Appendix 1

'Joint Guarantees' and the Evolution of a World Development Fund: a Scheme

Guarantee Arrangements

1. It was suggested in Chapter 3 that central bank cooperation which would have the effect of recycling OPEC surpluses off-market and through the IMF, could also facilitate the negotiation of 'jointly shared guarantees' between governments, which alone could place this lending on a longer-term footing. These guarantees in turn could lead to the establishment of a World Development Fund. It is therefore necessary to consider in more detail the alternative guarantee arrangements which might be available for supporting long-term lending.

2. At least three types of guarantee arrangement are open to governments to establish among themselves for the purpose of underwriting any flotations of bonds raised in the capital markets, irrespective of whether they are to underpin any permanent new development agency.

3. The first and simplest type of guarantee would be a 'full joint and several guarantee' of the bonds of the participating governments. Each government would, under such a guarantee, be liable for the full amount of the guaranteed obligations and a bondholder could make a claim against any single guarantor for the full amount due. The guarantor governments could, by arrangement, determine the proportion of their respective liabilities as among themselves, and any guarantor paying a bondholder more than its agreed share could recover from the other guarantors.

4. Secondly, and at the other extreme, would be a 'several guarantee' under

which each government would guarantee only a specified proportion of each bond. This would present greater difficulty for bondholders since, unless special arrangements were made, it would be necessary in the event of a default to make a claim against each guarantor government.

5. A third and intermediate possibility would be an arrangement under which each member government, while giving only a 'several guarantee', would contribute, in an amount based on the proportion of the bonds guaranteed by it, to a fund in which the bondholders would share if there were a default. This approach is illustrated by the Austrian Government Guaranteed Loan (1923-43) arranged by the Financial Committee of the League of Nations. The net effect of such an arrangement would have many of the characteristics of, but would fall short of, a 'full joint and several guarantee'. It is this third approach which may be described as a 'limited joint and several guarantee'.

6. This type of guarantee would be somewhat similar to the arrangement by which the member governments of a development agency 'guarantee' that agency's obligations on the basis of its callable capital. Strictly speaking, bonds issued by the agency are not guaranteed by the agency's member governments. However, in case of a default on its bonds, or to prevent a default, the agency can call for payment of the callable as distinct from paid-in capital of its member governments and use the amounts received to make the required payments on its bonds. Each government's obligation to make payments on such calls is not dependent on payment being made by other member governments and, since successive calls may be made until sufficient funds are available to pay the obligations of the agency, the system is very like a 'joint and several guarantee'. But since each government is liable only to the extent of its uncalled capital, such a system is not equivalent to a 'full joint and several guarantee', as no single government can be liable for the total amount being guaranteed by all participating governments together.

7. It follows from this account of possible guarantee mechanisms that any desired system of guarantees can be established among participating governments prior to the formal setting up of an agency. Indeed, in the case of the Brandt Commission's proposed new institution the transitional stage involving 'jointly shared guarantees' between governments could well take the form of their establishing a system of 'limited joint and several guarantees', along the lines of the Austrian loan guarantee procedure referred to above. This would enable them to raise funds pending the formal establishment of a new institution in a manner which would obviate the need in the first instance for the formal putting in of capital subscriptions. Such a system could also be set up pending the subsequent joining in with the institution of governments which may not initially participate in the guarantees. All that would be

required would be for the guarantor governments to designate an entity endowed with a legal personality – which could indeed be one of the participatory governments – to raise funds on the strength of their collective guarantee. The funds that would be raised could include the proceeds of off-market reserve diversification arrangements referred to earlier, which would have initially been channelled through the IMF, pending the setting up of the selected system of guarantees.

8. Once a system of 'limited joint and several guarantees' has been instituted, the guarantees could be converted subsequently into the callable capital of a permanent lending institution, though further negotiations will be required to determine its paid-in capital. In the light, however, of the difficulties that are likely to arise if negotiations were conducted on a world-wide basis, it has been suggested that both the system of guarantees and the subsequent negotiations for paid-in capital should be conducted sequentially and, to begin with, at the level of interested countries. This will mean that at an early stage 'jointly shared guarantees' among interested governments would have been operative which could lead in the next stage to the setting up of an institution involving these same governments. This approach has been suggested both because of the urgency of the balance of payments needs of non-oil developing countries and because of the existence of a willingess among OPEC governments to proceed somewhat along these lines, as evident by a recent proposal[1] to transform the OPEC Speciál Fund into a Development Agency.

