International Lawyer

Volume 11 | Number 2 Article 5

1977

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Recommended Citation
Robert F. Meagher, *The Expansion and Modification of the IMF's Compensatory Finance Facility*, 11 INT'L L. 277 (1977)
https://scholar.smu.edu/til/vol11/iss2/5

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The Expansion and Modification of the IMF's Compensatory Finance Facility

On September 1, 1975, United States Secretary of State Henry Kissinger set forth a series of development proposals in a speech delivered by Ambassador Moynihan to the Seventh Special Session of the United Nations General Assembly.[1] This represented a gargantuan effort on the part of the United States to replace the negative atmosphere of confrontation which had characterized the Sixth Special Session of 1974, with a series of positive conciliatory initiatives.

This brief article is concerned with one of these initiatives: a development security facility to stabilize commodity export earnings, essentially a proposal to revise and expand the compensatory finance facility of the International Monetary Fund (IMF).

Background

Primary commodities account for 80 percent of total export earnings of developing countries (LDCs),[2] most of which are dependent on one, two or three such products.[3] For the most part, these nations have become independent within the last twenty years, and it is only recently that they have turned their attention from purely political questions to issues of political economy.

In the commodity area LDCs have two basic goals: the elimination of wide fluctuations and an absolute increase in export earnings. Over the years they have made efforts to create and support institutional devices to achieve these goals,

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[1] "Global Consensus and Economic Development" September 1, 1975, United Nations, N.Y., (Department of State, Bureau of Public Affairs—The Secretary of State).

[2] EXPORT EARNINGS FLUCTUATIONS AND ECONOMIC DEVELOPMENT: AN ANALYSIS OF COMPENSATING FINANCING SCHEMES (A.I.D. Discussion Paper No. 32, Bureau for Program and Policy Coordination, 1975) p.1.

[3] *Id.*

including: international commodity agreements,[4] producer associations,[5] supplementary financing,[6] indexation,[7] buffer stocks,[8] and compensatory finance.[9] Some of these solutions require interference with the market through control of prices, production and/or the behavior of producing and consuming countries. Others, primarily concerned with short-run fluctuations, rely on the market mechanism. Compensatory finance schemes fall in the latter category and their purpose is to provide access to medium-term finance to enable countries to bridge temporary shortfalls in commodity export earnings. Such schemes are the focus of this article.

Creation of the IMF Compensatory Finance Facility

There is substantial instability associated with commodity exports. Prices fluctuate widely and production, particularly of food crops, does the same. Being far more dependent on commodity exports than the developed countries, LDCs are more seriously affected by this instability. Reductions in export earnings affect import capacity and investment planning and generate multiplier effects which have an adverse impact on national income, employment and government revenue.[10]

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[4]*International Commodity Agreements*, XXVIII LAW AND CONTEMPORARY PROBLEMS (Duke University 1963); *International Commodity Stabilization Arrangements* HEARINGS BEFORE THE SUBCOMMITTEE ON INTERNATIONAL TRADE, INVESTMENT AND MONETARY POLICY OF THE COMMITTEE ON BANKING, CURRENCY AND HOUSING, HOUSE OF REPRESENTATIVES 94th/2nd, July 9 and 10, 1975; Fox, W., TIN: THE WORKING OF A COMMODITY AGREEMENT, Mining Journal Books (London 1974); FISHER, BART, THE INTERNATIONAL COFFEE AGREEMENT: A STUDY IN COFFEE DIPLOMACY (Praeger 1972).

