DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

DEPUTY ASSISTANT SECRETARY

February 18, 1976

Dear Mr. Eskin:

At an earlier meeting of the LOS deep seabeds working group, Treasury was requested to clarify the current United States policy with regard to compensatory finance and to relate such policy to the ongoing efforts at reaching agreement on an international regime for the deep seabeds. In accordance with this request, I am sending the attached set of papers.

The first paper attached sketches a brief outline of the current U.S. policy with respect to compensatory finance and a draft U.S. position on this issue for use in the context of the deep seabed negotiations. The subsequent papers are designed to provide a further explanation of compensatory financing as an issue and U.S. initiatives in this area, along with related current developments, and to acquaint the reader with the operations and services of the international financial institutions, paying specific attention to assistance rendered to developing countries exhibiting substantial economic dependence on primary commodities.

Should you need any additional information, please do not hesitate to contact me.

Sincerely yours,

Robert Vastine

Mr. Otho E. Eskin
Staff Director
Office of the Law of the Sea
Negotiations
Room 4321
Department of State
Washington, D.C. 20520

Attachments: U.S. Policy with Regard to Compensatory Financing and Draft U.S. Position Concerning Compensation of LDC Land-Based Producers in the Future Regime of the Deep Seabed

IMF Press Release No. 75/65

Compensatory Financing

Compensatory Financing Schemes

Activities of International Lending Development Institutions (IDLI's)

IMF Extended Fund Facility

U.S. POLICY WITH REGARD TO COMPENSATORY FINANCING AND DRAFT U.S. POSITION CONCERNING COMPENSATION OF LDC LAND-BASED PRODUCERS IN THE FUTURE REGIME FOR THE DEEP SEABED

As a result of the comprehensive review of U.S. commodity policy undertaken in 1975 by the EPB/NSC Task Force established for that purpose, it was concluded that compensatory financing of temporary export shortfalls is preferable to comprehensive commodity price arrangements as a means of dealing with the problems created for developing countries by excessive fluctuations in export earnings. This policy has consistently been reaffirmed in recent statements at the highest levels.

The United States has strongly supported an expanded multilateral compensatory financing program as reflected in our proposal for a Development Security Facility in the IMF. A major element of that proposal is reflected in the December, 1975 decision by the IMF Directors to substantially liberalize the existing IMF Compensatory Finance Facility. The other element of the U.S. proposal, expansion of the scope of the proposed Trust Fund to permit it to undertake compensatory financing, remains on the table but has not received much support. This proposal, which would benefit only developing countries, would:

-- be permitted to make grants to the poorest countries of compensatory drawings from the IMF in the event such countries are unable to complete repayment within the IMF's five-year repayment period; and

-- based on short falls in export earnings from a select group of commodities, provide additional compensatory financing on concessional terms for poor countries and on more extended maturities than are available under the IMF for other LDCs.

Finally, in the continuing belief that the best way for developing countries to reduce long-term dependence on exports of primary products for foreign exchange earnings is to diversify their economies through their own efforts, the U.S. is currently seeking to expand the authorized capital of the InterAmerican Development Bank and the Asian Development Bank, and to become a member of the African Development Fund. All these measures will result in a significant increase in the amount of loans available for purposes of general economic development.

The above measures constitute the core of existing U.S. policy with respect to compensatory financing and the general strengthening of international financial institutions concerned with economic development. The U.S. should state that current compensatory financing arrangements are responsive to the immediate concerns of land-based producers of the minerals to be derived from manganese nodules and that further measures in this area are not warranted. The U.S. should also emphasize the importance of the various development lending institutions as a source of the capital required in adjusting to any economic dislocations brought about through deep seabed mining and relate that the U.S. has undertaken extensive initiatives in this regard since the last session of the LOS Conference. In constructing their own lending program, the IFI's work closely with the borrowing countries to assist them in establishing economic and financial policies conducive to development.

