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Agenda Item 15

Attached is a copy of a paper entitled "Operating a Stabilization Mechanism" which is for discussion under Agenda Item 15.

Attachment

Distribution:

CG Members
TAC Members
TAC Chairman
TAC Secretariat
Center Board Chairmen
Center Directors

Operating a Stabilization Mechanism

Purpose of Paper

1. The need for a stabilization mechanism for use in funding the CGIAR was analyzed in a paper 1/ prepared by the CGIAR Secretariat, dated April 18, 1983, that was discussed by the Group at its May 1983 meeting in Paris. At that meeting the Group collectively welcomed the concept of a stabilization mechanism, recognizing that it addressed important funding and program management issues at the centers. It also welcomed the willingness of the World Bank to provide start-up funds for such a mechanism. The Group requested the CGIAR Secretariat to prepare a paper explaining how it would operate and be administered. The stabilization mechanism was discussed with Center Directors and TAC at their meeting in Tunis in June - July 1983, where both groups strongly supported it. This paper deals with the purpose of the stabilization mechanism and how it will function and be administered. The paper will be discussed by the Group at International Centers Week 1983.

Background

2. As indicated in the April 1983 paper, uncertainty about funding levels extending well into the budget year has become an important concern of centers. The degree of uncertainty about funding, which has increased over the last few years, has caused difficulties in financial planning for the centers and has led in some cases to suboptimal use of funds. At the beginning of the year, with a considerable proportion of the total funding uncertain, centers have tended to be conservative and set program levels well below their approved programs. Recruitment of staff to fill vacancies and the starting of new programs have been postponed. When, later in the year, available funds came close to the approved program level it has been too late to use the funds for the postponed activities. Instead, the funds have been used for replacement of equipment, capital expenditures, increase in working capital, creation of new reserves, or have had to be carried forward to the following year. A more accurate assessment of the likely availability of funds earlier in the year would have permitted a more efficient use of the contributions received.

3. Three factors cause this uncertainty: (a) lack of timely knowledge of donors' contributions and of their allocation among centers, (b) fluctuations in the dollar value of contributions pledged and disbursed in currencies other than the US dollar; and (c) uncertainty with respect to levels of inflation and the movement of exchange rates for currencies in which expenditures are made.

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4. The remedy to the first of these factors lies with donors. Timely notification of donors' contributions and allocations among centers is very important. In January 1982 the secretariat advised centers of the funding prospects for 1982 based on information received from donors at or after ICW 1981. Of the total amount of contributions estimated at that time, two thirds were confirmed and allocated among centers. The exact amount and allocation of the balance was uncertain. In January 1983 only one third of the total contribution for 1983 had been confirmed and allocated.

5. Some donors, for institutional reasons, are not in a position to provide firm information on either the level of their contributions or their allocation until well into the year. This is mainly the case for those donors whose fiscal years do not correspond to the calendar year used by the CGIAR system. Since some major donors are in this position, the dollar amount involved is quite substantial. Uncertainty about what donors will eventually do in turn causes the World Bank, acting as donor of last resort, to postpone allocating its funds until well into the year. This can compound the problem for the centers.

6. Donors are therefore urged to provide the secretariat as early as possible with information on the level and allocation of their contributions. Donors confronted with differences in fiscal years could perhaps give a general indication that would permit the secretariat to make reliable estimates. For example, they might confirm that neither the system nor any center would receive less than the year before in terms of donor currency. All donors are also urged to avoid changing patterns of planned contributions during the year (such as shifts between core and special project funding).

Purpose of Fund

7. Incomplete or uncertain information on donors' contributions and their allocation among centers is an important factor of instability, as are changes in donor intentions during the year. It is not desirable, however, that the stabilization mechanism be used to make up for shortfalls in contributions by donors to the system, or to individual centers, because this could constitute a disincentive for donors to contribute as much as possible.

8. Over the longer term it is hoped that the funds at the disposal of the system for stabilization may become large enough so that they can help the system to adjust to major shifts in the level of contributions. A significant reduction in level could occur from one year to the next through voluntary or involuntary action by one or more important donors. Such an event could have a serious impact on the centers affected. A stabilization fund large enough to ease such a transition is not in sight for the present. However, for this and other reasons it is desirable to manage the stabilization fund so as to build up its level from year to year, insofar as this can be accomplished given short term needs.

9. The principal purpose to which the stabilization mechanism could be devoted in 1984, would be to compensate centers for two kinds of unforeseen losses; for losses caused by variations in the exchange rates of the currencies in which contributions are made, and losses due to unforeseen inflation not compensated by changes in the exchange rates of the currency in which expenditures are made. Unforeseen problems of other kinds, (but not, as noted above, failure of a donor to make a pledged or expected contribution) would also be considered as grounds for the use of stabilization resources. Other remedies, such as emergency contributions, would be considered as well.

10. In addition to making payments to centers, the fund would also receive payments from centers that obtained windfall gains because of the same kinds of events.

11. Since it is not desirable to make a lot of small payments into or out of the stabilization fund, and since the calculation of some of the changes involved cannot always be precise, payments would not be made if the changes involved were minimal.

