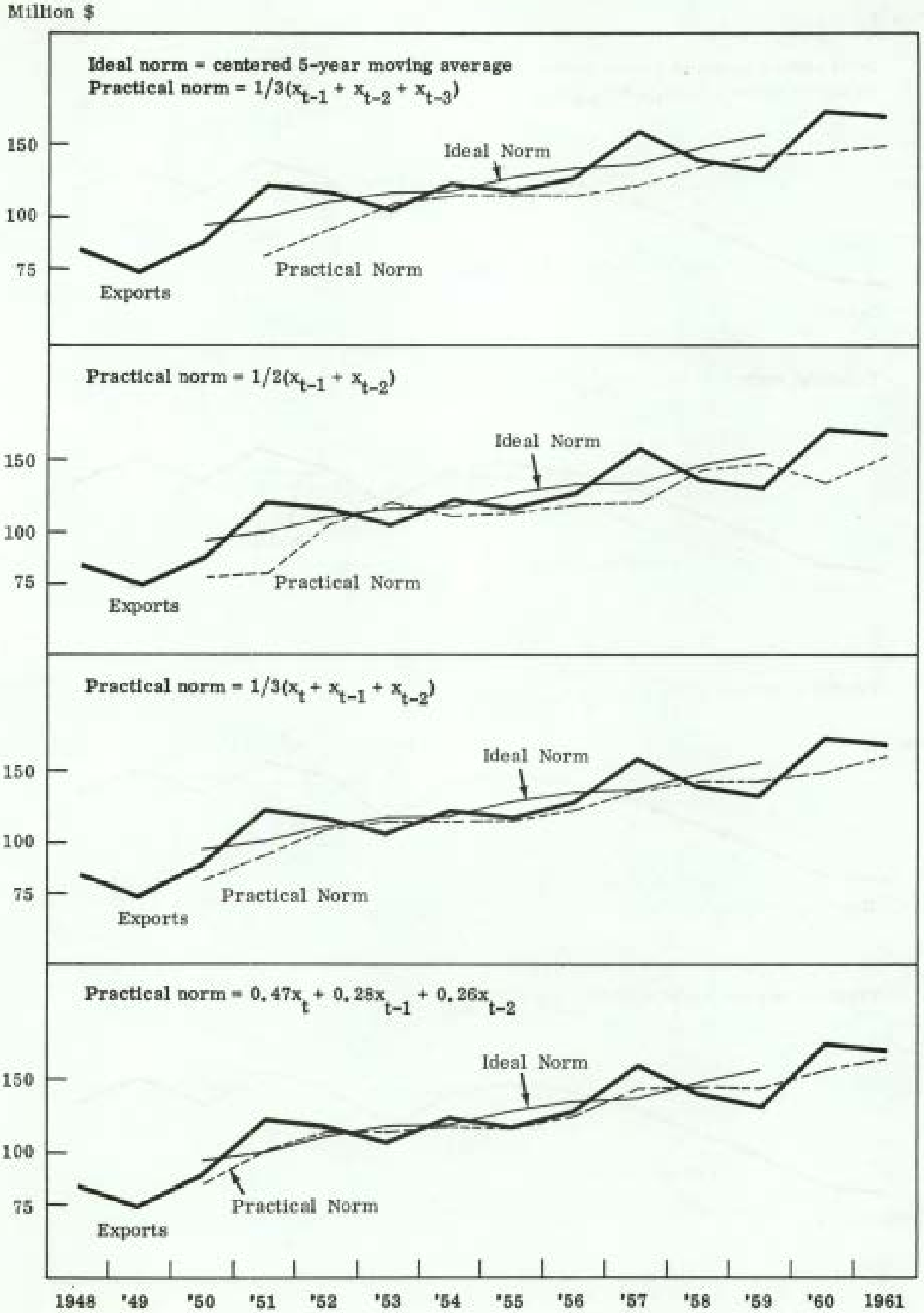
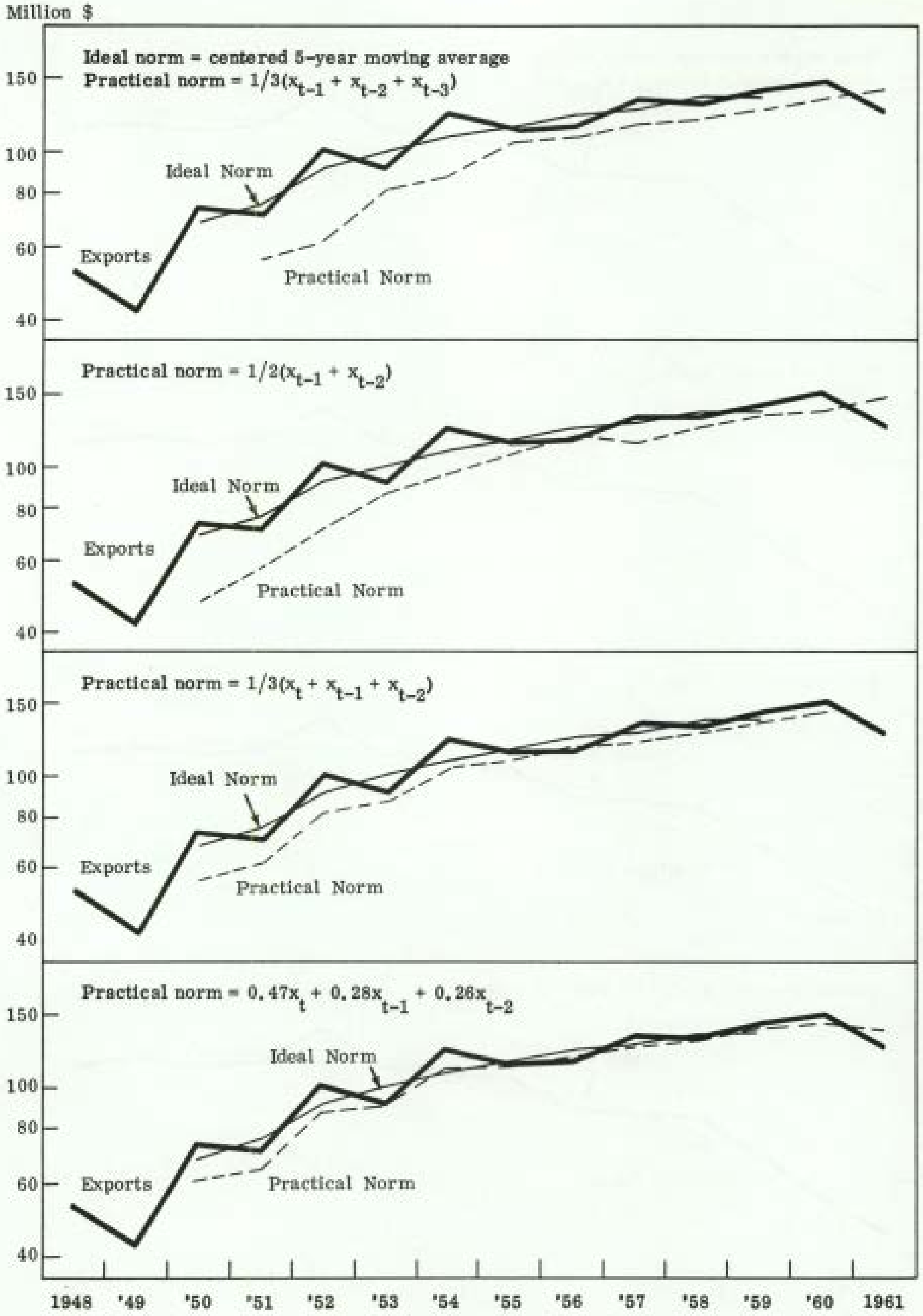
'59
'60
1961

DOMINICAN REPUBLIC



ECUADOR


Million $
Ideal norm = centered 5-year moving average
Practical norm = 1/3(x_{t-1} + x_{t-2} + x_{t-3})
Ideal Norm
Exports
Practical Norm
Practical norm = 1/2(x_{t-1} + x_{t-2})
Ideal Norm
Exports
Practical Norm
Practical norm = 1/3(x_t + x_{t-1} + x_{t-2})
Ideal Norm
Exports
Practical Norm
Practical norm = 0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}
Ideal Norm
Exports
Practical Norm
150
100
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1948
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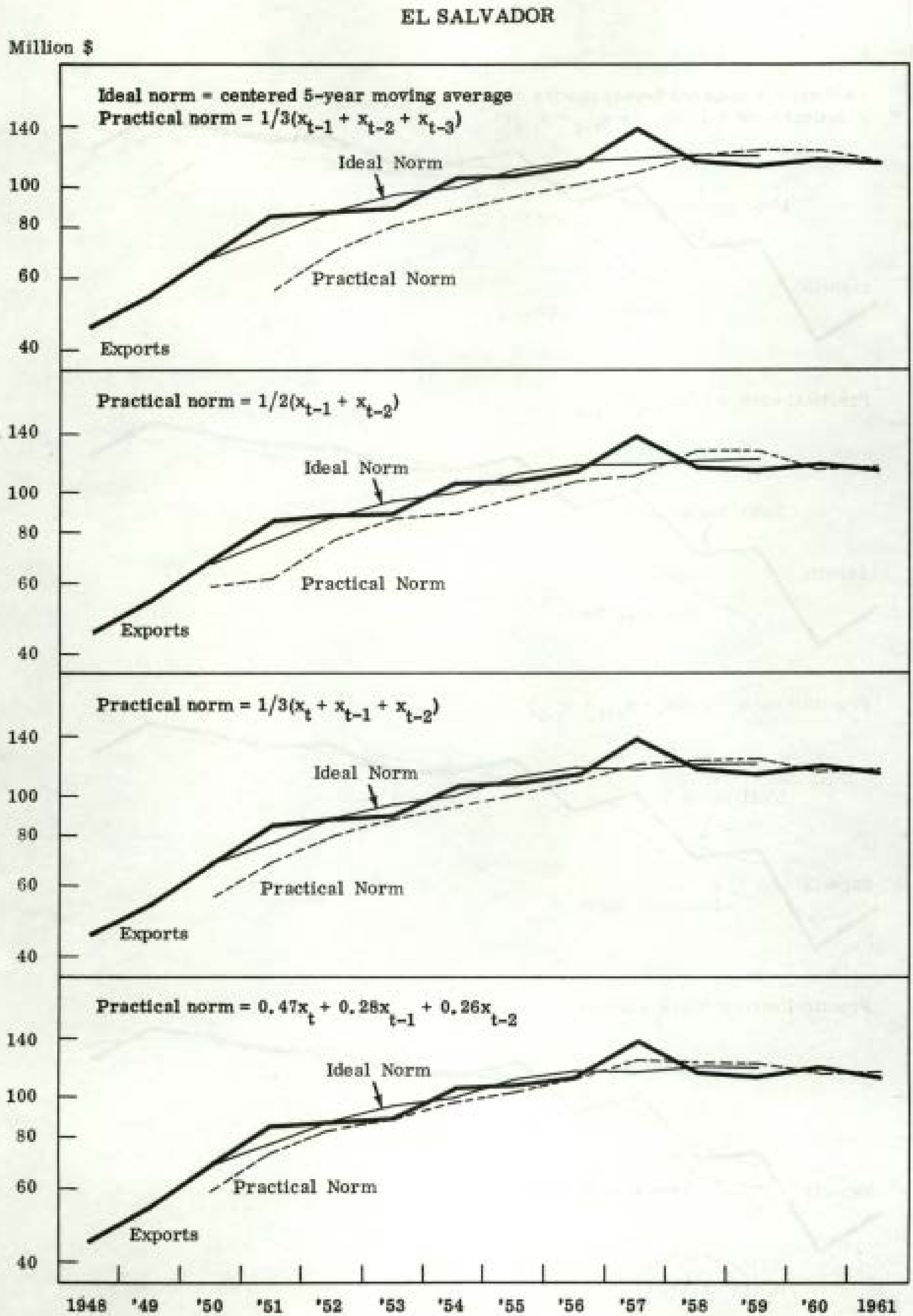
1961


EL SALVADOR
Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
Ideal Norm
Practical Norm
Exports
Practical norm = $1/2(x_{t-1} + x_{t-2})$
Ideal Norm
Practical Norm
Exports
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
Ideal Norm
Practical Norm
Exports
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
Ideal Norm
Practical Norm
Exports
140
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1948
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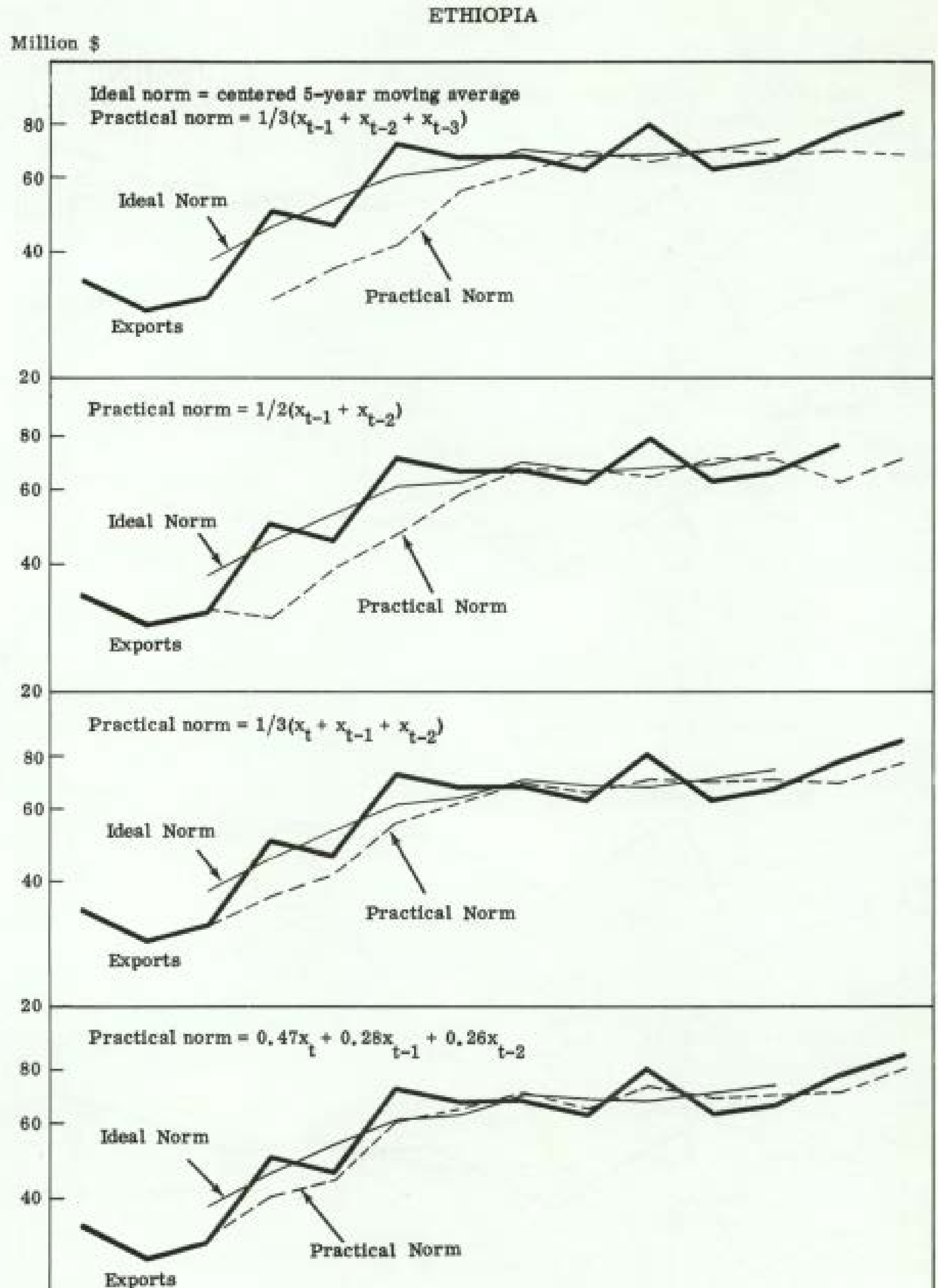
1961



ETHIOPIA
Million $
Ideal norm = centered 5-year moving average
Practical norm = 1/3(x t-1 + x t-2 + x t-3)
Ideal Norm
Practical Norm
Exports
Practical norm = 1/2(x t-1 + x t-2)
Ideal Norm
Practical Norm
Exports
Practical norm = 1/3(x t + x t-1 + x t-2)
Ideal Norm
Practical Norm
Exports
Practical norm = 0.47x t + 0.28x t-1 + 0.26x t-2
Ideal Norm
Practical Norm
Exports
80
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1948
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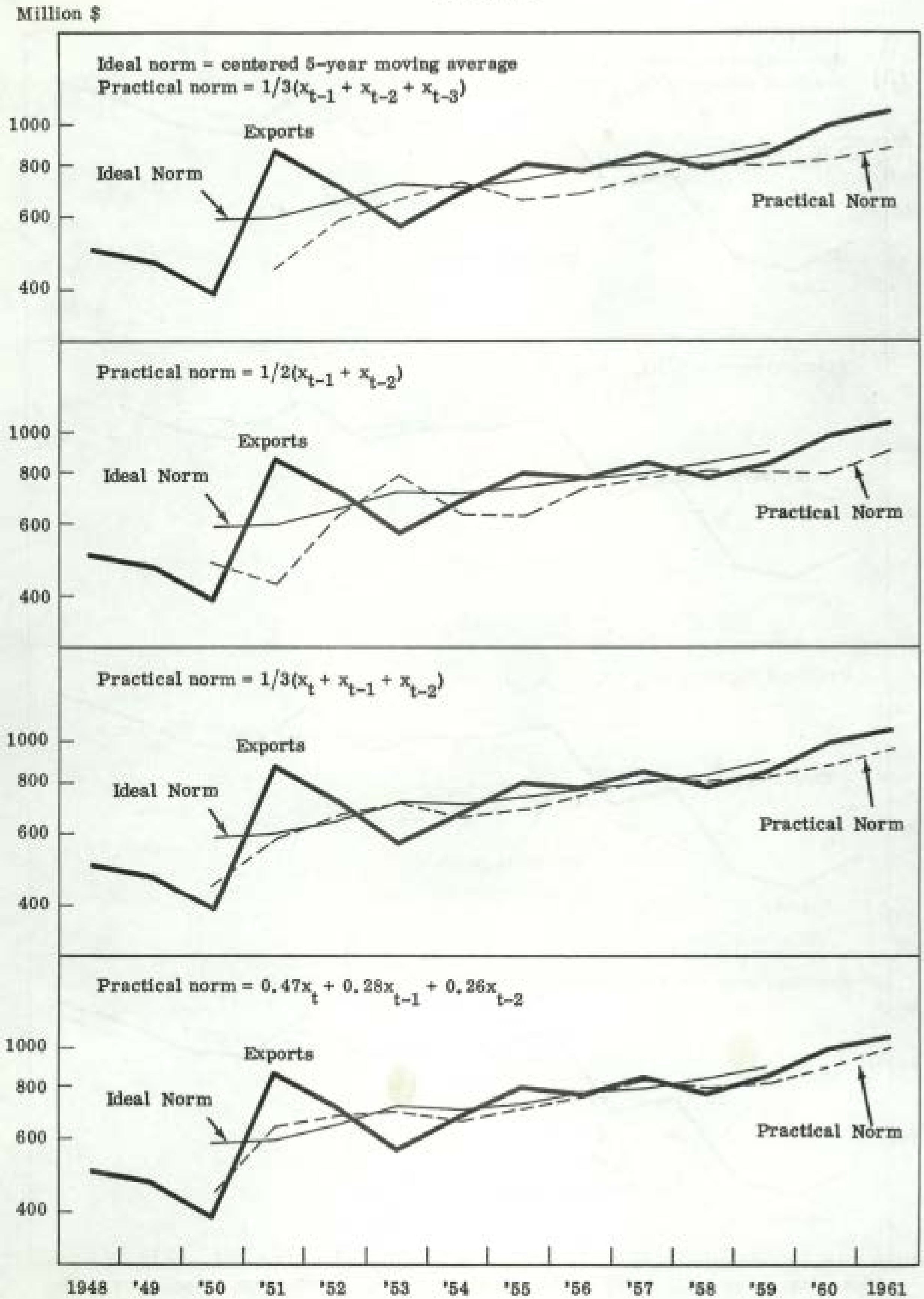
'60
1961

FINLAND


Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
Exports
Ideal Norm
Practical Norm
Practical norm = $1/2(x_{t-1} + x_{t-2})$
Exports
Ideal Norm
Practical Norm
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
Exports
Ideal Norm
Practical Norm
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
Exports
Ideal Norm
Practical Norm
1000
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1948
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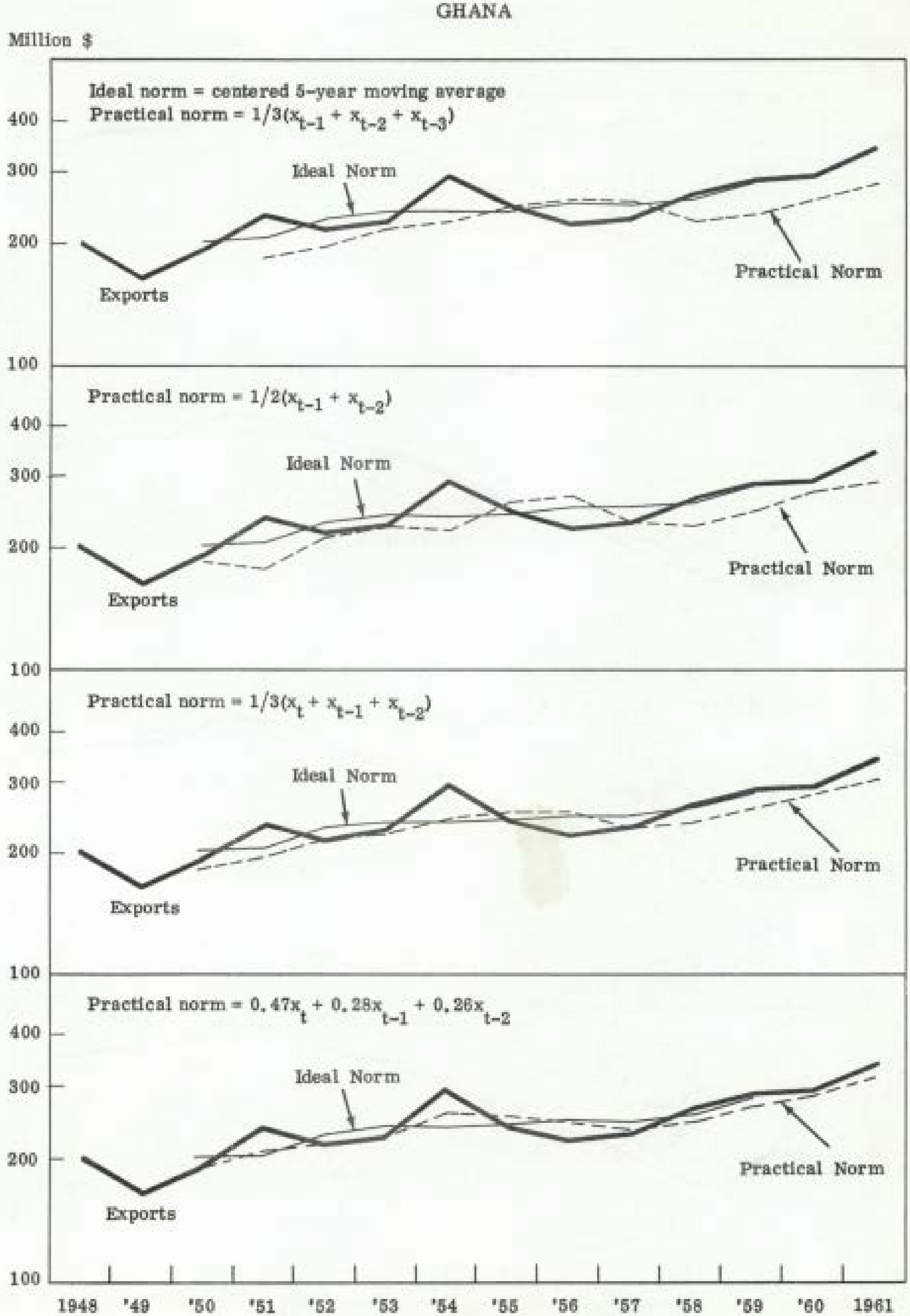
1961