In cases where countries are dependent on a single primary commodity, the development institutions make a particular effort to advise and aid the country to diversify into other areas. With respect to diversification, it should be noted that the IMF's Extended Fund Facility, which was established in September, 1974, is prepared to make a commitment for up to three years to provide resources to members facing a financing need due to payments difficulties in connection with programs to correct structural maladjustments to their economies. Drawings from these facilities have longer repayment periods -- four to eight years -- than regular credit tranche drawings.

Any proposal in the context of the LOS Conference which would affect U.S. policies on the lending of international financial institutions, commodities, and/or would involve a U.S. financial contribution over and above the amount necessary to defray ISRA's initial administrative expenses must be referred back to Washington for consideration by the appropriate interagency forums.

PRESS RELEASE NO. 75/65

FOR IMMEDIATE RELEASE
December 29, 1975

The International Monetary Fund has reviewed its policies in connection with compensatory financing of export fluctuations and has decided to change the provisions of the facility so as to provide greater access to members, particularly primary exporters, encountering balance of payments difficulties caused by temporary export shortfalls.

Over the past few years, views have been expressed on ways of increasing the usefulness of the compensatory financing facility to Fund members. In its Press Communiqué of June 12, 1975 following its third meeting, the Interim Committee of the Board of Governors on the International Monetary System stated: "The Committee considered various proposals to assist members in dealing with problems arising from sharp fluctuations in the prices of primary products. In this connection, the Committee requested the Executive Directors (of the Fund) to consider appropriate modifications of the Fund's (facility) on the compensatory financing of export fluctuations." This request was welcomed by the Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries (the Development Committee) in its Press Communiqué of June 13, 1975.

Under the new decision (attached), the Fund will be prepared to authorize drawings up to 75 per cent of a member's quota (instead of 50 per cent under the 1966 Decision), provided that, except in disasters or major emergencies, drawings outstanding will not be increased by a net amount of more than 50 per cent (previously 25 per cent) of the member's quota in any 12-month period. As previously, members can expect that their requests for drawings will be met where the Fund is satisfied that the shortfall is of a short-term character and is largely attributable to circumstances beyond the member's control, and that the member will cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties. Requests for drawings which would increase the drawings outstanding under this decision beyond 50 per cent of the member's quota (previously 25 per cent) will be met only if the Fund is satisfied that the member has been cooperating with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties.

The existence and amount of an export shortfall for the purpose of any drawing under this decision shall be determined with respect to the latest 12-month period preceding the drawing request for which the Fund has sufficient statistical data. However, in order to improve the timeliness of assistance, the Fund may allow drawings with respect to a shortfall period for which export data are estimated for a period of up to six months. Moreover, the rules relating to reclassification of ordinary drawings into compensatory drawings have been liberalized to allow such reclassification to be made within 18 months from the date of the ordinary drawing (instead of six months under the 1966 Decision).

The Fund will review the formula for computing the shortfall (paragraph 6 of the attached Decision) not later than March 31, 1977, and will review this decision as a whole when experience and developing circumstances make this desirable. The Fund will review the decision in any event whenever drawings in any 12-month period exceed 1.5 billion special drawing rights (SDRs) or outstanding drawings exceed SDR 3.0 billion.

Since the compensatory financing facility was introduced in 1963, purchases have been made by 35 member countries. The amount of assistance provided has totaled SDR 1,221 million, of which SDR 722 million remains outstanding.

Attachment

Attachment

INTERNATIONAL MONETARY FUND

Compensatory Financing of Export Fluctuations

Executive Board Decision - December 24, 1975

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 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 continue to 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.

3. Drawings outstanding under this decision may amount to 75 per cent of the member's quota provided that (i) except in the case of shortfalls resulting from disasters or major emergencies, such drawings will not be increased by a net amount of more than 50 per cent of the member's quota in any 12-month period, and (ii) requests for drawings which would increase the drawings outstanding under this decision beyond 50 per cent of the member's quota will be met only if the Fund is satisfied that the member has been cooperating with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties.