[5]*See* the Charter of Economic Rights and Duties of States A/Res/3281 (XXIX) 15 January 1975 Article 5. Agreement Establishing the International Bauxite Association 1974; an Agreement to Establish the Intergovernmental Council of Copper Exporting Countries (CIPEC) 8 June 1967; Revision of CIPEC's Agreement 26 June 1974; Agreement Establishing the Association of Iron Ore Exporting Countries, 3 April 1975; *Raw Material Procedures Eye the OPEC Model: Who? Where? How?* in BUSINESS INTERNATIONAL, November 7, 1975, pp. 358, 359; Bergsten, C.F., *The New Era in World Commodity Markets*, CHALLENGE, September/October 1974; Mikesell, R., *More Third World Cartels Ahead?*, CHALLENGE November/December 1974; Bergsten, C.F., *The Threat from the Third World*, FOREIGN POLICY Summer 1973; MUGHRABY, M., PERMANENT SOVEREIGNTY OVER OIL RESOURCES (Middle East Research and Publication Center, Beirut, 1966)—the text of the OPEC agreement is included as an appendix.

[6]Proceedings of the United Nations Conference on Trade and Development, E/Conf. 46/141, Vol. I (1964). Resolution A.IV.18 p. 52, pp. 200-203; United Nations Conference on Trade and Development, Second Session, TD/97, Vol. I (1968), Resolution 30 (II) pp. 42, 43 and pp. 288-290, 437, 448.

[7]The Indexation of Prices TD/B/503 Supp. 1, 30 July 1974; TD/B/503 Supp. 1, add.1, 5 July 1974; TD/ B/ 503, 6 August 1974; TD/ B/ 563, 7 July 1975.

[8]An Integrated Programme for Commodities TD/B/C.1/166, 9 December 1974 and Supp. 1,2,3,4,5.

[9]E/Conf. 46/141, Vol. I (1964) Resolution A.IV.17 p. 52, and pp. 125, 139, 200-203. TD/97, Vol. I (1968), Resolution 31 (II p. 43 and pp. 290, 437, 438); TD/B/C.1/166 Supp. 4, 13 December 1974; TD/B/C.1/195, 16 October 1975; TD/189 March 1976; TD/184 4 March 1976 pp. 14, 15; Compensating Financing of Export Fluctuations: a recond report by the International Monetary Fund (no date); A.I.D. Discussion paper no. 32, *op. cit.*

[10]A.I.D. Discussion paper no. 32 *op. cit.*, p. 6.

At the suggestion of the United Nations Commission on International Commodity Trade, the IMF carried out a study and issued a report entitled *Compensatory Financing of Export Fluctuations*, which resulted in the creation of a compensatory finance facility in 1963.[11] The facility was designed to finance deficits arising from short-term export shortfalls attributable to circumstances beyond the member's control and resulting in balance of payments difficulties. In order to create the facility, a number of questions had to be answered: Should only the poorer members of the IMF be able to use the facility? What would be the source of funds? Would it be necessary to raise IMF quotas? What would be the limit on individual country drawings? What should be the terms and conditions of the drawings and repurchases? How should one determine and measure a short-term export shortfall? Should the focus be on export receipts, export prices, terms of trade or the importing power of exports? Should there be exclusions for artificially induced shortfalls? What relationship should there be between other drawing from the IMF and the new facility?

After study and consultation, the following standards were established:[12] There would be no increase in members' quotas. All members would have access to the facility, and the amount of permissible drawings would "normally" be up to 25 percent of the member's regular quota. Repurchases[13] would be made within three to five years, thus maintaining the concept of a short-term facility. Eligible shortfalls had to result in balance of payments difficulties, be of a short-term character and be attributable to circumstances beyond the member's control, *i.e.*, not based on interference with the market by devices such as export controls. The member also had to cooperate with the IMF to find solutions. The shortfall would be measured by averaging export revenue for a five-year period and comparing that average with the shortfall year, the difference being the compensable shortfall. Calculations were based on actual revenue for the shortfall year and the two preceding years, plus estimates for the two following years. The average level of export forecasts for the post-shortfall years could not exceed 110 percent of the average level in the two years prior to the shortfall and could not be assumed to be less than the level of exports experienced in the shortfall year itself. Whenever compensatory finance repurchases were made, the amount for additional drawings was increased *pro tanto.* Regular quotas were waived in relation to compensatory finance drawings, although the latter were counted against future regular drawings.

