

# Chapter 6

## Finance

6.1 By the end of the 1980s a perverse situation had developed in international financial flows. The developing countries were receiving significantly smaller amounts of external finance than at the beginning of the decade and were in fact making large financial transfers abroad, while the United States and some other industrial countries were absorbing large amounts of capital from abroad. For much of the developing world the reduction of financial flows occurred at a time of increasing import stringency—that is, at the very time when more finance was required. Greater resources will be required to raise investment levels, to restore the infrastructure and to sustain the economic expansion needed to accommodate increases in per capita consumption levels that have fallen seriously in the 1980s. Increased domestic saving will need to play a crucial role in meeting these additional demands. But there will also be a need for additional balance of payments support to deal with the poor state of current balances, as a consequence of weak export earnings and onerous debt-service obligations, and to meet the additional import requirements arising out of structural adjustment programmes. However, several economic and political developments are likely to preempt the global savings which developing countries need to revive growth. Concerted action is required to ensure that current developments do not impede the provision of adequate external finance to developing countries.

### Financial Flows in the 1980s

6.2 In the last decade, there were significant changes in the volume and composition of financial flows to developing countries. The broad picture is that net financial flows fell by half by the mid-1980s and stabilised thereafter (see Table 6.1 on p.68). The major contributory factor was

**Table 6.1**  
**Total Net Resource Flows to Developing Countries<sup>a</sup>**

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1981	1985	1989
	Current \$ billion									Percent of total		
<b>I. OFFICIAL DEVELOPMENT FINANCE (ODF)</b>	<b>45.5</b>	<b>44.2</b>	<b>42.4</b>	<b>47.7</b>	<b>48.9</b>	<b>56.3</b>	<b>61.6</b>	<b>66.0</b>	<b>69.0</b>	<b>33.1</b>	<b>58.0</b>	<b>62.5</b>
1. Official Development Assistance (ODA)	36.8	33.9	33.9	35.0	37.3	44.5	48.3	51.6	53.1	26.8	44.2	48.1
of which: Bilateral disbursements	28.9	26.3	26.3	27.2	28.8	34.9	38.2	40.3	40.5	21.0	34.2	36.7
Multilateral disbursements	7.9	7.6	7.6	7.8	8.5	9.6	10.1	11.3	12.6	5.7	10.1	11.4
2. Other ODF	8.7	10.3	8.5	12.7	11.6	11.8	13.3	14.4	15.9	6.3	13.8	14.4
of which: Bilateral disbursements	3.0	3.7	1.3	4.5	3.7	4.0	6.6	7.9	9.0	2.2	4.4	8.2
Multilateral disbursements	5.7	6.6	7.2	8.2	7.9	7.8	6.7	6.5	6.9	4.1	9.4	6.2
<b>II. TOTAL EXPORT CREDITS</b>	<b>17.6</b>	<b>13.7</b>	<b>4.6</b>	<b>6.2</b>	<b>4.0</b>	<b>-0.7</b>	<b>-2.6</b>	<b>-0.5</b>	<b>1.2</b>	<b>12.8</b>	<b>4.7</b>	<b>1.1</b>
1. DAC Countries	16.2	12.7	3.9	5.2	3.4	-0.9	-2.9	-0.9	1.0	11.8	4.0	0.9
of which: Short-term	2.9	3.0	-3.5	0.3	3.2	0.2	0.3	0.4	0.2	1.0	0.7	0.2
2. Other Countries	1.4	1.0	0.7	1.0	0.6	0.2	0.3	0.4	0.2	1.0	0.7	0.2
<b>III. PRIVATE FLOWS</b>	<b>74.3</b>	<b>58.2</b>	<b>47.9</b>	<b>31.7</b>	<b>31.4</b>	<b>28.2</b>	<b>34.5</b>	<b>40.4</b>	<b>40.2</b>	<b>54.1</b>	<b>37.2</b>	<b>36.4</b>
1. Direct Investment	17.2	12.8	9.3	11.3	6.6	11.3	21.0	25.1	22.0	12.5	7.8	19.9
of which: Offshore Centres	4.1	4.1	3.7	3.8	3.7	6.8	13.5	9.9	9.9	38.1	18.0	7.2
2. International bank lending <sup>a</sup>	52.3	37.9	35.0	17.2	15.2	7.0	7.0	5.8	8.0	0.9	6.4	0.9
of which: Short-term	22.0	15.0	-25.0	-6.0	12.0	-4.0	5.0	2.0	4.0	1.1	1.5	4.5
3. Total bond lending	1.3	4.8	1.0	0.3	5.4	2.7	0.5	0.4	1.0	1.5	3.4	3.8
4. Other private	1.5	0.4	0.3	0.3	1.3	3.9	2.5	4.9	5.0	1.5	3.4	3.8
5. Grants by non-governmental organisations	2.0	2.3	2.3	2.6	2.9	3.3	3.5	4.2	4.2	1.5	3.4	3.8
<b>TOTAL NET RESOURCE FLOWS (I+II+III)</b>	<b>137.4</b>	<b>116.1</b>	<b>94.9</b>	<b>85.6</b>	<b>84.3</b>	<b>83.8</b>	<b>93.5</b>	<b>105.9</b>	<b>110.4</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Memorandum items:												
Total net credits from IMF	6.6	6.4	12.5	5.4	0.8	-1.4	-4.7	-4.0	-3.2			
Interest and dividends paid by LDCs	-86.4	-95.3	-84.2	-94.5	-95.6	-83.2	-79.0	97.9	-107.7			
	At 1988 prices and exchange rates											
Total Net Resource Flows	201.9	174.5	143.0	131.7	128.3	103.4	100.3	105.9	111.5			
Total Official Development Finance	66.8	66.4	63.9	73.4	74.5	69.5	66.1	66.0	69.7			
Total ODA receipts from all sources	54.1	51.0	51.1	53.8	56.8	54.9	51.8	51.6	53.6			
Total DAC ODA (bilateral and multilateral)	37.6	41.8	41.6	44.2	44.8	45.3	44.6	48.1	47.4			