4. The existence and amount of an export shortfall for the purpose of any drawing under this decision shall be determined with respect to the latest 12-month period preceding the drawing request for which the Fund has sufficient statistical data, provided that the Fund may allow a member to draw in respect of a shortfall for a 12-month period ending not later than six months after the latest month for which the Fund has sufficient statistical data.

5. 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 based partly on statistical calculation and partly on appraisal of export prospects.

6. The shortfall for the purposes of this decision shall be the amount by which the member's export earnings in the shortfall year are less than the average of the member's export earnings for the five-year period centered on the shortfall year. In computing the five-year average, earnings in the two post-shortfall years will be deemed to be equal to earnings in the two pre-shortfall years multiplied by the ratio of the sum of earnings in the most recent three years to that in the three preceding years. If the Fund considers that the result of the computations under the previous sentence is not reasonable, the Fund, in conjunction with the member, will use an estimate based on a judgmental forecast. When the Fund allows a member to draw under the proviso in paragraph 4 above, the Fund may use such methods of estimating exports during the period for which sufficient statistical data are not available as it considers reasonable.

7. Any member requesting a drawing under this decision will be expected to represent that it will make a repurchase corresponding to the drawing in accordance with the principles of Executive Board Decision No. 102-(52/11), adopted February 13, 1952, as renewed by Executive Board Decision No. 270-(53/95), adopted December 23, 1953. Approximately one year and two years after a drawing by a member under this decision, the Fund, after consultation with the member, may recommend to the member that, in view of an improvement in its balance of payments and reserve position, it should make a repurchase in respect of a part or all of the outstanding drawing. The Fund will expect the member to repurchase in accordance with the recommendation.

8. A member requesting a drawing under the proviso in paragraph 4 above will also be expected to represent that, if the amount drawn on the basis of partially estimated data exceeds the amount that could have been

drawn for the full 12-month period under paragraph 6 above, the member will make a prompt repurchase in respect of the outstanding drawing, in an amount equivalent to the excess.

9. Whenever the Fund's holdings of a member's currency resulting from a drawing under this decision are reduced by the member's repurchase or otherwise, the member's access to this facility, in accordance with its terms, will be restored pro tanto.

10. When drawings are made under this decision, the Fund will so indicate in an appropriate manner. Within 18 months from the date of any drawing made under the Fund's tranche policies or under the Extended Fund Facility, a member may request that all or part of the amount outstanding be reclassified and treated, for all purposes of this decision, as a drawing made under this decision. The Fund will agree to such a request if at the time of the drawing under the tranche policies or the Extended Fund Facility the member could have met the requirements for a drawing of an equal amount under this decision.

11. 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 the Fund's 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 this decision or (ii) to the extent that drawings in accordance with this decision are still outstanding.

Moreover, the Fund will apply its tranche policies to drawing requests by a member as if the Fund's holdings of the member's currency were less than its actual holdings of that currency by the amount of any drawings outstanding under this decision.

12. The Fund will review the formula in paragraph 6 not later than March 31, 1977, and will review this decision as a whole when experience and developing circumstances make this desirable. The Fund will review this decision in any event whenever (i) drawings under this decision in any 12-month period exceed SDR 1.5 billion or (ii) outstanding drawings under this decision exceed SDR 3.0 billion.

INTERNATIONAL MONETARY FUND

Stabilization of Prices of Primary Products

Executive Board Decision - December 24, 1975

Paragraph 2 of Executive Board Decision No. 2772-(69/47), adopted June 25, 1969, is amended to read:

> 2. In accordance with paragraph 1 above, the total of purchases outstanding pursuant to paragraph 1 of this decision shall not exceed 50 per cent of quota.

COMPENSATORY FINANCING

ISSUE

LDCs will exert pressure to create a compensatory financing facility outside the IMF both at UNCTAD IV and in the finance and raw materials commissions in the producer-consumer dialogue.

