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Friedman UNCTAD Files - Geneva Meeting on Oct. 30 - Nov. 13, 1967
Suppl. Finance / Notes

Archives
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Irving Friedman UNCTAD Files: Geneva Meeting on Supplementary Finance, October 30 - November 13, 1957 - Notes

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1) want ~~[illegible]~~ to
encourage country to give
highest priority to develop

2) want develop program

1) export projections
question of methodology

2) policy packages - rather
of [illegible]

3) consultation
4) timing of help

5) amount needed to have
worldwide

CV

from also look with
Cap Fin - wherever
feasible -

Also where C.F.
do no cover
SFS - need

OK on "fixed fund"

Hope [illegible] -
would $500-yr [illegible]
[illegible] to serve
purposes to under it
[illegible]

[illegible]

(8)

Canada - ~~[illegible]~~

we agree with

Bulgaria (p. 46)

f(6)

is Agency obliged to
compensate short falls —
or able to use judgment

Could it consider how
poly purpose was
implemented?

Could it deny assistance

Do not favor
automatic funds —
but allow discretionary —
could be speedy — bearing
poly purpose or irregular
conditions

Key point on
"Finery" - is that
we can try to avoid
disruption of utility
agreed programmes -

---

differences not as much
as seen on surface

Ger -
major question is one
of "fund" - can
system function

(3)

what sort of consultants
after initial understanding
ex ante (forces of World
Bankstar) - will it
secure progress?

(i) time to identify
(ii) time to do the things -

Export - not highly -
because have criteria
of good behavior -

((Try to perfect scheme
to which we are entirely
committed

Jyper

(2)

guarantee effectiveness –

(a) agreement – [illegible] projection

(b) full [illegible] on intended

policies to achieve targets

agency have [illegible]

preparing projections

Rely on scrutiny by

those that do financing of

plans –

Hope agency financial

within Bal [illegible] –

no communities problems

Quote IMF-SDR

[illegible] and authority

hard to find blame Petrone
rejoicing uncertainty
Most peaceful & is hard to
thrash out question of magnitude
of province ??
Is there other basis for
finding cost estimate ?

At some point
would it be useful
if I commented on
(a) Study on Commodity
Price Stabilization
Briefly
(b) Why the avoided
question of judging
~~comparative~~ comparative
use of money, i.e. if
supplementary finance was
not additional - ?

Indian

(1) Buildings Bldg

(a) no open ended financial commitments

(b) export projection

(c) principle of policy understanding

(2) Operational efficiency of Scheme –

Questions raised about Scheme – all boil down to whether Scheme can be administered efficiently – some feel too rigid; too others certain questions unanswered.

Other scheme gives discretion to Agency as [illegible]

6:15

BESS 8

Mrs Jaquarter
new Jersey

Janet Corkery

6!15

BE #558

Irving,

I've denounced you — said that I detested the term 'policy package', much preferred 'policy understanding' Ha!

Sorry

JO

The Ec Advisors
to the President

(1)

Brazil

Argentina

UAB

Export projects

"Poly Package" –
call it "poly understanding" –
hint to export performance

Brazil
(a) no interference
with domestic concept
(b) positive – to

81

on quasi-ended conflict
element of inertia of
export projection
policy paralyze - still not
classified - worthy
corner-stone

export projection
not apple on scope or
~~[illegible]~~ revision -
methodology

Poly Paper "insurance
release" for Development Plan

To: Chairman

If and when

you wish - we could

report on

(a) what we have done

on export shortfalls and other causes of

disruption

(b) on what we are

doing on commodity

price stabilization

study

ISE

Irving

No, I think
he is simply trying
to state what he
understands to be
the criticisms made
by France, Germany & Japan
to some extent
even U.S..

RD

"impression" and
"emphasis". To capture

(1)

Argentina

India

Nigeria

UK

(1) Ag. of market

(c) no conflict

(b) [illegible] done

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2 November 1967

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TRADE AND DEVELOPMENT BOARD
Committee on Invisibles and Financing
related to Trade
Intergovernmental Group on Supplementary Financing
Third session
Geneva, 30 October 1967

DRAFT OUTLINE OF THE REPORT OF THE THIRD SESSION OF THE INTERGOVERNMENTAL GROUP ON SUPPLEMENTARY FINANCING

Note by the Drafting Group

I. Introduction

(i) Terms of reference

(a) interpretation;

(b) relation of various parts of the report to parts of the terms of reference (paras. 1 and 2 (i) to (vi) - the World Bank Scheme) (paras. 2 (vii) and (viii) - how the World Bank Scheme relates to other things) (paras. 2 (ix) brief statement) (para. 3 no consideration).

(ii) Problems only indirectly related to the Scheme set out in the World Bank Study but arising from the terms of reference.

(a) commodity problems;

(b) relative importance of export shortfalls as a cause of disruption;

(c) the "additional" character of SFM.

(iii) General statement of findings

II. The Scheme proposed in the World Bank staff study

Head Note

In each section of this chapter will be found:

(a) a brief indication of the views of the staff of the Bank as set forth on the study or elsewhere;

(b) a note of the main criticisms expressed about each feature of the Scheme;

(c) modifications which have been suggested to meet these criticisms;

(d) such conclusions as the Intergovernmental Group may have reached.

If it seems possible and appropriate, modifications of various features suggested might be assembled in the form of an amended scheme or schemes.

1. Points of understanding between the Agency and the country.
   - (a) The development plan;
   - (b) A financing plan;
   - (c) A statement of policies;
   - (d) Export expectations*;
   - (e) Plans to meet any unexpected shortfall.
2. The operation of the Scheme.
   - (a) overages;
   - (b) economies;
   - (c) other resources (especially the resources of the IMF)**;
   - (d) assessment of the implentation of policies and programmes***.
3. Form, terms and conditions of assistance.
4. Costs and "rationing".