GHANA
Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
Ideal Norm
Practical Norm
Exports
Practical norm = $1/2(x_{t-1} + x_{t-2})$
Ideal Norm
Practical Norm
Exports
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
Ideal Norm
Practical Norm
Exports
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
Ideal Norm
Practical Norm
Exports
400
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1948
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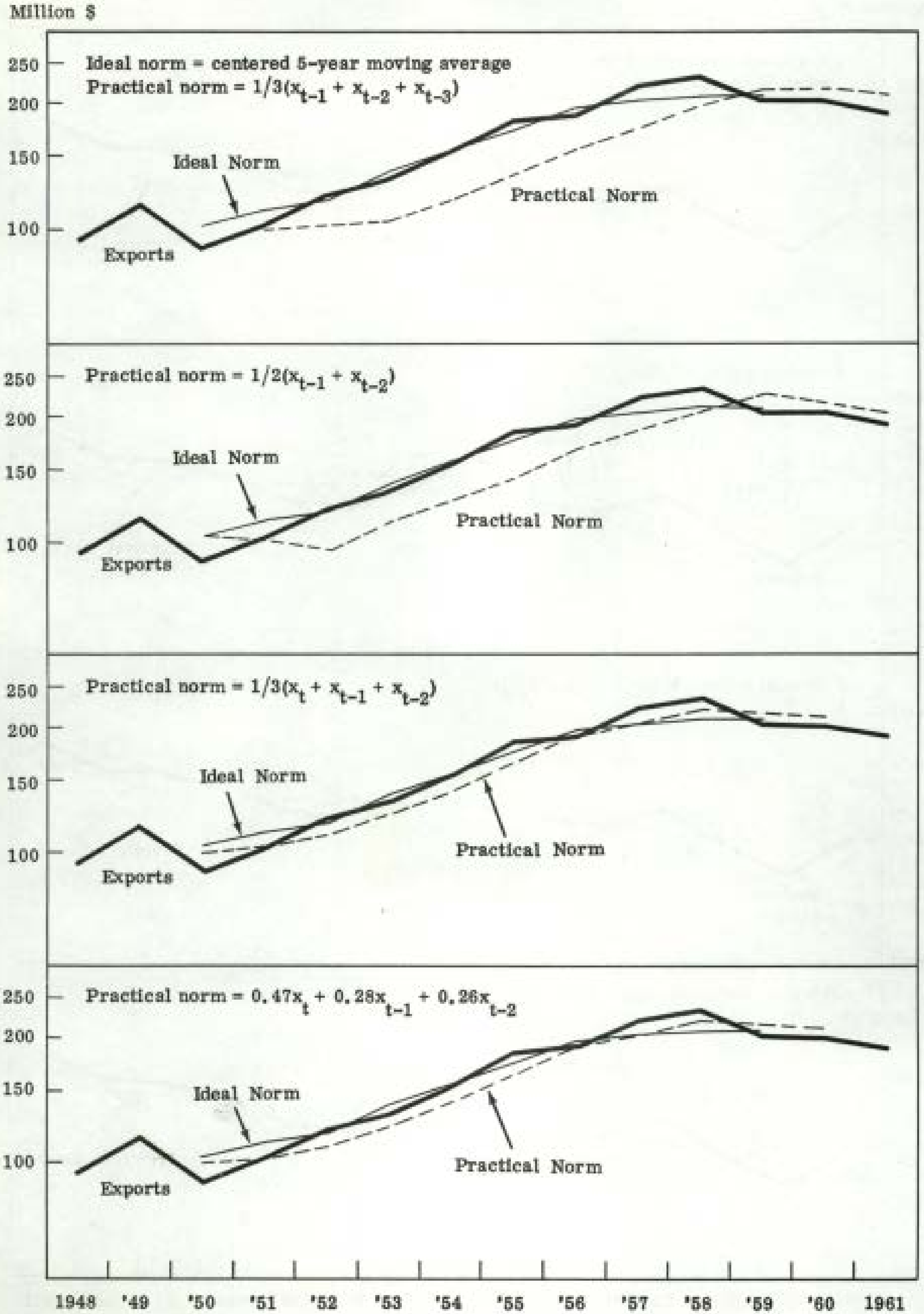
1961

GREECE


Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
Ideal Norm
Practical Norm
Exports
Practical norm = $1/2(x_{t-1} + x_{t-2})$
Ideal Norm
Practical Norm
Exports
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
Ideal Norm
Practical Norm
Exports
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
Ideal Norm
Practical Norm
Exports
250
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1948
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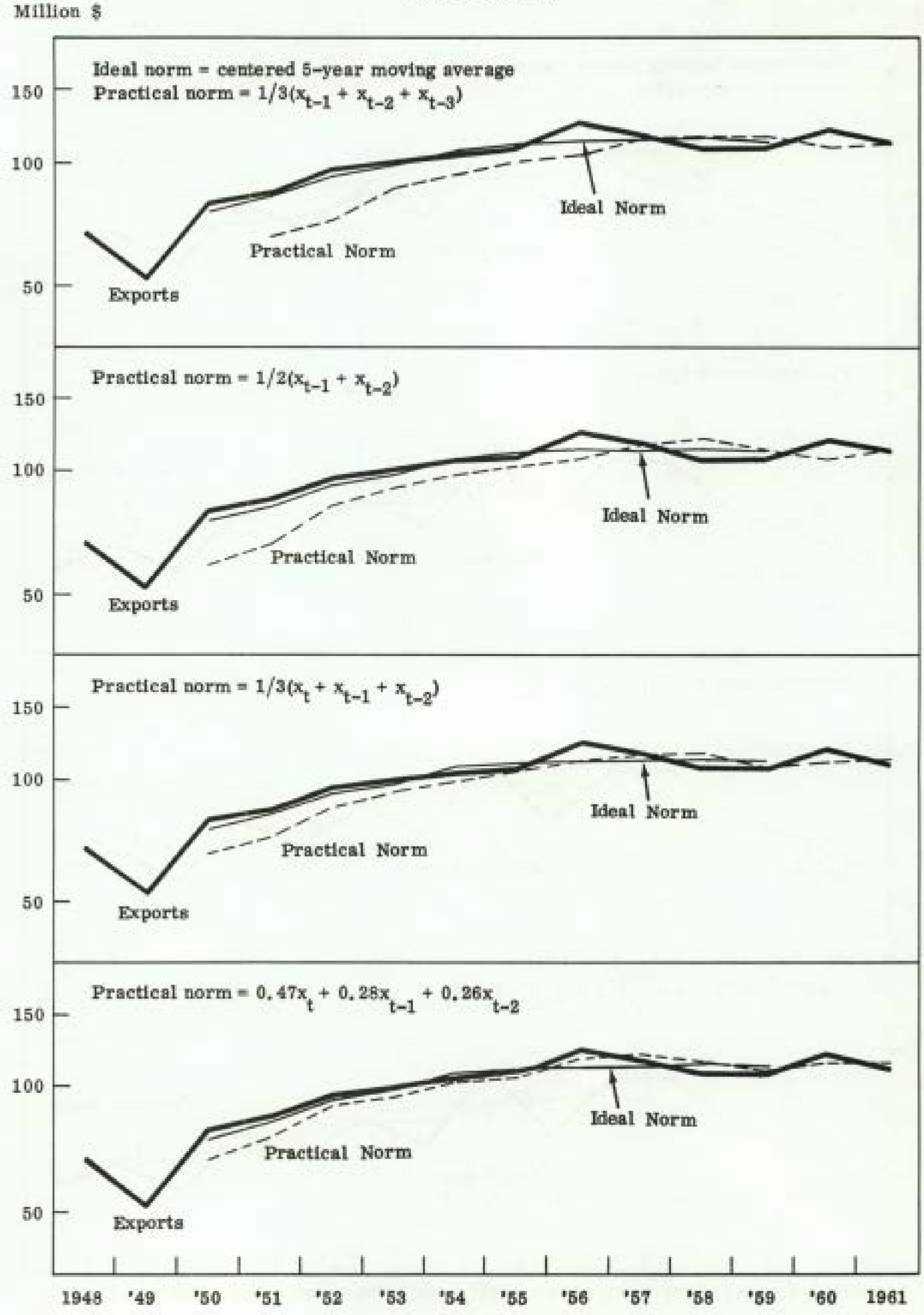
1961

GUATEMALA



Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
150
100
50
Ideal Norm
Practical Norm
Exports
Practical norm = $1/2(x_{t-1} + x_{t-2})$
Ideal Norm
Practical Norm
Exports
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
Ideal Norm
Practical Norm
Exports
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
Ideal Norm
Practical Norm
Exports
1948
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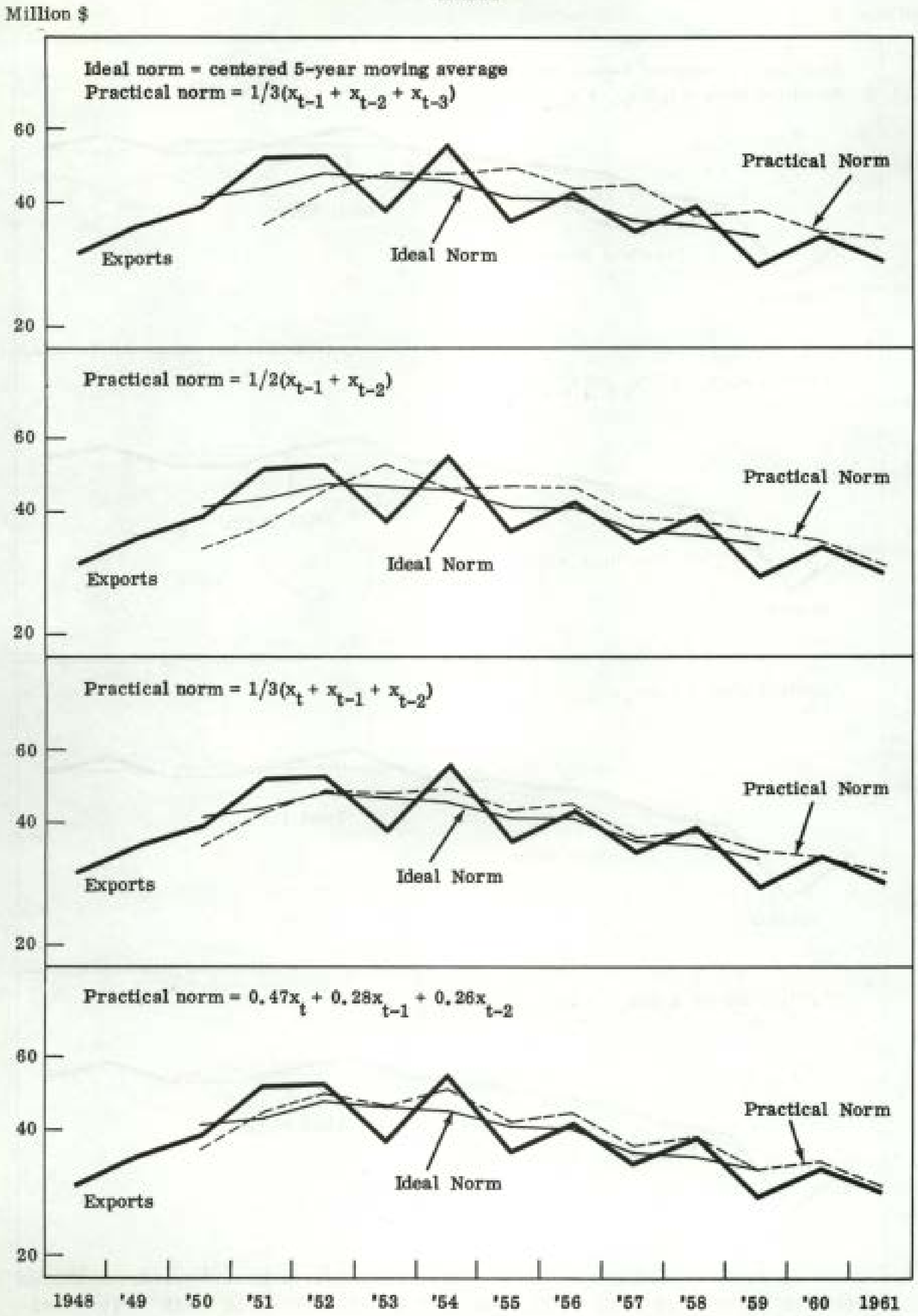
'60
1961

HAITI


Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
Practical Norm
Exports
Ideal Norm
Practical norm = $1/2(x_{t-1} + x_{t-2})$
Practical Norm
Exports
Ideal Norm
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
Practical Norm
Exports
Ideal Norm
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
Practical Norm
Exports
Ideal Norm
60
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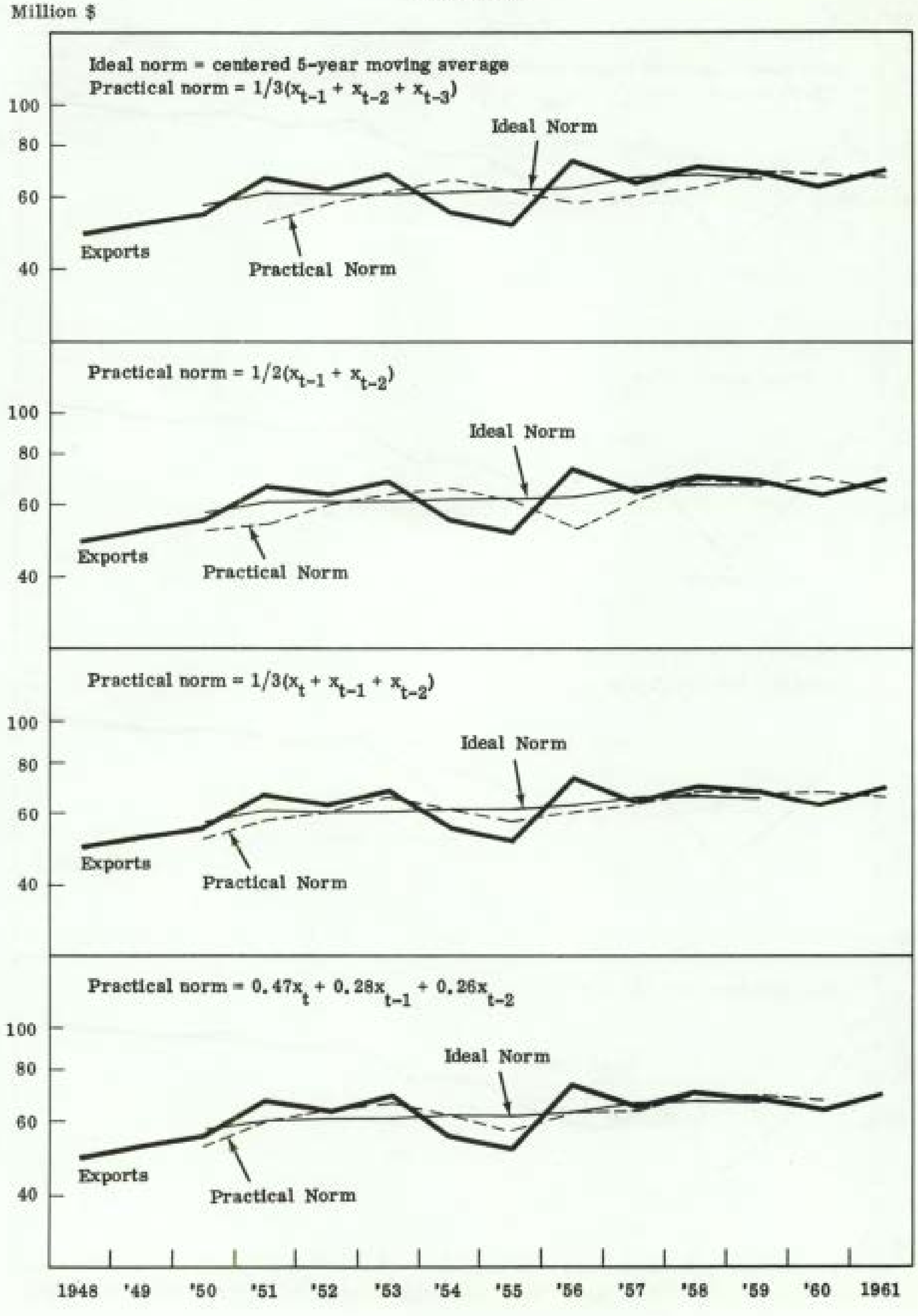
'60
1961

HONDURAS


Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
100
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40
Ideal Norm
Exports
Practical Norm
Practical norm = $1/2(x_{t-1} + x_{t-2})$
100
80
60
40
Ideal Norm
Exports
Practical Norm
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
100
80
60
40
Ideal Norm
Exports
Practical Norm
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
100
80
60
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Ideal Norm
Exports
Practical Norm
1948
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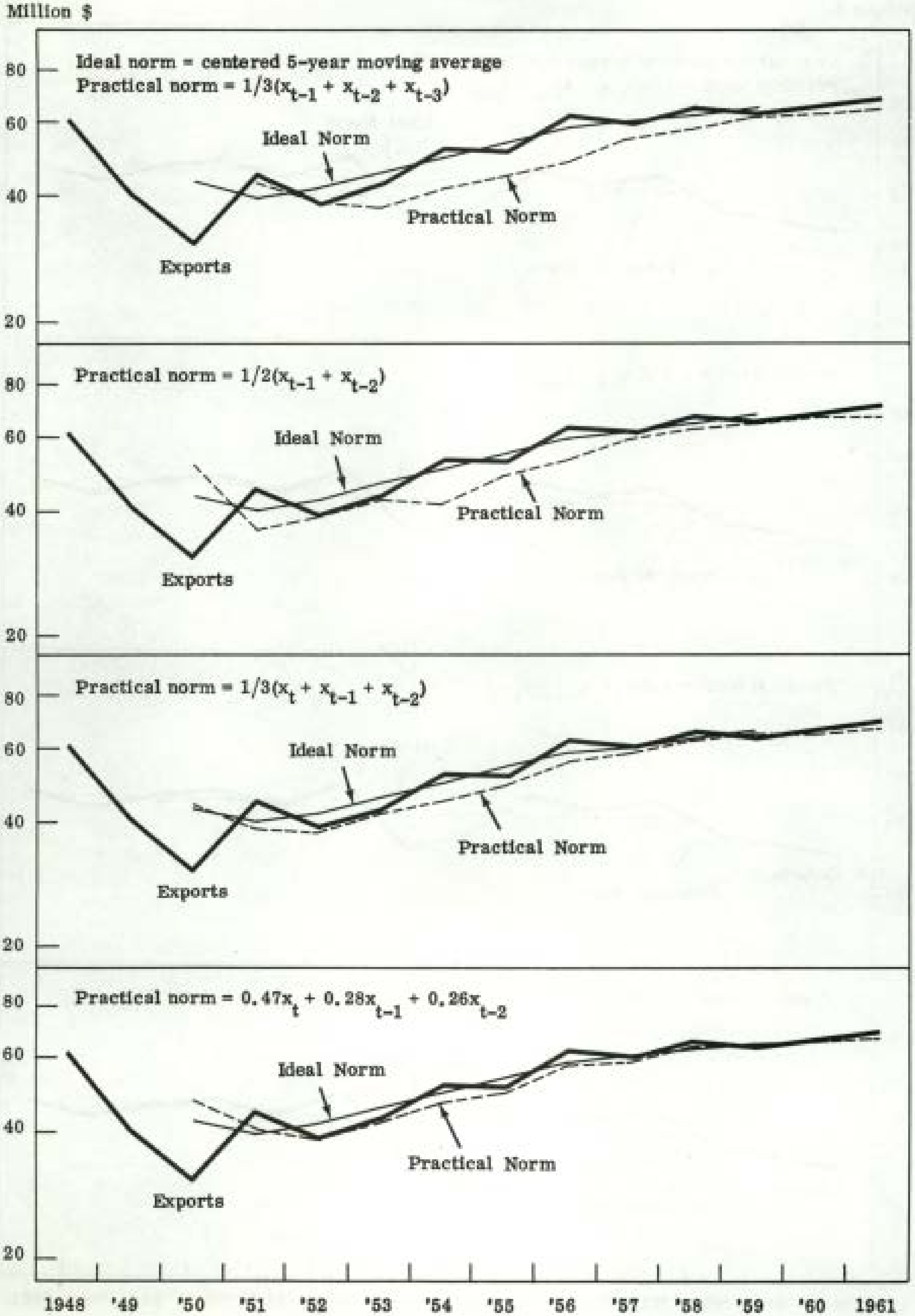
'60
1961

ICELAND


Million $
Ideal norm = centered 5-year moving average
Practical norm = 1/3(x_{t-1} + x_{t-2} + x_{t-3})
Ideal Norm
Practical Norm
Exports
Practical norm = 1/2(x_{t-1} + x_{t-2})
Ideal Norm
Practical Norm
Exports
Practical norm = 1/3(x_t + x_{t-1} + x_{t-2})
Ideal Norm
Practical Norm
Exports
Practical norm = 0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}
Ideal Norm
Practical Norm
Exports
80
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1948
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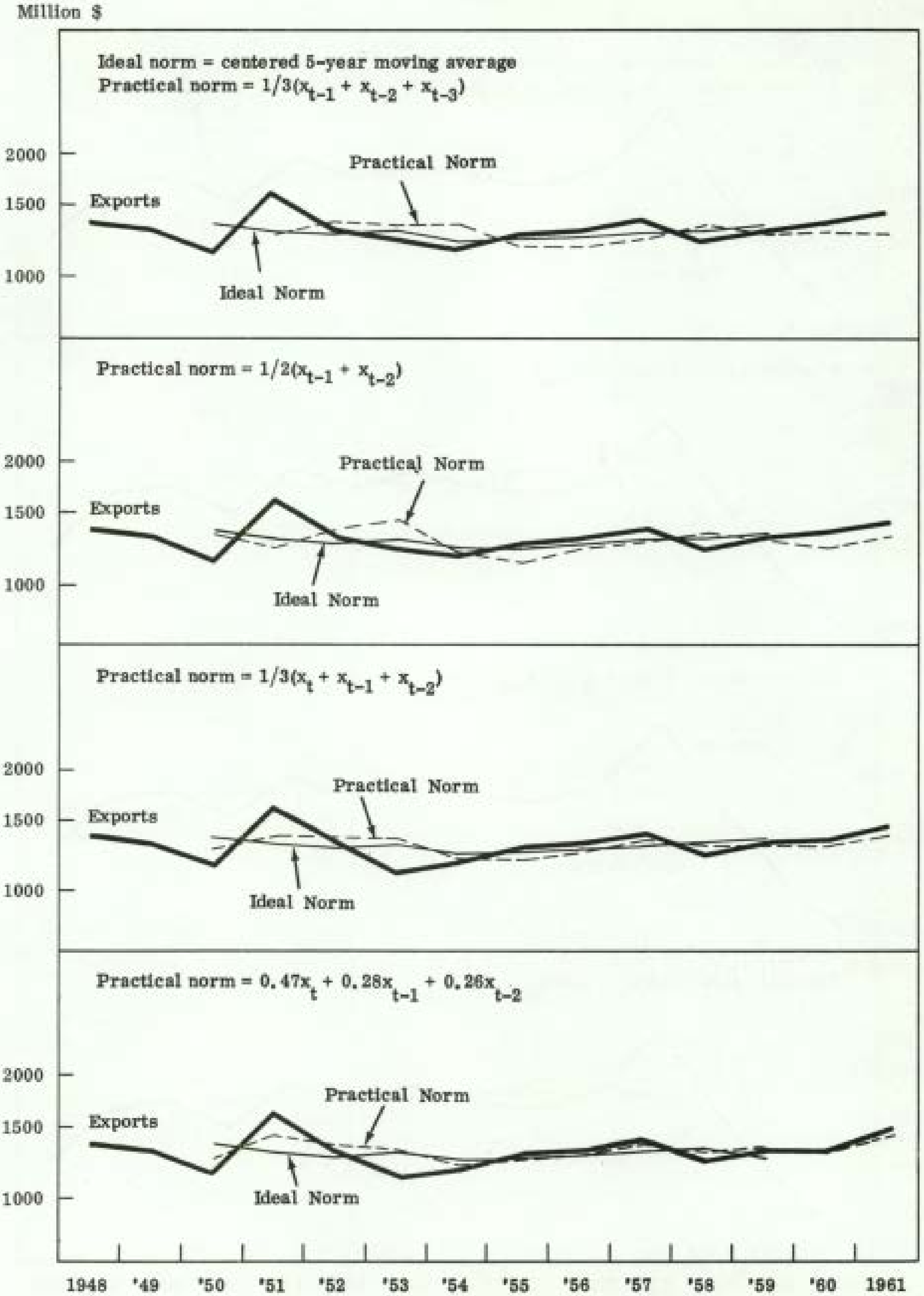
'60
1961