CURRENT STATUS

The U.S. proposed at the UN Seventh Special Session the creation of a Development Security Facility in the IMF as a more comprehensive and effective means of meeting LDC concerns about excessive export earning fluctuations than would commodity price arrangements. A major element of the U.S. proposals has been achieved with the liberalization of the IMF's compensatory financing facility. Our proposal to expand the Trust Fund to permit it to undertake compensatory financing remains on the table although it has not received widespread support.

On December 24, 1975, the IMF Executive Directors agreed to liberalize the IMF Compensatory Finance Facility by increasing member countries' total outstanding drawings from 50% to 75% of quota, their annual drawings from 25% to 50% of quota, and liberalizing the formula for calculating export earning shortfalls. The January 7-8 Interim Committee Meeting deferred decisions on the operational provisions of the Trust Fund, including our compensatory proposals, and this subject will be considered by the Executive Board.

The UNCTAD Secretariat's "Integrated Commodity Program" includes a compensatory finance facility which would compensate countries for shortfalls in their commodity or total export earnings, index export earnings to changes in the price of their imports (this form of indexation was specifically rejected in the liberalization of the IMF CFF), provide assistance on concessional terms and operate automatically without the current IMF constraints on recipient country behavior.

The EC Commission is now developing a "Global Approach to Commodity Problems," which endorses not only such vehicles for export earnings stabilization as the CFF and the Trust Fund, but also the stabilization of individual commodity earnings through an arrangement similar to STABEX (contained in the Lome Convention between the EC and its 46 Associated States).

The OECD High Level Group on Commodities established at its December 2-3 Meeting an Expert Subgroup on Export Earning Stabilization to review the "criteria for the basic elements of an arrangement of export earnings stabilization" additional to the IMF facility. The Subgroup has not met yet.

U.S. POSITION

The U.S. has consistently opposed the indexation of commodity prices or export earnings in every international forum, and would oppose as unrealistic any move to create a new international institution in addition to the IMF to dispense compensatory finance. The U.S. considers that the liberalization of the IMF CFF is responsive to LDC concerns. Our proposals to expand the Trust Fund remain on the table.

BACKGROUND

The UNCTAD Secretariat first proposed its compensatory financing scheme as part of its "Integrated Commodity Program" at the first meeting of the 8th UNCTAD Committee on Commodities, February 10-21, 1975. Throughout the spring and summer of 1975, the UNCTAD scheme underwent extensive study by both the UNCTAD Secretariat and the developed countries, but no conclusions could be reached on that or any other elements of the UNCTAD Integrated Program.

COMPENSATORY FINANCING SCHEMES

The major element of the U.S. proposed development security facility has been implemented with the IMF Executive Board decision to substantially liberalize the IMF's compensatory financing facility. The proposed expansion of the Trust Fund to permit it to undertake compensatory financing remains under discussion in the Board. Other proposals (e.g., by Sweden and UNCTAD) to increase the coverage and level of compensatory finance available to LDCs may now be actively pushed in international fora outside the IMF.

December 24, 1975, the IMF Executive Directors decided to liberalize access to the existing compensatory financing facility by increasing the annual drawing limit from 25% to 50% of a member's quota and the total outstanding drawing limit from 50% to 75% of quota. By so doing, they have increased the maximum potential access by $2 billion. The Directors also decided to make changes in the formula for calculating export earnings shortfalls which improve its ability to take account of recent inflation in determining a country's export earnings trend.

The January 7-8, 1976, Interim Committee Meeting deferred a decision on U.S. proposals to expand the Trust Fund to include compensatory financing to LDCs dependent on export earnings from a select list of commodities and concessional assistance for the poorest LDCs. Germany was the only other Committee member to actively support the U.S. proposals. Other members of the Committee have been reluctant to broaden the Trust Fund. This issue will be taken up by the Executive Board in the context of upcoming discussions on the details of Trust Fund operations.