III. Relationship of supplementary financing measures to other types of assistance.

IV. Other possible methods which might be employed for the same purpose.

(1) A more discretionary scheme which offers assistance after ex-post examination.

(2) Refinancing short-term assistance (notably drawings on the International Monetary Fund).

(3) Schemes purporting to eliminate the causes of adverse movements in export prices.

V. The Agency.

VI. Conclusions.

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* Including or excluding invisibles.

** Note the problem of the "persistency criterion" World Bank Study, p.41.

*** Including the determination of the amount of assistance a determination which may or may not take account of changes in import prices.

RATIONING —>

The Scheme is based on the assumption that the Agency would have enough funds to achieve its objective, but some provision would have to be made for it to ration its resources if they proved to be inadequate. The Group agreed that, should it be necessary, there should be the possibility of rationing the Agency's resources. It was suggested, however, that although rationing might be considered as an emergency measure, it should not be conceived of as being a normal feature of the Scheme.

Various forms of rationing were mentioned. Among them :

(i) a pro rata system whereby a country's share in total eligible shortfalls could determine its share in total disbursements by the Agency. It was recognized that this system might encounter difficulties in ascertaining all the actual and potential shortfalls of a given period. To get around this difficulty, the Agency might consider claims under the Scheme on an annual basis.

(ii) Rationing on the basis of needs, as reflected, say, in per capita income, and

(iii) Rationing according to the ability of countries to withstand the disruptive effects of shortfalls, taking account of their reserve

positions. It was pointed out that these were sufficient elements of flexibility in the Scheme to permit the adjustment of eligible claims to available resources so that second and third forms of rationing would appear to be less appropriate.

~~DRAFT - 2~~
~~NASarma.~~

II. THE SCHEME PROPOSED IN THE WORLD BANK STAFF STUDY

The Scheme for Supplementary Finance suggested by the staff of the World Bank is designed to help avoid the disruption of well-conceived development programs when this disruption could potentially be caused by a lack of foreign exchange due to an unexpected export shortfall. The Bank Staff Scheme provides for effective understanding between a member country and the administering Agency on export projections and development programs and policies. If a country acts within the framework of such an agreement and if actual exports are lower than agreed projections, there is a prima facie ~~claim~~ case for ~~prompt~~ prompt assistance under the Scheme, provided the country ~~was~~ is fulfilling ~~its obligations~~ the understandings at the time the shortfall occurred.

1. Basis of the Bank Staff Scheme

a) The Development Plan - a financing plan and plans to meet unexpected shortfalls

A basic element of the initial understanding between the Agency and a country is the development program. The development program would also include :

(i) a financing plan for public sector investment and as good estimates as possible on private investment, stating the anticipated levels of investment in principal sectors and domestic and external sources of financing, and

manner conducive to maintaining the development investment of the country

The assistance is to be used to allow the ~~[illegible]~~ level investment to be maintained and to permit any necessary adjustment in the structure of investment to take place in an orderly manner

(ii) a projection of ~~the balance of payments including estimates of the principal components of exports, imports, use of reserves, and categories of external financing~~.

The Bank Staff note that ~~some~~ many developing countries ~~have reached the stage of being~~ are able to formulate comprehensive and systematic ~~medium-term~~ development programs, covering a period of about five years. However, ~~it is recognized that~~ some other countries ~~have not yet reached that stage~~; in these cases, the ~~Agency would adopt a flexible interpretation of~~ the criterion of potential disruption in the event of an export shortfall, would take into account their partial ~~development~~ investment program. In evaluating the development programs of member countries, the Agency would avail itself of the experience of the World Bank Group which has been engaged in providing technical and financial assistance to developing countries in connection with their development efforts and in making periodic reviews of these efforts.

Some members of the Group emphasized the need for flexibility in respect of formulation of development programs. In particular, a development program should not take for granted a single figure of foreign aid or of other external financial resources; it should be devised on sets of alternative assumptions to preserve flexibility.

Under the Bank Staff Scheme, it would be expected that, to the extent feasible, an export shortfall would be offset by use of the country's own foreign exchange reserves, drawings on the IMF, other sources of finance and feasible internal adjustments. While consideration would be necessary to determine to what extent other available sources of finance were being used, and if feasible adjustments were being made, it was agreed in the Group that this would not prejudice the certainty or speed of assistance, particularly since regular consultations between the Agency and its members would be taking place in the normal course of events.

b) Export Expectations

An integral part of the Bank Staff Scheme is a mutually agreed projection of 'reasonable expectations' of export earnings over a period of years, so that this could be used to determine whether and to what extent an unexpected shortfall of export earnings occurred during the period. This understanding between the Agency and the country on an export projection would cover the period over which the country has formulated its development plan - normally within a range of 4-6 years. The export projection indicates the amount of foreign exchange which the country may reasonably anticipate earning from its exports in each year of this period. Such projections are based on reasonable assumptions regarding

world and country trade developments and regarding ~~export~~ policies, Such projections together with projections of other items affecting foreign exchange availability are required by developing countries in formulating their investment programs. The experience of the World Bank in making export projections has been considerable, and the Bank Staff has stated that usable export projections can be made to establish reasonable expectations for the purposes of the Scheme. Their ~~quantity~~ could of course be improved, and the Bank in its own projection work is constantly trying to improve its analytical tools as more statistical data are made available. The ~~elements of~~ objectivity and ~~realizing that/characterize~~ the assessment a country's prospects of ~~earning foreign exchange through exports made by such an international~~ agency may be expected to ensure equity among countries.

Although based for the most part on major commodity exports, the Bank's projections would take all merchandise exports into account. As for including invisibles in export projections, it was agreed that this be decided on a country-by-country basis depending on the significance of these items in the balance of ~~payments~~ of a country and the nature of the data available.

