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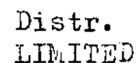

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AFRICAN DEVELOPMENT BANK
QUESTIONS RELATING TO THE USE OF MEMBER CURRENCIES

(Note by the Executive Secretary)

63-615

INTRODUCTION[1]

1. The Note on the Currency of the Equity Capital of the Bank (E/CN.14/FMAB/8), deals with the desirability for the Bank of obtaining its paid-up, as well as its callable, capital in convertible currencies: since during the early years of its operations, when the Bank will want to rely on its paid-up capital, it will have little use for most members' currencies, while its credit worthiness for obtaining needed additional resources through borrowing will, to a significant extent, depend on its ability to offer to potential lenders the guarantee that its callable capital is payable in the convertible currencies which it needs to borrow.

I. LOANS BY MEMBERS UNDER THE BANK'S SPECIAL BORROWING POWERS

2. Hence there is no expectation that for some years to come the Bank will need or use currencies of all its members. Circumstances may, however, be anticipated in which it can utilize currencies of some member countries. Thus, while none of the African countries is as yet either a capital exporter or, to any significant degree, a producer of capital goods or technology, some industries do exist in some member countries or are in the process of being established, whose products could be used for the development projects located in other member countries. It would clearly be wasteful for the Bank to purchase these currencies with its convertible currency resources which, under the best of circumstances, will not satisfy the combined needs of all its members. On the other hand, the amounts which the Bank is likely to need in any one member currency are bound to be limited, and will, moreover, be drawn chiefly from the more developed member countries which are in a position to produce the required goods and services.

1/ Mr. Abdul G. El Emary, on leave, from the International Finance Corporation, formerly Governor of the Bank of Egypt, served as a Consultant to the Executive Secretary in the preparation of this Note.

7. On these bases, the amounts to be loaned by the relatively more developed member countries could certainly be provided either out of budgetary resources or through the Central Bank, and will not, therefore, constitute a heavy burden on the lending members.

8. Within these limits which are designed to safeguard the interests of the lending member, the Bank's power to require these loans in case of need would have the following advantages:

(a) It would demonstrate once more the principle of self-help among African countries in the promotion of the development of Africa.

(b) It would also demonstrate the principle of African solidarity, in that the relatively more advanced and wealthier countries would provide additional resources for development projects in the other countries.

(c) As a practical advantage, it would serve to promote intra-African trade. It is evident that trade between African countries is almost non-existent, with the exception of certain agricultural food products; yet some industries are established or under establishment in several African countries, whose products might be utilized in the development of other member countries.

(d) It could facilitate the use of any surplus technical personnel who may be, or may become, available in the more developed member countries for use on development projects in other member countries.

(e) It would enable the Bank to reserve its scarce resources in convertible currencies for needed purchases from non-member countries.

9. The special borrowing powers of the Bank may become less important as capital markets develop in different member countries. The Bank will resort to these markets as they become available for the floating of its securities. Until such time, however, the scheme here outlined will be of great importance to the effective financial management of the Bank.

II. FINANCING OF LOCAL EXPENSES ON DEVELOPMENT PROJECTS[1]

10. A point closely related to the foregoing problem concerns the question whether the African Development Bank should finance expenditure incurred not only in foreign exchange but also in the currency of the member country in which the project in question is carried out (The latter is defined as "local currency" in the Draft Agreement - see Art.16) or whether it should limit its activities to the financing of foreign currency expenditure only.

11. In order to facilitate further consideration of this issue, it may be useful to analyse the resources which are likely to be at the Bank's disposal, - especially in the early years of its existence.

12. It is provided that the actually paid-up part of the Bank's capital will amount to $ 100 million in the fifth year of its existence. The Bank may be able to secure additional resources by way of loans and grants. The latter resources will either be in convertible currencies, or in non-convertible currencies of lender countries (in which case they may be tied to purchases from these countries) or in funds in currencies of some of the Bank's member countries resulting from the proceeds of the sale of surplus products supplied by the donor countries. Only in the last case, would the Bank have member currencies which it could reasonably use to contribute to the financing of the local expenses of a development project. But the Bank would be wasting its foreign currency resources, if it financed local currency expenditure in respect of a project by the sale of some of its foreign currency resources. These foreign currency resources, no matter how plentiful they might be, will not satisfy the pressing foreign currency needs of Africa. This is the reason for the wording of Article 16 of the Draft Agreement[2].

13. Even if, one were to provide in the Agreement that as much as one-fourth or one-third of the paid-up capital might be effected in members' non-convertible currencies, the amount in each member's currency thus put

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1/ See Article 16 of the Draft Agreement. (Doc. E/CN.14/FMAB/4/Add.1).

2/ See also the discussion of this issue in the Note on the Currency of the Equity Capital. (Doc. E/CN.14/FMAB/8).

at the disposal of the Bank would be insignificant in relation to the local currency requirements of even a single development project located in such member's territory. In fact, this would be the only use the Bank could make of most member currencies if it were to receive them as part payment of the paid-up portion of their capital subscriptions. To the extent to which they would be paid in non-convertible local currency, therefore, they would have to go right back to the member in question (as a contribution to local currency costs). They would thus in reality add nothing to the Bank's real resources, while the Bank's credit position in the world capital markets would be correspondingly weakened, if a portion of the paid-up part of the capital were to be effected in local currencies.

14. On the other hand, from the point of view of the members, there need be no fear that any of them would face inflationary problems as a result of having to resort to deficit financing, even up to one-third of their capital subscriptions, as a result of financing part of the local expenses of projects whose foreign currency costs were being financed by the Bank. Such deficit financing up to the equivalent of, e.g. $330,000 in the case of small countries, or $ 10 million in the case of large countries[1], would not by itself be of a size to place inflationary pressures on their respective economies.

15. There may be cases, however, where a project indirectly gives rise to an increase in the demand for foreign exchange in the country in whose territory it is carried out. These are exceptional cases and they must be examined as such by the Bank's management. In such cases, the management might find it necessary to grant finance in convertible currencies to meet a reasonable proportion of the local expenses[2] on the project.

1/ On the basis of a minimum of $ 1 million subscription for small countries and of a maximum of $ 30 million subscription for large countries.

2/ To the same effect, see IBRD, Art.IV(3); IDA, Art.V(2)(e); IADB, Art.III(6).

16. Except for this situation and that described in paragraph 12 above (where the Bank receives member currencies directly from non-African grantors), it would therefore be advisable for the Bank to restrict its operations to the financing of foreign currency costs of development projects at least during its early years.

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