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[11]Compensatory Financing of Export Fluctuations *op. cit.*

[12]Decision no. 1477—(63/8), adopted February 27, 1963 of the IMF Executive Directors.

[13]The Fund does not use the words loans or repayments in relation to the facility because when a member uses the fund's resources the member pays an equivalent amount of its own currency for the currency it receives. *See* GOLD, J. THE STAND-BY ARRANGEMENTS OF THE INTERNATIONAL MONETARY FUND, (IMF 1970), p. 8.

An improvement in the trend of commodity prices following the creation of the facility restricted drawings to only three between 1963 and 1966.[14]

UNCTAD I — Geneva 1964

In 1964 the first United Nations Conference on Trade and Development (UNCTAD) was held in Geneva, leading to the establishment of a permanent organization reporting directly to the United Nations General Assembly. Dominated by LDCs, it quickly became the intellectual and organizational center for these countries, with commodity problems a central concern. During the 1964 session, a resolution[15] on compensatory finance was passed without dissent. After acknowledging the IMF facility as "a definite step towards the solution of short-term financing problems." the resolution proceeded as follows:

> 1. *Recommends* that Government members of the International Monetary Fund study the following measures:
>
> (1) To increase, as soon as possible, the amount allocated by the Fund to compensatory financing, over and above its current transactions, from 25 percent to 50 percent of a member country's quota;
>
> (2) To replace compensatory credits entirely outside the structure of the gold and successive credit tranches, so that the drawing of compensatory credits would not directly or indirectly prejudice a member's ability to make an ordinary drawing;
>
> (3) To explore ways to secure possible refinancing of compensatory financing obligations of the developing countries in the event of persistent shortfall in export receipts beyond the control of the country affected.
>
> 2. *Requests* that the International Monetary Fund, in its determination of the shortfall in export receipts, consider giving greater weight to the actual experience of the preceding years.

In addition to the above, a related resolution[16] was passed requesting the World Bank to conduct a study of the feasibility of a scheme "to deal with problems arising from adverse movements in export proceeds which prove to be of a nature or duration which cannot adequately be dealt with by short-term balance of payments support. Its purpose should be to provide longer term assistance to developing countries which would help them to avoid disruption of their development programmes."

The 1966 Amendment of the IMF's Facility

As noted earlier, only three countries utilized the IMF facility during 1963-66. Although the principal factor was the improvement of commodity prices, many believed that the poorest countries with very low quotas were not sufficiently provided for by the 1963 facility. The IMF took two steps which dealt with this concern.[17] Since paragraph 3 of the 1963 decision permitted an upward adjustment of quotas of certain primary exporting countries, more than 20 quota

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[14]Compensatory Financing of Export Fluctuations *op. cit.*, p. 3.
[15]Resolution A.IV.17 *op. cit.*
[16]Resolution A.IV.18 *op. cit.*
[17]Compensatory Financing of Export Fluctuations *op. cit.*, p. 2.

increases were approved and 15 other countries appeared to be eligible for similar action. Secondly, in February, 1966 there was a general quota increase in the IMF. In addition, in 1965 the Governors of the IMF recommended certain changes in the facility which were ultimately adopted in September, 1966:[18]