It was noted that the differences in methods of calculating export shortfalls under the World Bank Scheme and the I.M.F Compensatory Financing Facility reflected differences in basic objectives: the former was designed to deal with the unpredictability of export earnings, the latter with their instability. The Scheme is designed to provide countries with an assurance that a projected level of export proceeds envisaged as part of an agreed development plan will be available throughout the plan period. A shortfall from the projected level of export proceeds would, after agreement on suitable adjustments and use of other sources of finance, be offset by supplementary finance. ~~The Fund Facility, not directly linked to the planning process, is intended to offset~~ negative deviations from a medium-term trend of exports, ~~whether such fluctuations are foreseen or not.~~

Since investment calculations must be based on export projections and the ~~length~~ of the latter by its very nature must be tied to the former, the Bank Staff has suggested that, for the purposes of supplementary finance scheme, during the operation of the development plan the underlying export projection should not be subject to revision except when ~~substantial~~ changes warrant a major reordering of the investment pattern and development strategy.

In the course of the Group's deliberations, the logical necessity of a norm or standard of reference for measuring export shortfalls was widely stressed.

While recognizing that export projections could play a valuable role in the framework of development planning, one delegation felt that they were not suited to serve as a basis for the calculation of claims. In its view export projections were unreliable due to the difficulty of judging exactly all relevant factors of market developments as well as to the frequent lack of appropriate information and statistics. This delegation proposed instead that a determination as to whether a reduction in export receipts constituted a shortfall from reasonable expectations should be made by the Agency ex post on the basis of certain established guidelines. Most delegations expressed their disagreement with this position. In their view export projections were an essential element of a supplementary finance scheme so as to assure certainty and speed of assistance.

During discussion a reference was made to the possibility of rather frequent revision of export projections; however, it was widely felt that such procedures would defeat the basic objective of the scheme. (Second Session, p.9.) A view that seemed to have a measure of support in the Group related to the revision of export projections when a development

program itself needed revision due to changed circumstances. It was also suggested that a mid-term review of export projections may lend useful necessary flexibility to the operation of the Scheme.

c) Policy Understandings and Consultations

There was agreement in the Group that a policy understanding between the Administering Agency and a member country was essential for the Scheme. The policy understanding, as envisaged in the Bank Staff Study, would be arrived at through close cooperation and exchange of views between the Agency and the country. Its formulation would be based on a objective and realistic evaluation of the member's needs and possibilities and a pragmatic assessment of the proposed measures for achieving the objectives of the development programs. These understandings would be essentially of the same scope and character as are necessary for extending broad support in development finance to a country. In reaching policy understandings, it is possible and advisable to make use of procedures already obtaining in international organizations like the World Bank Group and the International Monetary Fund. This meant that where a country had an already existing understanding with such organizations, the Agency would avail itself of this and thus avoid duplication. It was recognized by the Group that the policy understanding could not be restricted to the export sector only; the factors and

There was consideration given to the possibility of limiting this understanding to the export sector only

policies affecting exports arise in other sectors of the economy too.

It was also recognized by the Group that policies cannot be defined in general or detailed terms applicable uniformly to all countries. In certain cases the understanding may be fairly comprehensive and in other cases only embody certain critical points such as fiscal and monetary policy. Again, the time horizon of various elements in a policy understanding may be different. There was necessarily an element of discretion and judgment of the Agency. It was also necessary to reappraise and, as appropriate, to revise the policy understanding. Accordingly, the initial understanding cannot be assumed to be frozen. On the contrary, it would be adapted to the particular circumstances that would arise in the course of a planning period.

It was emphasized that the assessment of performance should be based on economic criteria, and there is no question of interference with the sovereignty of nations. The contents of performance understandings should be such as to ensure the effectiveness of the Scheme. The policy understanding that is reached is arrived at through constant consultations, interchange of knowledge and views. The Agency would be an international one, with

an international responsibility accountable to the community of nations.

The Bank Staff Scheme in pursuance of the initial understanding envisages periodic review and consultations between the Agency and member countries, similar to those of such institutions as the World Bank Group and the International Monetary Fund. The frequency of consultations may vary from country to country depending on the nature of the case, but in no case can they take place without the concurrence of the country. The view was expressed that such ~~regular~~ consultations could only be justified and ~~would~~ prove useful if they ensured certain and speedy assistance to member ~~countries~~ countries. following the agreed policies and programs.

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

OFFICE MEMORANDUM

TO: Mr. Irving S. Friedman DATE: October 27, 1967

FROM: R. M. Sundrum

SUBJECT: British Note on Annual Revisions of Export Projections.

1. Recently, Mr. Philip Hayes visited us in the Bank and discussed the errors of estimation in export projections. His position seemed to be that the errors involved in making a five-year projection were not much greater than those involved in annual revisions. If this were true, it might be used as an argument in favor of five-year projections, but at the same time, it is an argument for lower estimates of the costs of financing shortfalls from five-year projections.

2. On his return to London, Mr. Hayes has sent me a technical note by his colleague, Mr. C. H. Harvie, Chief Statistician of the Ministry of Overseas Development, raising doubts on what he called "the World Bank's view" that the errors of projection might be halved by annual revisions. I do not know where Mr. Hayes got the idea that this was the World Bank's view, but I believe that this view is correct, and that our support of five-year projections should be based, not on the relatively small errors of such projections, but because of their great value in formulating development plans over a sufficiently long period of time to achieve greatest efficiency in making investment decisions. In any case, I feel that Mr. Harvie's arguments based on the trend extrapolation method of projections are not relevant to the more appropriate procedure of export projection, which, I believe, is used in the Bank's work. I am enclosing a note discussing the technical issue.