INDIA


Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
2000
1500
1000
Exports
Practical Norm
Ideal Norm
Practical norm = $1/2(x_{t-1} + x_{t-2})$
2000
1500
1000
Exports
Practical Norm
Ideal Norm
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
2000
1500
1000
Exports
Practical Norm
Ideal Norm
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
2000
1500
1000
Exports
Practical Norm
Ideal Norm
1948
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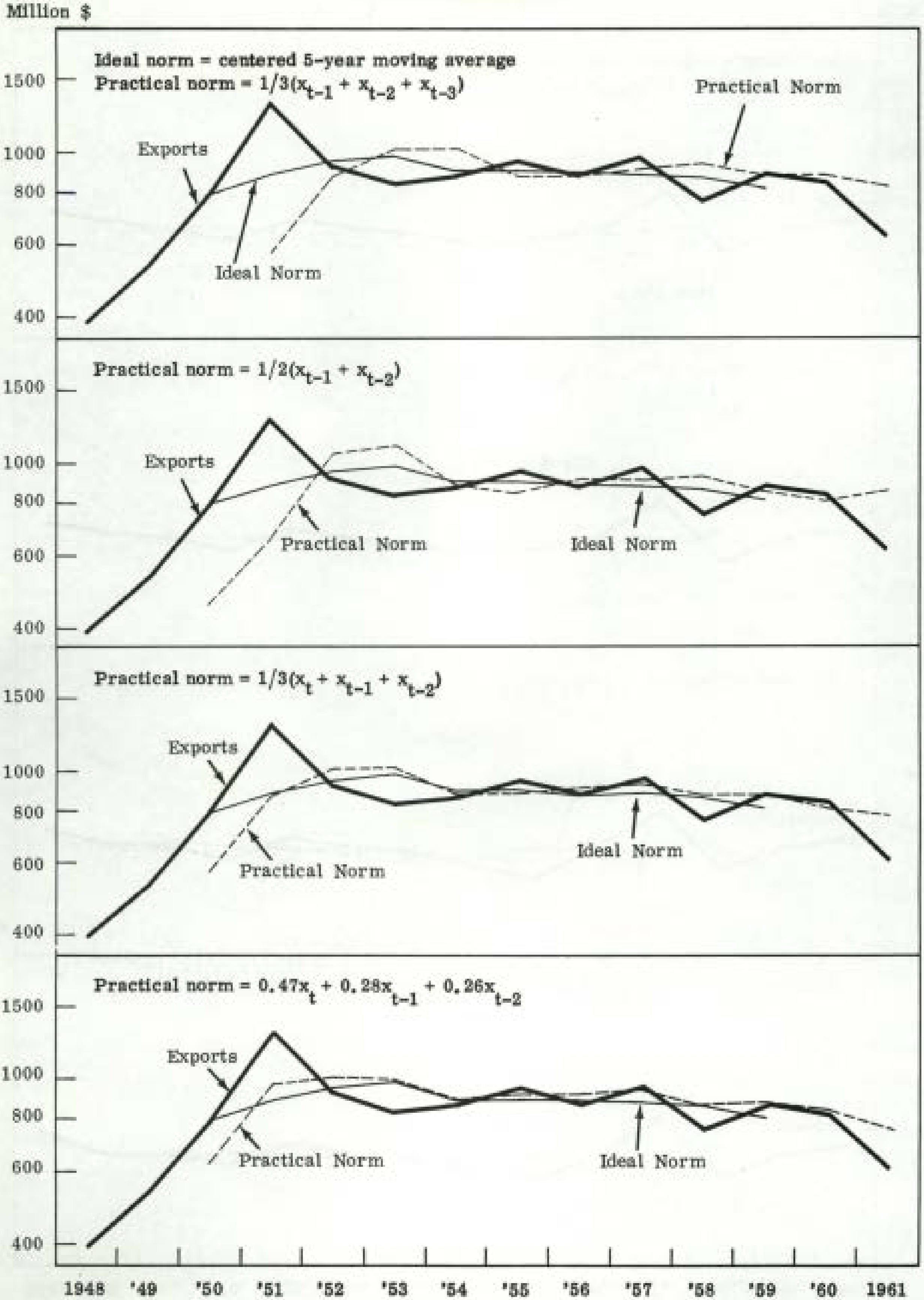
1961

INDONESIA


Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
Practical Norm
Exports
Ideal Norm
Practical norm = $1/2(x_{t-1} + x_{t-2})$
Exports
Practical Norm
Ideal Norm
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
Exports
Ideal Norm
Practical Norm
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
Exports
Practical Norm
Ideal Norm
1500
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1948
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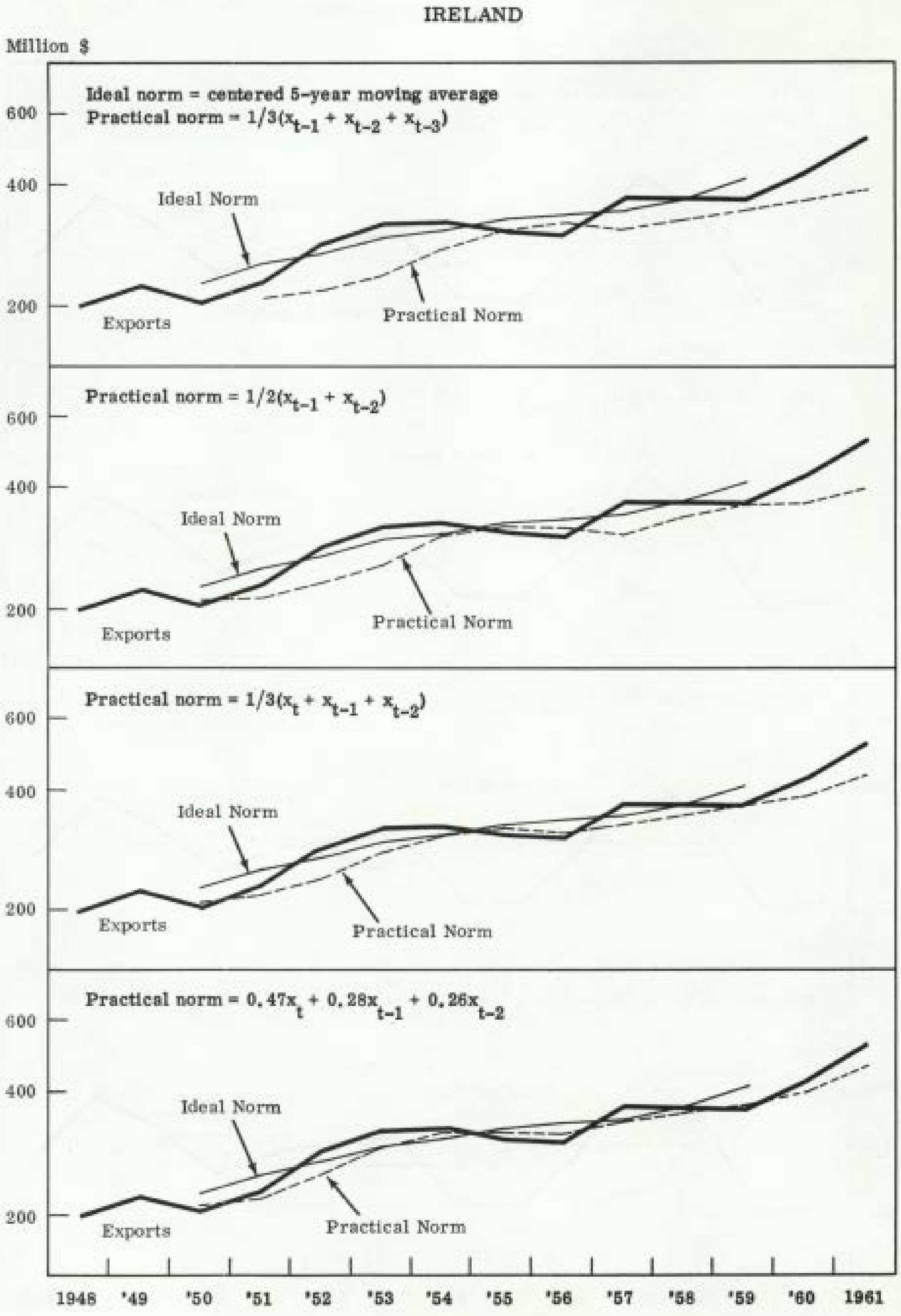
1961



IRELAND
Million $
Ideal norm = centered 5-year moving average
Practical norm = 1/3(x_{t-1} + x_{t-2} + x_{t-3})
Practical norm = 1/2(x_{t-1} + x_{t-2})
Practical norm = 1/3(x_t + x_{t-1} + x_{t-2})
Practical norm = 0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}
Ideal Norm
Practical Norm
Exports
600
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1948
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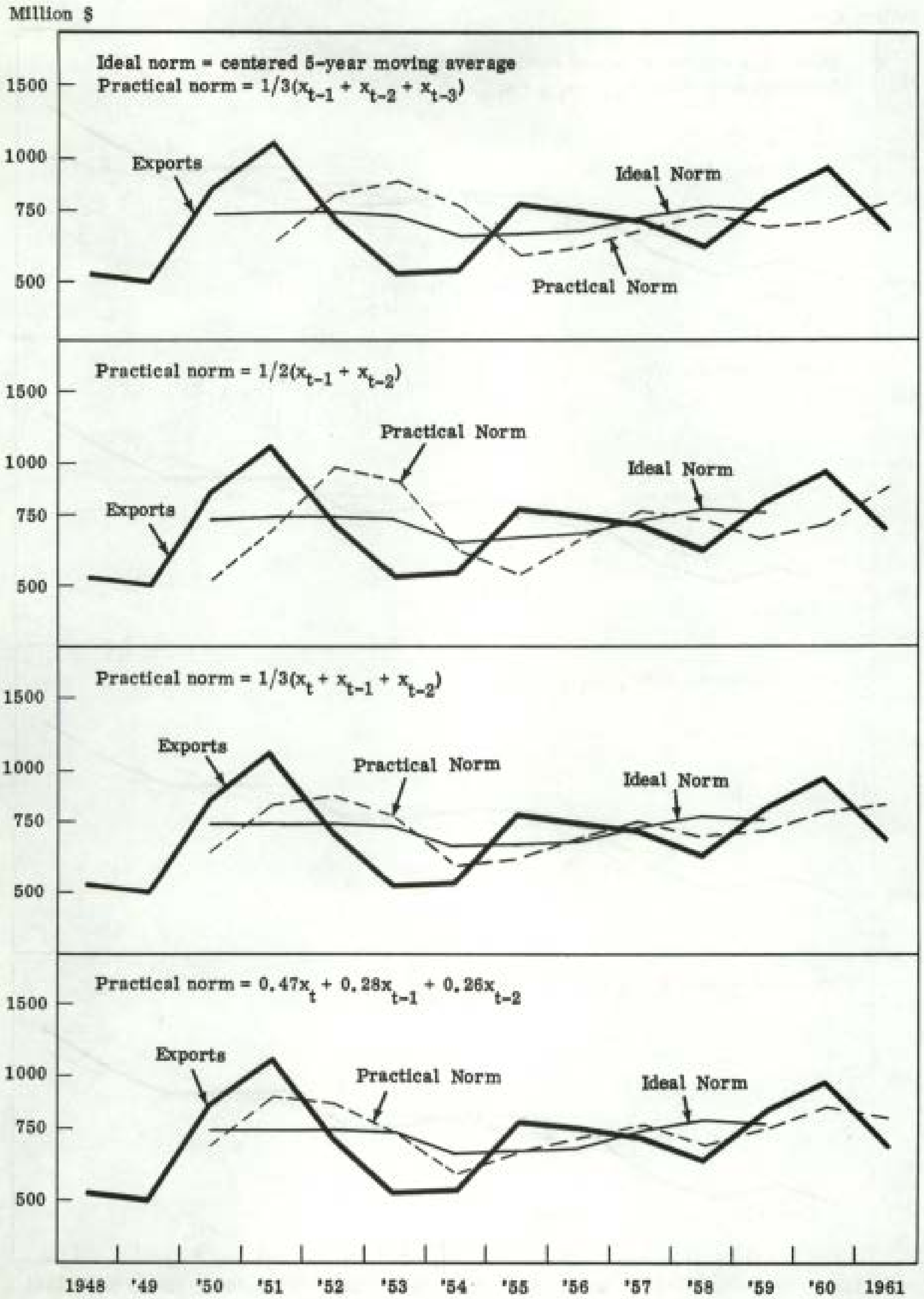
1961

MALAYA



Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
1500
1000
750
500
Exports
Ideal Norm
Practical Norm
Practical norm = $1/2(x_{t-1} + x_{t-2})$
1500
1000
750
500
Practical Norm
Ideal Norm
Exports
Practical norm = $1/3(x_t + x_{t-1} + x_{t-2})$
1500
1000
750
500
Exports
Practical Norm
Ideal Norm
Practical norm = $0.47x_t + 0.28x_{t-1} + 0.26x_{t-2}$
1500
1000
750
500
Exports
Practical Norm
Ideal Norm
1948
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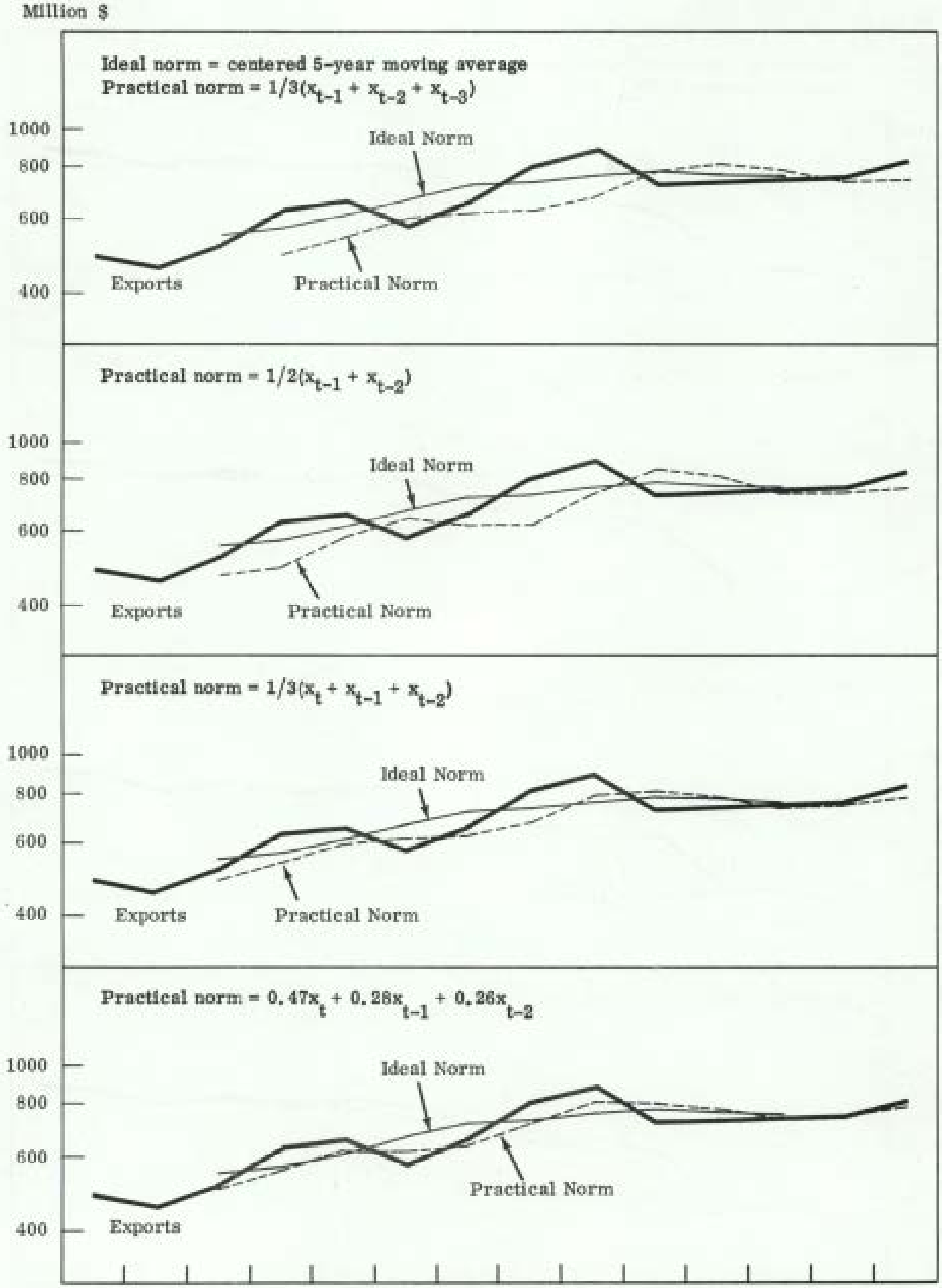
1961

MEXICO


Million $
Ideal norm = centered 5-year moving average
Practical norm = 1/3(x t-1 + x t-2 + x t-3)
1000
800
600
400
Ideal Norm
Exports
Practical Norm
Practical norm = 1/2(x t-1 + x t-2)
1000
800
600
400
Ideal Norm
Exports
Practical Norm
Practical norm = 1/3(x t + x t-1 + x t-2)
1000
800
600
400
Ideal Norm
Exports
Practical Norm
Practical norm = 0.47x t + 0.28x t-1 + 0.26x t-2
1000
800
600
400
Ideal Norm
Practical Norm
Exports
1948
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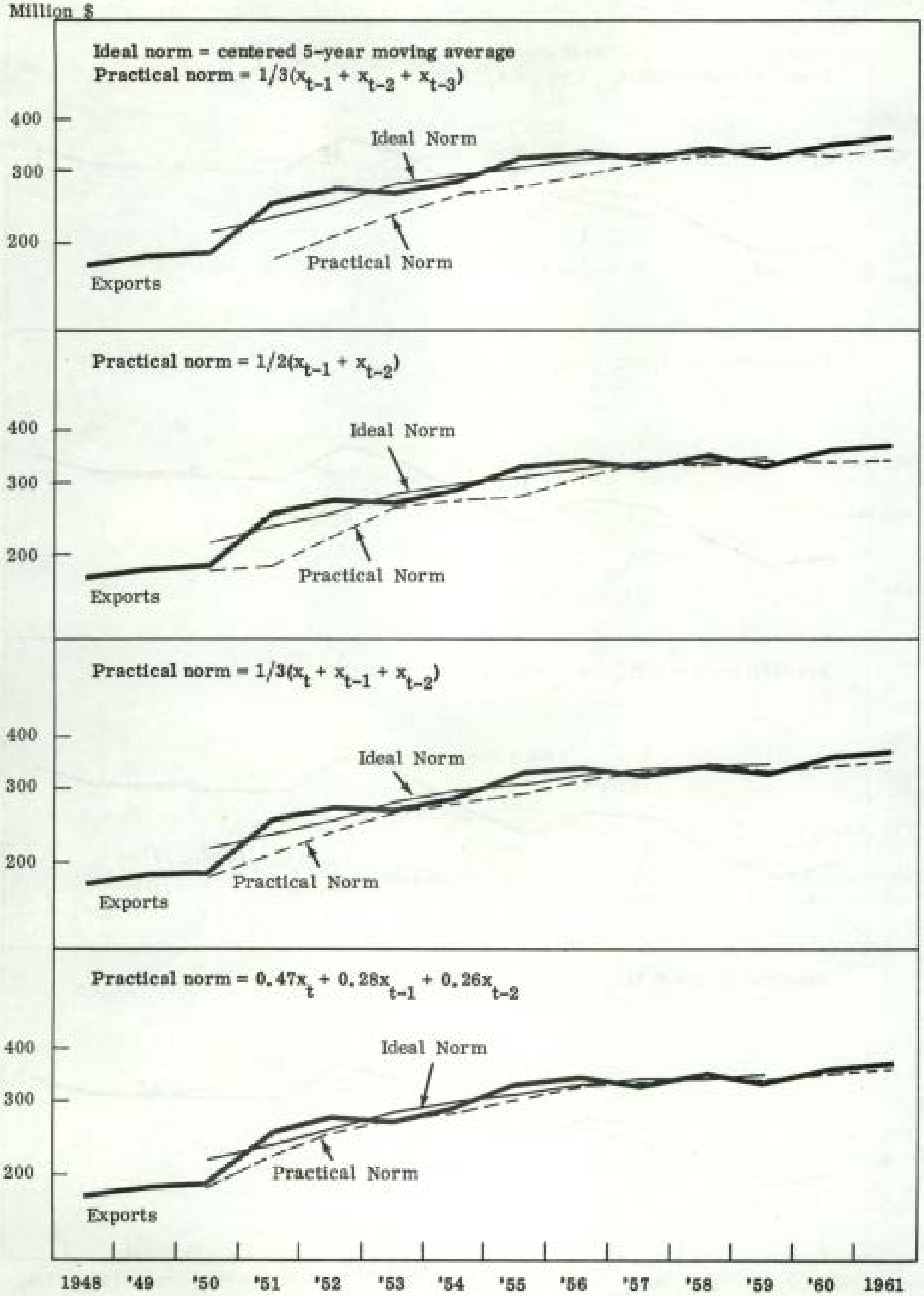
'60
1961

MOROCCO



Million $
Ideal norm = centered 5-year moving average
Practical norm = $1/3(x_{t-1} + x_{t-2} + x_{t-3})$
400
300
200
Ideal Norm
Practical Norm
Exports
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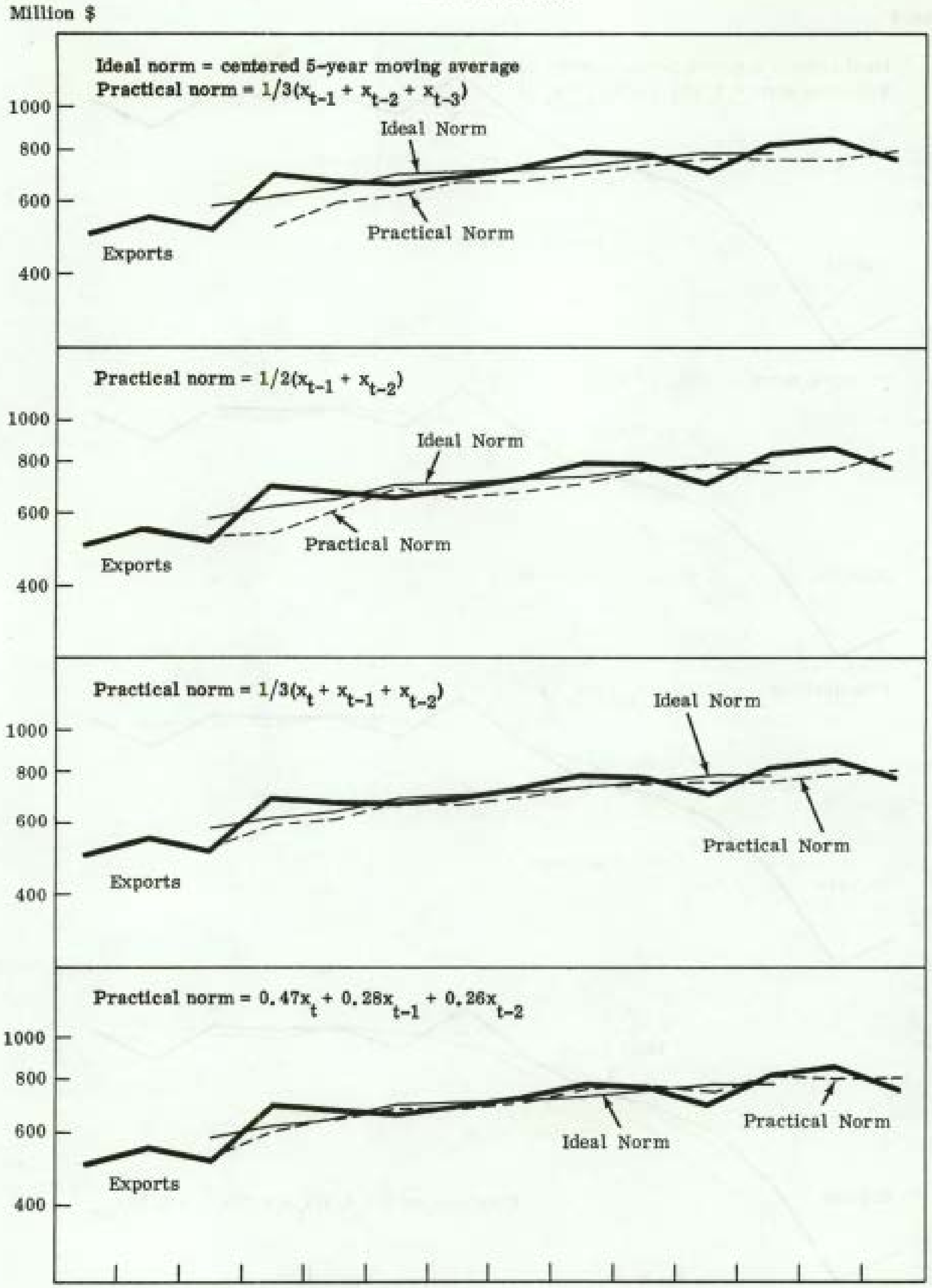