Sweden has proposed the creation of an additional facility outside the IMF which would specifically link compensatory financing to shortfalls in commodity, rather than total, export earnings. This proposal was first put forward at the UN Seventh Special Session, but has remained dormant in the intervening months. The OECD High Level Goup on Commodities established at its December 2-3 Meeting an Expert Subgroup on Export Earnings Stabilization to review the "criteria for and basic elements of an arrangement on export earnings stabilization (additional to the IMF facility)," including the Swedish proposal. The Subgroup was due to meet January 22-23, but its first session has been postponed.

The Swedish proposal, while vague, is largely modelled after the EC-ACP STABEX scheme. Like STABEX, it would provide differential treatment for developing country recipients on the basis of their per capita income and would require that only those commodities that constitute a minimum percentage of a country's total export earnings be eligible for compensation. However, the Swedish proposal would cover all developing countries and all primary commodities which they export and would compensate earnings shortfalls from commodity exports to all markets - not just those exports shipped to developed countries.

Under the Swedish scheme, compensation payments for earnings shortfalls would only be constrained by the total financial resources available in the system in any given year. Individual countries would not be restricted by quota shares or the size of their previous drawings. The scheme also contains no sanctions for limiting access to countries which do not take appropriate measures to correct their balance of payments position. Financing for the scheme would come directly from contributing countries or from borrowed funds, with interest costs shared among the donor countries.

Pressures to create a concessional compensatory financing facility outside the IMF may run high between now and UNCTAD IV next May. The UNCTAD Secretariat first proposed such a compensatory financing scheme as part of its "Integrated Commodity Approach" at the first meeting of the 8th UNCTAD Committee on Commodities last February. It would base compensatory payments on shortfalls in either total merchandise exports or total commodity exports and would adjust export earnings for changes in the price of imports (i.e. indexation).

The U.S., along with other developed countries, has expressed its opposition to the indexation of export earnings for compensatory financing purposes within the IMF facility and such a provision was speicifcally rejected in the agreed liberalization of the IMF facility. The U.S. has proposed that, withing the Trust Fund, developing countries be compensated for shortfalls in their commodity export earnings, but only for a select list of commodities.

BACKGROUND

More liberal access to compensatory finance facilities for devleoping countries has been an active subject since 1973, when the Fund began to consider anew changes in its compensatory finance facility. It received fresh impetus when, at the January 15-16, 1975, Interim Committee Meeting, the ministers agreed that the Fund's Executive Directors review the system and make explicit changes. The UNCTAD Secretariat then unveiled its compensatory financing at the first session of the 8th UNCTAD Committee on Commodities, February 10-21, 1975. Throughout the spring and summer of 1975, the UNCTAD scheme underwent extensive study by both the UNCTAD Secretariat and the developed countries, but no conclusions could be reached on that or any other elements of the UNCTAD integrated commodity program.

In September, the U.S. unveiled its proposal for the creation of a Development Security Facility (DSF) at the UN Seventh Special Session. The Development Security Facility incorporated both modifications in the existing IMF compensatory finance facility and a broadening of the proposed Trust Fund to compensate export earnings shortfalls for those LDCs dependent on a sèlect list of commodities.

The U.S. proposed the DSF as a constructive alternative to the creation of multiple commodity agreements for stabilizing commodity prices. In view of IMF consideration of expanded compensatory financing, the UNCTAD Secretariat downplayed its proposal for a compensatory finance facility outside the IMF. The LDC's are now likely to press for further concessions, especially on indexation, and may attempt to obtain leverage in the CIEC and other forums to press for further liberalization of the IMF facility and adoption of an integrated buffer stock program including IMF financing.

Attachments:
Establishment of a Trust Fund

IMF Compensation Formula
Calculation of Compensable Shortfalls

A. Gault 2-6-76

Establishment of a Trust Fund in the IMF

Members at the January 7-8, 1976 IMF Interim Committee Meeting in Kingston, Jamaica, agreed to promptly establish a Trust Fund to channel profits on sales of 1/6th of the IMF's gold holdings.

The Interim Committee, in setting broad outlines for the Trust Fund, deferred action on specific details of the Trust Fund's operations, including the two U.S. proposals for broadening the Trust Fund to include certain compensatory financing arrangements. Details of the Trust Fund are yet to be worked out by the Executive Board.

