CHAPTER 1

AID AND EXTERNAL FINANCE FOR THE NON-OIL DEVELOPING COUNTRIES

External Financial Position

Since late 1973, the non-oil developing countries have been confronted with the need for heavy external financing to cover substantially enlarged current account deficits in spite of sharp reductions in their economic growth rates. The reasons for the larger combined deficit,[1] which emerged in 1974 and increased further to $ 37.0 billion in 1975 from $ 28.4 billion in the previous year, are well known. These included the steep increases in import prices of petroleum, manufactured goods and essential foods on the one hand, and the end of the short-lived commodity boom and the deepening influence of the recession in industrialised countries on exports from the developing countries on the other.

The impact of the world recession was felt much more severely in 1975 than in the previous year. The demand for the exports - other than oil - of developing countries fell in 1975 by nearly 10 per cent. Most of this effect was concentrated in middle and higher income developing countries whose exports are more sensitive to changes in demand; the growth rate in their export volume was reduced to 1.3 per cent a year in 1973-75 from over 8 per cent between 1967-73. While the volume of exports from poorest countries - those with per capita income of less than $ 200 - was less affected, these countries, with few exceptions, were seriously hit by sharp declines in commodity prices, upon which most of them depend for foreign exchange earnings. At the same time, the import bills of all groups of developing countries were increased by high oil prices and by continuing rises in prices of manufactures, as inflation in the industrialised world continued despite the recession.

The worsening balance of payments situation forced non-oil developing countries to reduce their level of economic activity in order to bring current account deficits more into line with available financing. External borrowing had enabled the middle income countries to avoid a sharp deceleration in growth rates in 1973 and 1974; but a pronounced fall in the rate of growth took place in 1975. The poorer countries grew at a rate barely higher than their population increase during 1973-75 and even their growth rate was possible only because of good harvest towards the end of the period in some of the largest poorer countries.

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1. Current account deficit figures and those on their financing in the following section are IMF estimates on a balance of payments reporting basis. Data of resource flows in the remainder of the report, derived from the DAC sources are not directly comparable with those on the balance of payments basis. For aggregates, DAC also uses a wider list of non-oil developing countries than that used by the IMF.

Beyond 1975, growth prospects in both the poorer and the middle income developing countries depend to a large extent on substantial availability of external finance on appropriate terms, particularly in view of the continuing difficulties deriving from the slow recovery from the world recession and the sharp increases in future debt service payments on recent borrowings by the middle income developing countries. Domestic adjustment measures can bring a significant reduction in balance of payments deficits only through reducing even further the recent low growth rates. The increased borrowings in recent years have been largely used for sound investment and developmental purposes; these will assist in improving the economic performance in future, provided that a favourable external economic environment exists; their effect could, however, be reduced if the momentum of growth is halted.

The experience of the Commonwealth developing countries, in terms of enlarged deficits and low growth rates, was not generally dissimilar to that of other non-oil developing countries. A number of Commonwealth countries were among those which had to take sharp adjustment measures in 1975, while some others were able to avert a sharp curtailment in their growth rate only with the help of external borrowing. As a group, the Commonwealth developing countries do not, however, make use of commercial borrowing to the same extent as do some other non-oil developing countries. While their share of total official flows increased in 1975 the Commonwealth developing countries accounted for only 17 per cent of overall net flows of external resources, including private flows, to non-oil developing countries, as against 21 per cent in 1974.

Financing Deficits

Taken as a group, the non-oil developing countries financed a large part of the $ 37 billion combined deficit in 1975 through a further escalation of net borrowings from both official and market sources; they also drew on their reserves during the year. Net borrowings from all sources (official, commercial and the IMF), adjusted for reserve accumulation, financed 71 per cent of the 1975 deficit, compared with 68 per cent in 1974 and only 46 per cent during 1970-73.

On a balance of payments basis, "net official flows"[1] (excluding the IMF) increased from $12.7 billion in 1974 to $18.7 billion in 1975, most of the increase being in the form of semi-concessional or non-concessional flows; net transfers which do not affect the debt position of the non-oil developing countries increased by only $1.2 billion.

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1. Net official flows include grants and concessional loans from official agencies as well as "Other Official Flows" (OOF). This later category mainly includes: official export credits; official loans for development purposes whose grant element is below 25 per cent; purchases by central monetary institutions of bonds issued by multilateral agencies; and acquisition by the official sector of equity investment in other countries.