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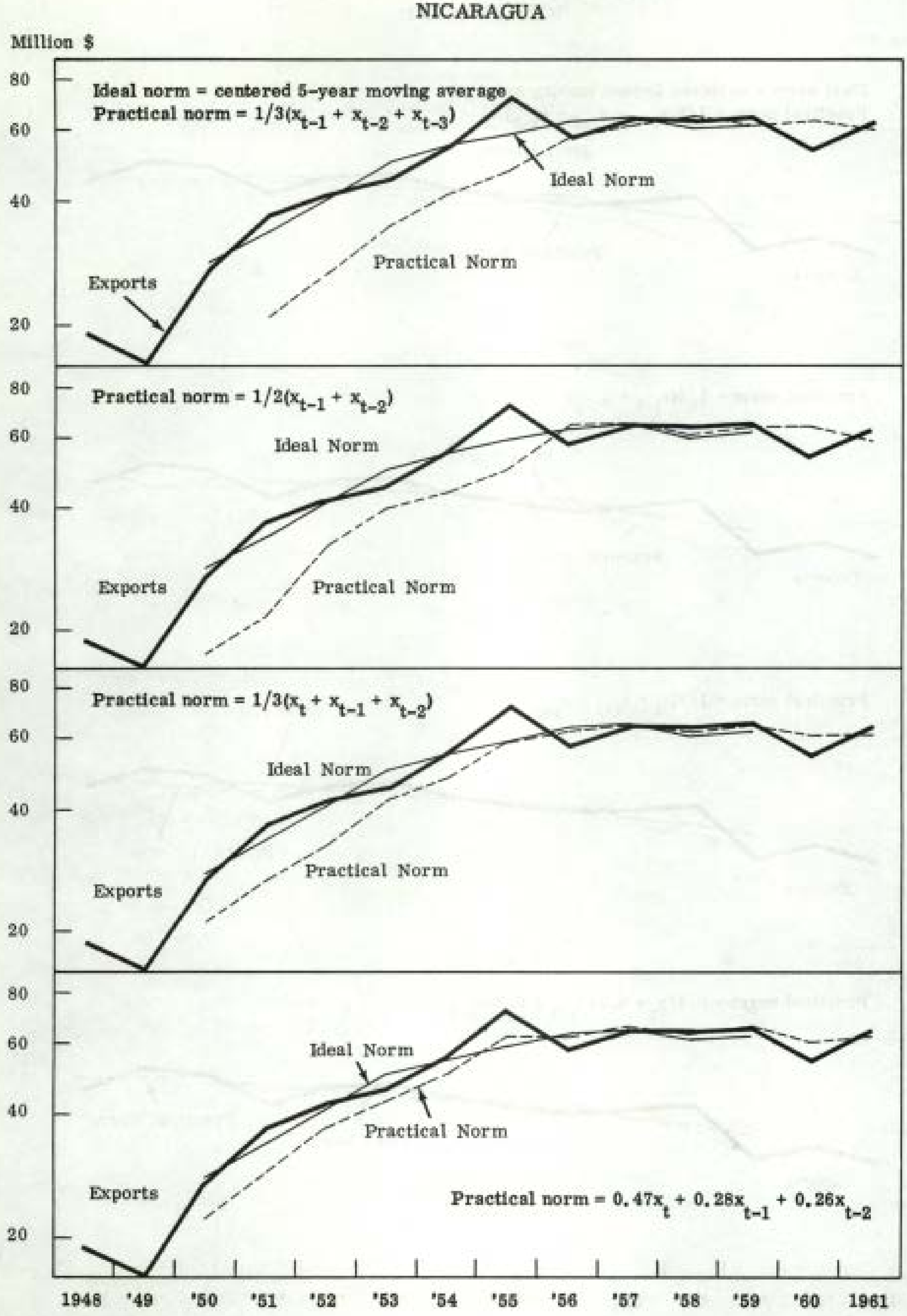
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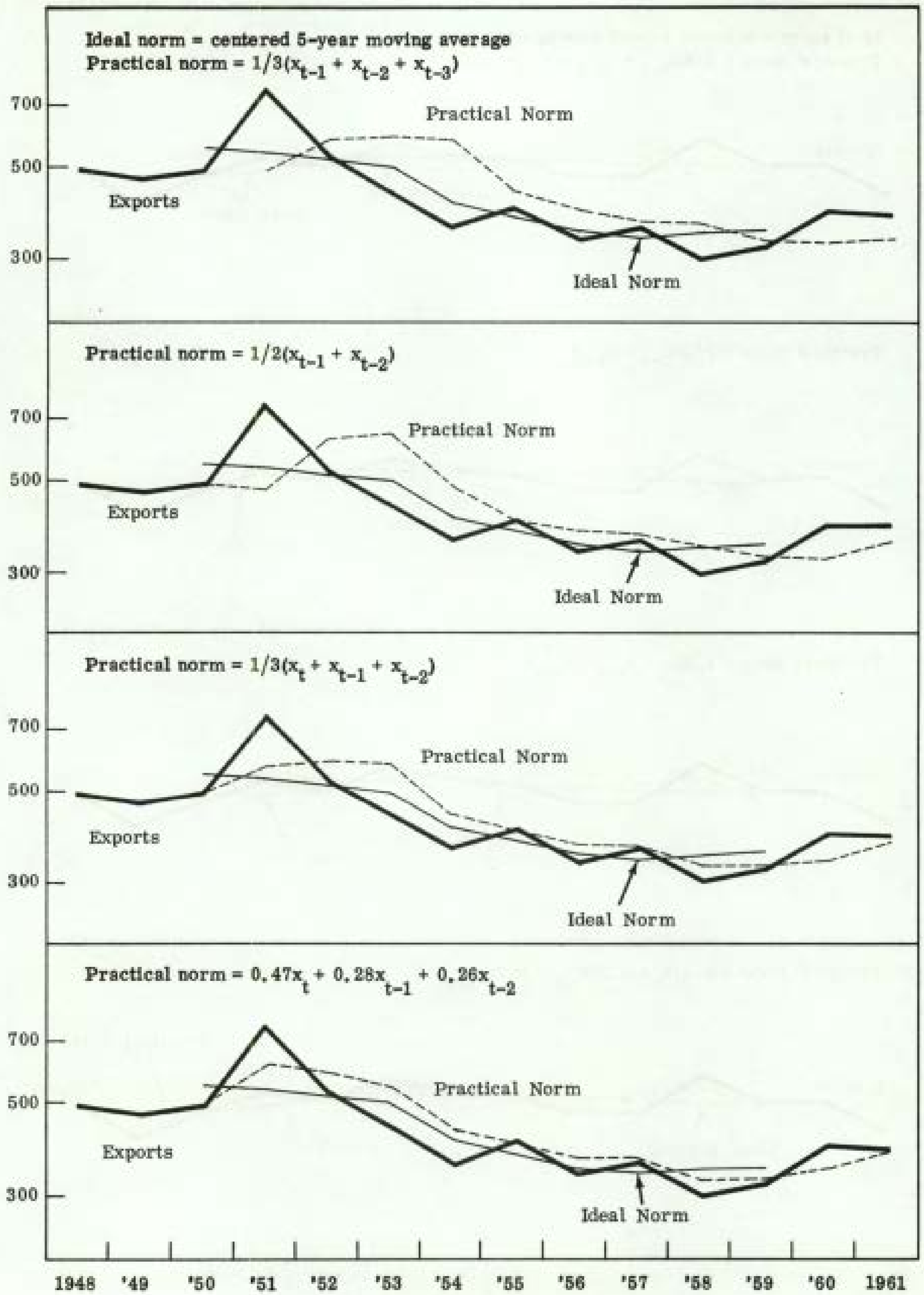

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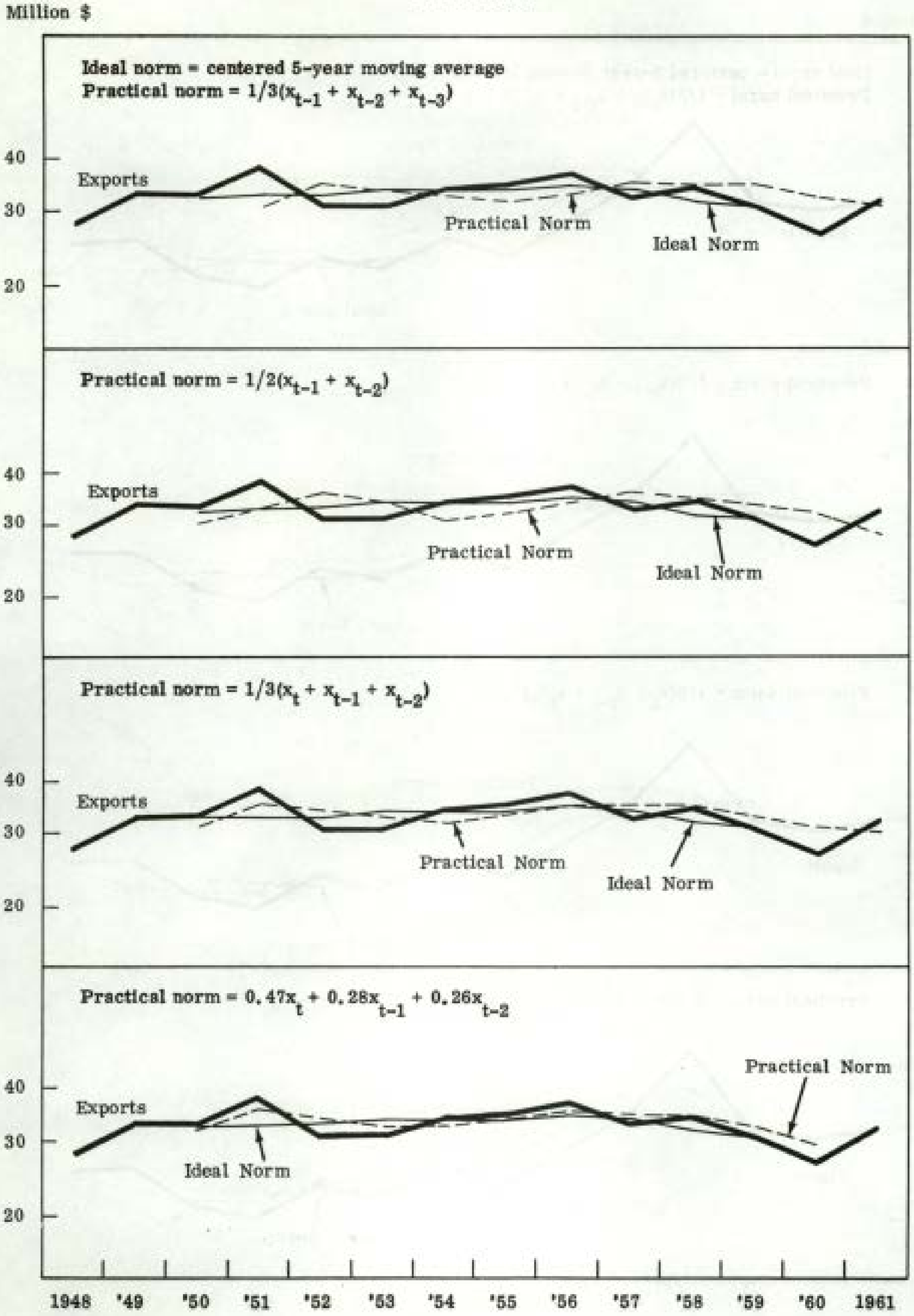
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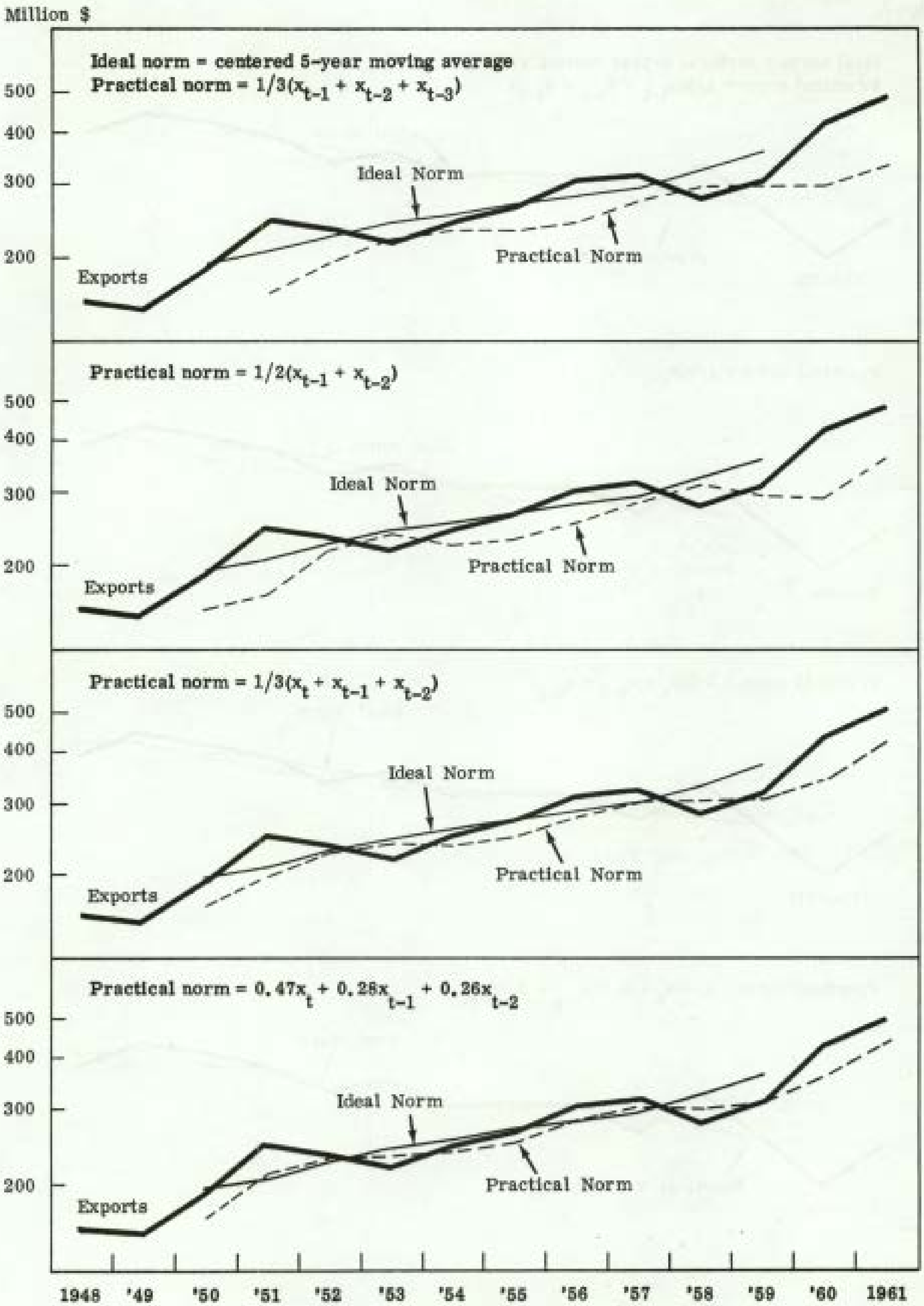
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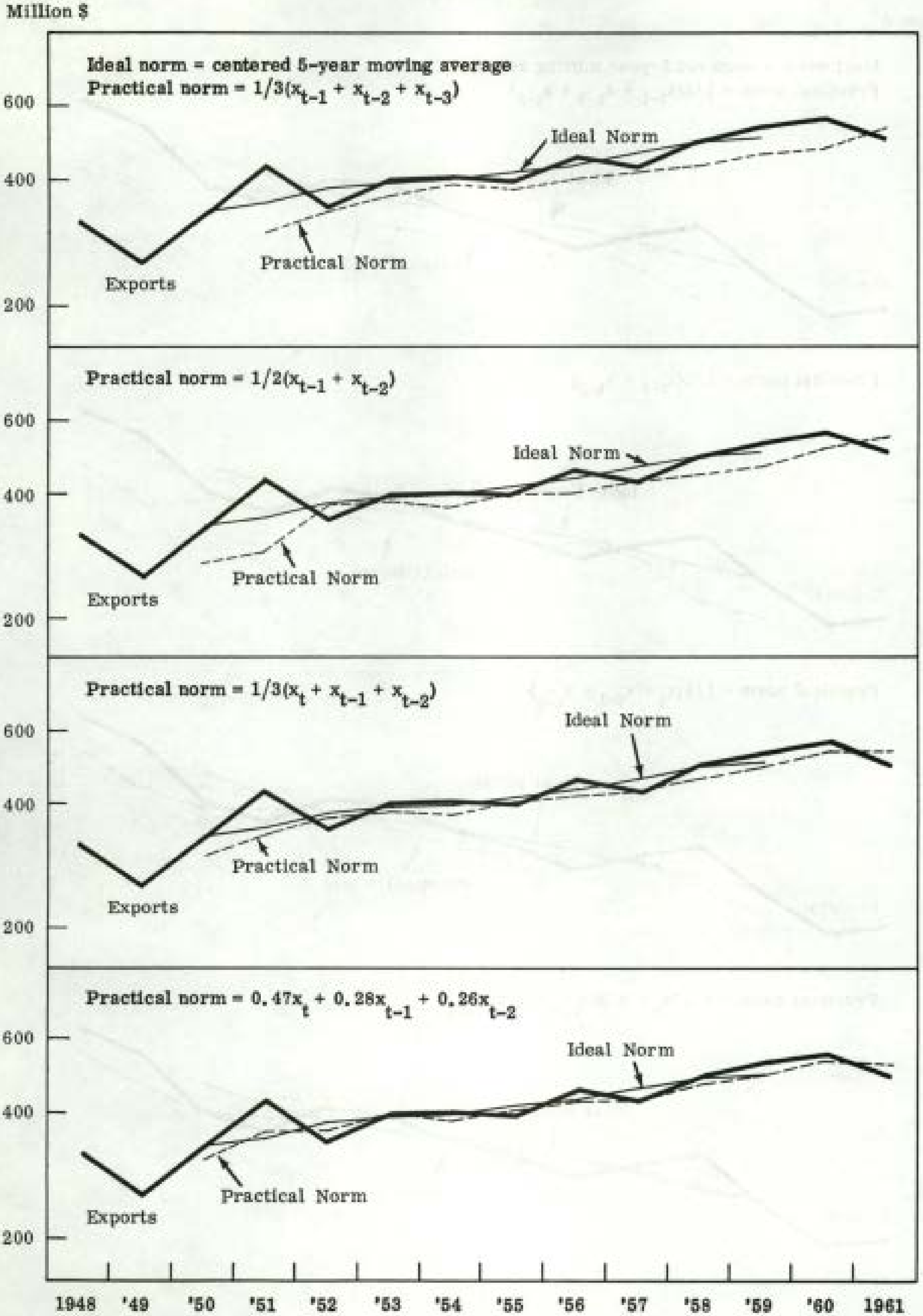

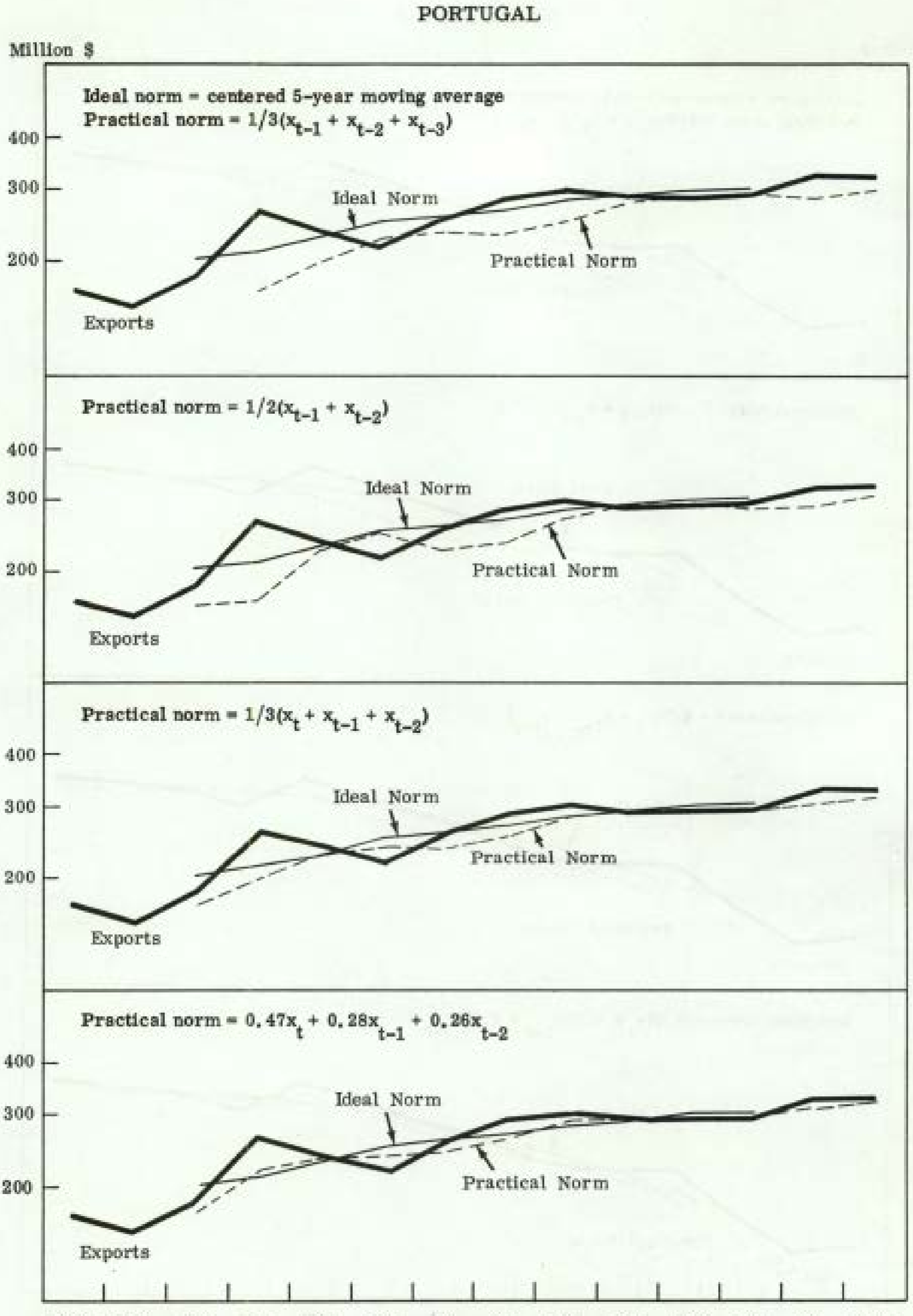
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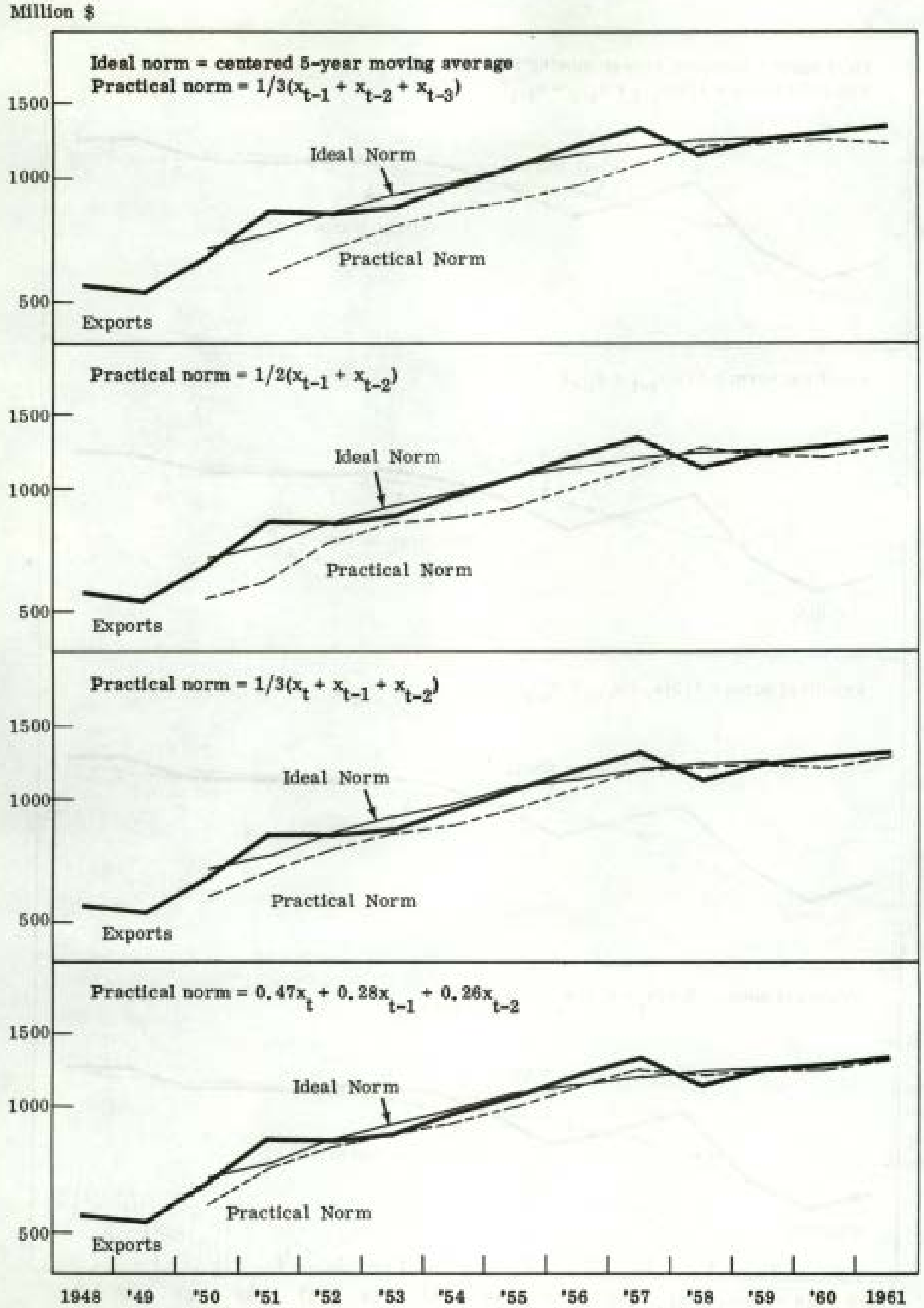