<sup>a</sup> Flows from all sources, i.e. including DAC, Eastern Europe, and Arab and other developing country donors. Excludes Taiwan.

Source: Development Co-operation, Report by the Chairman of the Development Assistance Committee, OECD, December 1990.

the precipitous decline in private flows. This resulted largely from the virtual collapse of commercial bank lending, with the onset of the debt crisis. Private investment flows also fell sharply. Official development finance remained stable in real terms, but export credits recorded a sharp decline. As a proportion of total flows, those of international capital markets fell from 40 per cent in 1981 to 9 per cent in 1989; and those of export credits from 13 per cent to 1 per cent in the same period. By the end of the 1980s, official finance accounted for nearly two-thirds of total flows, compared with one-third at the beginning of the decade. This composition of resource flows represented a return to the situation in the 1960s. The rise in the share of official flows reflected both a reduction in other flows and some increase in official finance as a result of the support provided for structural adjustment programmes and the debt strategy. While there was also some revival of total flows, much of this reflected capitalisation of interest arrears rather than new money.

6.3 In interpreting these aggregate figures, it is necessary to take account of differences between countries and regions. In some areas, such as East Asia, private flows were largely determined by demand factors, and the opportunities for investment. In others, such as Latin America, they shrank because of debt-servicing difficulties. In Africa, official finance expanded sufficiently to compensate for the falls in private flows, and the total remained stagnant.

6.4 The large and rising amount of interest payments meant, however, that net transfers<sup>1</sup> fell sharply. On an annual basis, developing countries received about \$67 billion in net transfers during 1980-82. But from the mid-1980s interest and dividend payments sharply reduced or even eliminated the net receipts of these countries (see Table 6.2 on p.70). It is noteworthy that in 1989 debt-related net outflows amounted to \$52 billion for the 111 developing countries which report their debt to the World Bank. It is estimated that over the period 1983-89, these countries transferred \$243 billion to their creditors. While the highly-indebted middle-income countries suffered from the burden of commercial debt, the debt-distressed low-income and lower middle-income countries were seriously affected by servicing official debt, both bilateral and multilateral. A large number of developing countries started the 1990s from a point where private flows were depressed, and net transfers either negligible or negative. The prospects for financial flows for the rest of the 1990s are even more sombre.