The U.S. had proposed that the Trust Fund be broadened to provide:

(1) Grants to the poorest developing countries for the repayment of drawings from the regular IMF compensatory finance facilities in the event such countries are unable to complete repayment within the normal five-year period.

(2) Additional compensatory financing loans to developing countries dependent upon export earnings from a specified list of commodities. For poorer countries, such loans would be on concessional terms.

These proposals are still being discussed by the Executive Directors, but are actively supported only by the U.S. and Germany.

A. Gault 2-6-76

THE COMPENSATION FORMULA

Compensable shortfalls may be calculated by:

$$S_T = \frac{1973+1974+1975+1976+1977}{5} - 1975$$

(1975 = the shortfall year)

According to the formula:

$$1976+1977 = \left[\frac{1975+1974+1973}{1972+1971+1970}\right] \times \left[\frac{1973+1974}{1}\right]$$

Let: $1975=X_T$; $1974=X_{T-1}$; $1973=X_{T-2}$; $1972=X_{T-3}$; $1971=X_{T-4}$; $1970=X_{T-5}$; and $1976=X_{T+1}$; $1977=X_{T\,2}$.

THEN:

$$S_T = \frac{X_{T-2}+X_{T-1}+X_T+X_{T+1}+X_{T+2}}{5} - X_T$$

$$S_T = \frac{X_{T-2}+X_{T-1}+X_T+X_{T+1}+X_{T+2} -5X_T}{5} = \frac{X_{T-2}+X_{T-1}+X_{T+1}+X_{T+2}}{5} - \frac{4X_T}{5}$$

$$S_T = .2\left[(X_{T-2}+X_{T-1})+(X_{T+1}+X_{T+2})\right] - .8X_T$$

BUT: $$X_{T+1}+X_{T+2} = \left[\frac{X_T+X_{T-1}+X_{T-2}}{X_{T-3}+X_{T-4}+X_{T-5}}\right] \times \left[\frac{X_{T-1}+X_{T-2}}{1}\right]$$

THEREFORE:

$$S_T = .2\left[(X_{T-1}+X_{T-2}) + \left(\frac{X_T+X_{T-1}+X_{T-2}}{X_{T-3}+X_{T-4}+X_{T-5}}\right)\left(\frac{X_{T-1}+X_{T-2}}{1}\right)\right] - .8X_T$$

$$S_T = .2\left[(X_{T-1}+X_{T-2})\left(1+ \frac{X_T+X_{T-1}+X_{T-2}}{\quad}\right)\right] - .8X_T$$

IMF CALCULATION OF COMPENSABLE SHORTFALLS

Under the old techniques, a compensable export shortfall was calculated as the difference between exports in the shortfall year and a five year average of exports that included actual earnings in the shortfall year and the two preceding years and forecasts of earnings in the two post shortfall years. The average level of forecast exports could not be more than 10 percent greater than the average level in the two pre-shortfall years. Under the new decision the shortfall is calculated as follows:

"The shortfall will represent the amount by which the member's export earnings in the shortfall year are less than the average of the member's export earnings for the five-year period centered on the shortfall year. In computing the five-year average, earnings in the two post-shortfall years will be deemed to be equal to earnings in the two pre-shortfall years multiplied by the ratio of the sum of earnings in the most recent three years (including the shortfall year) to that in the three preceding years."

If the Fund considers that the result of the computations under the formula is not reasonable, the Fund can use estimates based on judgmental forecast.

T = shortfall year
X_T= earnings in shortfall year
S_T= amount of shortfall compensation

$$S_T = .2 \left[(X_{T-1}+X_{T-2}) \left(1 + \frac{X_T+X_{T-1}+X_{T-2}}{X_{T-3}+X_{T-4}+X_{T-5}}\right)\right] - .8X_T$$

(See attached derivation of IMF Compensation formula)

Example: New Formula

Given a country with the following earnings table:

YEAR	1970	1971	1972	1973	1974	1975	1976	1977
EARNINGS (in $ mil.)	110	126	125	140	160	x	y	z

1975 represents the shortfall year.