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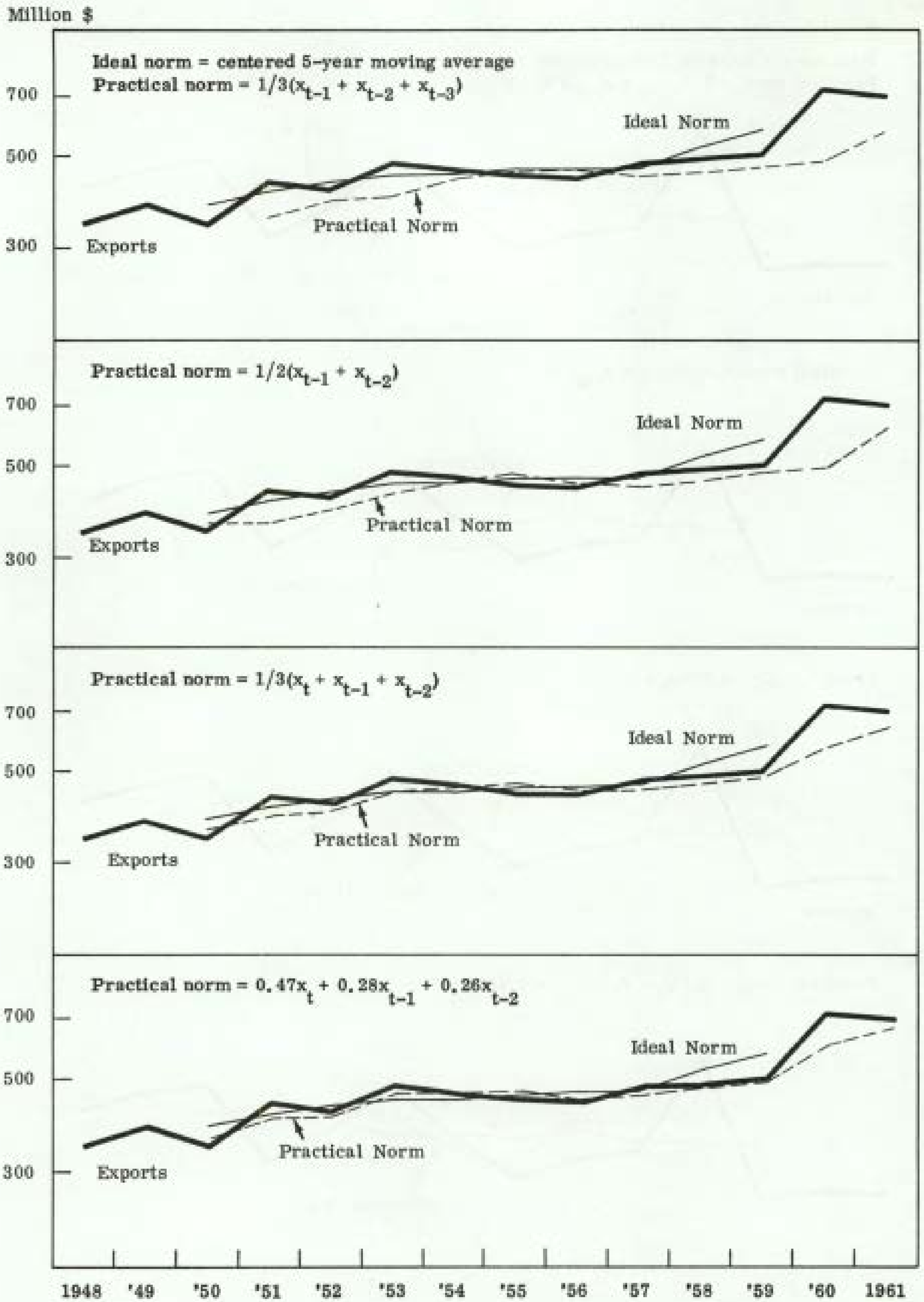

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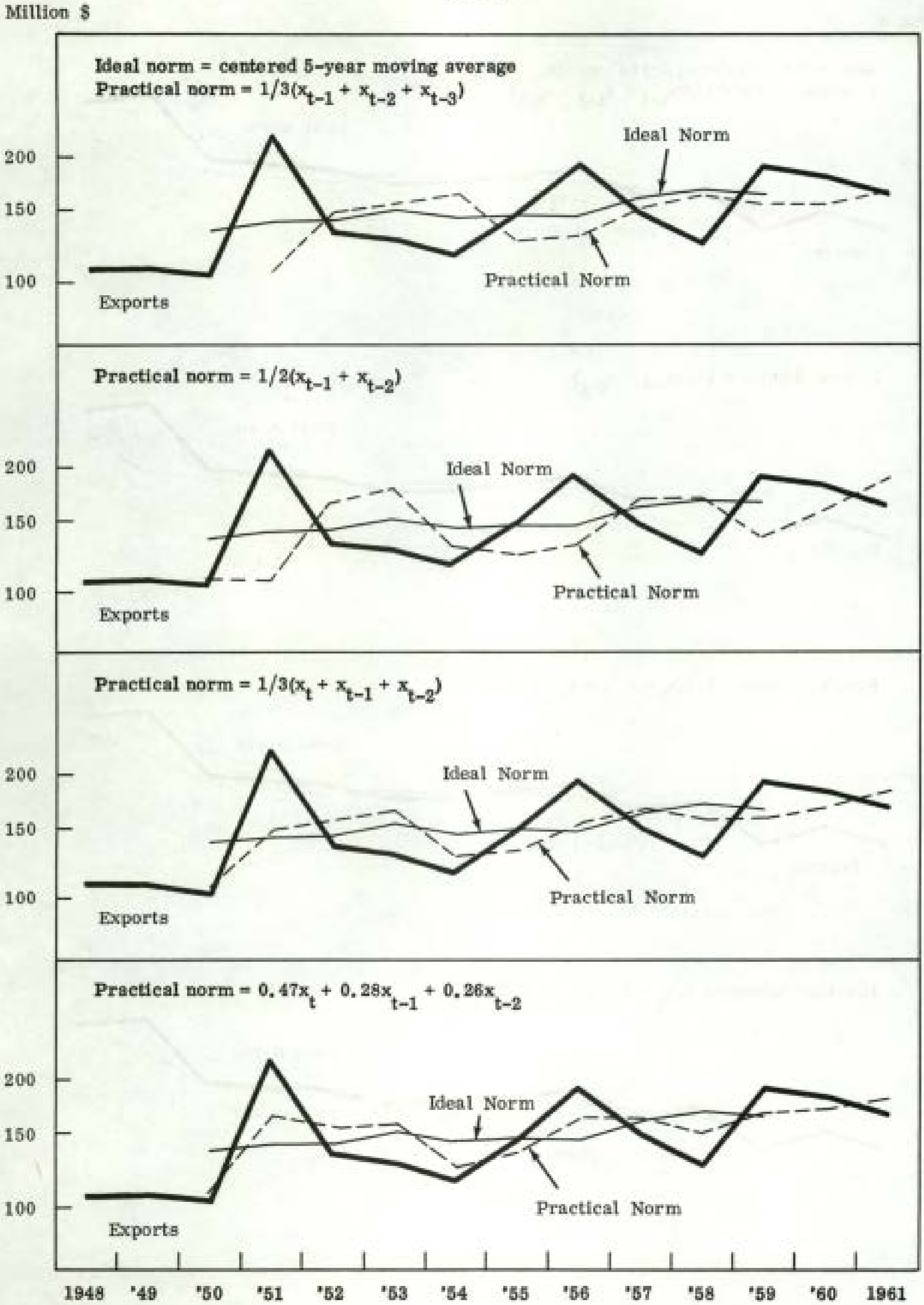

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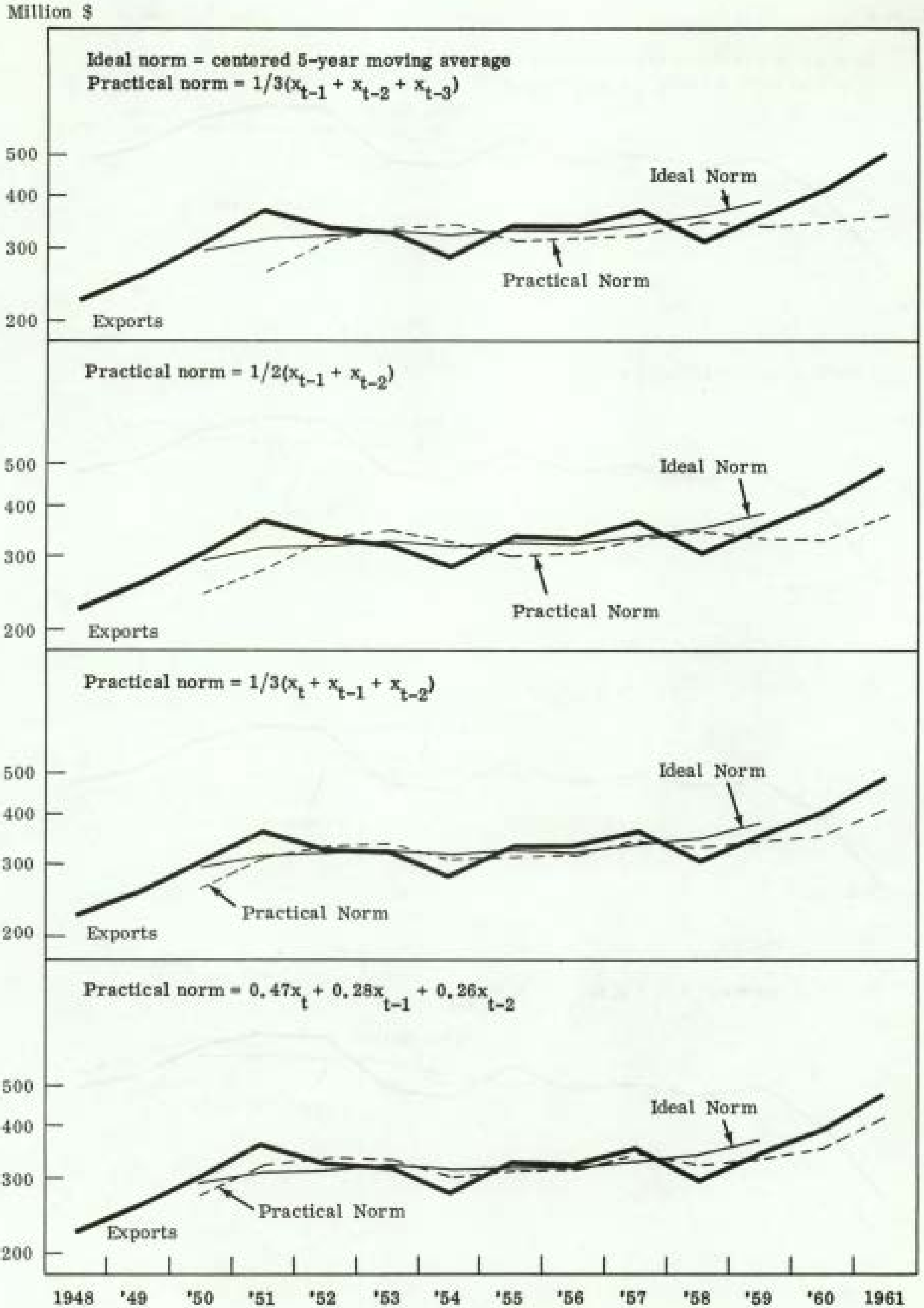
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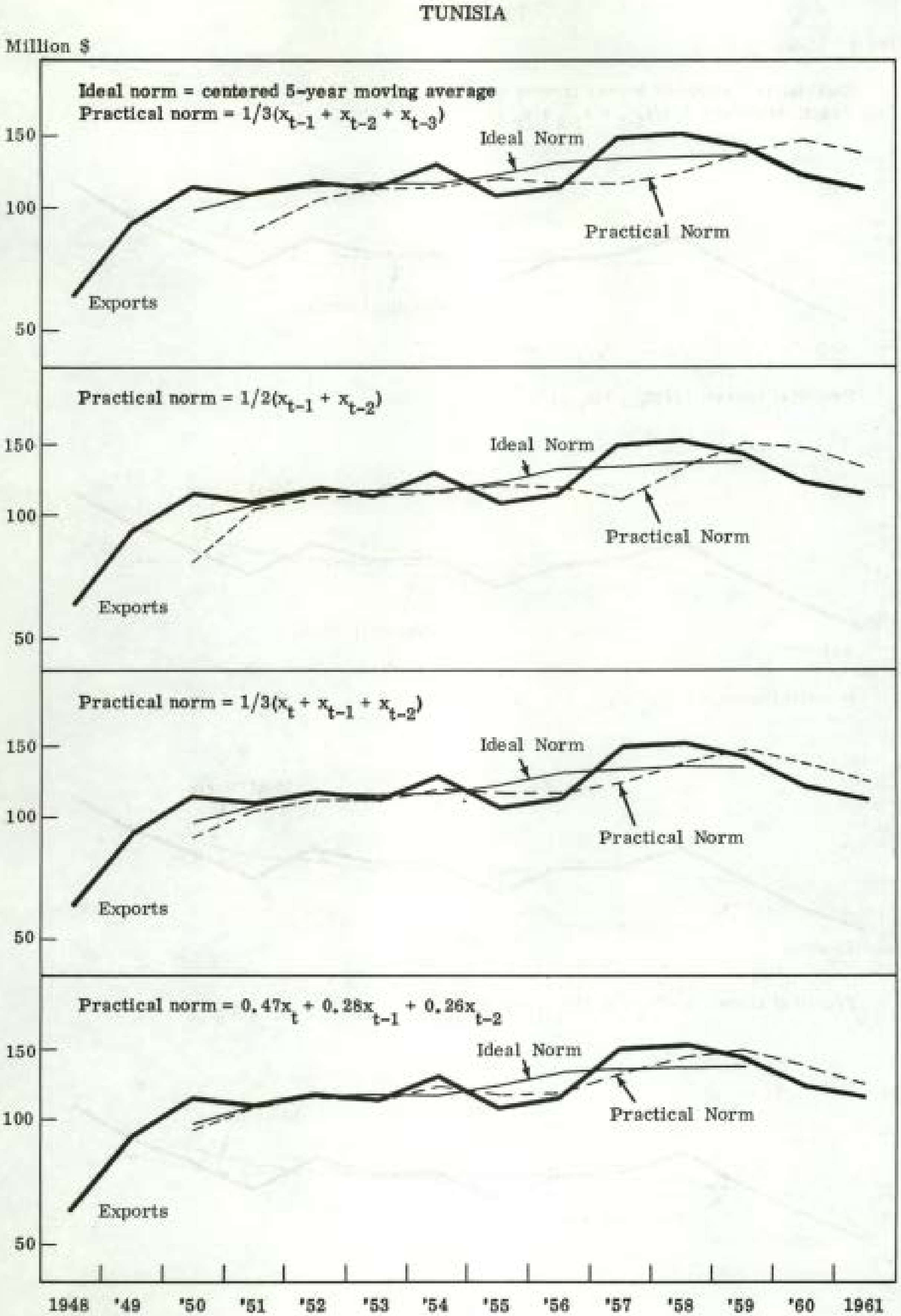
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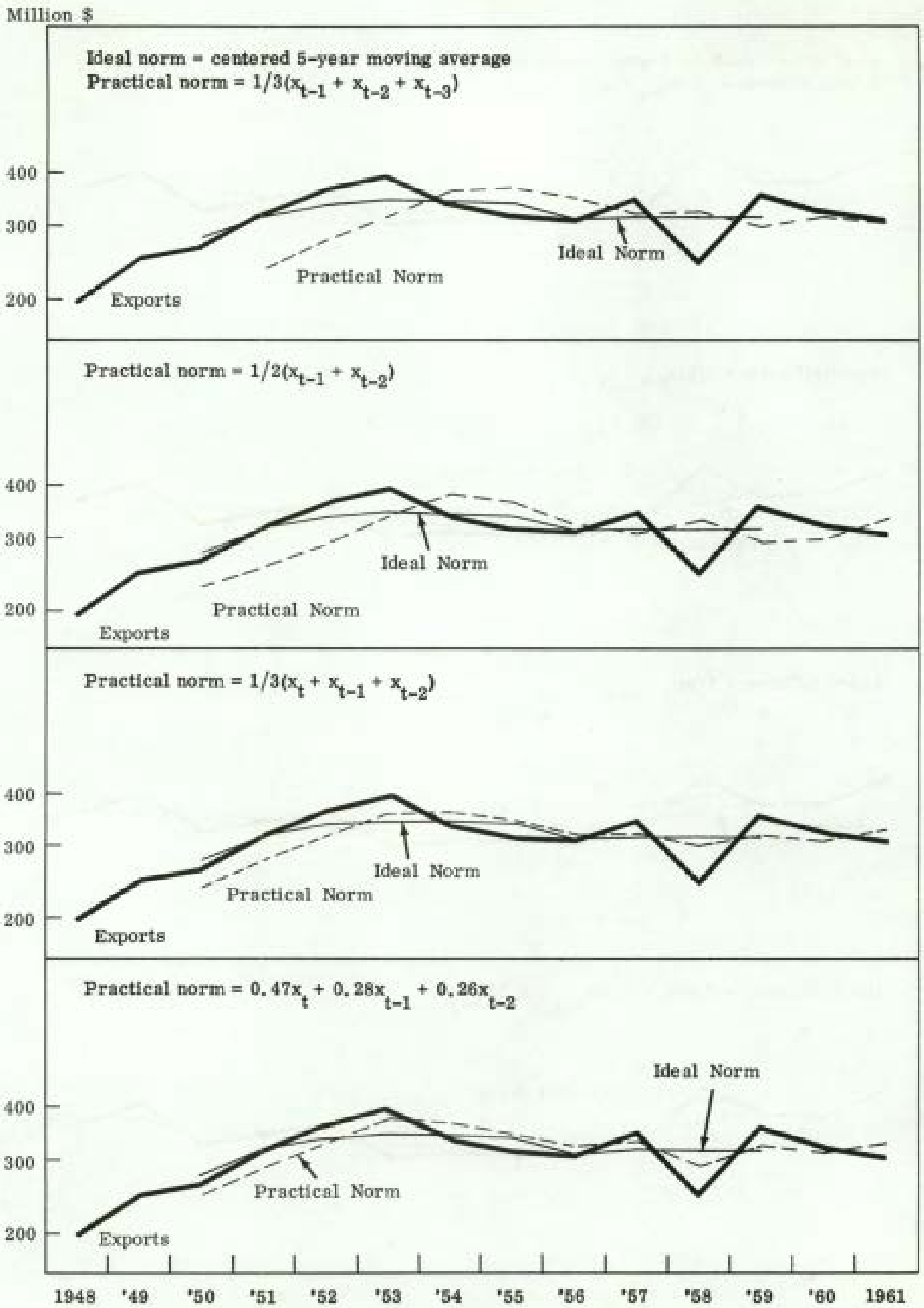

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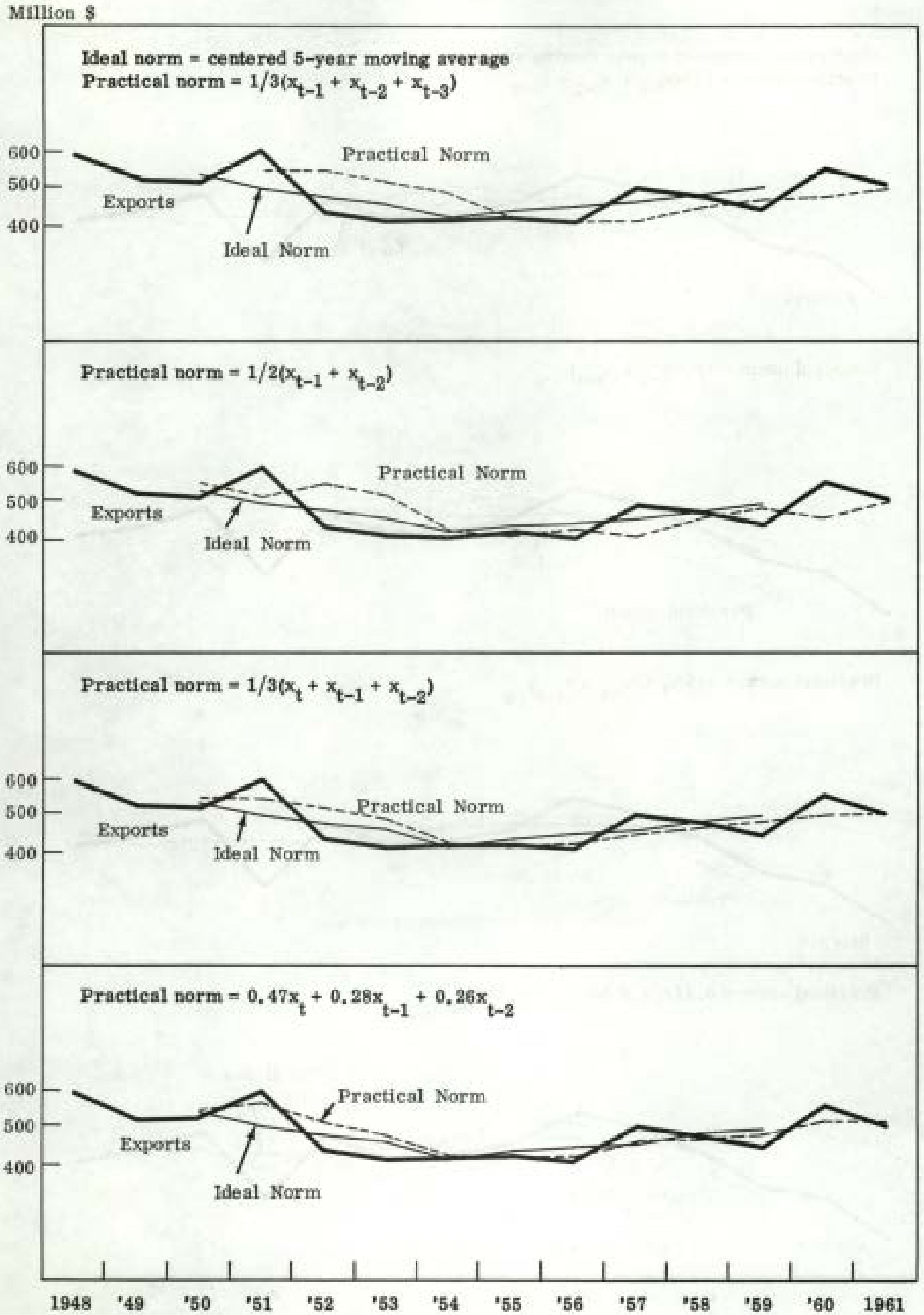