12. In addition, some account needs to be taken of the overall financial condition of the particular center in relation to that of other centers. It would not seem appropriate, for example, to make payments from the stabilization fund to a center that has received contributions putting it at the top of or above its approved bracket, when other centers were close to the bottom of the bracket. Similarly, a center below the bottom of the bracket should not be asked to give up a windfall, if other centers are doing much better in relation to their approved budget levels.

Operational Procedures

13. At the beginning of the year the secretariat would advise centers, as it does now, of the pledges made and amounts allocated to each center on the basis of information which the secretariat considers reliable. The exchange rate used would be that for January 1, or a date shortly before. Any difference between this rate and the exchange rate in effect when the center actually received the contribution would be a potential claim on, or obligation to, the stabilization fund. There should be few problems, working with the centers, in calculating the amount involved.

14. All centers' budgets have a built-in provision for price increases which is assessed on the basis of: (a) distribution of expenditures among different currencies used; (b) estimated domestic inflation in centers' host countries and other countries where they operate; (c) estimated fluctuation of these countries' currencies against the US dollar; and (d) estimated inflation rate in the US dollar market. These estimates have to be made 18 to 24 months in advance and are subject to large errors. If it transpired during the year that the combined effect of all four factors had resulted in a significant underestimation of the overall price provision for any one center, that center would have a potential claim on the stabilization fund. If it transpired that such factors had been substantially overestimated, there would be a potential claim by the fund on the center.

15. Identification of changes in exchange rates is a relatively simple matter. Assessment of the impact of inflation is more complex, particularly when dealing in a variety of markets, as is the case for all centers. Although price changes shown in cost of living indexes are not always good proxies for the price changes actually experienced by centers, there is no agreed methodology yet for a better approach. Moreover, information is collected and becomes available only after considerable delays. Some kinds of price changes are a result of management decisions, and are thus appropriate for consideration in the budget process. For example, the level of salary increases may fall into this category. Others may be outside management control. For example, the level of salaries and benefits may be dictated by decisions of local or national authorities. The secretariat will be in close touch with the centers on a continuous basis, to review price changes in countries where major expenditures are made by the centers, as well as any other changes affecting the centers and, to compare them with the assumptions built into the centers' budgets.

16. At the end of September each year potential claims would be calculated for each center. Payments would then be made to the center, or a contribution requested from the center. Additional potential claims for the balance of the year would be considered as they arose.

Funding and Management

17. The stabilization fund would be open to contributions from CGIAR members, preferably out of increments to their regular contributions to the CGIAR supported centers' programs.

18. Funds will accumulate through contributions from donors, balances rolled over from one year to the next, proceeds of investing the monies and funds paid in by the centers.

19. If for any reason a center is not able to make a payment to the stabilization fund during the year in which the obligation is incurred, the obligation would be carried over into the next year.

20. The secretariat would manage the funds with the assistance of the World Bank (for investment) and report each year at Centers Week on the status of the fund. This would include the level of funding, proceeds from investment and how the funds had been used to the benefit of the centers and/or the system. An audited statement would be provided each year.

Establishment of the Fund

22. The World Bank has increased its contributions for 1984 from 10% to 12.5% of estimated requirements to allow the establishment of a stabilization fund. It is proposed that the stabilization fund be set up immediately after the Group has given its consent, using the World Bank contribution only, if necessary.

23. The initiation of the stabilization mechanism in 1984 depends on the Group's agreement. It also depends on the level of funding provided by donors in 1984. The Group will probably not wish to initiate a stabilization fund at the expense of cutting deeply into centers' approved 1984 programs and budgets. If available funds do not reach, or only barely reach, the minimum funding requirements of 1984, as recommended by TAC, the Group might wish to postpone the initiation of the mechanism and use all available funds to support the 1984 programs.

24. The funding prospects for 1984 will be presented to the Group by the secretariat based on pledges made during Centers Week. At that time, the secretariat will make a recommendation regarding the amount to be set aside for the stabilization mechanism in 1984. When approving centers' programs and budgets for 1984, as recommended by TAC, the Group will also be asked to approve the amount set aside for the stabilization mechanism. The Group should also provide the secretariat with guidance on the action to be taken should the funding situation change markedly in the interval between International Centers Week and the opening of fiscal 1984.

25. If the concept and approach to the operation of the stabilization mechanism is approved, and funding prospects permit, the secretariat will notify centers of 1984 funding prospects in the context of a stabilization mechanism as described above. The secretariat will subsequently report to the Group at each meeting, and between meetings as required, on the status and use of the stabilization mechanism.

Next Steps

26. The Group is asked to approve the proposed concept and operating modalities described above so that, if funding prospects for 1984 permit, the stabilization mechanism can be set up immediately.

27. Those donors who can contribute to such a mechanism under the modalities set out above (e.g. delegating management authority to the secretariat, allowing funds to be invested and held indefinitely) are asked to inform the secretariat of their willingness to contribute, the amount of the contribution and the timing of its disbursement.