1. The drawing limit was raised from 25 to 50 percent of quotas in all circumstances, and this was not qualified as in the 1963 decision by the word "normally." Except for shortfalls due to disasters or major emergencies, the net amount outstanding could not increase by more than 25 percent of the quota during any twelve-month period; requests which would increase drawings beyond 25 percent would be approved only if the IMF was satisfied that the member "had been cooperating with the Fund to find appropriate solutions for its balance of payments difficulties."
2. Regular and compensatory drawings were made independent of one another.
3. Repurchase policy was modified. In order to ensure the short-term character of the facility, the outside limit of five years was retained. Under the 1963 decision regular repurchase policy had been followed, *i.e.*, one-half was made in the fourth year and one-half in the fifth year. Under the 1966 decision, the IMF maintained the old rule and recommended that "as soon as possible after the end of each of the four years following a drawing under paragraph (5), the member repurchase an amount of the Fund's holdings of the member's currency approximately equal to one-half of the amount by which the member's exports exceed medium-term trend of its exports."
4. A reclassification procedure was instituted.[19] It had been IMF practice to require that requests for compensatory finance be related to "an export shortfall over the latest twelve-month period for which, at the time of the request, a reliable estimate of actual exports can be made." It is obviously desirable that "the time lag between the shortfall and compensatory financing should be as short as possible." Because of delays in developing a "reliable estimate" the IMF decided to permit the "use of the stand-by and ordinary drawing facilities for the compensation of export shortfalls" and "to allow members, within a six-month period of any drawing to reclassify all or part of it as a compensatory drawing." The drawing had to satisfy the conditions for which it was made, *i.e.*, regular or stand-by, and when reclassified it would have to satisfy the conditions for a compensatory drawing.

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[18]Decision No. 2192—(66/81), September 20, 1966.
[19]Compensatory Financing of Export Fluctuations *op. cit.*, pp. 12, 13.

UNCTAD II—New Delhi 1968

Reactions to the 1966 decision were generally favorable, although the LDCs did not believe that it was far-reaching enough. First, in the *Charter of Algiers*[20] issued by the Group of 77 prior to UNCTAD II and subsequently during the 1968 New Delhi Conference itself,[21] they urged a further review and liberalization so that: (1) drawings would be immediately available up to 50 percent of the member's quota and not subject to any conditions; (2) repurchases would be linked to the recovery of exports rather than a rigid outer time limit of three to five years. If this could not be done, they asked for the inclusion of a refinancing provision in cases where exports did not recover; (3) account be taken of the fact that IMF quotas were inadequate in light of the magnitude of some LDCs' needs; (4) interest charges should be calculated separately from those employed in respect of ordinary drawings and should not attract the IMF's normal progressive interest provisions; (5) export shortfalls should be calculated in real terms; (6) adverse movements in import prices should render an LDC eligible for a compensatory drawing; (7) as suggested in the 1964 UNCTAD resolution, the formula for calculating shortfalls should be modified by taking as a basis a country's average exports during three or more normal years preceding the drawing.

The IMF representative to the UNCTAD II conference argued that the short-term nature of the facility prevented the IMF from refinancing and/or extending the repurchase period and that the IMF's method of calculating shortfalls yielded a volume of assistance as great as that proposed by the LDCs.[22] Inasmuch as the 1966 decision was still relatively new (18 months) members were urged to give it a chance to operate. Answers to some of the other objections may be found in IMF publications.[23]

UNCTAD III—Santiago 1972

When UNCTAD III convened in Santiago in 1972, the concerns over the effects of the 1971 international monetary crisis dominated the meeting. Although no specific resolution on compensatory financing was issued, there was a resolution[24] on utilizing the World Bank to assist in price stabilization, along with discussions of supplementary financing.

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[20]TD/97, Vol. I (1968), p. 431 *et. seq.*

[21]*Id.*, pp. 43, 290.

[22]*Id.*, p. 290.

[23]Compensatory Financing of Export Fluctuations *op. cit.*, pp. 8-12, 27.

[24]Proceedings of the United Nations Conference on Trade and Development, third session TD/180, Vol. I (1972) Resolution 54 (III) p. 79.

Sixth Special Session of the United Nations General Assembly

At the end of the Sixth Special Session of the United Nations General Assembly, which met to discuss the OPEC-induced crisis of 1973/74, resolutions were passed concerning a Declaration[25] and a Programme of Action[26] on the Establishment of a New International Economic Order. Article II.1.(i) of the Programme of Action provides for a "Review of the methods of operation of the International Monetary Fund, in particular . . . the system of compensatory financing . . . so as to enable the developing countries to make more effective use of [it]." This very general provision was expanded on in *An Integrated Programme for Commodities,*[27] a report by the Secretary General of UNCTAD published on December 9, 1974, which noted that compensatory financing would serve a role in the integrated program and asserted that "the expansion and liberalization of IMF assistance would probably be of significant help."[28] While problems would still exist, they would be greatly alleviated if "appropriate changes could be made in the IMF facility to enlarge the amounts transacted and the number of countries using the facility."[29] These changes included:[30]