Technical Note on Revision of Export Projections

1. In order to project a variable X by extrapolating a past trend, let us assume that we start with data in the form X_t (t = 1,2, ... n). To this data, we may fit a trend such as:

$$X_t = a + b\,t \quad \ldots \quad \ldots \quad \ldots \quad \ldots (1)$$

Such a trend will not fit the observed values exactly, due to what may be called 'fluctuations' around the trend. A measure of such fluctuations is given by

$$S^2 = \frac{1}{n}\sum (X_t - a - bt)^2 \quad \ldots \quad \ldots (2)$$

If we now use this fitted trend to estimate X at time t = T, the reliability of this estimate may be indicated by the usual formula for the error of a predicted value, namely

$$\text{Var } ({}_nX_T) = S^2\left(1 + \frac{1}{n}\right) + S^2\left(T - \bar{n}\right)^2 / \sigma_t^2 \quad \ldots (3)$$

where ${}_nX_T$ is the estimate for t = T based on trend fitted to past observations for n years, and σ_t^2 is the variance of t(i.e. t = 1,2,...n). The two parts of this formula may be considered, approximately, as the error due to fluctuation and the error in our estimate of the trend coefficients a and b respectively. It is clear from the formula that the error in the estimate of X_T increases with T. The formula can be used to measure the extent to which the error in projecting five years ahead (i.e. for T = n+5) is greater than the error in projecting for one year ahead (i.e. for T = n+1). However, the efficiency of the one year projection over the 5 year projection by this method depends on the period n of past experience which is used to estimate the trend. The way in which the relative efficiency of the one year projection (measured by the ratio of the standard errors) varies with n is shown in the following table.

Table 1. Relative Efficiency of 1 Year Projections Over 5 Year Projections.

n	Efficiency
2	3.42
3	2.75
4	2.37
5	2.12
6	1.95
7	1.82
8	1.73
9	1.65
10	1.59

We see from this table, that the relative efficiency of the one year projection will be less than two, only if the trend is based on data for more than 5 years in the past.

2. The Bank Staff Scheme for Supplementary Financial Measures is based on projections for the total export earnings of the next five years. The estimate according to a single five-year projection may be written:

$$K_5 = {}_nX_{n+1} + {}_nX_{n+2} + {}_nX_{n+3} + {}_nX_{n+4} + {}_nX_{n+5} \quad \ldots \quad \ldots \quad (4)$$

The estimate according to annual revisions, where each quantity is estimated the preceding year, so that later estimates are based on a longer period of past experience, may be written:

$$K_1 = {}_nX_{n+1} + {}_{n+1}X_{n+2} + {}_{n+2}X_{n+3} + {}_{n+3}X_{n+4} + {}_{n+4}X_{n+5} \quad \ldots \quad (5)$$

Assuming that the errors in the estimate of each year's exports are independent, the relative efficiency of K_1 over K_5 is shown in the following table for a few values of n.

Table 2. Relative Efficiency of K_1 over K_5

n	Relative Efficiency
2	2.885
3	2.181
4	1.863
5	1.680
6	1.560
7	1.475
8	1.413
9	1.365
10	1.326

3. In practice, however, export projections are unlikely to be made by the trend extrapolation method. In the more usual procedure, the estimate X_T of exports at future time T is based on previous values of X_t as well as of a number of other variables, say U_t, V_t, W_t, Y_t, Z_t etc. representing supply conditions, demand condition, investment decisions, etc. In using these variables, account is taken of the time-lag with which each of these variables is likely to exert its greatest influence on X_T; if, for instance, such a time-lag for the variable U is assumed to be k, then the value of U_{T-k}, if already known, will be given great weight in estimating X_T. Thus the estimation procedure may be described by the relationship

$$X = f(X_{T-j}, U_{T-k}, V_{T-l}, W_{T-m}, Y_{T-n}, Z_{T-p}, \text{etc.}) \ldots \quad (6)$$

where j, k, l, m, n, p are the estimated time-lags and may take one or more values. In particular, it is generally found that X_{T-1} has a large influence on X_T. This shows a particularly important difference between this method of estimation and the method of trend extrapolation in which each of the past observations X_1, X_2, ... X_n is given equal weight. According to the procedure (6),

an estimate for the immediate future can use information provided by variables acting with a shorter time-lag, the sort of information not available in estimating for the more distant future. Further, it is generally to be expected that such information is more significant in reducing estimation error than that provided by variables acting over a longer time-lag. Hence, it is generally to be expected that the relative efficiency of annual projections over five-year projections is likely to be considerably greater than that indicated by the theory of trend extrapolation.

Reference.....

Mr. Hayes

S.F.M. - Revision of Export Projections

1. Suppose one is using the simplest of all forecasting techniques, extrapolating a log linear trend. Let the equation be:

Log y = b log t (where y and t are deviations from their means)

Write log y = z and log t = x

Then a standard error of a forecast will be:

$$S_{\hat{z}} = \sqrt{S_{zx}^2\left(1 + \frac{1}{n}\right) + S_b^2 x^2} \qquad \text{(Equation 1)}$$

Where S_{zx} = standard error of estimate

S_b = standard error of regression coefficient b

Now a forecast may go wrong for two reasons: (i) because the regression plane has been inaccurately determined; or (ii) because of a deviation from the regression plane. The term $\left(\frac{S_{zx}^2}{n} + S_b^2 \cdot x^2\right)$ represents the variance due to the estimated regression plane differing from the true regression plane. And S_{zx}^2 the component due to a deviation from the regression plane. It is at once apparent that the further ahead for which the forecast is made, the higher the standard error of the forecast (because x^2 will be higher the further ahead the projection). One cannot generalize on the relative standard errors of forecasts one year ahead and five years ahead. The latter will be higher; but how much higher will depend on the terms in equation (1). But since $S_b^2 = \frac{S_{zx}^2}{\Sigma x^2} < S_{zx}^2$ and since $S_{\hat{z}}$ is the square root of the terms shown, the ratio of the standard errors of forecasts five years ahead and one year ahead will inevitably be much less than 2.