Financing of Current Account Deficits of Non-Oil Developing Countries

US $ billion

	1974	1975
Current account deficit [a]	28.4	37.0
A. Financing through transactions that do not affect net debt positions	9.1	10.0
Net unrequited transfers received by governments of non-oil developing countries	4.9	6.1
Direct investment flows, net	4.2	3.9
B. Long-term loans received by governments from official sources,net	7.6	12.6
C. Other net borrowing and use of reserves [b]	11.7	14.4
Long-term borrowing from non-residents (other than official sources), net	8.7	9.3
From private banks abroad	7.0	8.5
Through suppliers' credits	0.8	1.3
Other sources [c]	0.9	-0.5
Short-term borrowing (other than from monetary authorities), net	4.3	2.9
Use of reserve-related credit facilities, net [d]	1.3	3.4
Reduction of reserve assets (accumulation, -)	-2.5	0.8
Residual errors and omissions [e]	-0.1	-2.0

a Net total of balances on goods,services, and private transfers, as defined for Balance of Payments Yearbook purposes (with sign reversed).

b Includes any net use of nonreserve claims on nonresidents, errors and omissions in reported balance of payments statements for individual countries, and minor deficiencies in coverage.

c Including errors and residuals which arise from the mismatching of data taken from creditor and debtor records.

d Comprises use of IMF credit and short-term borrowing by monetary authorities from other monetary authorities.

e Errors and omissions in reported balance of payments statements for individual countries, plus minor deficiencies in coverage.

Source: IMF

The most striking feature has been the use of net market borrowings (including short-term) which increased from an annual average of $4.1 billion in 1970-73 to $13.1 billion in 1974 and was only slightly lower at $12.2 billion in 1975. Market borrowings in 1975, including long-term flows of $8.5 billion from commercial banks and short-term borrowings of $2.9 billion, most of which were also provided by commercial banks, represented about a third of the total deficit. The relatively higher cost and shorter average maturities of loans from these sources, as compared with bilateral and multilateral development loans will obviously result in larger increases in debt service charges and in gross financing requirements for a given deficit.

In 1975, increased use was also made of IMF resources, particularly under the oil facility; these credits together with some short-term borrowings from other monetary authorities amounted to only $3.4 billion i.e. less than 10 per cent of the combined deficit. Most of the remainder of the financing was in the form of net direct investment which, at $3.9 billion, was a little less than in 1974.

Overseas Development Assistance (ODA)[1]

An increase in ODA is particularly important for those developing countries which are heavily dependent on concessional assistance and also for those which have only a limited capacity, in relation to their financial needs, to utilise commercial funds. In absolute terms, net ODA disbursements increased moderately, from $10.8 billion in 1973 to $14.8 billion in 1974 and $17.1 billion in 1975. 1975 saw the first increase, in real terms, in ODA since 1972. While in 1974 the nominal growth of ODA was offset by an approximately equal rise in prices (and in 1973 there had been a 15 per cent reduction in real terms), the volume of ODA provided by members of the Development Assistance Committee of the Organisation for Economic Co-operation and Development (which account for some four-fifths of total international aid) rose in real terms by about 7 per cent in 1975.

Commonwealth developing countries have shared in ODA increases, although the proportion of total aid accounted for by the Commonwealth developing countries combined remained less than commensurate with their share in the total population of non-oil developing countries. The net receipts by Commonwealth developing countries of bilateral ODA from the DAC countries rose in 1975 from just over $2 billion in 1974 to almost $3 billion in 1975 and accounted for 30 per cent of total DAC bilateral flows of $9.8 billion in 1975 compared with 25 per cent in 1974. The Commonwealth share of total concessional flows, both bilateral (from DAC countries) and multilateral, was 29 per cent in 1975 compared with 26 per cent in 1974.

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1. ODA is defined as those flows to developing countries and multilateral institutions provided by official agencies, administered with the promotion of the economic development and welfare of developing countries as the main objective, and which are concessional in character, having a grant element of at least 25 per cent. Net ODA disbursement flows mean disbursements net of amortization - that is to say repayments on account of similar transactions in the past. If transactions are recorded net of interest as well as net of amortization, the term "net ODA transfer" is used.