(i) more flexible conditions as regards the balance of payments criterion for assistance;
(ii) relaxed limits on the amounts available as determined by IMF quotas to take account of the size of shortfalls;
(iii) easier requirements on the completion of detailed export statistics within a relatively brief period of the shortfall in exports;
(iv) extension of the repayment period beyond five years, by linking it more closely with export recovery; and
(v) greater attention to the import purchasing power of a country's exports.

Lomé Convention[31]

The IMF compensatory finance facility remained the only such international mechanism until February, 1975, when the Lomé Convention between the European Economic Community (EEC) and 46 African, Caribbean and Asian (ACP) states was signed. Title II of the Convention provides for the stabilization of export earnings of the ACP states and has become known as STABEX.

[25] A/Res/3201 (S-VI), 9 May 1974.
[26] A/Res/3202 (S-VI), 16 May 1974.
[27] TD/B/C.1/166 and Supps. 1, 2, 3, 4, 5.
[28] *Id.*, p. 15.
[29] *Id.*
[30] *Id.*
[31] THE COURIER—No. 31, Special Issue March 1975. This issue contains the text of the Convention as well as articles on the negotiations. For a critical view of STABEX *see*, WALL, DAVID THE EUROPEAN COMMUNITY'S LOMÉ CONVENTION: STABEX AND THE THIRD WORLD'S ASPIRATIONS (Trade Policy Research Center, London).

Under this scheme any ACP state exporting specified raw materials (12 principal products and certain sub-products for a total of 29) to the Community receives compensation for shortfalls in export revenues from EEC countries, provided the exports meet two independent standards. First, during the year preceding the application, export earnings on one or more of the specified commodities must equal 7.5 percent of total export earnings, although poorer and specially situated states need show only 2.5 percent. Thus, the first test relates to the importance of the product in total exports. Second, each eligible commodity has a moving reference level equal to the average earnings derived from the export of the commodity to EEC countries over the preceding four years. An ACP country may request a transfer when export earnings of the commodity to EEC states have decreased by 7.5 percent or in the case of poorer and specially situated states 2.5 percent. The difference between the reference level and actual earnings constitutes the basis of the transfer, which bears no interest.

The ACP states, excepting a list of the 24 poorer countries, are expected to contribute to the reconstitution of resources to the extent they have received them over a five-year period. This is to be done each year that "the unit value of the exports is higher than the reference unit value" and "the quantity actually exported to the Community is at least equal to the reference quantity." If these two conditions fail to prevail sufficiently over the five-year period to equal the amount of the transfer, the Council of Ministers has the right to either request all or part of the amount outstanding or waive the right to repayment.

Approximately US $465 million, equal to 375 units of account, are available to STABEX over the five-year period of the agreement. The money has been divided into five equal installments but there is provision for drawing up to 20 percent of the following year's installment.

STABEX differs from the IMF's compensatory finance facility in a number of ways. First, only ACP members may draw on STABEX. Second, STABEX compensates for a shortfall in earnings for each commodity, not all commodities. Third, STABEX limits the commodities covered both in particular and on the basis of their importance in the trade of the affected country with the EEC. Fourth, the STABEX reference level is based on an average of the four preceding years, whereas the IMF facility looks both to the past and the future. Fifth, STABEX applies different standards of eligibility for funds and repayment among ACP countries. Sixth, STABEX funds are much more limited than those of the IMF. Seventh, STABEX payments do not incur interest.