2. If one uses a regression equation with several independent variables, the standard error of a forecast (for, say, two independent variables) becomes:

$$S_{\hat{z}} = \sqrt{S_{z \cdot x_1 x_2}^2\left(1 + \frac{1}{n}\right) + S_{b_1}^2 \cdot x_1^2 + S_{b_2}^2 \cdot x_2^2 + 2S_{b_1 b_2}^2 x_1 \cdot x_2}$$

Again the standard error of a forecast five years ahead will be higher than that for one year ahead. But the ratio of the two standard errors will, as before almost certainly be considerably less than 2. (1)

3. In time series, error terms are quite frequently auto-correlated. In this case, one would adopt a more sophisticated approach than the straightforward 'Least-square' regression technique. Moreover, in making a projection, one would make use of the form of the autocorrelation. It nevertheless remains true that, the further ahead a prediction, the larger its standard error.

4. Above we have been comparing the standard error of a forecast one year ahead and 5 years ahead. But this is not the appropriate comparison for S.F.M. The appropriate comparison is between the standard error of a forecast 1 year ahead and the mean standard error for the full 5-year period. If S_{z_1}, S_{z_2} stand for standard errors of forecasts 1 year ahedd, 2 years ahead ..... then the appropriate comparison is between $S_{\hat{z}_1}$ and $\sqrt{S_{\hat{z}_1}^2 + S_{\hat{z}_2}^2 \cdots S_{\hat{z}_5}^2}/5$

The latter will likely be smaller than the former (although one cannot state categorically that it will be so).

5. I imagine that export forecasts will be made not by mathematical techniques - or not entirely so - but partly by 'judgement'. For example, the price of rubber and therefore the value of future rubber exports, will depend partly on the price of synthetic rubber. And this will depend on technological progress in this industry. It is easier to foresee such progress one year ahead than 5. In 5 years there might be a major technological breakthrough, now undreamed of. If so a projection of the value of Malaya's rubber exports 5 years ahead might be

/considerably

CODE 18-75

(1) On the assumption that projected independent variable are without error

considerably wrong. (This example is illustrative - not meant to be realistic.)

6. If export projections are made partly by using mathematical techniques and partly by judgement, it becomes impossible to say anything definite about average errors of S.F.M. forecasts for 1 year and for a full 5-year period. No doubt cases such as instanced in paragraph 5 do occur. But one must not exaggerate their importance. All in all, my hunch is the same as yours: that the World Bank's view that average errors in S.F.M. will be halved by having annual revisions is far too sanguin.

(C.H. Harvie)
18th October, 1967

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

OFFICE MEMORANDUM

TO: Mr. Irving S. Friedman

DATE: October 23, 1967

FROM: R. M. Sundrum

SUBJECT: Study of Export Shortfalls

The paper on Shortfalls has been revised in the light of comments received from the members of our group on Supplementary Finance and from Mr. Guy Orcutt. I am enclosing a copy of the newly written chapter on "Summary and Conclusions".

I would like your approval to send (i) one or two copies to the Fund and (ii) 50 copies to Mr. Sarma in Geneva for distribution to members of the Expert Group.

Chapter 6. Summary and Conclusions

6.1 The Problem

An attempt has been made in this study to collect and analyze the statistical data needed to assess the relative significance of export shortfalls as a factor leading to the disruption of development programs of the less-developed countries. Two approaches to the study of the role of exports in development were distinguished in Chapter 1, the planning approach involving planned programs of development activities based on expectations of available resources in the future and the trend approach dealing with fluctuations around trends based largely on past experience. The concepts of 'shortfall from expectations' and 'disruption of development programs' belong essentially to the planning approach; one consequence of this fact is that a complete study of the relative significance of various shortfalls as factors leading to the disruption of development programs was not possible, because expectations about future resources and programs about future development were not available explicitly in the previous experience of a sufficiently large number of countries to arrive at any general conclusions. However, an attempt has been made in this study to organize the available statistical data which may be useful as background information in forming a judgment about the relative significance of export shortfalls.

6.2 The Magnitude of Shortfalls

The problem of assessing the relative significance of various types of shortfalls may be divided into two parts; one part dealing with the relative magnitudes of shortfalls in various types of foreign exchange receipts and the other part dealing with the extent to which these shortfalls tend to disrupt development programs. The first part of the problem has been

considered in Chapter 2. In this chapter, data published in the International Financial Statistics on the foreign exchange receipts of 35 less-developed countries, which accounted for 57% of the exports of all less-developed countries, for the period 1956-65, were classified into three types, namely:

X: earnings from exports of goods,

A: net transfers and capital inflows on government account, and

P: net transfers and capital inflows on private account.

Then, each country's shortfalls from expectations of each of these types of foreign exchange receipts were divided into three parts, namely:

(i) Shortfalls from uniform expectations, due to unexpected changes in each country's share in the total receipts of a group of countries;

(ii) Shortfalls from global expectations, being a country's share in the shortfall of actual global receipts of a group of countries from the corresponding global expectations; and

(iii) Shortfalls from particular expectations, due to each country's special circumstances and the policies followed or to be followed by that country.

Of these three parts, a quantitative estimate based on past experience could be made only in the case of the first part, the shortfalls from uniform expectations. The statistical results of Chapter 2 indicate that of the three types of foreign exchange receipts, the magnitude of export shortfalls from uniform expectations in the period 1961-65 was less than that of other shortfalls, for the 35 countries for which data was available. However, some types of exchange receipts were highly concentrated

in certain countries. As a result, it was found that when 5 such countries were omitted from the sample, the magnitude of export shortfalls for the remaining group of 30 countries was greater than that of the other types of shortfalls. A similar calculation was also made of the extent to which unexpectedly large imports of consumer goods might have led to shortfalls in the availability of foreign exchange for developmental purposes and it was found that the magnitude of such shortfalls was considerably less than that of export shortfalls in the 23 less-developed countries in the period 1961-63 for which data was available.

Similar statistical methods could not be used to estimate the magnitude of shortfalls from global and particular expectations. As far as qualitative judgments could be made about these magnitudes, there did not seem to be any reason to believe that the conclusions derived from shortfalls from uniform expectations would be seriously affected when the other aspects of shortfalls were taken into account.