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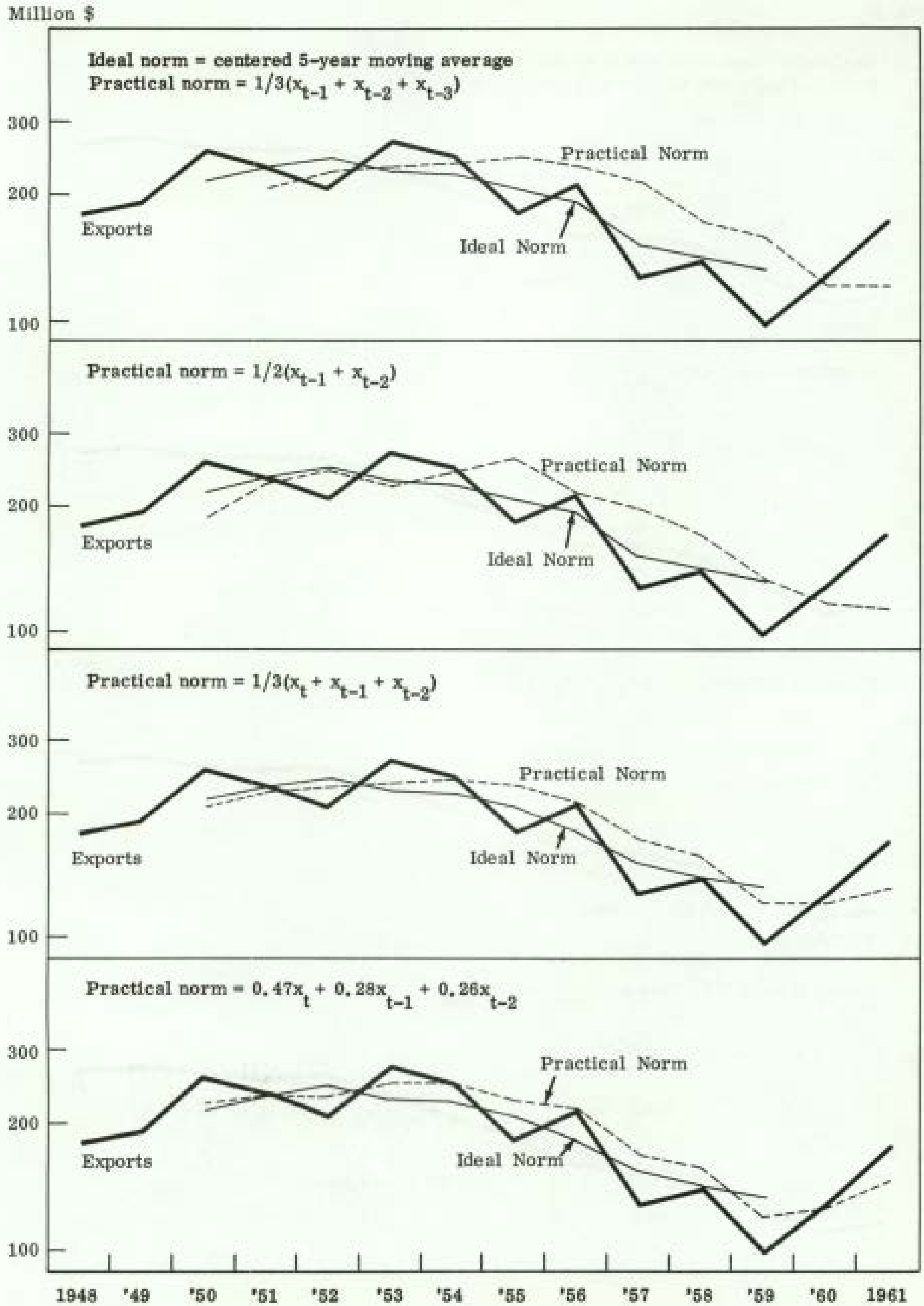
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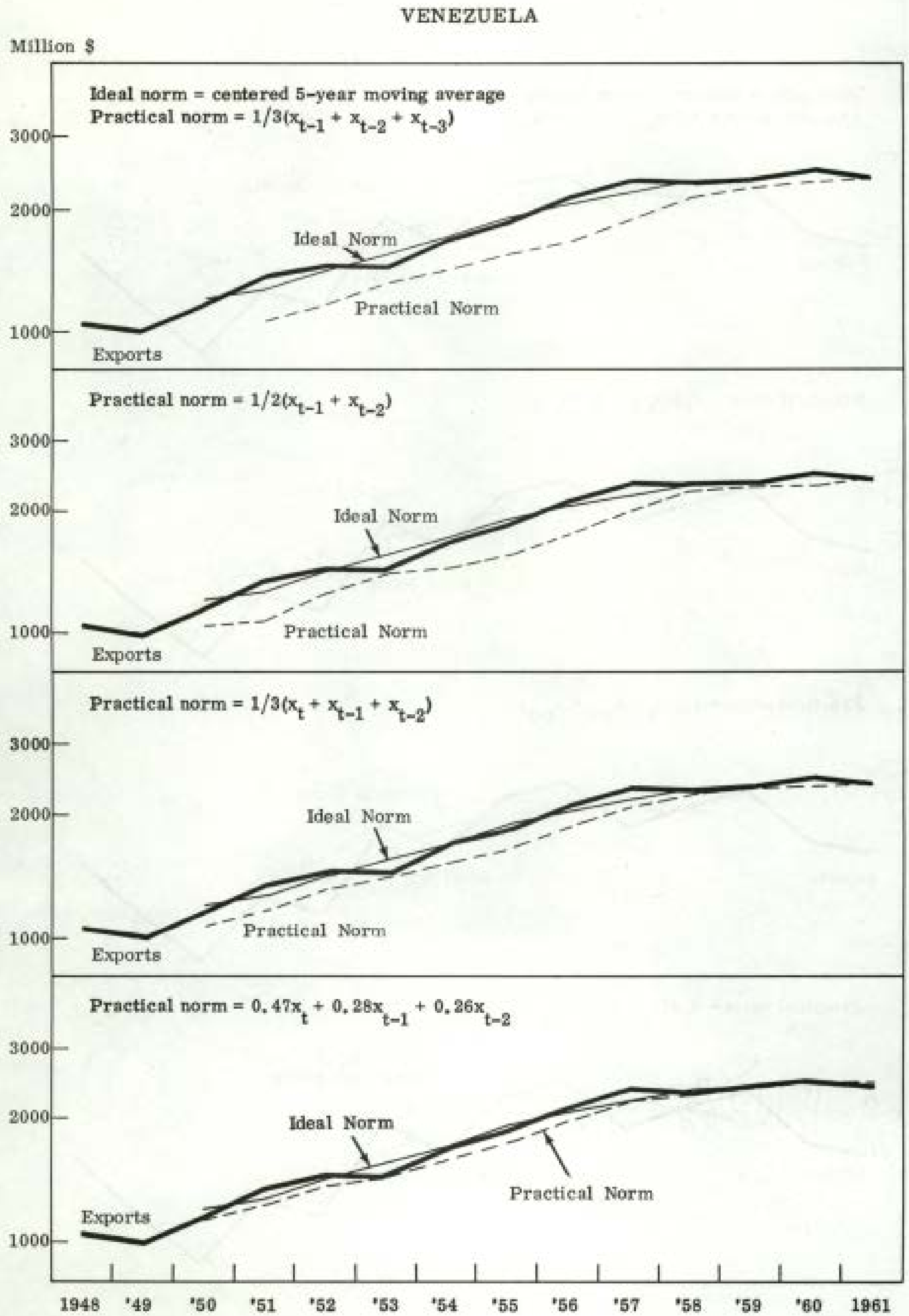
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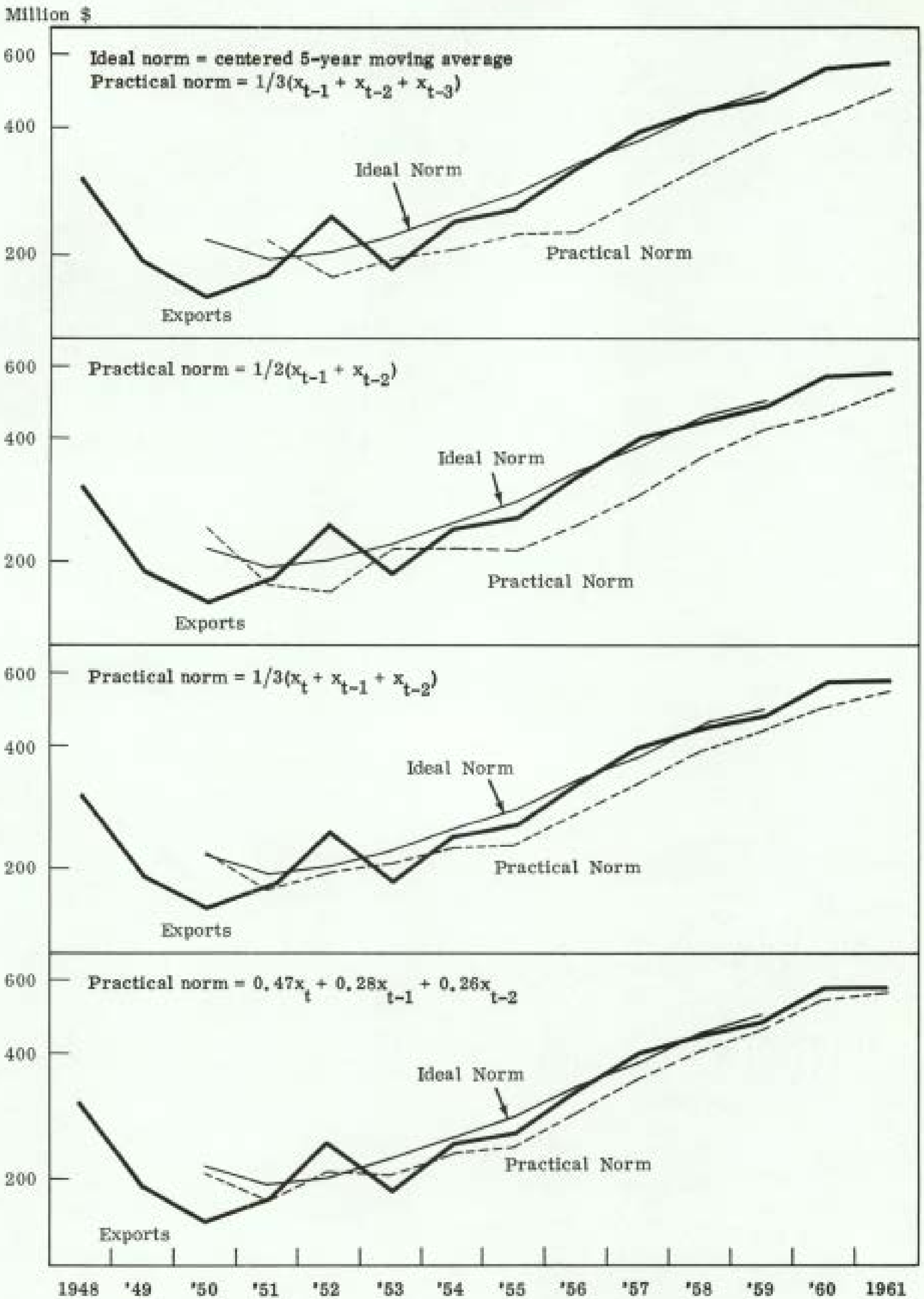
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FOR AGENDA

Mr. Jorge Del Canto

Room 807

(1) #1

SM/62/34

April 27, 1962

To: Members of the Executive Board

From: The Secretary

Subject: Compensatory Financing of Commodity Fluctuations and the Role of the IMF

The attached memorandum is circulated for consideration by the Executive Directors at a meeting tentatively scheduled for Friday, May 4, 1962.

Att:(1)

Other Distribution:
Department Heads
Division Chiefs

INTERNATIONAL MONETARY FUND

Compensatory Financing of Commodity Fluctuations
and the Role of the IMF

Prepared by the Research and Statistics Department

April 26, 1962

Introduction

In April 1960 the Fund staff submitted to the UN Commission on International Commodity Trade a study1/ in response to a request by that Commission that the IMF inform it regarding its policies and procedures regarding international measures to compensate for fluctuations in receipts from the export of primary commodities. Since then, the topic of compensatory financing has been actively discussed by a number of international bodies. Notable among these is the UN Group of Experts2/which, in January 1961 produced the report entitled "International Compensation for Fluctuations in Commodity Trade,"3/ the UN Commission on International Commodity Trade, at its 8th (1960) and 9th (1961) sessions, the Group of Experts reporting to the Special Meeting of the Inter-American Economic and Social Council of the Organization of American States at Punta del Este in August 1961 4/and that Special Meeting itself.5/

The most detailed deliberations to date, however, are those undertaken in recent months by a group of governmental experts set up by the Organization of American States at the Punta del Este meeting, to analyze the proposal for the stabilization of export proceeds contained in the report of the first Expert Group to the Punta del Este meeting, as well as any other alternative proposals, and to prepare a draft plan for the creation of mechanisms for compensatory financing.

1/ "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations" (SM/60/14, Rev. 2. Also Staff Papers, November 1960.)

2/ Appointed by General Assembly Resolution 1423 (XIV).

3/ UN document E/3447.

4/ See "Latin American Export Commodities: Market Problems" especially Chapter IV, "Measures to Offset Fluctuations in Export Receipts."

5/ See Report by IMF observers SM/61/71.

The meeting resulted in the preparation of a plan for the setting up of a new intergovernmental institution on a world scale, termed "International Fund for Stabilization of Export Receipts."1/ It is contemplated that this plan will be transmitted to the United Nations for the information of, and almost certainly for discussion by, the 10th session of the Commission on International Commodity Trade, which takes place in Rome in May 1962.

At this meeting the Commission on International Commodity Trade will also have before it the proposal for a Development Insurance Fund, put forward in January 1961 by a UN Expert Group and elaborated in a recent report by the UN Secretariat, as well as a scheme on somewhat similar lines for applying compensatory financing to individual commodities, recently worked out by the Secretariats of the UN and the FAO. Since governments have now had ample time to consider the scheme for an Insurance Fund this plan may be discussed in some detail. On the other hand, governments have had only a brief time to consider the Organization of American States plan. The most that can be expected, at the Rome meeting, is that the Commission on International Commodity Trade will decide whether to take as a basis of future discussions the Organization of American States plan, the UN insurance plan or some other alternative and will arrange to pursue such further discussions later in the year. It is possible also that as a supplement or alternative to these schemes the question may once again be raised of widening the activity of the IMF in the sphere of compensatory financing of export fluctuations of primary producing countries.

In the following sections a brief account of various proposals for the compensatory financing of export fluctuations that have been made in recent years, including both those affecting the use of IMF resources and those involving the setting up of new institutions, is provided for the Board's information.

I. Suggestions for Increased Compensatory Use of IMF Resources

The following are the principal suggestions that have been made by UN or Organization of American States Experts regarding the policies and practices of the IMF in the use of its own resources.

(a) Qualitative criteria for the use of Fund resources. The Commission for International Commodity Trade, at its session of May 1961 "considered that it would be desirable if the Fund would study the question whether the present criteria for the use of its resources are fully adapted to circumstances in which payments difficulties arise mainly from fluctuations in

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1/ See Report by IMF observers (SM/62/33).

primary product markets." The Group of Experts reporting to the Organization of American States Conference at Punta del Este on the market problems of Latin American Export Commodities was more explicit. "It is not clear" they said (p. 25) "why unsatisfactory financial policies should debar countries from temporary aid to offset cyclical fluctuations on their export receipts. A country that has inflation must, in the interest of its own development, take measures to restore financial stability. It is nevertheless entitled to help when its export receipts decline because of adverse conditions in world markets." To Mr. Qureshi also, in Appendix III of the UN Experts Report, it seemed unfair that the Fund's assistance should be used "as a handle to force borrowing countries to pursue policies considered appropriate by the Fund." (p. 80).

(b) Stand-by or near stand-bys for compensatory financing. According to the Report of the UN Expert Group (p. 29) "Through the increased use of stand-by arrangements or consultative procedures the Fund should aim to clarify with interested members the conditions which would assure that the full use of the quota without waiver (Fund holdings of 200 per cent of a member's currency) or even more will be readily granted if it appears justifiable according to forecasts of commodity markets and other relevant considerations."

(c) Extension of gold-tranche criterion to later tranches. The following suggestion is contained in the report of the UN Experts (p. 28). "In so far as drawings on the Fund are automatic, a country whose export proceeds fall has reliable access to a source of compensatory financing. At present only 25 per cent of a member country's quota comes close to being automatically available. Any significant increase in this percentage which the Fund could institute would be a valuable step towards providing compensatory financing to meet the needs of primary producing countries when threatened with the adverse impact of a decline in export proceeds."

(d) Automatic compensatory drawing rights in first credit tranche. In Appendix II of the Report of the UN Experts one of the Experts (M. L. Qureshi) suggested that "to offset fluctuations in the export proceeds of primary producing countries, compensatory drawings and repayments should be determined automatically by a formula. The fluctuations should be measured as a deviation from a trend which can be estimated on the basis of a moving average of three preceding years. A shortfall in export proceeds in any year should entitle the country concerned to draw from the Fund automatically up to, say, an amount which causes the Fund's holdings of the country's currency to equal 125 per cent of its quota----- Subsequently, when export proceeds are above the trend, the excess earnings should be used automatically to repay the earlier drawings." From the context it appears Mr. Qureshi had in mind full compensation of shortfalls as defined, up to the 125 per cent point, and subsequent repayment of the whole of any excess of export proceeds over trend.

(e) Automatic compensatory drawing rights additional to normal facilities. At the Special Meeting of the Organization of American States at Punta del Este, Chile advanced the proposal that Fund members affected by price declines in important export commodities should be enabled to draw from the IMF in amounts determined by the magnitude of the price decline in question relative to the average price of the preceding 3 years and by the volume of exports affected. Drawings under these special arrangements would be repaid when prices rose above the level of the three preceding years. The ability of members to make ordinary drawings would not be affected by the amounts outstanding under these special arrangements.

II. Schemes for Compensatory Financing Outside the Fund

As was mentioned above three schemes for the compensatory financing of export fluctuations, using resources other than those of the International Monetary Fund, are likely to be discussed at the May 1962 meeting of the Commission on International Commodity Trade in Rome.

Two of these schemes are designed to provide compensatory payments for shortfalls in the over-all exports of countries and envisage the setting up of institutions with a world-wide membership, whose functions inevitably overlap, to a greater or lesser extent, with those of the International Monetary Fund.

(1) The UN Experts, though hopeful that the compensatory financing activities of the IMF would gain in importance, doubted whether these activities, present or prospective, offered a complete answer to the need for measures to offset instability in the export trade of primary producing countries. Their principal recommendation involved the setting up of something in the nature of an international social insurance fund. To this fund all members would make annual contributions, determined mainly by the level of their exports and national income, sufficient, in the aggregate, to cover actual or prospective disbursements over a period of years. Claims would arise in case of export shortfalls measured against average receipts in the preceding three or four years and (partial) compensation for such shortfalls would take the form of either (a) "grants," (b) "contingent loans" offering a somewhat more substantial compensation for such shortfalls, and repayable out of such surpluses over trend as might subsequently occur within a 3 to 5 year period, any amount outstanding at the end of that time to be written off, or of (c) some mixture of grants and contingent

loans. Each of the variants of this scheme would, and is intended to, effect a net transfer of income from industrial and high income primary producing participants as a group to low income primary producers as a group. In the "grant" variant of the scheme the incidence of benefits and costs would, of course, depend on the basis of assessment of contributions, the method of determining shortfalls, and the degree of compensation provided for shortfalls. Suppose a scheme under which contributions are proportional to export proceeds, shortfalls are measured relative to a moving average of the preceding 3 years, shortfalls up to 5 per cent of exports are uncompensated, and 50 per cent of additional shortfalls are compensated. Had such a scheme been in operation over the 7-year period 1953-59, it is estimated that contributions and benefits would have averaged $468 million per annum and that industrial and high income primary producing countries would have made a net contribution to low income primary producing countries averaging $241 million per annum.

Variants of the scheme involving "contingent" loans--i.e. loans automatically repayable out of any surpluses over trend for a period of years and cancellable thereafter--would, of course, be less costly. Data provided by the UN Experts suggest that, with a similar scale of compensation to that already considered, with repayments on a similar basis, but with cancellation of any portion of a debt remaining outstanding after 3 years, repayments might on the average amount to something like 40 per cent of benefits.

With the exception of the Swedish representative in the Commission on International Commodity Trade there has been little indication, on the part of industrial countries, of support for the insurance proposals of the UN Expert Group. Even many of the primary producing countries appear to be deterred from supporting it, probably because of apprehensions as to the effect it might have on the willingness of industrial countries to provide aid in other forms.

(2) An extensive description of the scheme put forward by the Organization of American States Group of Experts on the Stabilization of Export Receipts, was given in the IMF observers' Report on the Meeting of that Group (SM/62/33) and need not be repeated here. Some comparisons between the UN and the Organization of American States schemes may, however, be useful. Both schemes provide financial assistance to countries whose export proceeds fall below a statistically determined standard--viz. a moving average of the preceding three years. But whereas the UN scheme is on an insurance-cum-contingent loan basis the Organization of American States scheme is on a pure loan basis. Under the UN scheme all members could participate formally on the same basis, paying in insurance premiums and receiving outright benefits

and contingent loans; under the Organization of American States scheme, on the other hand there would be two classes of members, one of which (the low-income primary producers) would pay subscriptions in cash but would be entitled to borrow, while the other would provide resources in the form of permanent credit arrangements, but would not have the right to borrow. Whereas the UN scheme would be likely to involve a more or less continuous net transfer from the industrial and the high income primary producing countries to the low-income primary producing countries, the Organization of American States scheme is intended to be financially self balancing and the only element of aid involved is the provision of credit at rates of interest based on those prevailing for government paper in industrial countries. While the UN scheme sets no limit on the assistance that may be received, confines any repayment to what can be met out of export receipts in good years, and cancels debts that persist too long, the Organization of American States scheme limits the amount that each country can borrow, and insists on repayment within five years.

(3) The third scheme applies the UN insurance-cum-contingent-loan principle with certain modifications to individual products. Under these proposals 50 per cent of shortfalls from the previous three years average in export receipts from the commodity in question would be compensated, with symmetrical repayments on export excesses over that average. Any remaining obligations would be cancelled after three years. Three main variants have been examined by the UN Secretariat: (a) A scheme covering exporters only; such a scheme, however, would result in net transfers among primary producing countries and is therefore thought to offer little incentive for exporters to participate. (b) A scheme covering exporters and importers; the latter would contribute but have no occasion to draw; this would be in part an aid scheme with net transfers from importing to exporting countries. (c) The third approach examined provides compensation for price fluctuations only, entitling exporters to compensation when prices are below, and importers when they are above, a trend level computed on the basis of a series of previous years' exports.

In connection with schemes (1) and (2), particularly the Organization of American States scheme, the idea has been mentioned--though not definitely proposed--that the new institution in question should be in some way associated with the IMF. The UN Expert Group, while considering that it would be "premature to be specific about the form of machinery suitable for insurance proposals" suggested that "one approach would be to set up the necessary funds as a trust fund to be administered by the most suitable existing organization." In its subsequent discussion of structural factors hampering the growth of exports of commodities, which, it considered, "should be the subject of discussion between affected countries and the authority administering any new compensatory fund" the Experts mentioned that "Among other agencies the IMF, in its dealings with members has regard to these matters through its regular consultations." In the Organization of American States plan explicit mention of the possibility of associating the proposed Export Stabilization Fund with the IMF is made both on the Report of the Expert Group and in the draft Articles of Agreement. The Report states, "The institution should cooperate with other international organizations having similar interests, particularly the International Monetary Fund in the case of a world-wide institution and the Inter-American Development Bank in the case of a regional institution. It is essential to avoid unnecessary duplication of technical facilities and staff already available in other institutions. On the important question of the precise relationship between the institution and the International Monetary Fund, in the case of a world-wide institution, a wide range of possibilities was considered, from complete integration at one extreme to complete autonomy at the other extreme. The Group of Experts found, however, that the weightiest considerations are largely of a political nature and, therefore, beyond the competence of technical experts. Consequently, the Group thought it best to leave this question for decision at a political level at a later stage."

III. Guidance to Fund Observers

In the light of considerations set forth in the preceding sections it is suggested that the Fund representatives at the forthcoming meeting of the Commission on International Commodity Trade in Rome should be instructed (a) to declare the great interest of the Fund in the problem of the underdeveloped countries generally; (b) to restate the present policies of the Fund with respect to financing of export fluctuations and mention the assistance the Fund has recently been giving to countries with faltering export proceeds; (c) to state that the Fund has taken note of the various suggestions made as to the development of its policies and is continuing to give consideration to these suggestions, bearing in mind the possibility that separate institutions may be set up for the explicit purpose of providing automatic credit; and (d) to state that the Fund is ready to participate actively in discussions on alternative means for compensatory financing.

in this field

in the individual discussions of proposals

proposals for action by other institutions in ~~their field~~;

III. Guidance to Fund Observers

In the light of considerations set forth in the preceding sections it is suggested that the Fund representatives at the forthcoming meeting of the Commission on International Commodity Trade in Rome should be instructed (a) to declare the great interest of the Fund in the problem of the underdeveloped countries generally; (b) to restate the present policies of the Fund with respect to financing of export fluctuations and mention the assistance the Fund has recently been giving to countries with faltering export proceeds; (c) to state that the Fund has taken note of the various suggestions made as to the development of its policies and is continuing to give consideration to these suggestions, bearing in mind proposals for action in this field by other institutions; and (d) to state that the Fund is ready to participate actively in the international discussion of proposals for compensatory financing.

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

For Immediate Attention

Mr. Jorge Del Canto

Room 807

(1) #1

EBD/62/55

April 26, 1962

To: Members of the Executive Board

From: The Secretary

Subject: UN Commission on International Commodity Trade - 10th Session

On May 14-23 the CICT will hold its 10th Session at FAO Headquarters in Rome. This meeting will be preceded by a Working Party of CICT to consider the annual review of the situation of international trade in primary commodities and, on May 7-14, by a Joint Meeting with the FAO's Committee on Commodity Problems.

Amongst the items on the CICT agenda will be that of compensatory financial measures to offset fluctuations in the export income of primary producing countries. The CICT will have before it the report of the UN Group of Experts on this subject (UN Document E/3447) with which the Fund cooperated. The reports of the discussions on this subject which took place recently under the auspices of the Organization of American States (see SM/62/33) will probably also be before the Commission.

It is proposed that the Fund shall be represented at this group of meetings by Mr. J. J. Polak, Mr. Marcus Fleming, and Miss Gertrud Lovasy of the Research and Statistics Department, and Mr. George Nicoletopoulos of the Legal Department as the course of the discussions calls for.

In the absence of objection by the close of business on Tuesday, May 1, 1962, the proposal will be deemed approved by the Executive Board and so recorded in the minutes of the next meeting thereafter.

Other Distribution:
Department Heads
Division Chiefs

175%

200%

12

Office Memorandum

kii

TO : Mr. E. W. Robichek DATE: April 25, 1962

FROM : P. J. Brand PJB

SUBJECT : Compensatory Financing

My principal misgiving about the draft paper is the indication that the Fund should go further than it has in providing compensatory financing for declines in export receipts and thereby dig the ground from under any separate scheme. I do not think this is either necessary or desirable. It is true that pages 11-13 are couched in terms of what is technically feasible, but it is hardly necessary to discuss feasibility since a lot of things are possible within the framework of the Fund's authority. The intention seems to be to promote some sort of special export compensation arrangement within the Fund. I consider proposal (d) on page 17 particularly unfortunate in that it seems to hold out a "carrot", namely, that the Fund would relax its policies if the member countries abandoned their plans for a separate scheme (whether or not closely related to the Fund). I think this kind of maneuver should definitely be avoided.

I take it that my above comments are more or less in the same direction as Mr. Finch's reaction.

Aside from the above, I have indicated corrections in wording which ~~seemed~~ seem to be necessary in a few places.

Mr. C. David Finch

J. J. Polak

April 23, 1962

Compensatory Financing

The attached is a draft paper for submission to the Board on compensatory financing. A separate paper summarizing the OAS discussions and report is being circulated to the Board today.

Before I submit the present paper up to the Managing Director I should like to receive any reactions you might have with respect to it.

As time is getting short might I ask for any reactions by tomorrow noon, so that I can give the paper to the Managing Director by the end of tomorrow.

Attachment

March 29, 1962

A Comparison of Forecasting
Formulae for Normal Exports

by J. Marcus Fleming, R. R. Rhomberg and Lorette Boissonneault

In recent years a number of proposals have been made for arrangements whereby short-term fluctuations in the export receipts of primary producing countries would be automatically offset, in whole or in part, by international transfers in the form of grants, loans and repayments, or by insurance transactions.