Thus, STABEX includes a number of features which were originally sought for the IMF facility, including automaticity, a reference level based on an average of the four years preceding the reference year and the repayment provisions mentioned above. However, only U.S. $465 million is available to STABEX over the five-year period of the agreement and a recent source

indicates that STABEX is already facing financial problems.[32]

Kissinger's Development Security Facility

The atmosphere at the opening of the Seventh Special Session of the United Nations General Assembly was tense because of the confrontation politics which had prevailed at the Sixth Special Session and the XXIX General Assembly. Tension was reduced greatly following the reading of Kissinger's speech by Ambassador Moynihan, in which forty-one specific proposals were offered to bring about global consensus and economic development.[33] These included a suggestion to create a new development security facility to stabilize overall export earnings. Secretary Kissinger described the facility as follows:

> Let me set forth our proposal: The United States proposes creation—in the International Monetary Fund (IMF)—of a new development security facility to stabilize overall export earnings.
>
> The facility would give loans to sustain development programs in the face of export fluctuations—up to U.S.$2.5 billion, and possibly more, in a single year, and a potential total of U.S.$10 billion in outstanding loans.
>
> Assistance would be available to all developing countries which need to finance shortfalls in export earnings, unless the shortfalls are caused by their own acts of policy.
>
> The poorest countries would be permitted to convert their loans into grants under prescribed conditions. These grants would be financed by the proceeds of sales of IMF gold channeled through the proposed $2 billion trust fund now under negotiation.
>
> Eligible countries could draw most, or under certain conditions all, of their IMF quotas in addition to their normal drawing rights. Much of that could be drawn in a single year, if necessary: part automatically; part subject to balance-of-payments conditions; and part reserved for cases of particularly violent swings in commodity earnings.
>
> Shortfalls would be calculated according to a formula geared to future growth as well as current and past exports. In this way the facility helps countries protect their development plans.
>
> This facility would replace the IMF's compensatory finance facility; it would not be available for industrial countries.
>
> The United States will present its detailed proposals to the board of directors of the IMF this month.

The suggested changes in the Fund's facility are threefold:

1. Industrial countries are excluded from the use of the facility. Inasmuch as they have made only one drawing from the facility, this is largely a suggested codification of existing practice.
2. Although no figures are used, there is an implicit raising of permissible drawings to "most, or under certain conditions all, of their IMF quotas in addition to their

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[32]Commodities Bulletin, No. 81, April 3, 1976. Although the Convention came into force formally only this week (April 3, 1976), it is retroactive to January 1, 1975, and requests for payments from ACP countries for 1975 are expected to exceed the EEC's budget for that year, despite the fact that most commodity prices moved up.

The largest payout will be to timber producers, such as Congo, but Ethiopia (cotton, skins and hides), Fiji (copra oil), Niger (groundnuts), Benin (cotton, palm oil, cocoa) and Burundi (coffee) are also expected to make application.

[33]*See* footnote 1, *supra*.

normal drawing rights" from the 50 percent limit. The language "part automatically; part subject to balance-of-payments conditions; and part reserved for cases of particularly violent swings in commodity earnings" appears to be a reaffirmation of the 1966 standards.

3. The most important change is the provision permitting poorer countries to "convert their loans to grants under prescribed conditions" with funds coming from the proceeds of sales of IMF gold channeled through a trust fund.

At the conclusion of the Seventh Special Session, the final resolution on international trade contained the following statement on compensatory financing:[34]

> *International trade:*
> I.3.(d) Substantially improve facilities for compensatory financing of exports revenue fluctuations through the widening and enlarging of the existing facilities. Note has been taken of the various proposals regarding a comprehensive scheme for the stabilization of export earnings of developing countries and for a Development Security Facility as well as specific measures for the benefit of the developing countries most in need;

In the week following the Kissinger speech, the United States presented the detailed provisions of its proposal to the IMF.[35] It suggested: (1) modifications of the 1966 compensatory finance facility in respect of the computation of shortfalls, limitation on access to the facility, the size of permissible drawings and the time frame for the full compensatory finance drawing; and (2) linkages with the approved, but not yet established, Trust Fund.