6.3 Magnitude of Fluctuations

The second part of the evaluation of the relative significance of export shortfalls concerns the extent to which the various types of shortfalls tended to disrupt development programs. While it was not possible to make a direct statistical investigation of this problem, for lack of sufficient data, some light on this question is thrown indirectly by the statistical relationship between fluctuations in the various types of foreign exchange receipts and fluctuations in various types of investment expenditures, in a number of less-developed countries for which data was available. As a preliminary to the study of these relationships, estimates of the magnitude of fluctuations in the various types of foreign exchange receipts were derived in Chapter 3.

The methods used for measuring the magnitude of shortfalls and the magnitude of fluctuations give some indication of the basic difference between these two concepts for individual countries, but for groups of countries it was found that the relative magnitude of fluctuations in the three types of foreign exchange receipts corresponded closely to the relative magnitude of shortfalls in these receipts.

The method of analysis of fluctuations was also applied to various types of foreign exchange expenditures in Chapter 4. The results of this analysis indicate that the fluctuations in exchange receipts were mostly reflected in the foreign exchange reserves for the entire sample of 35 countries in the period 1956-65, but excluding countries with a concentration of particular types of receipts, it was found that the fluctuations in total receipts were mostly reflected in the expenditure on imports of the remaining group of 30 countries.

6.4 Interrelations Between Foreign Exchange and Investment Variables

The relationship between foreign exchange variables and investment variables was investigated in Chapter 5 by means of correction analysis. In that chapter, it is shown that the correlation between the time series of any two variables for a group of countries may be divided into two parts, namely the correlation between growth rates along linear trends and the correlation between fluctuations around these trends. The correlation between fluctuations in the foreign exchange variables and the investment variables was taken as the most relevant indication of the relationship between shortfalls and the disruption of development programs, given the limitations of the available data.

One finding of this statistical investigation in Chapter 5 was that the correlations between the foreign exchange variables and the investment variables were rather small, but it cannot be concluded from this result that the corresponding economic relationships were weak. It was indicated in that chapter that the small values of the direct correlations between the two sets of variables were due to the fact that the influence of foreign exchange variables on the investment variables operated through a number of intermediate variables, so that a series of disturbing factors were compounded over a chain of relationships.

In Chapter 5, it was found that fluctuations in investment expenditures had approximately the same degree of correlations with all types of exchange receipts. However, a considerable part of the governmental and private inflows of foreign exchange are disbursed to the less-developed countries according to the pattern of their investment expenditures; to that extent, the fluctuations in the A and P receipts are due to the fluctuations in investments rather than the other way around. Hence, as far as the causal influence of fluctuations in receipts on fluctuations in investment is concerned, this appears to have been most significant in the case of export earnings.

Fluctuations in exchange receipts are not the same as shortfalls from expectations of these receipts, and fluctuations in investment expenditures are not the same as disruption of development programs, but the two sets of concepts are related to some extent. In fact, it was found that the relative magnitude of fluctuations in the three types of exchange receipts corresponded closely to the relative magnitude of shortfalls. This relationship, combined with the significant influence of export fluctuations on investment activity, suggests that export shortfalls are a significant factor in leading to disruption of development programs. This tendency is likely to be stronger, the more closely the planning approach to development is implemented.

It has not been possible to arrive at a precise measurement of the relative significance of export shortfalls in the disruption of development programs, but such statistical evidence from past experience as it has been possible to examine in this study seems to indicate that shortfalls from expectation of export earnings have been quantitatively quite large in most of the less-developed countries, and that such shortfalls constitute a significant factor hindering the orderly implementation of development programs in the less-developed countries.

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Statement by Dr. Raúl Prebisch, Secretary-General of UNCTAD, at the twenty-eighth meeting of the Intergovernmental Group on Supplementary Financing on 30 October 1967

Thank you Mr. Chairman. First of all I would like to express my appreciation to you for giving me this opportunity to participate in this very constructive debate. I do so a few days after the Algerian conference of the 77 developing countries, to which I had the honour of being invited as an observer by the Co-ordinating Committee of the Group of 77 and the Government of Algeria.

As you have said Mr. Chairman, this conference underlined the importance of supplementary finance. It discussed the matter on lines similar to those followed at the sessions of this Intergovernmental Group. May I take this opportunity to say that in my view this meeting of the 77 in Algeria was a very constructive meeting and a very useful one. Governments present there laid the basis for a good dialogue with developed and socialist countries at the New Delhi conference.

Contrary to many views held before the Algiers meeting, the unity of the 77, or rather 86, governments of developing countries was concentrated on a series of common denominators. One of the most admirable aspects of this meeting was the efforts of those having dissenting views to arrive at very constructive compromises. The emphasis that was placed on supplementary finance at Algiers shows again that the concern that the first Conference of Geneva showed in this matter is quite valid today. This is a problem whose solution is of paramount importance to developing countries.

In considering this matter, we should not be unduly influenced by short-term considerations. It is true, Mr. Chairman and distinguished delegates, that the situation is not easy from the immediate point of view. It is also true that first things should come first, and that the first thing is to replenish the IDA. But you are not working for the next year or the next two years. You are working in my view for the establishment of a formal mechanism that will serve developing countries for a long period of time. The difficulties that you may encounter at present should be considered philosophically as temporary difficulties. Meanwhile, I think that it would be quite wise to continue the work so as to present a set of basic, sound principles to the New Delhi Conference.