<sup>1</sup> Net transfers are defined as net flows minus net outflows on account of interest and dividends.

**Table 6.2**  
**Aggregate Net Financial Transfers by Region<sup>a</sup>**  
**\$ billion at 1988 prices and exchange rates**

	Average 1980-82	1984	1985	1986	1987	1988	1989
Sub-Saharan Africa	16	9	13	17	17	14	14
North African and Middle East	-11	-11	-6	-4	-6	-7	-6
Asian LDCs	11	11	15	14	17	17	9
Other Asia	5	-6	-9	-9	-11	-5	-1
Western Hemisphere	37	-17	-31	-19	-6	-17	-15
Other <sup>b</sup>	8	0	1	1	5	6	1
Total LDCs <sup>c</sup>	67	-14	-17	1	16	8	3
For reference.							
Least developed countries	14	14	15	14	14	13	13

<sup>a</sup> Net Financial Transfers are defined as total Net Resource Flows minus investment income payments (interest and dividends) by developing countries. Total net flows include official and private grants (including technical co-operation), direct investment and total long- and short-term loans minus loan repayments. For further explanation on Net Financial Transfers see Financing and External Debt of Developing Countries, 1988 Survey (Chapter VI), OECD, Paris, 1989.

<sup>b</sup> European LDCs, Oceania.

<sup>c</sup> Excluding Taiwan.

*Source:* Development Co-operation, Report by the Chairman of the Development Assistance Committee, OECD, December 1990.

## **New Developments**

### *Eastern Europe and the Soviet Union*

6.5 With the end of the Cold War, and economic liberalisation, Eastern Europe and the Soviet Union are imposing new demands on the stock of global savings. Their needs for finance to support the reform and structural transformation of their economies are immense. The international financial institutions and western governments have begun to assist the East European countries in a variety of ways. By the middle of 1991, it was estimated that over \$28 billion had been committed in new credits, grants, technical assistance and credit investment guarantees to these countries. And it is expected that these amounts will build up substantially over the next few years. At the same time, increased relief for the heavily indebted East European countries, particularly Poland, is being conceded. In addition, the threat of economic and political instability in the Soviet Union seems likely to force the West to consider seriously the provision of substantial assistance to that country.

6.6 Eastern Europe and the Soviet Union offer considerable potential attractions to private capital: large potential markets, valuable resource endowments, including trained manpower and potentially cheap bases for production in close proximity to major markets. Private investment, which might otherwise have gone to the developing world, may flow to Eastern Europe. Private capital flows—direct and portfolio investment, bank lending and trade credit—have so far been relatively small but are likely to increase if economic and political conditions in Eastern Europe and the Soviet Union improve. The investment climate will be an important factor in determining the size of flows. With improvements in the investment climate which these countries are attempting to achieve, an increase in private flows may constitute a more important diversion than that in official flows.

6.7 Overall, therefore, Eastern Europe and the Soviet Union are likely to make a substantial and growing demand on official and private international flows of capital. Strategic and political considerations, and the threat of mass migration from the region, are likely to create the necessary political will in Western Europe to support such flows.

### *Unification of Germany*

6.8 Unification is placing very large demands on German savings. It is conservatively estimated that the savings/investment gap in the eastern Länder may amount to about 10 per cent of total capital formation in the western Länder. The German Government can be expected to give

overriding priority to the needs of the eastern Länder, especially in the context of the current political dissatisfaction with rehabilitation progress there. Already the German fiscal deficit has risen sharply. German banking and industry will similarly prefer to look for opportunities in the east of the country. The result is likely to be a marked reduction in net capital outflows from Germany to the developing world and elsewhere. Overall capital outflows from west Germany, which were running at a rate of \$50 billion per annum, may decline by more than half in the 1990s.