Modification of the 1966 Compensatory Finance Facility

The compensable shortfall was, as explained earlier, based on a five-year average, including the two years following the shortfall year, for which the IMF had to project commodity revenues. Since projections could not exceed 110 percent of average past export earnings, the facility had only limited usefulness in times of high inflation. The United States now proposed to raise the limit to 120 percent. In light of the new facility created under the Lomé Convention, the United States also proposed that the IMF deduct compensatory financing available to a country under international arrangements outside the IMF, on the grounds that this was "a simple, more equitable, and economically sounder way of dealing with and taking account of the inflation problem than complex attempts to compensate for shortfalls in 'real' export earnings."

With respect to the size of the drawing, the United States announced that if the facility were limited to LDCs, it would support a drawing limit equal to 100 percent of the quota instead of the existing maximum of 50 percent. Or, if not,

[34] A/Res/3362 (S-VII), 19 September 1975.

[35] United States Proposals for Stabilizing Export Earnings of Developing Countries, September 12, 1975.

the United States would still support an increase to 75 percent. In addition, the United States advocated an increase from 25 to 50 percent for drawings on the facility within any twelve-month period.

The IMF had established a buffer stock facility[36] and limited combined drawings from this and the compensatory finance facility to 75 percent. The United States supported the elimination of the combined quota limit.

Establishment of a Trust Fund

At the 1973 Annual Meeting of the IMF it had been agreed to establish a Trust Fund to assist LDCs with the proceeds from the sale of a designated portion of the IMF's gold reserves. It was estimated that this Trust Fund would have approximately U.S. $2 billion. The United States proposed that Trust Fund resources be used (a) to provide grants for the repayment of compensatory financing drawings from the IMF by the poorest LDCs (income per capita below U.S. $200) in the event such countries were unable to complete payments within a five-year period; and (b) as a source of additional compensatory financing loans to LDCs dependent on export earnings from a specified list of commodities. To be eligible a country would have to demonstrate the existence of a serious balance of payments problem arising from a shortfall in total export earnings from specified commodities. The first 25 percent of the country's compensatory finance would come from the IMF's regular facility, after which the member could utilize either the regular facility or the Trust Fund.

The United States suggested differentiated terms and sources of funding for compensatory financing loans from the Trust Fund based upon the per capita income of the borrowing countries. Those with incomes below U.S. $375 per capita could borrow at concessional rates (2 to 3 percent) over 10-12 years. The funds would come from the sale of IMF gold, donor country contributions and borrowed funds. For those countries with per capita incomes of U.S. $375-1,000, drawings would be financed by medium-term borrowings, and the country would repay over 5 to 8 years with interest at a rate to cover the cost of financing.

The United States proposal was an attempt to liberalize the existing IMF facility by redefining the compensable shortfall, increasing the amount which could be drawn, and by linking the IMF's compensatory finance facility to the proposed Trust Fund to ease the financial burden on poorer countries and increase the amount of funds available to all LDCs in relation to specified commodities.

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[36]*IMF Survey* Vol. 21, No. 27, July 11, 1969, p. 213 and Vol. 22, No. 48, December 4, 1970, p. 393.

Implementation of Modifications to the IMF's Compensatory Finance Facility

On December 24, 1975 the IMF modified the conditions of the compensatory finance facility,[37] adopting most of the Kissinger proposals. The size of the drawings was increased but these drawings were not limited to LDCs and thus the limit was increased to only 75 percent of quotas rather than 100 percent. Up to 50 percent could be drawn in a twelve-month period. The common limitation on outstanding drawings under the compensatory financing and buffer stock financing facilities was abolished and the computation of the compensable shortfall was modified. This last point had posed serious problems because of the rampant inflation in the 1970s. Different approaches to this problem were considered. "One solution was to measure shortfalls in real terms by dividing nominal earnings by a price index taken as unity in the shortfall year. This solution was studied but not adopted. Instead, it was decided to conduct, as in the past, all calculations in nominal terms, but to eliminate any forecast limit."[38] The modification was more liberal than the United States formula and will permit larger drawings during periods of inflation. The language in the decision reads: "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 preceding years." If the IMF finds the result not reasonable it will employ a "judgmental forecast." This formula is to be reviewed not later than March 31, 1977. If the drawings in any twelve-month period exceed SDR 1.5 billion (approximately U.S. $1.8 billion) or outstanding drawings exceed SDR 3 billion (approximately U.S. $3.6 billion) the rules of the entire facility will be reviewed.