The OPEC Agency

9. The two stages suggested above, namely, first the elaboration of a system of 'limited joint and several guarantees' among interested governments and second their conversion into the callable capital of a new institution, could first be applied to the proposal for transforming the OPEC Special Fund into a Development Agency. What would be required, in the first place, is the adoption in the context of the proposal, *mutatis mutandis,* of the mechanism for elaborating 'limited joint and several guarantees' by interested OPEC governments, so that the OPEC Special Fund itself is enabled to disburse monies in advance of the formal commencement of operations of the proposed Agency.

10. The current proposal envisages an Agency with a capital of $20 billion

1. Joint proposal by the Algerian and Venezuelan delegations on *The need for additional financial cooperation between OPEC member countries and other developing countries,* presented to the LV Conference of OPEC Ministers, Caracas, 17 December 1979.

to be fully operational by 1983 with half the capital, that is $10 billion, paid-in. The Agency's operations, however, are expected to commence at the beginning of 1981 on the basis of $5 billion paid-in capital and a total initial capital of $10 billion. The difference between paid-in and total capital would constitute callable capital which would support the raising of funds in capital markets on terms yielding normal commercial returns to countries which subscribe to the bonds of the Agency. There is a built-in provision to facilitate the participation of non-OPEC developing countries in the Agency from the outset; the Special Fund's outstanding loans to developing countries, amounting to $1 billion, will be treated as part of the paid-in capital of the Agency, which would enable loan repayments by developing countries to be counted in their capital subscription.

11. The Agency would undertake the following activities :

(i) financing of balance of payments deficits ;

(ii) financing under favourable terms of economic and social development projects recognised by recipient countries as priority projects, including the development of renewable and non-renewable sources of energy ;

(iii) financing of projects intended to reinforce integration between developing countries in order to promote their collective self-reliance ;

(iv) financing of projects intended to upgrade the value of the raw materials produced by developing countries ;

(v) underwriting of export credits between developing countries, especially in the area of energy supply ;

(vi) financing of commercial operations of developing countries under market conditions ; and

(vii) underwriting loans floated by developing countries on financial markets.

The Agency is thus conceived of as a Third World body designed primarily to promote collective self-reliance within its membership, involving 'jointly shared guarantees' between OPEC and other developing countries.

12. An outstanding feature of the proposal is the conservative capital structure that is envisaged, implying a paid-in capital at all times of 50 per cent. This compares, for instance, with the 20 per cent ratio of the paid-in capital to total capital with which the World Bank commenced operations, and the 7 per cent ratio underlying the World Bank's current capital increase.

The reason for the conservatism is explained in the proposal by the need to utilise part of the Agency's capital to subsidise lending. There are, however, alternative ways of introducing an acceptable element of concessionality while enhancing the lending potential of the $9 billion worth of additional resources which the OPEC members are expected to contribute to the Agency.

13. Assuming that an acceptable degree of concessionality is provided by Third Window terms, a 'once-for-all' contribution of $1 in cash generates the required interest subsidy for $4 worth of lending, provided that the $4 is raised at 8 per cent, roughly the current rate for Deutsche Mark denominated bonds, and that the borrowing is supported by a system of 'joint and several guarantees'. On this basis the undisbursed portion – $2 billion – of the cash amount of $ 2.4 billion with which it is intended to replenish the OPEC Special Fund this year can be treated as a 'once-for-all' interest subsidy contribution for supporting programme lending on Third Window terms. If a similar cash amount for the same purpose were to be available for interest subsidy purposes in 1981, lending up to a total of $16 billion would become possible during 1980-1981. Since $4 billion of the $10 billion contribution called for in the original proposal would have been so set aside, only the balance of $6 billion (of which $1 billion will be the non-OPEC developing country contribution) will remain available to be reckoned, *strictu sensu*, for paid-in capital purposes. This procedure would thus imply the creation of an Agency with a total capitalisation of $22 billion, $6 billion of which will be paid-in capital, with a ratio of paid-in to total capital of 27 per cent; and a 'once-for-all' interest subsidy contribution of $4 billion would enable it to lend up to $16 billion on Third Window terms.

World Development Fund

14. Further, if the developed countries were to provide, as suggested in Chapter 3, equal and matching contributions for both interest subsidy and paid-in capital purposes, an embryonic World Development Fund could be established with an initial size of $44 billion. It would have a paid-in capital of $ 12 billion, of which $5 billion would be provided by OPEC countries, another $ 5 billion by developed countries and $ 2 billion by developing countries; the last-mentioned amount would be generated, as under the above proposal for the OPEC Agency, by treating the debt service payments of non-OPEC developing countries as their contribution to the paid-in capital. There would be in addition a 'once-for-all' interest subsidy contribution jointly provided by OPEC and the developed market economies of $8 billion, permitting a total lending on Third Window terms of $32 billion that will have been borrowed in capital markets.