### *European Community*

6.9 The completion of a single market in the European Community, together with other moves towards political and economic union, carries with it the potential, in the short- to medium-term, of attracting inflows of capital and leading to a greater deployment of European savings within the Community than hitherto. Taken together with the West European commitment to Eastern Europe and the Soviet Union referred to earlier, it seems likely that European investment in the developing world will be limited throughout the 1990s. There is also the risk that such a constriction in capital flows might not be compensated by increased exports, as the European single market may mean reduced access for developing countries' products, through trade diversion, unless it is accompanied by deliberate measures of trade liberalisation with third countries, especially for products of interest to developing countries.

### *Japan*

6.10 In recent years, Japan has implemented important recycling programmes which have increased assistance to developing countries. Between 1986 and March 1992 such programmes will amount to some \$65 billion. Japan is now the largest source of official development assistance. But the country's balance of payments surpluses, which at their peak in the middle-1980s exceeded \$80 billion, have now declined to half that level, and are set to diminish further. The past four decades were dedicated to the establishment of Japan's trading and financial links with the outside world. However, there are now strong domestic demands for increased consumption, and for investment in physical and social infrastructure. These domestic pressures are reinforced by Western, particularly United States, pressure on the Japanese to increase imports. The ageing population and increased welfare expenditure also seem likely to limit Japanese savings and overseas investment in the long run. (See Annex 6 on pp.172-175 for a review of savings behaviour in industrial countries.)

## *United States*

6.11 In the United States, the savings rate has fallen sharply since the early 1970s. During the 1980s, the US deficit constituted a major net demand on world savings, and over the decade the country became the world's biggest debtor. In 1989, the United States attracted an inflow of \$124 billion from abroad, particularly from Japan and Europe.

6.12 The future demands of the United States for foreign savings will depend largely on how the Federal Government's fiscal position evolves. The IMF last year suggested that fiscal deficits were likely to persist for several years, pre-empting a large part of global savings and exerting upward pressure on international interest rates. Although the United States made significant progress in reducing its balance of payments deficit during 1990, the Gulf crisis and the current downturn in the US economy have increased uncertainty regarding future progress. A significant recession could increase the budget deficit by raising the cost of deposit insurance, and reducing revenues.

## *The Peace Dividend*

6.13 The ending of the Cold War led to hopes of reductions in defence expenditure. The agreement on conventional forces in Europe heightened these expectations; and some countries have already undertaken cuts in military expenditure. Recent developments, however, are less promising. Difficulties with the implementation of the Conventional Forces in Europe agreement point to the possibility of a retrogression in East/West relations. And the Gulf War, and the new security arrangements in the Middle East, may mean that the cuts in defence expenditure in the short run will be less than originally envisaged.

6.14 On balance, however, it seems possible that the developed world, in particular, will spend less on defence. The already agreed disarmament measures should create a sizeable peace dividend. Given the mobilisation of political will, a reduction in defence expenditure could lead to increased assistance to developing countries. Recent estimates suggest that a 10 per cent cut in the NATO budget could permit a doubling of aid to developing countries (see Box 6.1 on pp.74-75 and Annex 7 on pp.176-179).

6.15 It needs to be acknowledged, however, that there may be significant adjustment costs in redeploying resources from military to civilian use. There are in addition many competing claims on the peace dividend. One is the reduction in fiscal deficits in countries such as the United States. Another is the pent-up demand for funds to improve social services and infrastructure, neglected in the 1980s. But in so far as the

## Box 6.1

### The Peace Dividend

The end of the Cold War has raised the prospect of substantial cutbacks in military expenditures worldwide, although the need for new security structures in the Middle East and certain other parts of the world have raised some new requirements for military spending. The potential peace dividend that could accrue from cutbacks in military spending however, needs to be distinguished from the actual, or realised, peace dividend. The latter is the amount of resources released from reductions in military spending that are actually used for non-military uses, especially for meeting the social agenda. It is also not identical with the peace dividend for development, i.e. that part of the actual, or realised, peace dividend which is allocated as Third World aid. Questions therefore arise about the possible size of these various forms of peace dividend.