There is another important development, Mr. Chairman, on which I would like to make a few comments. I remember that when we began considering this problem there were some that maintained the view that really there was no great need for supplementary finance. They pointed to the creation, in 1963, of the International Monetary Fund's Compensatory Financing Facility. In 1963 the facility was created and between 1963 and 1966 only three countries - Brazil, Sudan and the UAR took advantage of it. This gave some people the impression that if a single fire brigade was ample for the existing situation, why create a supplementary brigade? We should remember that those years 1963-66 were favourable years from the point of view of exports of primary producing countries, so that the need for this type of compensatory operation was less than in normal times. However, between September 1966 and September 1967, a number of countries took advantage of the facility of the International Monetary Fund, not only due to the liberalization of the facility, and this was a great contribution, but due to the fact that exports of developing countries have not continued to grow at such a satisfactory rate. In the year September 1966 to September 1967 the countries using the facility included Ceylon, Colombia, Dominican Republic, Ghana, Haiti, New Zealand and Syria. I am happy to see New Zealand there among the primary producing countries benefiting from the facility. We may note further that in this 12-month period, the use of the facility amounted to $102 million, as against $87 million in the three years before. That shows that changes of circumstances have promoted a greater interest in using the facility.

Recently there have been new developments, such as in rubber and other products, that may make it more important than in the immediate past to have such facilities at the immediate disposal of primary producers.

It is gratifying to see that the International Monetary Fund has been able to face the first impact of adverse movements of exports of developing countries by lending additional resources, but we all know that the purpose of these operations of the Fund is different from the purpose of supplementary finance. The purpose of the Fund facility is to soften the fluctuations of the foreign sector of the economy of developing countries, giving them time to adjust to a new external situation. The purpose of the supplementary finance scheme presented by the staff of the Bank, is to avoid any shrinking of the investment plan of the country in question.

Now Mr. Chairman, as you said and rightly so, this Group should not deal again with problems that have been solved, but rather with the problems that still require further consideration. Let me comment on some of them: the problem of the policy package first and secondly the problem of the alleged open-ended nature of the scheme.

In regard to the policy package, I wonder if we have not in effect created a new problem instead of considering an old problem. The problem of the relation between external financing and economic policy is not a new problem. Developing countries have for years been pressing international institutions and governments to link their lending operations to the needs of development plans. On such a basis developing countries might be assured of sufficient external resources to complement the mobilization of domestic resources during the life of the plan. When the staff of the World Bank, in elaborating their proposal on supplementary finance, made reference to a policy-package, they were, in my view, isolating a problem relating to supplementary finance, when in fact this is a problem of basic finance. And basic finance is, of course, much more important than supplementary finance.

The governments represented in Algiers stressed the need not to enter into any type of measure that would impinge on the sovereign prerogatives of developing countries. This is a principle that should not be limited to supplementary finance but to basic finance as well. I think, Mr. Chairman, that in this matter your Group has made great progress and that the suggestions of the distinguished delegate of Ceylon, Mr. Jayawardena, have been duly considered by the Group.[1/] It is obvious that if this

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1/ TD/B/C.3/44-TD/B/C.3/AC.3/17, Annexes A.1 and A.2, pp. 2-7.

scheme of supplementary finance has, as a fundamental purpose, avoiding the disruption of development programmes due to unforeseen export shortfalls, then lending institutions need to be satisfied that the development plan, and the associated export projections are feasible; secondly, that the plan is being implemented; and thirdly, that there is a danger of disruption of this plan due to a shortfall of export proceeds - this shortfall being due to factors outside the control of the developing country concerned. For me these requirements are obvious, but a delicate point of another character arises - how far should lending institutions go into the analysis of the problem that disruption of plans resulting from export shortfalls creates for the developing countries? In this respect, from reading the records of your discussions I see that the distinguished official of the Bank, Mr. Irving Friedman, has expressed the view that, taking into account the legitimate concern of developing countries, the Agency (and I hope that the Agency would be closely connected with the World Bank) would see that the exchange of information would not go beyond the usual procedures of consortia, or consultative groups, or - to speak of a more systematic example - of the Inter-American Committee for the Alliance for Progress which deals with the development programmes of Latin American governments.[1/] Mr. Friedman has been very clear in stating that the Agency would not go further than the World Bank has been accustomed to go in its relations with interested governments. I hope, therefore, Mr. Chairman, that your Group will be able to find the proper formula for solving this delicate problem.

The other problem that I have in mind is that of the concern over the possible open-ended nature of the scheme. I may recall to you, Mr. Chairman, and to your colleagues, that in my youth I once was a central banker, and, if I may say so without detriment to my present activities, I was on the conservative side on all these matters. Sir, I fully understand the position of those governments that, with sound financial views, would not like to enter into open-ended commitments. But is it necessary to have an open-ended commitment in this matter? I don't think so, Sir. I think that the estimate that the World Bank has made of yearly needs between $300 and 400 million is a reasonable estimate. Nobody can tell without practical experience what the actual

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1/ TD/B/C.3/44-TD/B/C.3/AC.3/17, Annex A.3, pp. 10-12.

requirements would be, but let us suppose that owing to unforeseen shortfalls of exports in exceptionally difficult times, claims exceeded resources. There would be no way out other than to impose some system of rationing. If I remember well, when this matter was discussed at the first meetings of this Group, it was suggested by the distinguished representative of Ceylon that if funds were for the time being insufficient, one would make use of what one had and then consider whether some increase in funds might be required in the future.[1/] Well, I would much prefer to face commitments on the basis of clear principles as to how to use the resources available and how to introduce a system of rationing when it is unavoidable, rather than adopt an uncertain solution. I think that it will be possible to find a proper method to solve this problem, and in this respect I would underline the importance that the Ministerial Meeting of Algiers gave to the consideration of the needs of least developed countries in the developing world.

It would be a source of serious uncertainty if there were no reference to the amount of resources for which countries might be eligible in the event of export shortfalls, and no reference to the guiding principles, or to the principles of application of the system. I am very worried about such an uncertain solution, because one of the fundamental objectives of this scheme is to give developing countries that have formulated sound and feasible development plans reasonable assurances that if an unforseen shortfall occurs, that is not due to their own actions, they will, after a short study of the situation, obtain access to additional resources to prevent interruption of their development plans. If the scheme were of another type, what would happen? When a shortfall occurred the Agency would have to study the situation carefully and this, as we all know, would take time, and the decision would take time, and while all this lengthy procedure was followed, the country concerned would already be facing disruption of its development plan. The scheme would thus be self-defeating unless, as the World Bank has wisely proposed, there is some system with a fixed amount of resources, as a minimum, to be used in accordance with definite principles. So that, if I may formulate my own humble opinion, I would strongly recommend that this group should not deviate from the main idea of the World Bank staff, which I consider a very sound and constructive idea.