Earnings in 1976 and 1977 are calculated by the following ratio:

$$1976 + 1977 = \left[\frac{1975+1974+1973}{1972+1971+1970}\right] \times [1973+1974]$$

If 1975 earnings = $160 million

The five year average (1973 through 1977) for shortfall compensation purposes would be $168.2 million*, and the country would be eligible for $8.2 million in compensatory financing payments, assuming that the $8.2 million did not represent more than 50% of a country's quota in the IMF and the country did not have drawings from the facility that would bring total outstanding drawings to more than 75% of quota.

* 1976 + 1977 must = $190.5 million; let 1976=185; 1977=196

If 1975 earnings = $173 million

The five-year average for shortfall compensation purposes would be $196.5 million* and the country would ostensibly still be eligible for compensation payments of $.2 million.

* 1976 + 1977 must = $393 million; let 1976=190; 1977=203

NOTE: If country Y's export earnings table had shown a constant annual growth rate through 1975 (e.g., 1970 = 110, 1971 = 121, 1972 = 133, 1973 = 146, 1974 = 160, 1975 = 176), then country Y could still have been technically eligible for compensation payments in 1975 (≅$1.2 million). This anomaly is caused by statistical discrepancies by using a five-year arithmetical average against a growth rate which is growing geometrically.

Example: Old Formula

Under the previous rules (1966 decision), the average level of exports forecast for the two post-shortfall years could not be more than 10% above the average level in the two years prior to the shortfall year.

Under the previous constraint, country Y's earnings table would have been calculated as follows:

YEAR	1970	1971	1972	1973	1974	1975	1976	1977
EARNINGS (in $ mil.)	110	126	125	140	160	x	163	167

(earnings in 1976 and 1977 are hypothetical numbers which meet the requirement that, 1976 + 1977 = [1973 + 1974] x 110%).

If 1975 earnings = $160 million

The five year average for shortfall compensation purposes would be $158 million, and the country would not be eligible for compensatory financing.

COMPARISON OF COMPENSATION BENEFITS

1975 EARNINGS	OLD FORMULA	NEW FORMULA
$160 million	$.0 million	$8.2 million
$173 million	$0	$.2 million

NOTE: If country Y's export earnings table had shown a constant annual growth rate through 1974, but levelled off in 1975 (e.g., 1970 = 110, 1971 = 121, 1972 = 133, 1973 = 146, 1974 = 160, 1975 = 160), country Y would still have been eligible for some shortfall compensation (@ $.4 million). It clearly would not have been eligible for compensation if the growth rate had been sustained through 1975 (e.g., 1975 = 176).

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Anne Gault 2-6-76

Activities of the International Development Lending Institutions (IDLIs)

The principal international institutions engaged in providing economic assistance to the developing countries are the International Bank for Reconstruction and Development (IBRD), its concessional affiliate, the International Development Association (IDA), the International Finance Corporation (IFC), the Inter-American Development Bank (IDB), the Asian Development Bank (ADB) and the African Development Bank (AFDB), and its soft loan affiliate the African Development Fund (AFDF).

While the IBRD/IDA and ADB make some so-called program loans to provide general balance of payments relief to countries in difficulties, the IDLI's principally lend to help finance specific projects crucial to the economic development of the borrowing country. Such loans are made for projects in the following sectors: agriculture and agro industry; industry and industrial development banks; public utilities (including electric power and water supply); transport/communications; education and health; tourism. To fund their lending programs these institutions draw on both their ordinary capital resources, which are lent on near market terms, and their concessional resources, which are lent primarily to their poorest members on concessional terms. Through December 1975 the IDLI's have committed a total of $51.8 billion in loans on both concessional and non-concessional terms. At the end of 1975 the total capital resources of these banks totalled $56.6 billion. (See tables and chart for details).