In fact, East-West detente and disarmament agreements have already set in motion a reduction in global military spending, which declined from \$1,016 billion in 1987 to \$950 billion in 1989 (or by about 3 per cent a year). The main reductions took place in the USA, USSR and Eastern Europe; spending also declined in developing countries from \$173 billion to \$146 billion (largely as a result of the cessation of the Iran-Iraq hostilities). In 1990 and 1991, however, the Gulf War is likely to result in increased military spending.

With the momentum maintained in the East-West understandings on disarmament, it is conceivable that annual reductions of some 2 to 4 per cent in armaments expenditure could occur during the 1990s. This means that the potential peace dividend would range from \$200-\$400 billion (in constant dollars) in the year 2000, with the USA and the USSR each cutting expenditure by about \$50-100 billion. Total savings could be in the range of \$1.5-2.5 trillion during the 1990s, with the USA, USSR and Eastern Europe each saving between \$350 and \$675 billion, and the other industrial countries between \$270 and \$570 billion. For East European countries in particular, with the new post-communist governments in place and the prospective collapse of the Warsaw Pact, the cuts could turn out to be much deeper than assumed.

There is, however, a basic question as to whether this potential peace dividend will get absorbed by the current budget-balancing exercises, or whether a whole or some part of it will become available for non-military uses. Given the sizes of fiscal imbalances

in the USA, USSR and East European countries, it is very likely that most of the cutbacks in military expenditure in these countries will be used to correct the fiscal imbalances.

But even here, in so far as cutbacks in military spending help to eliminate the need for cuts in pressing social programmes, or foreign assistance budgets, budget balancing is not a neutral exercise with regard to the social agenda. However, the situation will be different in industrial countries without fiscal problems, as they may be able to utilise a substantial proportion of the potential peace dividend for non-military uses. Equally, they may be tempted to reduce the taxation of their peoples.

A further question concerns the use of the peace dividend for development. In all countries, including those with fiscal problems, there would be strong pressures to increase domestic social spending. Accordingly, a higher priority for aid to the Third World would require a raising of public consciousness in industrial countries on the importance of enhancing aid as a means to promote a more peaceful and prosperous world. If it is assumed that half of the potential peace dividend in industrial countries (USA and other OECD countries) is actually realised, and a quarter of this is allocated to development, this would represent additional real aid of \$12-25 billion (in 1990 prices) by the year 2000, over and above what would have resulted from increases at historical rates (i.e. about 2 per cent per annum).

It has also to be recognised that if deep cuts in armed forces and defence hardware were implemented, there would be significant adjustment costs in the industrial countries. These would be reflected in increased unemployment benefits, retraining costs for retrenched labour, loss of capital investment in production of military hardware, reduced production levels in, and export earnings from, defence-related industries, etc. However, the costs would be essentially of a short-term nature, and no different from those incurred in any other phase of adjustment.

In developing countries military spending increased from \$24 billion in 1960 to \$173 billion in 1987, i.e. at an annual rate of 7.5 per cent. Yet if military spending in the Third World were frozen in nominal terms, it would release \$15 billion of resources annually for human development. That peace dividend would be sufficient to put all children in primary schools, implement a programme of universal child immunisation, eliminate child malnourishment and extend primary health-care facilities to all children.

peace dividend represents a rise in global savings—whether a part of it is diverted to developing countries or not—it will improve global economic conditions by reducing pressure on interest rates, from which all countries stand to benefit.

6.16 There is also considerable scope for the realisation of a peace dividend in the developing countries, where military expenditures have increased even more rapidly than in industrial countries in the last three decades. To the extent that the military build-up was a consequence of the Cold War tensions, the ending of the Cold War provides an opportunity to realise a peace-dividend in the South also. Improved global security arrangements and conflict resolution mechanisms are necessary for the realisation of a further peace dividend.