1/ TD/B/C.3/41-TD/B/C.3/AC.3/16, Chapter I, Sections 3(g) and (h), pp.9-10.

Another concern of the developing countries that met in Algiers was to assure that this new scheme would involve the provision of additional resources and not the transfer of resources from basic finance to supplementary finance. I think that this is the underlying idea of the whole scheme. A transfer of resources from basic finance would not have any meaning. The amount of $300 to $400 millions required should be in addition to the resources available for basic finance.

Another problem is that which has emerged from the different approaches of the Fund and the World Bank. In this case, as well as in others, I am persuaded that it is possible to find a proper solution. I fully understand and sympathize with the remarks that the representatives of the Fund have made in this matter,[1/] and I had the opportunity and the privilege of talking to some members of the staff of the Fund recently in Washington about it. I think that this is a matter that would emerge independently of this debate because the Fund has a specific field of action - a very important field, but one which does not extend to the whole problem of avoiding or minimizing the impact of external fluctuations on the continuity of economic policies of the developing countries. What is the purpose of the Fund? It is to put at the disposal of a developing country suffering a contraction of exports, or a deficit for other reasons in its balance of payments, time for a smooth adjustment to a new situation. And in this concept, there is no central concern about the impact of any adjustment on the investment programme of the country. The approach of the World Bank, and of the first Conference, is different; it is not to facilitate an adjustment that might in certain circumstances require a contraction of the development programme, but to avoid such a contraction as far as possible. This is a problem that, with or without supplementary finance, should sooner or later have been considered by the lending institutions, in view of the need to assure continuity of economic development policies.

It is a fortunate thing that this matter has emerged in this discussion. If governments accept the second view, and it is timely to do so, that it is necessary to give continuity to development programmes, then I am sure that the International Monetary Fund, in consultation with the World Bank, could find a suitable formula for an appropriate type of adjustment policy - not a policy requiring the contraction of investment programmes, but a policy that would facilitate an orderly functioning of the monetary mechanism, avoiding disruption of the exchange system, inflationary tendencies,

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1/ TD/B/C.3/44-TD/B/C.3/AC.3/17, Annexes A.5 and A.6, pp.16-20.

and so forth. This is a challenge for the two institutions to agree on a joint policy conception that would combine short-term and long-term interests. As I have said, even in the absence of this proposal, such a policy was badly needed as a natural development of 20 years of experience in the life of these two institutions.

Mr. Chairman, I am persuaded that if these major problems were solved, solutions to the other minor, technical problems about how to calculate export projections, overages, and so forth would readily be found.

In the light of these considerations, I am wondering if the moment has not arrived to agree in this meeting on the need to present to the New Delhi Conference a clear set of proposals - not two sets of proposals, or an alternative proposal, which may make the task of the New Delhi Conference difficult. Notwithstanding the efforts of governments to concentrate on a short series of points of crystallization, as the Chairman of the Trade and Development Board, Mr. Jolles, put it, the discussion of all these problems will take time. If delegations do not have a clear-cut presentation of fundamental principles, that is if the governments have to decide between two, or many, or several alternatives, we may not arrive at New Delhi at an agreement on supplementary finance. Of course, in points of detail alternatives are possible, and I am sure that governments will welcome the presentation of these alternatives. But, if the alternatives are a system with a fixed amount of resources whose application is subject to certain well-established principles, and a system where there is no such provision of resources, where there is no reference to shortfalls of exports, a system, where in an attempt to avoid open-ended financing, one arrives at a scheme with open-ended discretion, I am afraid that we may seriously jeopardize the success of the New Delhi Conference in this particular respect.

I sincerely hope that a sustained effort will be made to agree on the main lines of the scheme. The Group will probably have an opportunity for another meeting after the Conference, so that everything points to the need to agree on fundamental issues at this time and to leave details for further elaboration after the second UNCTAD.

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SUPPLEMENTARY FINANCIAL MEASURES

The Bank Staff report on Supplementary Financial Measures was prepared in response to a request from the 1964 UNCTAD, for a scheme to provide assistance to developing countries which would help them to avoid disruption of their development programs due to unexpected shortfalls in their export earnings. The study was forwarded to the United Nations in December 1965.

The Supplementary Finance Scheme is designed to help avoid the disruption of well-conceived development programs which have commanded international support for their financing, when this disruption could potentially be caused by a lack of foreign exchange due to an unexpected export shortfall. Thus, supplementary finance is viewed as part of basic development finance, though this particular assistance becomes available when an unexpected shortfall in exports occurs. The terms suggested for supplementary financial assistance are consequently similar to those appropriate for the financing of long-term investments. A basic feature of the Scheme is a "Policy Package", that is, an agreement between the agency administering the Scheme and a member country, about the development program to be undertaken by the country and a set of basic development policies which are objectively regarded as appropriate by the international community. On the basis of certain available data on export projections and shortfalls for several countries during the period 1957-1963, and on certain assumptions, it is estimated in the Study that the financial requirements of the Scheme for an initial five-year period would average $300-400 million a year.

The proposals came up for a general discussion at a meeting of the UNCTAD Committee on Invisibles and Financing in April 1966. At that meeting an Intergovernmental Group was set up to consider the Scheme in detail. A preliminary discussion of some of the aspects of the Scheme took place at the first session of this group in October 1966. The following additional technical papers have been prepared by the Bank staff, and have been forwarded to the UNCTAD, clarifying and elaborating some of these aspects:

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

The next meeting of the Intergovernmental Group will be during February 6 to 17th. Bank staff would participate in these discussions.