The Kissinger proposals relating to the Trust Fund were not adopted at the same time because the IMF had not worked out the procedures for its gold sales. Subsequently, the Interim Committee of the IMF Board of Governors met in Kingston, Jamaica on January 7 to 8, 1976. As stated in the Press Release on this meeting:[39]

> 6.(a) it was agreed that the necessary steps should be taken to establish the Trust Fund without delay. Its resources would be derived from the profits of the sales of the Fund's gold, which should be augmented by voluntary national contributions. It was agreed that the amount of gold available for sale in accordance with the agreement reached by the Committee at its fourth meeting should be disposed of over a four-year period. The resources of the Trust Fund should be used to provide balance assistance on concessionary terms to members with low per capita incomes. Initially, eligible members would be those with per capita incomes in 1973 not in excess of SDR 300.

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[37] *See* Press Release No. 75/65 of the IMF dated December 29, 1975 and the attachment which is the 1975 decision.

[38] GOREUX, L. COMPENSATORY FINANCING OF EXPORT FLUCTUATIONS: APPLICATION OF THE 1975 DECISION. Appendix II, p. 10, IMF 1976.

[39] *See* Press Release No. 76/1 of the IMF dated January 8, 1976.

On May 6, 1976 the IMF announced that its first auction of gold would be held in Washington, D.C. on June 2, 1976 and that the Trust Fund had been established.[40] Sales of one-sixth of the IMF's gold (25 million ounces) will take place over a four-year period. To date two sales of 780,000 ounces and 750,000 ounces have taken place at prices of U.S. $126 and U.S. $122 per ounce, respectively.

The Trust Fund will receive the profits from the sale, equal to the difference between SDR 35 per ounce (approximately U.S. $41) and the auction price. Sixty-one countries with per capita incomes of U.S. $400 or less, listed in an Annex to the decision, are eligible for Trust Fund loans on concessional terms to carry out balance of payments adjustment programs. Repayments will be in ten equal semi-annual installments—beginning not later than the end of the first six months of the sixth year in which the loan was made. Payment must be completed at the end of the tenth year after the date of the initial disbursement. Interest is to be charged at the rate of one-half of one percent per annum on the outstanding balance of a loan in semi-annual installments.

The Trust Fund provides an additional source of low-cost funds to poorer LDCs. It does not go as far as the Kissinger proposal in permitting loans to be converted into grants. However, the low interest rate and long repayment periods may make it more attractive than the Kissinger proposal.

Conclusion

Most of Secretary Kissinger's proposal for a development security facility has been or is in the process of being adopted. It has resulted in an expansion and liberalization of the IMF's compensatory finance facility. This is perhaps most clearly illustrated by the following figures: during the entire twelve-year period from the establishment of the compensatory finance facility in 1963 to December 24, 1975, when the IMF modified the facility's conditions along the lines of the Kissinger proposal, total drawings amounted to only U.S. $1.46 billion.[41] From December 24, 1975 to the present time, drawings have totalled over U.S. $2 billion[42]—a truly dramatic increase.

On the whole, both the developed and developing countries have supported the Kissinger proposal. However, LDCs consider compensatory financing to be no more than a small part of their proposed integrated commodity program. In their view it is a necessary but not sufficient condition for economic development.

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[40]The text of the decision and instrument to establish the Trust Fund has been reproduced in IMF Survey Vol. 5, No. 10, May 17, 1976, p. 147 *et. seq.*

[41]GOREUX, L. *op. cit.* p.1.

[42]Conversation with L. Goreux at International Monetary Fund.