### **Implications for Developing Countries**

6.17 All the developments described above have significant implications for the world economy in general and for the developing countries in particular.

6.18 The reliance by developed countries more on monetary than on fiscal policy to fight inflation contributed to an upward pressure on interest rates in the 1980s. The continuation of such a policy stance, together with an accentuation in the global imbalance between the supply of and demand for savings which current developments suggest, implies that interest rates throughout the industrialised world are likely to remain high in the medium term. Bond yields in Germany have already risen and this has put an upward pressure on West European interest rates. It is, however, encouraging that the German Government has sought to moderate such pressure by increasing taxes to fund the costs of unification and the Gulf War. The current global economic slowdown would argue for lower interest rates. However, the need to overcome continuing inflationary pressures, arising from the persistent savings/investment imbalance, presents a contrary requirement. Every percentage point on global interest rates amounts to a debt-service liability of \$6 billion for the developing countries as a whole; and through the contractionary impact on industrial countries' growth, high interest rates also affect developing countries' prospects.

6.19 The developing world was able to attract relatively limited flows of private funds during the 1980s. It faces increased competition for such flows from the eastern Länder of Germany, Eastern Europe and the Soviet Union. Yet foreign private investment is an important element in the efforts many developing countries are making to attract greater external finance.

6.20 The prospects for official flows are also a source of concern for developing countries. Many donors have pledged not to divert official development assistance to Eastern Europe and the Soviet Union. However, in the absence of a real increase in overall aid budgets, competition from these two areas must remain a reality. A disintegrating Soviet Union, in particular, could occasion a large provision of funds, for strategic and humanitarian reasons and to avoid massive emigration to the West. A report on the Soviet economy suggested that aid in the range of \$10-15 billion a year would be necessary to provide support 'during a time of difficult transition to integration of the economy of the USSR into the world economy'.<sup>1</sup> Press reports suggest that the Soviet Union may be looking for assistance of the order of \$150 billion over the next five to six years from the G7. Adding in Eastern Europe would make the estimated requirements even larger. Assuming a diversion of even \$10 billion a year in aid to the Soviet Union and Eastern Europe, there would be a reduction in flows of official development assistance (ODA) from member countries of the Development Assistance Committee (DAC) of about 20 per cent below their 1989 levels, if total aid budgets were to remain constant in real terms. At the very least, there is a danger that the requirements of the Soviet Union and Eastern Europe would prevent a real increase in aid flows to the developing countries. If that were to happen, flows of ODA to the developing world would fall to 0.27 per cent of the combined GNP of the DAC member countries by 1995, compared with 0.33 per cent in 1989, which was itself well below the agreed UN target of 0.7 per cent.

6.21 There is a similar danger that developments in the Middle East will result in a substantial diversion of official flows from other Third World countries for military, security and rehabilitation purposes. Short-term costs have already had an impact on the budgets of many donors. The United States, Japan, Germany, Saudi Arabia and other Gulf States are contributing heavily to Middle East countries affected by the crisis. In the longer term reconstruction programmes and security arrangements in the area could require grants, loans, investment and debt forgiveness. Kuwaiti capital now invested abroad would to a significant extent be repatriated. The Middle East could well rival Eastern Europe and the Soviet Union as a competitor for the donor countries' limited resources earmarked for development.

6.22 These developments, however, have to be set against increased trade opportunities that could arise from increased imports by Japan

<sup>1</sup> 'The Economy of the USSR', International Monetary Fund, World Bank, Organisation of Economic Cooperation and Development, and European Bank for Reconstruction and Development (Dec. 1990).

and the unification of Germany. Such improved opportunities may partly compensate for the reduction of Japanese or German surpluses for investment or aid.