15. With the implementation of the current round of SDR allocations, most of the amount required for the above purposes from developed countries could be raised by drawing on counterpart national currencies in respect of their SDR allocations, thus avoiding any additional burden on their government budgets. A total of SDR 8 billion will be available for the years 1980 and 1981, of which 70 per cent, or nearly SDR 6 billion will accrue to the developed countries under the current rules governing the SDR allocations. The equivalent of over $7 billion, which could voluntarily be parted with in the form of counterpart national currencies, will implement in effect the 'link' proposal now also endorsed by the Brandt Commission without needing an amendment of IMF articles.

16. It would be reasonable to expect that a Fund of this magnitude, involving developed countries as well, would be in a position to widen its range of activities as compared with those listed above for the transformed OPEC Special Fund. Specifically, the missing elements in the current system of development finance as suggested by the Brandt Commission could be added to the functions of the new institution. These would include, in particular, finance for reinforcing regional integration efforts (for providing the necessary external line of credit) and a project focus in the area of energy and food.

17. Finally, it should be noted that, as far as the transitional period is concerned, if the OPEC Special Fund were to proceed on the basis suggested above, the $2 billion cash resources available to it in 1980 would enable it to raise, on the basis of supporting guarantees from OPEC governments, up to $8 billion to be disbursed on Third Window terms by simply using the $2 billion as a 'once-for-all' interest subsidy contribution. This amount of $8 billion would be within the range of additional financing that would be required by non-oil developing countries in 1980 and provide some margin for carrying-over into 1981. A proportion of the funds raised in 1980 could be used to finance a rebate, as suggested in Chapter 3, on the incremental oil-bill of the low-income non-oil developing countries.

18. The bulk of the lending in this transitional phase would need to be for the financing of the balance of payments deficits, which is listed as the first of the functions to be undertaken by the proposed OPEC Agency. This lending would need to be on the basis of conditionality that is, at the same time, stringent enough to encourage the required structural adjustments, for example, to a higher and possibly rising level of prices, and easy enough to encourage countries to have ready recourse to it. While no generalised rule can obviously cover individual cases, this suggests, as a guideline, a degree of conditionality somewhere between the IMF reserve tranche and upper

tranche conditionality, that is, first credit tranche conditionality with modifications. It does not seem useful to specify in any greater detail at this stage the patterns of conditionality within which the Agency should work, except to say that the kinds of modification to current IMF practice recommended in the Brandt Commission's report would apply *a fortiori* to the functions of the Agency from the outset.

Appendix 2

Members of the Group of Experts

Prof. H.W. Arndt (Chairman)	Professor of Economics, Research School of Pacific Studies, Australian National University, Canberra.
Prof. A.D. Brownlie	Vice-Chancellor, University of Canterbury, New Zealand.
Sir Alec Cairncross	Chancellor of the University of Glasgow; formerly Master of St. Peter's College, Oxford and Head of UK Government Economic Service 1964-69.
Dr. William G. Demas (Vice-Chairman)	President, Caribbean Development Bank, Barbados.
H.E. Dr. Lal Jayawardena	Ambassador of the Republic of Sri Lanka to Belgium, Netherlands and Luxembourg and the European Communities. formerly Secretary to the Treasury and Secretary, Ministry of Finance and Planning, Sri Lanka.
H.E. Mr. W.J. Jenkins	Ambassador of Canada to Saudi Arabia; ex-Vice President (Policy), Canadian International Development Agency.
Mr. D.C. Mulaisho	Special Assistant (Economic) to the President of Zambia.
Mr. Ramon V. Navaratnam	Deputy Secretary-General, Ministry of Finance, Government of Malaysia.
Prof. H.M.A. Onitiri	Director, Nigerian Institute of Social and Economic Research, University of Ibadan, Ibadan, Nigeria.
Prof. Amartya Sen	Drummond Professor of Political Economy, Oxford University and Fellow of All Souls College, Oxford; formerly Professor of Economics, Delhi School of Economics, India.

Secretariat	(Economic Affairs Division, Commonwealth Secretariat)
Dr. Bimal Jalan	Director
Dr. B. Persaud	Assistant Director
Mr. Q.S. Siddiqi	Assistant Director
Mr. I.R. Thomas	Chief Economics Officer