Sources of ODA

Traditionally, the principal source of bilateral and multilateral aid for developing countries has been the developed market economy countries which are members of the DAC. Net ODA from these countries increased from $11.3 billion in 1974 to $13.6 billion in 1975. By comparison with flows from the DAC countries, aid from the centrally planned economies has been relatively small in total. The total provided by these countries (including China) declined significantly from $1.1 billion in 1974 to $0.8 billion in 1975. Since 1974 the surplus-earning, petroleum-exporting countries have become major providers of aid; their net disbursements in 1975 amounted to $2.7 billion as compared with $2.5 billion in 1974. However, disbursements in subsequent periods are expected to catch up with further substantial commitments of concessional assistance. More recently OPEC has begun to diversify its aid disbursements to include a larger number of developing countries. As a percentage of their GNP, net ODA disbursements by the OPEC countries remained about 1.35 per cent in 1975.

Only two DAC countries (Sweden and the Netherlands) exceeded the 0.7 per cent aid target in 1975. Australia achieved a proportion of 0.61 per cent and ranked fifth after Norway and France. Canada provided 0.58 per cent of GNP as aid, which was slightly less than Belgium and about the same as Denmark, and was followed by New Zealand with 0.52 per cent. West Germany transferred about 0.40 per cent of GNP and Britain about 0.37 per cent, which was just above the DAC average of 0.36 per cent. The remaining DAC countries transferred less 0.30 per cent of GNP.

The four Commonwealth DAC countries (Britain, Canada, Australia and New Zealand) disbursed $2.3 billion (net) in ODA in 1975. In current dollars this was 21 per cent above the level of disbursements in 1974. The aid performance of the Commonwealth members was above the average DAC performance; with a GNP equal to 13 per cent of the total GNP of DAC countries, the Commonwealth donors provided 17 per cent of the groups total net ODA. Nevertheless, each of the Commonwealth donors remained below the aid target of 0.7 per cent of GNP and jointly they recorded a ratio of 0.48 per cent in 1975.

Bilateral aid from Commonwealth countries continued to be concentrated on Commonwealth recipients in 1975. Just over 68 per cent of Commonwealth bilateral ODA went to Commonwealth countries; Australia had the highest concentration of 82 per cent, followed by Britain with 76 per cent, New Zealand with 63 per cent and Canada with 52 per cent. The share of net ODA accounted for by bilateral flows from Commonwealth developed countries was 72 per cent in 1975, the same as for DAC countries as a whole.

Terms of ODA

For DAC members as a group, the terms of their ODA softened in 1975. The grant element of total commitments reached 88.3 per cent in 1975 compared with 86.0 per cent in 1974 and 87.5 per cent in 1973. Total commitments, at $ 16.6 billion, were 9.5 per cent higher in current terms than in the previous year. The share of grants in commitments rose from 65.4 per cent to 69.0 per cent and the grant element of loans increased from 59.5 per cent in 1974 to 62.3 per cent in 1975 although this remained below the 1973 grant element of loans of 63.0 per cent.

The 1972 Terms Target of an average grant element of at least 84 per cent in their ODA programmes was met in 1975 by all the DAC countries except Japan. The ODA programmes of the Commonwealth members of the DAC remain among the most concessional. The grant element of Australian commitments was restored to the 100 per cent level in 1975 while for New Zealand the grant element is estimated to have continued above 98 per cent. The British grant element rose from 85.4 per cent to 96.9 per cent reflecting a sharp rise in the share of grants in total commitments. The grant element in Canada's aid remained relatively unchanged, being 97.2 per cent in 1974 and 96.4 per cent in 1975.

Other Financial Flows

Total official flows, net, from Commonwealth donor countries rose from $2.1 billion in 1974 to $ 2.5 billion in 1975 while for DAC countries as a whole there was an increase from $ 13.5 billion to $ 16.6 billion. Thus, official flows not qualifying as ODA from all DAC countries rose by some $ 840 million or 39 per cent; the largest increase in absolute terms was in official export credits, followed by equities and other bilateral assets and by non-concessionary contributions to multilateral institutions, while the volume accounted for by debt reorganisation fell sharply. In the case of Commonwealth member countries, on the other hand, there was a decline in these flows, which are in any case a small proportion of the total. There was some increase in the use of official export credits by Canada but a sharp drop in the flow of equities and other bilateral assets from Britain.

Net private flows to non-oil developing countries rose sharply from $ 14.5 billion in 1974 to $ 23.3 billion in 1975, an increase of 61 per cent. However, flows from the Commonwealth members except Canada fell, and so the share of the four Commonwealth countries in the DAC total declined from 17.2 per cent in 1974 to 10.8 per cent in 1975.