It is an essential feature of all of these schemes, and indeed of any conceivable scheme, of compensatory financing that compensable fluctuations in exports be defined in terms of the deviations of actual exports from some normal level. Moreover, if positive and negative deviations are to come into approximate balance over an appropriate period, two conditions must be fulfilled:

(a) The norm itself from which the deviations are measured must move with the movement in actual exports, though more gradually than the movement in actual exports, and the shorter the period within which an approximate balance between positive and negative deviations is to be attained, the more responsive the norm must be to the movements in actual exports.

(b) The norm should, ideally, reflect not only the actual exports of the more or less recent past but also those of the more or less immediate future. Otherwise, if the movement in actual exports has a persistent tendency in one direction, the movement in the norm will lag continuously behind that in actual exports so that, if the persistent trend is upwards, positive deviations of actual exports from the norm will predominate, and if the trend is downwards, negative deviations will be the rule.

In "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations"[1/] a five year moving average of exports centered on the middle year is taken as the statistical definition of normal exports. The norm thus reflects the influence of exports up to two years before and two years after the year to which it relates. This definition seems--from the charts contained in that paper--to result in deviations that correspond reasonably well with what economists usually have in mind when they speak of the compensation of short-term export fluctuations.

Any attempt, however, to compensate or offset by financial means export fluctuations measured in relation to this ideal statistical norm runs into the practical difficulty that the norm for any year cannot be derived from export data that are already established at the time when the estimation has to be made. The essence of a national policy of stabilization involving the use of compensatory financing (whether by means of national reserve movements or by international transfers) is that the country should strive to bring about a level of imports related (apart from any temporary factors affecting import needs themselves) to the normal level of exports. Policies designed to achieve this end must themselves be undertaken in advance. Thus a government pursuing a policy of stabilization will act in 1962 in such a way as to adjust imports in

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1/ IMF Staff Papers, November 1960.

1963 to the normal exports of 1963. But this norm, as defined above, can only be estimated with the aid of forecasts of exports in 1963, 1964 and 1965 (taken in conjunction with the already known exports of 1961 and 1962). Again, it is desirable that actual compensatory international transfers (loans or grants) should be made as soon as possible after the export deviation to which they relate, e.g. that any shortfalls of actual exports in 1962 beneath the norm for 1962 should be compensated by the end of that year. But this means that by the end of 1962 it should be possible to estimate the norm for that year, which involves anticipating actual exports in 1963 and 1964.

It is clear that for practical purposes some method has to be found of forecasting normal exports--defined as we defined them--for any year on the basis of data relating to previous years. The definition of 'norm' as a moving average centered on the middle year would seem to indicate that the natural method of doing this would be to forecast actual exports for a number of years ahead and then deduce from past and forecast figures the level of normal exports for the year in question. However, insofar as statistical methods are employed to make the forecast, there seems to be no advantage in proceeding by this roundabout route: it is simpler to forecast normal exports--as defined--directly.

Insofar as export norms are being forecast by the countries themselves for the purpose of determining appropriate policies or even by organizations such as the IMF for the purpose of advising their members on policy or for the purpose of providing compensatory credit on a discretionary basis, the forecasts in question can be on the basis of a combination of quantitative and qualitative information relating to the circumstances of the particular country. Even in such cases it may be helpful as a stage or element in the forecasting process to combine relevant statistical data of immediately preceding years in dynamic (forecasting) formulae derived by statistical regression from data relating to a considerable number of years. For such purposes, the forecasting formulae can be tailormade to fit the circumstances of each country and may differ, as regards both the determining variables and the relative weights assigned to them, from country to country. Moreover, though the actual exports of immediately preceding years will always bulk large in the forecasting of export norms, data reflecting other economic magnitudes likely to affect future exports e.g. domestic cost trends or the level of economic activity in other countries might well find a place in such calculations.

The situation is altered, and the scope for accurate forecasting considerably narrowed--when the formula sought is to serve in connection with a multi-national scheme for compensatory financing. For this purpose a general formula will have to be selected which can be applied to a case at hand quickly and without resort to potentially controversial statistical manipulations.

The present paper deals exclusively with formulae deemed to be sufficiently simple in concept and uniform in character to be acceptable in connection with an international scheme. These formulae are tested for their relative success in forecasting export norms as defined above. This success can never be as great as that of formulae tailormade to suit the circumstances of individual countries. It is hoped to test formulae of the latter type in a subsequent paper.

The relations tested

Some of the forecasting relationships tested were of a simple type defined a priori without the use of regression.

1. The export norm of any year is equal

(a) to the actual exports of the previous year, $[N_t = X_{t-1}]$, or

(b) to the unweighted mean of the exports of the two previous years, $[N_t = \frac{1}{2}(X_{t-1} + X_{t-2})]$, or

(c) to the unweighted mean of the exports of the three previous years, $[N_t = 1/3\,(X_{t-1} + X_{t-2} + X_{t-3})]$.

2. The export norm of any year is a homogeneous linear function of the exports of the three previous years, that is to say, the estimated norm is a weighted average of the exports of the three previous years; the weights were determined by least squares regression (without constant term) over the years 1948-58 in four different ways:

(a) Both actual exports and normal exports were aggregated year by year for 43 countries and a least squares regression was applied to the annual aggregates.

(b) Regressions of export norms on actual exports were obtained for the individual countries, and each of the three resulting coefficients, or weights, was averaged over the 43 countries.

(c) A third set of coefficients was taken from a single regression, for all years and all countries, of normal exports on actual exports in each of the three preceding years, expressed in U.S. dollars.

(d) The fourth set of weights was obtained from a similar regression equation, save that in this case the exports and norms of each country were first expressed in index numbers (average exports for each country = 100).

Table 1 sets forth the coefficients or weights assigned by regression analysis under the various formulae of type 2 to each of the 3 years preceding the year for which normal exports are to be estimated.

Table 1. Coefficients by Which Actual Exports in Each of the Three Preceding Years is Multiplied to Arrive at an Estimate of Normal Exports in the Current Year

Formula	t-1	t-2	t-3
2(a)	.51	.25	.28
2(b)	.58	.29	.17
2(c)	.60	.33	.11
2(d)	.61	.33	.09

It will be observed that in all cases the coefficients for the immediately preceding year (t-1) are considerably higher than those for either of the earlier years, and in all cases but one the coefficient for two years previous (t-2) is considerably higher than that for 3 years previous (t-3). Formulae including year t-4 were tried out but the regressions yielded insignificant coefficients for that year. In general the coefficients seem to add to more than unity: viz. 1.04 or--in the case 3(d)--1.03. In this way the general upward trend in aggregate exports of all 43 countries is reflected in the calculation.

3. Normal exports for any year in each country were estimated by extrapolating the straight line trend of actual exports of that country over a moving period of preceding years. The straight line trends are calculated for moving periods of 4 different lengths:

(a) 7 previous years,

(b) 6 previous years,

(c) 5 previous years,

(d) 4 previous years.

4. Actual exports for any current year and two subsequent years were estimated by applying to average exports for the two preceding years a straight line trend of exports calculated by regression over a certain period of previous years. Normal exports for the current year are then calculated by the definition of this norm, i.e. as a 5-year moving average centered on the middle year. This reduces to $N_t = 0.5 (X_{t-1} + X_{t-2}) + 1.5 c'$, where c' is the regression coefficient of X_t on t for a moving period of years prior to t. These straight line trends of exports are calculated for moving periods of four different lengths,

(a) 7 previous years,

(b) 6 previous years,

(c) 5 previous years,

(d) 4 previous years.

Table 2. Forecasts of Normal Exports of Primary Producing Countries
(defined as centered 5-year moving average of actual exports)

Errors as per cent of mean exports 1951-58, average of 43 countries

Estimate based on:	Period through 1958 as indicated: Mean Standard Error	1959: Mean Error
	(1951-58)	
1. A priori formulae		
(a) Last year of exports	11.61	10.54
(b) Last two years of exports, equal weights	10.26	7.60
(c) Last three years of exports, equal weights	11.92	8.74
2. Last three years of exports, weights based on:		
(a) Regression applied to total exports (43 countries)	10.00	7.83
(b) Average of coefficients of 43 countries	9.63	7.55
(c) Regression applied to all countries: dollar value	9.58	7.37
(d) Regression applied to all countries: indices	9.57	7.34
3. One year extrapolation from moving trend of exports:	(1955-58)	
(a) 7-year moving trend	10.36	8.05
(b) 6-year moving trend	10.06	8.25
(c) 5-year moving trend	11.26	7.89
(d) 4-year moving trend	13.14	10.15
4. Extrapolation from average exports of last 2 years based on:		
(a) 7-year moving trend	9.33	7.68
(b) 6-year moving trend	9.65	8.44
(c) 5-year moving trend	11.07	8.40
(d) 4-year moving trend	13.08	10.24

It will be seen that two tests are offered of the relative accuracy of the different formulae in forecasting normal exports:

(1) Computed values for normal exports have been compared with actual values of normal exports for the period 1951-58, in the case of formulae of types 1 and 2 and for the period 1955-58 in the case of formulae of types 3 and 4, and a standard error of estimate (as per cent of the mean normal export over the period 1951-58) has been computed. The first column of Table 2 gives the averages over all countries of these percentage standard errors. The periods to which the test applies are the same as those over which the regressions of the formulae of type 2 were calculated, and represent the largest postwar periods for which complete data for the computation of normal exports could be obtained.

(2) Values for normal exports in 1959 have been calculated from data of actual exports for 1957-60 and estimates for 1961, using available data for the first 3 quarters of that year. The estimates for normal exports in 1959 computed from the various formulae have been compared with actual normal exports and the residuals have been expressed as percentages of the mean of normal exports over the years 1951-58. The second column of Table 2 shows the averages over all countries of these percentage errors.

The second test has the disadvantage that it covers only one year and that the actual export values assumed for 1961 may diverge slightly from the final values later to be reported for the full year. On the other hand the results under the first test may be slightly too favorable to formulae of type 2 in that the results are tested by data relating to the same period for which the least-squares regression coefficients have been derived, i.e. there is some, though probably not a serious, loss of degrees of freedom. The standard errors applicable to formulae of types

3 and 4, being based on a smaller number of years, will be less reliable than those applicable to formulae of types 1 and 2. It will be noted that the mean errors for 1959 are uniformly lower than the mean standard errors given in the first column of Table 2. This fact is without significance in the evaluation of these tests; it merely implies that 1959 was a relatively "easy" year to forecast by any method, chiefly, no doubt, because the 1959 estimates are not affected by the Korean War disturbance.

These tests seem to show that:

(a) The most accurate, or least inaccurate, predictions of normal exports are those derived from formulae of type 2, viz., weighted averages of the actual exports of the preceding three years, and those of type 4, sub-type (a) and (b), viz., extrapolations from average exports of the last 2 years based on 7 or 6 years straight line trends.

(b) Of estimates made on the basis of the actual exports of the three preceding years those assigning an equal influence to the three past export values give less good results than those assigning an unequal influence determined by regression analysis. The best estimates in this category result from type 2(d). This is to be expected: since the weights are in this case derived from all the data in index number form, their application gives the smallest percentage deviations of estimated from actual normal exports for any weighting scheme for the three preceding years.

(c) Among the estimates of type 1, where only unweighted averages of recent past exports are considered, the results obtained by using the average of the last two years of exports are better than those using the estimate on the last three years or on the last year alone. This is not surprising in view of the relative weighting of the last three years that is found, by regression analysis, to give the best predictions. (See Table 1).

(d) Of estimates using extrapolation of straight line trends derived from the data of previous years, those based on longer-run trends, up to 6 or 7 years, give a better result than those based on short-run trends of 5 and 4 years. Still longer (i.e. 8 years) trends, however, are found to give poorer results than do 7 year trends.

(e) While some of the more elaborate formulae yield significantly better results than the 'naive' formula which takes the actual exports of each year to be the norm for the next year, the standard error is reduced only by 20 to 30 per cent.

(f) Even in the case of the best forecasting formulae the average deviation of estimated from actual 'normal' exports was of the order of 9½ per cent. Even in the good year 1959 it remained of the order of 7½ per cent.

Office Memorandum

TO : Mr. Jorge Del Canto

DATE: March 15, 1962

FROM : Paul J. Brand

SUBJECT : Paper on Compensatory Financing of Commodity Fluctuations

The paper as submitted to the Managing Director by Mr. Polak does not depart from the earlier draft plus proposed additions and amendments sent to us previously by Mr. Fleming.

As I mentioned to you orally, however, we are anxious to ensure that the statement which eventually emerges with regard to the Fund's policies on use of its resources (aside from the new scheme) not be subject to misinterpretation. This refers to the last sentence of the first full paragraph on page 6. It should be understood that it refers only to a situation where the export decline is entirely due to external factors, i.e., not to improper domestic or exchange policies. Moreover, it should be made clear that where a country has been and is in need of corrective policies, the mere fact that it also is experiencing an export decline caused by external factors will not give it access to the Fund's resources without adoption of the corrective policies which are needed in any event. If this is the meaning of "no additional corrective policies", we are in agreement with the intent. Mr. Fleming had undertaken, however, to add some language clarifying this point and this should be done before the statement is finalized.

As to other points, it should be mentioned that no decision has been taken by the OAS group as to the nature of the relations of the proposed Institute with the Fund (if the scheme is world-wide). The description on page 13, therefore, must be considered as tentative.

I also might call attention to the fact that the listing of Class B contributions in the first full paragraph on page 14 has been modified by the latest U.S. proposal, as shown in my memorandum of March 13. Of course, the latest U.S. proposal is also tentative and represents no more than a negotiating position.

INTERNATIONAL MONETARY FUND

5-2

Mr. Friedman[?]

This reproduces mainly the descriptive parts of the longer paper. But it spells out more fully the features of the probable OAS (Bernstein) scheme presumably because more details are now available.

Recommendations are very limited, e.g. p. 6 + 15. I see no great difficulty in them.

PJB

Paul J. Brand

INTERNATIONAL MONETARY FUND
WASHINGTON 25, D. C.

RESEARCH & STATISTICS
DEPARTMENT

CABLE ADDRESS
INTERFUND

March 2, 1962

MEMORANDUM

TO: Mr. Del Canto
Mr. Friedman
Mr. Gold
Mr. Williams

FROM: J. J. Polak

SUBJECT: Compensatory Financing of Commodity Fluctuations and the Role of the IMF

I am planning to submit to the Managing Director early next week the attached memorandum by Mr. Fleming. If you have any suggestions with respect to it would you let Mr. Fleming or myself know by the end of Monday.

Attachment

Statistical difficulty (export measurement)
Large indebtedness (past record - Peru, Bz, Col., Chile)

February 28, 1962

Compensatory Financing of Commodity Fluctuations
and the Role of the IMF

Introduction

Since April 1960 when a study[1] was submitted by the IMF to the UN Commission on International Commodity Trade, in response to a request by that Commission that the IMF inform it regarding its policies and procedures in relation to the compensatory financing of commodity fluctuations, the topic of compensatory financing has been actively discussed by a number of international bodies. Notable among these is the UN Group of Experts[2] which, in January 1961 produced the report entitled "International Compensation for Fluctuations in Commodity Trade," the UN Commission on International Commodity Trade, at its 8th (1960) and 9th (1961) sessions, the Group of Experts reporting to the Special Meeting of the Inter-American Economic and Social Council of the OAS at Punta del Este in August 1961[3] and that Special Meeting itself. The discussion is continuing, and may be approaching practical issues. As a result of the Punta del Este meeting, the OAS set up a new group of governmental experts to analyze the proposal for the stabilization of export proceeds contained in the report of the first Expert Group to the Punta del Este meeting, as well as any other alternative proposals, and to prepare a draft plan for the creation of mechanisms for compensatory financing. This second OAS Expert Group is now in session and is supposed to report by the end of March 1962 so that the draft plan

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1/ "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations" (SM/60/14, Rev. 2. Also Staff Papers, November 1960).

2/ Appointed by General Assembly Resolution 1423 (XIV).

3/ See "Latin American Export Commodities: Market Problems" especially Chapter IV, "Measures to Offset Fluctuations in Export Receipts."

can be considered by governments before the 10th session of the CICT, which takes place in Rome in May 1962. At this meeting the CICT is to have a further, intensive discussion of compensatory financing with the aid of a further report prepared by the UN Secretariat. Since the governments represented on the CICT will have had over a year to consider the UN Expert Group's report, it was hoped that some practical decisions might emerge. However, since the CICT will probably be confronted with a detailed proposal for a world wide compensatory scheme worked out by the OAS Experts, with the technical assistance of Mr. E. M. Bernstein, and since France is rumored to be hatching out still a third plan, it seems likely that the period of debate and indecision will be prolonged at least until the second half of 1962.

Most significant of all, a plan for compensatory credits to offset the export fluctuations of primary producing countries on lines roughly similar to the plan now under discussion in the OAS, is believed to have been worked out by an inter-departmental committee of the U.S. Government and may soon receive the official imprimatur.

The Americans have also obtained the agreement of the OAS Experts to communicate the main features of the OAS plan on an informal basis to the governments of other industrial countries.

Several questions arise from these discussions with respect to which the Fund will sooner or later have to determine its attitude. These are:

(1) How far can the Fund go towards adopting various modifications that have been suggested in its policies and practices with respect to the use of its own resources?

(2) What attitude should the Fund adopt towards proposals that have been made for setting up new international financial institutions or arrangements to provide compensatory financing for export fluctuations?

(3) To what extent should the Fund show willingness to accept functions of administration or management with respect to such outside financial arrangements as countries may decide to set up?

I. Compensatory Use of IMF Resources

The following are the principal suggestions that have been made by UN or OAS Experts regarding Fund policies and practices in the use of its own resources.

(a) Qualitative criteria for the use of Fund resources. The Commission for International Trade, at its session of May 1961 "considered that it would be desirable if the Fund would study the question whether the present criteria for the use of its resources are fully adapted to circumstances in which payments difficulties arise mainly from fluctuations in primary product markets." The Group of Experts reporting to the OAS Conference at Punta del Este on the market problems of Latin American Export Commodities was more explicit. "It is not clear" they said (p. 25) "why unsatisfactory financial policies should debar countries from temporary aid to offset cyclical fluctuations on their export receipts. A country that has inflation must, in the interest of its own development, take measures to restore financial stability. It is nevertheless entitled to help when its export receipts decline because of adverse conditions in world markets." To Mr. Qureshi also, in Appendix III of the UN Experts Report, it seemed unfair that the Fund's assistance should be used "as a handle to force borrowing countries to pursue policies considered appropriate by the Fund." (p. 80).

(b) Extension of gold-tranche criterion to later tranches. The following suggestion is contained in the report of the UN Experts (p. 28). "In so far as drawings on the Fund are automatic, a country whose export proceeds fall has reliable access to a source of compensatory financing. At present only 25 per cent of a member country's quota comes close to being automatically available. Any significant increase in this percentage which the Fund could institute would be a valuable step towards providing compensatory financing to meet the needs of primary producing countries when threatened with the adverse impact of a decline in export proceeds."

(c) Automatic compensatory drawing rights in first credit tranche. In Appendix II of the Report of the UN Experts one of the Experts (M. L. Qureshi) suggested that "to offset fluctuations in the export proceeds of primary producing countries, compensatory drawings and repayments should be determined automatically by a formula. The fluctuations should be measured as a deviation from a trend which can be estimated on the basis of a moving average of three preceding years. A shortfall in export proceeds in any year should entitle the country concerned to draw from the Fund automatically up to, say, an amount which causes the Fund's holdings of the country's currency to equal 125 per cent of its quota---- Subsequently, when export proceeds are above the trend, the excess earnings should be used automatically to repay the earlier drawings." From the context it appears Mr. Qureshi had in mind full compensation of shortfalls as defined, up to the 125 per cent point, and subsequent repayment of the whole of any excess of export proceeds over trend. He appears to take no overt account of compulsory repurchases.

(d) Automatic compensatory drawing rights additional to normal facilities. At the Special Meeting of the OAS at Punta del Este, Chile advanced the proposal that Fund members affected by price declines in important export commodities should be enabled to draw from the IMF in amounts determined by the magnitude of the price decline in question relative to the average price of the preceding 3 years and by the volume of exports affected. Drawings under these special arrangements would be repaid when prices rise above the level of the three preceding years. No mention was made of compulsory repurchases. The ability of members to make ordinary drawings would not be affected by the amounts outstanding under these special arrangements.

(e) Stand-by or near stand-bys for compensatory financing. According to the Report of the UN Expert Group (p. 29) "Through the increased use of stand-by arrangements or consultative procedures the Fund should aim to clarify with interested members the conditions which would assure that the full use of the quota without waiver (Fund holdings of 200 per cent of a member's currency) or even more will be readily granted if it appears justifiable according to forecasts of commodity markets and other relevant considerations."

At the 1961 CICT meeting the Fund indicated its willingness, in connection with its current review of practice and policies, to take into account the views expressed in the UN Experts report and other UN bodies regarding the Fund's role in compensatory financing. Since that time the situation has been altered by the international discussions that have been proceeding with a view to setting up a separate international agency devoted to the compensatory financing of commodity export fluctuations. These discussions, which are described in Section II below, now appear to be much more likely than was previously the case to attain to practical fruition. If some such agency comes into existence and especially if it operates, as is suggested in Section II below, to some extent as an affiliate to the IMF, both the case for extending the automatism of Fund operations and the pressure on the Fund to agree to such extension would be weakened.

In these circumstances it should suffice that the staff prepare, for incorporation in the Fund statement to the CICT and for the Annual Report, a new and up-to-date statement, backed where possible by reference to actual experience with Fund drawings, of the Fund's policies vis-a-vis primary producing countries faced by export declines. This statement should stress the extent to which the Fund seeks to assist members that are the victims of payments difficulties arising from the outside, and the measure in which members can count on Fund assistance in adverse circumstances of this nature, even though Fund transactions beyond the gold tranche are not "automatic."

Meanwhile consideration should be given at the staff level to the possibility to any modifications of Fund policy with respect to financing of export fluctuations that would be appropriate should the proposals for the separate International Compensatory Institution fail to win international acceptance.

II. Schemes for Compensatory Financing Outside the Fund

Two schemes for the compensatory financing of export fluctuations, using resources other than those of the IMF, are at present under active international considerations; that for an Insurance Fund, put forward by the UN Expert Group, and that for a Compensatory Loan Fund, current in course of elaboration by the (second) OAS Expert Group.

The UN Experts, though hopeful that the compensatory financing activities of the IMF would gain in importance, doubted whether the Fund's activities, present or prospective, offered a complete answer to the need for measures to offset instability in the export trade of primary producing countries. Their principal recommendation involved the setting up of something in the nature of an international social insurance fund into which all member contributors would pay contributions and against which members would make financial claims which would be paid automatically in prescribed circumstances. The contributions would be paid annually in proportion to exports, national income, or a mixture of the two, in aggregate amounts sufficient to cover either the actual disbursements of the year or the average prospective disbursements over a period of years. The benefits would be drawn in the form either of (a) grants offering a partial compensation for shortfalls in export proceeds below a trend figure based on a moving average of the preceding 3 or 4 years, or of (b) 'loans' offering a somewhat more substantial compensation for such shortfalls, and repayable out of such surpluses over trend as might subsequently occur within a 3 to 5 year period, any amount outstanding at the end of that time to be written off, or of (c) some mixture of grants and 'loans.'

Each of the variants of this scheme would, and is intended to, effect a net transfer of income on balance from industrial and high income primary producing participants as a group. The incidence of benefits and costs would, of course, depend on the basis of assessment of contributions and on the degree of compensation provided for shortfalls. On the assumptions that contributions were proportional to export proceeds, that shortfalls would have been measured relative to a moving average of the preceding 3 years, that shortfalls up to 5 per cent of exports would have been uncompensated, and 50 per cent of additional shortfalls would have been compensated, it is estimated that contributions and benefits over the 7 year period 1953-59 would have averaged $468 million per annum and that industrial and high income primary producing countries would have made a net contribution to low income primary producing countries averaging $241 million per annum.

Schemes involving 'contingent' loans--i.e. loans automatically repayable out of any surpluses over trend for a period of years and cancellable thereafter--would, of course, be less costly. Data provided by the UN Experts suggest that, with a similar scale of compensation to that already considered, with repayments on a similar basis, but with cancellation of any portion of a debt remaining outstanding after 3 years, repayments might on the average amount to something like 40 per cent of benefits.

In the resolution establishing the terms of reference of the UN Expert Group, the General Assembly laid down, or assumed, that any machinery to be created for offsetting the balance of payments effects of commodity fluctuations, should be 'within the framework of the United Nations.'

Whether or not this was intended to include existing specialized agencies is unclear. The Expert Group itself, while considering that it would be 'premature to be specific about the form of machinery suitable for insurance proposals' suggested that 'one approach would be to set up the necessary funds as a trust fund to be administered by the most suitable existing organization.' In its subsequent discussion of structural factors hampering the growth of exports of commodities, which considered 'should be the subject of discussion between affected countries and the authority administering any new compensatory fund' the Experts mentioned that 'Among other agencies the IMF, in its dealings with members has regard to these matters through its regular consultations.'

With the exception of the Swedish representative in the CICT there has been little indication, on the part of industrial countries, of support for the insurance proposals of the UN Expert Group. Even many of the primary producing countries appear to be deterred from supporting it, probably because of apprehensions as to the effect it might have on the willingness of industrial countries to provide aid in other forms.