In constructing their own lending program the IDLI's work closely with the borrowing countries to assist them in establishing economic and financial policies conducive to development. In cases where countries are dependent on a single export commodity or crop, the development institutions make a particular effort to advise and aid the country to diversify into other areas. Examples of this effort to encourage diversification include an IBRD loan to tin-rich Bolivia for a gas line; an IDB loan to Brazil to increase beef production and reduce dependence on coffee exports; World Bank loans to Morocco and Tunisia for development of tourism; an agricultural diversification loan to Senegal from IBRD and IFC to reduce dependence on ground nut exports.

Development Lending Institutions

Through December 1975
($ millions)

Bank	Cumulative Commitments
IBRD/IDA	38,704.5
IFC 1/	1,332.8
AFDB/AFDF	456.0
ADB/ADF	2,545.0
IDB/FSO/Other 2/	8,791.0
Total	51,829.3

1/ Estimated

2/ Includes bilateral funds administered by IDB

Capitalization of International Development Lending Institutions

December 31, 1975
($ millions)

A. Ordinary Capital	
IBRD	30,820.8
IFC	107.5
AFDB	469.3
ADB	3,202.0
IDB	5,965.0
Subtotal	40,564.7
B. Concessional	
IDA	10,773.8
AFDF	152.0
ADF*	685.0
FSO	4,394.3
Subtotal	16,005.1
Total	56,569.8

* Includes $305 million of Multi-purpose Special Fund

PRINCIPAL INTERNATIONAL DEVELOPMENT BANKS

World Bank Group
Pres. Robert McNamara
Hqtrs. Washington, D.C.

U.S. Capital Share 24%

World Bank Loans
20-25 yrs. at 8½%

U.S. Contribution 33% of Total

International Development Association (IDA)
Terms: 50 yrs. 3/4 of 1% service charge

U.S. Captial Share 31%

International Finance Corporation (IFC)
Loans & equity investments for private sector

Inter-American Development Bank
President: Antonio Ortiz Mena

Ordinary Capital
Loans for 20-25
at 8%

U.S. Capital Share 40%

Fund for Special Operations (FSO) up to 40 yrs. at 1-4% (Foor poorest Latin countries)

U.S. Contributions 70% of Total

Legally chartered entities with separate boards.

Funds only - Boards of Parent Group pass on loans from these funds.

Asian Development Bank (ADB)
President: Shiro Inoue
Hqtrs. Manila, Philippines

U.S. Contribution 14.1 of Total

Asian Development Fund (ADF) Loans 40 yrs. at 1% (For poorest Asian Countries)

Ordinary Capital Loans for 20-25 yrs. at 8 3/4% to 9 1/2%

U.S. Capital Share 10.4

No provision for non-regional membership

African Development Bank (AFDB)
President: A. Labidi
Hqtrs. Abidjan, Ivory Coast
Loans for 20-25 yars. at 6%

U.S. not yet a member1/

African Development Fund (ADF)
50 yr. loans at 3/4 of 1% Service charge for poorest African countries

1/Awaiting Congressional Action

Legally chartered entities with separate boards.

Funds only - Boards of Parent Group pass on loans from these funds.

INTERNATIONAL MONETARY FUND

Extended Fund Facility: Under this facility, which was estabished in September 1974, the Fund will be prepared to make a commitment for up to 3 years to provide resources to members facing a financing need due to payments difficulties arising from structural maladjustments in their economies. The member must, however, be prepared to undertake and adhere to a comprehensive reform program approved by the IMF that will cover a period of several years. Drawings from this facility may not exceed 140 percent of quota or bring the Fund's holdings of the member's currency above 265 percent of quota (excluding drawings from the other special facilities). Drawings have longer repayment periods, 4-8 years, than regular credit tranche drawings, and bear a slightly higher interest rate in the later years (i.e., 6-1/2 percent in years 5-8 instead of the current maximum 6 percent for regular drawings). In July 1975, the Executive Director approved the first drawing under this facility, to Kenya for SDR 67.2 million.