Total Flows

Largely as a result of the increase of private flows, the total net flow from all DAC countries to developing countries and multilateral agencies, official and private combined, rose to 1.05 per cent of GNP in 1975 from 0.81 per cent in 1974. Britain and Canada continued to exceed the UN target level of 1 per cent for total flows, with proportions of 1.01 per cent and 1.34 per cent respectively in 1975. Australia had exceeded the target in 1970 and 1971 but remained well below it in the three subsequent years and registered only 0.71 per cent in 1975. Total net flows from New Zealand rose from 0.40 per cent to 0.59 per cent of GNP in 1975.

Structure of Total Financial Flows

The large increases in total financial flows, at least in nominal terms, to the non-oil developing countries in 1974 and 1975 were accompanied by a significant change in their "quality" with regard to their geographical pattern, financial terms and purpose. The total net flow of financial resources received by developing countries from DAC countries and multilateral agencies was $38.2 billion in 1975 compared with $28.4 billion in 1974, an increase of 35 per cent. Of this $11.1 billion or 39 per cent consisted of concessional funds in 1974 but only $12.9 billion or 34 per cent in 1975. Flows from OPEC countries are estimated at $4.7 billion in 1974 and $6.0 billion in 1975. As with DAC disbursements, the proportion of concessional funds fell in 1975; they amounted to $2.5 billion or 53 per cent of the total in 1974 and to $2.7 billion or 46 per cent in 1975. The other principal source of developing country finance is the centrally planned economy countries. These flows, however, have been declining in relative importance in recent years and in 1975 there was a substantial drop in volume from $1.2 billion to $0.9 billion. The reduction was mainly in concessionary funds, which account for the bulk of CPE flows, but at the same time there was an increase in the grant element of concessionary flows reflecting the higher proportion accounted for by the relatively softer funds from China and also some softening of the terms of Soviet aid. A further element of total flows is the transfer of resources within the developing world itself, mainly in the form of technical assistance and contributions to multilateral agencies. Although still small in relation to the total these flows are of growing significance.

The marked increase in the flow of non-concessional finance going to developing countries (particularly in the form of bank lending and Euro-currency credits) and a corresponding fall in the proportion of ODA, and the consequent hardening of the terms of total receipts has serious implications for the debt situation of many developing countries. Previously the current account deficits of non-oil developing countries totalled about $ 9 billion a year and were covered by ODA disbursements, but by 1975 the deficit reached about $37 billion - i.e. almost three times the volume of ODA. Apart from the debt servicing problem this situation creates; it is becoming increasingly difficult for developing countries to obtain international bank finance. It is, therefore, essential not only to facilitate access to capital markets but also to increase the volume of ODA and make substantial progress towards the 0.7 per cent target. At projected rates of growth in the DAC countries a proportion of 1 per cent of GNP could be reached by 1985 if merely 2 per cent of the annual increase in GNP were transferred as ODA to the developing countries.

International Dialogue and Action

The International Development Strategy, adopted before the recent economic events, had concentrated in the field of finance on attaining certain targets, particularly the 0.7 per cent of GNP target for ODA. As noted above, the aid effort of most developed countries, in spite of increases in absolute terms, has fallen far short of the Strategy target. At the same time, the large external deficits and the nature of financing available since 1974 have led the international community to give increased attention to the wider questions of international monetary system, liquidity and credit creation. While reaffirming the 0.7 per cent target, the Programme of Action adopted at the Sixth Special Session of the UN General Assembly and the recommendations reiterated at the Seventh Special Session in 1975, as well as at UNCTAD IV in 1976, called for, among other things, an expansion and liberalisation of the IMF compensatory financing facility, measures to ensure that special drawing rights should become the central reserve asset of the international monetary system, and for providing relief from the mounting external debt burden of the non-oil developing countries.

Discussions in these and other fora resulted in some ad hoc decisions in 1975 and in the following years to provide additonal financing on a multilateral basis, but the process of restructuring the international monetary and credit systems has failed so far to make any substantial progress. Among the measures agreed for the enlargement and addition of the IMF facilities are the establishment of the oil facility, which lapsed in mid-1976, the temporary increase in the IMF credit tranches and the revision of its quotas, a limited expansion and liberalisation of the compensatory financing facility, and the creation of a trust fund to be financed in part by the sale of gold. Apart from the size of the total amount of IMF balance of payments support in relation to the deficits, the potential use of IMF facilities by the developing countries, though likely to increase, remains limited because of the conditions under which drawings can be obtained and the relatively short repayment periods. Nor has any real progress been made in evolving an internationally agreed strategy for dealing with the external debt problem of the non-oil developing countries.