Much more likely to receive serious consideration on the part of industrial countries is a scheme on the lines now under discussion in the OAS Expert Group. This scheme will probably appear in two variants, one applicable primarily to the Western Hemisphere, the other a world wide scheme. The latter variant, which is strongly preferred by the United States, will probably be referred for further discussion and elaboration to the CICT and the United Nations in general. The United States, whose policy though not yet officially promulgated, is understood to be nearing the point of crystallization, is not far from being committed to the promotion of some sort of compensatory financing scheme on a loan basis, and appears to be broadly in support of the sort of scheme in process of elaboration in the Expert Group, though without commitment as to its quantitative aspects and--as mentioned above--with a very strong preference for its universal, as distinct from its regional, variant.

While the Report of the OAS Expert Committee has not yet appeared a scheme for an Institution for Compensatory Financing will probably emerge with the following features:

(a) Primary producing participants of less than a given per capita income will be entitled almost automatically to obtain partial compensation for shortfalls in export proceeds as compared with a moving average of the 3 preceding years. In exceptional cases, however, e.g. when the shortfall is due to deliberate action on the part of the government concerned, or where the Institution decides that the transaction involves financial risks not contemplated by the Agreement, borrowing may be disallowed.

(b) Compensation for shortfalls will be partial and will probably amount to two thirds of the shortfall (unless resources should turn out to be insufficient).

(c) Compensation will take the form of loans with a maturity of 3 years which may be extended after consultation to a maximum of 5 years.

(d) Part--probably two thirds--of any excess of export proceeds over a moving average of the 3 preceding years will be used for prior repayment of loans contracted under (b).

(e) Borrowings less repayments will not be allowed to exceed a given maximum viz. 20 per cent of export receipts on the average of the preceding 3 years.

(f) The Institution may at its discretion provide loans up to part of the expected entitlement to compensation on the basis of preliminary estimates of exports.

(g) The Institution may at its discretion provide special loans to countries whose principal exports have suffered a severe decline in value even if exports as a whole have not declined sufficiently to create an entitlement to borrow.

(h) Should indebtedness continue for three years, or remain at the maximum for one year, or should there be inability to repay at the due date there will be consultations with the country in question, possibly involving outside organizations, with a view to (i) obtaining financial assistance in the form of postponement of repayment to the Institution (subject to the 5-year maximum), or refinancing (e.g. funding) of the indebtedness by outside agencies, and possibly (ii) recommending policy adjustments in the country itself.

(i) The resources of the Institution for Compensatory Financing would be provided by subscriptions and possibly also by market borrowing. The subscriptions would be drawn in part from the Category A members (i.e. the poorer primary producing countries that are entitled, in suitable circumstances, to borrow from the Institution) in foreign exchange and in part from Category B members (i.e. the industrial and richer primary producing countries, that are never entitled to borrow) in the form of various sorts of stand-bys. Subscriptions of Category A members will be paid up by installments over 3 years. One type of stand-by furnished by Category B members would be used only to ensure the repayment of market borrowings.

(j) Subscriptions, loans, and repayments would be in a selected group of convertible currencies. The choice of the particular currency (within the selected group) to be borrowed, and to be repaid lies with the borrowing country.

(k) The liquid assets of the Institution will be held in the currencies of the various Class B members in proportion to their subscriptions. The Institution will carry out whatever conversions are necessary to preserve these proportions.

(l) The assets and liabilities of the Institution will be of constant value in terms of gold.

(m) Apart from working balance the liquid assets (investments) of the Institution will be held in a special type of short-term paper (Special Depository Bills). Market borrowing will also be on short-term.

(n) The rate of interest received on the Special Depository Bills will vary with market rates on Treasury Bills. It is expected to be the same in all countries. The rates charged on loans will vary with the rates received on these bills, and will exceed these rates by ½ per cent. There will also be a ½ per cent transactions charge. Interest will be paid on such portion of the capital subscriptions as is received in cash at a rate of interest equal to or slightly less than that received on depository bills.

(o) It is suggested by Mr. Bernstein that the Institution should have a Board of Governors meeting annually, an Executive Board meeting quarterly, a General Manager and a small staff (half a dozen) of its own. It would be a separate legal entity and would take all important discretionary decisions.

(p) It is also suggested, however, that if the universal variant of the scheme is adopted the Institution should be affiliated to the IMF in the sense that:

(i) The Managing Director of the IMF would be Chairman of the Board of Directors of the I.C.F. and would interpret their policies between meetings;

(ii) The IMF would either participate in the consultations mentioned at (h) above, or even conduct the consultations itself, in which case it would presumably report to the I.C.F.;

(iii) The IMF would provide Secretary, Treasurer, technical staff (and possibly office space!) for the Institution, and would administer its ordinary financial operations (other than raising market loans).

(q) If the scheme is confined to Western Hemisphere countries it is generally assumed that functions similar to those suggested above for the IMF would be performed by the Inter-American Bank.

As regards the amount of resources likely to be required, a calculation based on the assumptions of 2/3 compensation for total export shortfalls, maximum permitted credit outstanding of 20 per cent of exports, 2/3 repayment of export excesses, and 100 per cent repayment of such excesses after credit has been outstanding for 3 years--but no compulsion to repay <u>in toto</u> at end of 5 years--indicates that for the 9 years 1952 to 1960 the maximum amount of credit outstanding for 63 low income countries would have been less than $1800 million, the figure nearly attained in 1958. This figure is quite sizeable as compared either to the maximum amount ever attained of outstanding Fund drawings by these countries, (viz. $1290 million in November 1961) or as compared with the amount of unused drawing potential (up to the 200 per cent point) which these countries possess in the Fund at the present time (viz. $2640 million). It has to be borne in mind, however, that the countries concerned would certainly not all have chosen to make use of their theoretical borrowing possibilities under the compensatory scheme had it been in operation over the 1952-1960 period.

However, $1800 million is the amount generally mentioned as appropriate to an Institution of Compensatory Financing of world-wide scope. Of this amount $600 million would be subscribed by the Category A members, some $425 million by the U.S., $625 million from the European industrial countries and $150 million from the high income countries of other regions.

The relationship which the OAS Experts suggest should prevail between the new Institution--if it is world wide--and the Fund resembles that which exists between the IFC and the Bank, but is likely, in several respects to be a looser one. In the first place, membership of the Fund, though a sufficient condition of acceptance as a member of the Institution, is not a necessary condition. In the second place, there is no provision, as yet, whereby countries belonging to the Institution must be represented on the Board of Directors of the Institution, by the same directors as represent them on the Board of the Fund. In the third place, it should not be surprising if the membership of the new organization were considerably smaller than that of the Fund. The advantages of membership are very dubious for any poor country with a rising growth trend of exports. And the responsibilities of B membership may not appeal to some of the better-off primary exporting countries with very variable exports who are nevertheless excluded from the facilities of the scheme.

Even if the connection between the Fund and the Institution is no closer than has so far been envisaged by the OAS Experts, the role envisaged for the Managing Director of the Fund, and the likelihood that, at any rate some of the Directors of the Institution would also be members of the Fund Board, would tend to ensure a certain degree of harmony between the actions of the Institution insofar as they are discretionary, and the policies of the Fund. Moreover, inside knowledge of the likely outcome of the automatic compensatory mechanism in the way of loans and repayments over the ensuing months would help the Fund to make appraisal of the payments prospects of some of its members and thus assist it in the conduct of its own business.

One question that may arise is whether the Fund if it accepts the idea of association with the Institution and the main lines of the Institution itself should attempt to get the negotiation of the final provisions of the scheme--i.e., not merely the details of the arrangement between the Fund and the Institution but the governing instrument of the Institution itself--transferred from the United Nations auspices to those of the Fund itself. Any such attempt would probably be unwise as it would arouse suspicions that the Fund might try to pervert the scheme from its original intention. A better approach would be for Fund representatives, after it had been agreed in principle that the Institution be affiliated to the Fund to participate actively in discussing the details of the scheme under UN auspices.

There are various technical aspects of the plan that will require staff consideration in that connection. It would, however, be premature to indicate Fund views on these technical aspects before the views of countries on the broad outlines of the scheme have become known.

February 28, 1962

Compensatory Financing of Commodity Fluctuations and the Role of the IMF

Introduction

Since April 1960 when a study[1] was submitted by the IMF to the UN Commission on International Commodity Trade, in response to a request by that Commission that the IMF inform it regarding its policies and procedures in relation to the compensatory financing of commodity fluctuations, the topic of compensatory financing has been actively discussed by a number of international bodies. Notable among these is the UN Group of Experts[2] which, in January 1961 produced the report entitled "International Compensation for Fluctuations in Commodity Trade," the UN Commission on International Commodity Trade, at its 8th (1960) and 9th (1961) sessions, the Group of Experts reporting to the Special Meeting of the Inter-American Economic and Social Council of the OAS at Punta del Este in August 1961[3] and that Special Meeting itself. The discussion is continuing, and may be approaching practical issues. As a result of the Punta del Este meeting, the OAS set up a new group of governmental experts to analyze the proposal for the stabilization of export proceeds contained in the report of the first Expert Group to the Punta del Este meeting, as well as any other alternative proposals, and to prepare a draft plan for the creation of mechanisms for compensatory financing. This second OAS Expert Group is now in session and is supposed to report by the end of March 1962 so that the draft plan

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1/ "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations" (SM/60/14, Rev. 2. Also Staff Papers, November 1960).

2/ Appointed by General Assembly Resolution 1423 (XIV).

3/ See "Latin American Export Commodities: Market Problems" especially Chapter IV, "Measures to Offset Fluctuations in Export Receipts."

can be considered by governments before the 10th session of the CICT, which takes place in Rome in May 1962. At this meeting the CICT is to have a further, intensive discussion of compensatory financing with the aid of a further report prepared by the UN Secretariat. Since the governments represented on the CICT will have had over a year to consider the UN Expert Group's report, it was hoped that some practical decisions might emerge. However, since the CICT will probably be confronted with a detailed proposal for a world wide compensatory scheme worked out by the OAS Experts, with the technical assistance of Mr. E. M. Bernstein, and since France is rumored to be hatching out still a third plan, it seems likely that the period of debate and indecision will be prolonged at least until the second half of 1962.

Most significant of all, a plan for compensatory credits to offset the export fluctuations of primary producing countries on lines roughly similar to the plan now under discussion in the OAS, is believed to have been worked out by an inter-departmental committee of the U.S. Government and may soon receive the official imprimatur.

The Americans have also obtained the agreement of the OAS Experts to communicate the main features of the OAS plan on an informal basis to the governments of other industrial countries.

Several questions arise from these discussions with respect to which the Fund will sooner or later have to determine its attitude. These are:

(1) How far can the Fund go towards adopting various modifications that have been suggested in its policies and practices with respect to the use of its own resources?

(2) What attitude should the Fund adopt towards proposals that have been made for setting up new international financial institutions or arrangements to provide compensatory financing for export fluctuations?

(3) To what extent should the Fund show willingness to accept functions of administration or management with respect to such outside financial arrangements as countries may decide to set up?

I. Compensatory Use of IMF Resources

The following are the principal suggestions that have been made by UN or OAS Experts regarding Fund policies and practices in the use of its own resources.

(a) Qualitative criteria for the use of Fund resources. The Commission for International Trade, at its session of May 1961 "considered that it would be desirable if the Fund would study the question whether the present criteria for the use of its resources are fully adapted to circumstances in which payments difficulties arise mainly from fluctuations in primary product markets." The Group of Experts reporting to the OAS Conference at Punta del Este on the market problems of Latin American Export Commodities was more explicit. "It is not clear" they said (p. 25) "why unsatisfactory financial policies should debar countries from temporary aid to offset cyclical fluctuations on their export receipts. A country that has inflation must, in the interest of its own development, take measures to restore financial stability. It is nevertheless entitled to help when its export receipts decline because of adverse conditions in world markets." To Mr. Qureshi also, in Appendix III of the UN Experts Report, it seemed unfair that the Fund's assistance should be used "as a handle to force borrowing countries to pursue policies considered appropriate by the Fund." (p. 80).

(b) Extension of gold-tranche criterion to later tranches. The following suggestion is contained in the report of the UN Experts (p. 28). "In so far as drawings on the Fund are automatic, a country whose export proceeds fall has reliable access to a source of compensatory financing. At present only 25 per cent of a member country's quota comes close to being automatically available. Any significant increase in this percentage which the Fund could institute would be a valuable step towards providing compensatory financing to meet the needs of primary producing countries when threatened with the adverse impact of a decline in export proceeds."

(c) Automatic compensatory drawing rights in first credit tranche. In Appendix II of the Report of the UN Experts one of the Experts (M. L. Qureshi) suggested that "to offset fluctuations in the export proceeds of primary producing countries, compensatory drawings and repayments should be determined automatically by a formula. The fluctuations should be measured as a deviation from a trend which can be estimated on the basis of a moving average of three preceding years. A shortfall in export proceeds in any year should entitle the country concerned to draw from the Fund automatically up to, say, an amount which causes the Fund's holdings of the country's currency to equal 125 per cent of its quota---- Subsequently, when export proceeds are above the trend, the excess earnings should be used automatically to repay the earlier drawings." From the context it appears Mr. Qureshi had in mind full compensation of shortfalls as defined, up to the 125 per cent point, and subsequent repayment of the whole of any excess of export proceeds over trend. He appears to take no overt account of compulsory repurchases.

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In these circumstances it should suffice that the staff prepare, for incorporation in the Fund statement to the CICT and for the Annual Report, a new and up-to-date statement, backed where possible by reference to actual experience with Fund drawings, of the Fund's policies vis-a-vis primary producing countries faced by export declines. This statement should stress the extent to which the Fund seeks to assist members that are the victims of payments difficulties arising from the outside, and the measure in which members can count on Fund assistance in adverse circumstances of this nature, even though Fund transactions beyond the gold tranche are not "automatic." In particular the statement should bring out the fact that, to the extent that a country's balance of payments deficit is due to a contraction in its exports that is temporary or self-correcting, no additional corrective policies are required as a condition of a drawing by the member on the Fund.

Meanwhile consideration should be given at the staff level to the possibility to any modifications of Fund policy with respect to financing of export fluctuations that would be appropriate should the proposals for the separate International Compensatory Institution fail to win international acceptance.

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(ii) The IMF would either participate in the consultations mentioned at (h) above, or even conduct the consultations itself, in which case it would presumably report to the I.C.F.;

(iii) The IMF would provide Secretary, Treasurer, technical staff (and possibly office space!) for the Institution, and would administer its ordinary financial operations (other than raising market loans).

(q) If the scheme is confined to Western Hemisphere countries it is generally assumed that functions similar to those suggested above for the IMF would be performed by the Inter-American Bank.

As regards the amount of resources likely to be required, a calculation based on the assumptions of 2/3 compensation for total export shortfalls, maximum permitted credit outstanding of 20 per cent of exports, 2/3 repayment of export excesses, and 100 per cent repayment of such excesses after credit has been outstanding for 3 years--but no compulsion to repay <u>in toto</u> at end of 5 years--indicates that for the 9 years 1952 to 1960 the maximum amount of credit outstanding for 63 low income countries would have been less than $1800 million, the figure nearly attained in 1958. This figure is quite sizeable as compared either to the maximum amount ever attained of outstanding Fund drawings by these countries, (viz. $1290 million in November 1961) or as compared with the amount of unused drawing potential (up to the 200 per cent point) which these countries possess in the Fund at the present time (viz. $2640 million). It has to be borne in mind, however, that the countries concerned would certainly not all have chosen to make use of their theoretical borrowing possibilities under the compensatory scheme had it been in operation over the 1952-1960 period.

However, $1800 million is the amount generally mentioned as appropriate to an Institution of Compensatory Financing of world-wide scope. Of this amount $600 million would be subscribed by the Category A members, some $425 million by the U.S., $625 million from the European industrial countries and $150 million from the high income countries of other regions.

The relationship which the OAS Experts suggest should prevail between the new Institution--if it is world wide--and the Fund resembles that which exists between the IFC and the Bank, but is likely, in several respects to be a looser one. In the first place, membership of the Fund, though a sufficient condition of acceptance as a member of the Institution, is not a necessary condition. In the second place, there is no provision, as yet, whereby countries belonging to the Institution must be represented on the Board of Directors of the Institution, by the same directors as represent them on the Board of the Fund. In the third place, it should not be surprising if the membership of the new organization were considerably smaller than that of the Fund. The advantages of membership are very dubious for any poor country with a rising growth trend of exports. And the responsibilities of B membership may not appeal to some of the better-off primary exporting countries with very variable exports who are nevertheless excluded from the facilities of the scheme.

While a separate Institution providing compensatory loans on a quasi-automatic basis may well lessen the dependence of member countries on the use of Fund resources and hence reduce the Fund's ability to influence their policies in an appropriate direction, it would be unwise for the Fund to resist its establishment in any way. Any opposition to a scheme that on other grounds was attracting support of less developed and industrialized countries alike would be unlikely to be effective and might react against the Fund's own position. The question is rather whether the Fund should accept such association as is offered it with the new Institution.

There are no doubt possibilities of friction involved in a close association between the Fund and any separately managed Institution. Clearly, the Fund's attitude must depend on the precise form of association that is proposed. However, even if the connection between the Fund and the Institution is no closer than has so far been envisaged by the OAS Experts, the role envisaged for the Managing Director of the Fund, and the likelihood that, at any rate some of the Directors of the Institution would also be members of the Fund Board, would tend to ensure a certain degree of harmony between the actions of the Institution insofar as they are discretionary, and the policies of the Fund. Moreover, inside knowledge of the likely outcome of the automatic compensatory mechanism in the way of loans and repayments over the ensuing months would help the Fund to make appraisal of the payments prospects of some of its members and thus assist it in the conduct of its own business. On balance it would seem that the Fund would do well to adopt a favorable attitude in principle towards association with an Institution whose functions are so intimately related to its own.

One question that may arise is whether the Fund if it accepts the idea of association with the Institution and the main lines of the Institution itself should attempt to get the negotiation of the final provisions of the scheme--i.e., not merely the details of the arrangement between the Fund and the Institution but the governing instrument of the Institution itself--transferred from the United Nations auspices to those of the Fund itself. Any such attempt would probably be unwise as it would arouse suspicions that the Fund might try to pervert the scheme from its original intention. A better approach would be for Fund representatives, after it had been agreed in principle that the Institution be affiliated to the Fund to participate actively in discussing the details of the scheme under UN auspices.

There are various technical aspects of the plan that will require staff consideration in that connection. It would, however, be premature to indicate Fund views on these technical aspects before the views of countries on the broad outlines of the scheme have become known.

Mr. Del Canto

Considerations Affecting Fund Policies and Interests with Respect to Compensatory Financing Schemes

(a) Fund policies with respect to the use of its own resources. At the 1961 CICT meeting the Fund indicated its willingness, in connection with its current review of policies and practices, to take into account the suggestions and views expressed in the UN Experts report and in other UN bodies regarding the Fund's role in compensatory financing. Moreover, in considering the desirability of setting up special arrangements for such financing outside the Fund (though possibly associated with it in some way) governments will wish to know whether the Fund has in any way modified its own policies and practices in this matter. In "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations" a number of considerations were adduced why it would be inappropriate for the Fund to make its resources available on an "automatic" basis in the sense of gearing its assistance to any statistical measurement of export fluctuations, though it was indicated that drawings within the gold tranche and to a lesser extent the first credit tranche were readily available and also that members of the Fund that were "taking appropriate steps to preserve internal financial stability and to maintain their balance in equilibrium, taking good years with bad and that (were) otherwise making satisfactory progress towards the fulfillment of the Fund's purposes (could) anticipate with confidence that financing (would) be available from the Fund which, in conjunction with a reasonable use of their own reserves, should be sufficient to enable them to overcome temporary payments difficulties arising from export fluctuations." Subsequent criticism of this stand in UN or OAS circles has focussed on two main points, (a) that some degree of automaticity in compensating export fluctuations is necessary to give countries confidence that they can rely on a reasonably steady flow of foreign exchange receipts and (b) that countries that may not be "otherwise making satisfactory progress towards the fulfillment of the Fund's purposes" should nevertheless be able to rely on financial assistance if their balances of payments are adversely affected by circumstances outside their control.

The issue before governments is the weight to be given to these two considerations as against the view expressed in "Fund Policies and Procedures in Relation to the Compensatory Financing of Commodity Fluctuations" that automatic assistance in excess of the total amount the Fund would otherwise have provided, "would be undesirable, since it would mean that assistance was being given where it was not really needed and might lead to the adoption of unduly inflationary policies."[1]

If members desired to move in the direction of greater automaticity it might well be possible for the Fund to grant facilities comparable to those now given to drawings within the gold tranche, to drawings within higher tranches and to grant them subject to some formula relating to the behavior of the export proceeds of the drawing country. This might take the form e.g.

(i) of adjusting general Fund policies with respect to drawings in successive tranches in such a way as to reduce the degree of justification required in the first and possibly the second credit tranche;

(ii) of providing that members, or a certain category of members, could draw amounts required to compensate partially for export shortfalls below some statistical standard without the degree of justification required under normal tranche policies; or

(iii) of permitting drawings under the arrangement described in (ii) above with the additional feature that such drawings would be left out of account in applying existing tranche policies to the member's "normal" drawings.

Depending on the magnitudes allowed, and any further conditions that might be added, this latter arrangement could be made comparable to the OAS proposal. However, any such arrangement would have to be a matter of stated Board policy rather than contract and the Board could not legally abrogate its power to alter that policy.

Apart from the question how, technically, a certain degree of automation could be fitted into the Fund's drawing policies, consideration would have to be given to a number of fundamental issues such as the following. Should the Fund extend special drawing facilities to some of its members and not to others? Would the Fund be justified in giving the overwhelming benefit of the doubt to requests for drawings related to a particular formula thus assuming that such requests were in accordance with the Fund's purposes? It should be noted that in any event any substantial increase in members' access to the Fund would raise the question of the adequacy of the Fund's resources.

Consideration of what the Fund's policies should be can not be divorced from other arrangements for compensatory financing. If any institution such as now discussed were in fact set up, such case as there might otherwise be for extending the automaticity of Fund transactions would be weakened if not destroyed. A consideration to be borne in mind in this connection is that if two radically different kinds of credit are to be provided, one on a statistical and another on a discretionary basis, it may be open to less confusion and misunderstanding that they should be provided out of separate funds though, as is discussed below, this would not necessarily prevent a close degree of cooperation between the IMF and a new compensatory institution.

(b) Relationship between the IMF and any separate institution for compensatory financing. It is convenient to consider this question in terms of the relationship between the IMF and the Compensatory Fund for Stabilization of Export Receipts rather than with the UN Development Insurance Fund. The Stabilization Fund is more similar in nature to the IMF than the Insurance Fund and the question of association with the IMF has been more specifically formulated in the former than in the latter case.

If governments decided to give serious consideration to the creation of a compensatory agency broadly along the OAS lines, two main issues would arise for the Fund: (i) what type of relationship with the new organization, if any, would it be willing to accept or anxious to secure, and (ii) assuming that the relationship is to be a close one, are there major provisions in the present plan in which the IMF might want to suggest changes?

(i) It would seem that the Fund would do well to adopt a favorable attitude in principle towards close association with an institution whose functions are so intimately related to its own. While there are, no doubt, in theory, possibilities of friction involved in a close association between the IMF and a separately managed institution, the fact that the activities of the new institution will be largely governed by automatic criteria minimizes this risk. Insofar as the exercise of discretion is called for in the operations of the new institution (e.g., with respect to interim loans, special loans, special settlements in the case of imminent default or suspension, in exceptional cases, of members' rights to borrow) the likelihood of divergency of interest between the new institution and the Fund would be reduced by the existence of a close association between the governing organs of the two bodies similar to that which exists between the IBRD and the IFC or IDA, where countries are represented in both institutions by the same Executive Directors and the same Governors. Even if the connection between the IMF and the Stabilization Fund is looser than this, links between the two organizations at the Management and staff levels would help to harmonize their policies. Moreover, inside knowledge of the likely outcome of the automatic compensatory mechanism in the way of loans and repayments over the ensuing months would help the Fund to appraise the payments prospects of some of its members and thus assist it in the conduct of its own business.

(ii) As regards the basic mechanics of the scheme, the Fund would of course not seek to have the statutes of the new body altered in the direction of mitigating the automatism of the scheme and making its operations more discretionary, i.e., more like those of the IMF itself. This would defeat the whole intention of countries in setting up a separate institution and might, in fact, multiply points of friction between the two institutions.

On the other hand there would appear to be a technical case for modifying some of the quantitative criteria governing borrowing rights and repayment obligations in any such plan that governments might want to adopt. As at present envisaged, countries would be able to borrow up to two-thirds of any shortfall in exports below the moving average of the preceding three years. On the other hand they would have to repay up to two-thirds of any excess of exports over the moving average of the preceding three years, subject to an overriding obligation that all loans must be repaid within a three- to five-year period and that total loans outstanding must not exceed 20 per cent of exports.

The exclusion of the current year from the measure of the normal value delays the use of available evidence of a changing trend. The proposal could be improved by giving weight to the exports of the current year in determining the standard from which shortfalls and excesses should be measured (or, alternatively, by reducing the proportion of such shortfalls or excesses to be compensated by loans or repayments). In general, it would appear possible to improve substantially on the stabilization features of the scheme by technical amendments some of which might at the same time reduce the total resources that would require to be provided.

The Fund could no doubt also be helpful in bringing its experience of 15 years' operation to bear in the drafting of any new international agreement in a field closely related to its own.