### **The Developing World's Financial Requirements**

6.23 By any assessment, the developing world's additional financial requirements are large. A consequence of the efforts to reduce domestic absorption in the 1980s was that investment levels fell sharply in many countries. The reforms implemented failed to revive private investment against a background of the continuing debt overhang, the shrinking domestic markets, threats of protectionism, and commodity price uncertainty and poor prospects for commodity exports. In sub-Saharan Africa, investment as a percentage of GDP fell to 15 per cent, compared with over 20 per cent in the 1973-80 period. In Latin America, the ratio fell to 15 per cent from nearly 25 per cent in the 1970s. In many instances, physical capital deteriorated and infrastructures fell into disrepair. Together with the shortage of imported inputs, this meant that bottlenecks became a common feature, and production was held back. A substantial revival of investment and an improvement in its quality is urgently needed to support capital rehabilitation and human resource development, if satisfactory economic growth rates are to be resumed and poverty and malnutrition reduced.

6.24 We believe that despite the difficult scenario we have sketched out for the 1990s, there is much that can be done to ease the financial stringency which confronts developing countries. There is scope for both domestic policy action and international efforts. We review the possibilities below.

### **Measures Needed**

6.25 A substantial part of the additional resources must necessarily be found through domestic policy reform and mobilisation efforts. In many countries, there is considerable scope for such additional domestic savings. Private savings are at present diminished by lack of macro-economic stability; and by inadequate and ill-functioning financial markets. Inflation, unrealistic exchange rates and lack of transparency and predictability in economic policy also promote capital flight. Reform is needed in all these respects. Public savings can be enhanced by strengthening budgetary operations through both rationalising expenditure and mobilising additional revenue. Opportunities to cut defence expenditure and realise a peace dividend must also be seized. Sound management of public finance is crucial for improved domestic resource mobilisation. Conspicuous consumption based on 'rentier' incomes derived from control regimes diminishes

saving, misallocates resources, and sets a bad example to the less fortunate. Dismantling controls and better tax administration could help improve both public and private savings. Improved allocation of resources and productivity of investment constitute a source of growth and, in turn, of savings.

6.26 It must, however, be recognised that all the additional resources needed cannot be met from domestic sources alone. The consumption levels in many countries have already been cut to intolerably low levels. And any resumption of growth—from which additional saving and investment could be generated—requires, as a matter of urgency, the provision of additional balance of payments support to alleviate the poor state of current balances, and to meet debt service obligations that are now crippling recovery. Without such assistance, essential imports (spare parts of machinery, essential raw materials, food, energy, medicines, etc) will be at risk and the whole development process endangered.

6.27 Domestic policy reform and a stable economic environment should improve the climate for foreign capital inflows on a voluntary basis, and provide a part of the additional external finance needed. We believe, however, that the size of such additional voluntary flows will be limited—if not insignificant—for some years to come; and that not all countries will be in a position to attract such flows despite policy reform. We also believe that the international community should consider taking certain measures to provide the necessary additional external finance. In the ensuing paragraphs, we consider the contribution that can be made through debt relief and rescheduling, by all classes of creditors; by private flows—direct, portfolio and loan; and by official development assistance, bilateral and multilateral. Finally, we look to the question of more effective use of capital flows.

### *Debt*

6.28 The first element of this international effort should be more effective measures to deal with the predicament of many debtor countries. The strategies adopted so far have had limited success and in many countries the debt situation has worsened dramatically. In the final analysis, the initiatives in place have not increased the capacity of debtor countries to repay. This raises serious questions about the debt management approaches that have been taken so far.

6.29 More recently, there has been greater recognition of the protracted nature of the problem. It is now increasingly accepted that many developing countries cannot service the whole of their external debts; and that more determined efforts need to be made to reduce the debt burden. In this context, it is useful to distinguish three types of debt,

each of which requires a different solution: commercial, bilateral, and multilateral.

### Commercial Debt

6.30 About 60 per cent of the total debt of developing countries is commercial. This category of debt is concentrated in some 20 middle-income developing countries, even though it imposes heavy burdens on a wider range of countries, including some low-income countries. The Baker plan (1985) proposed that countries pursuing economic reforms should receive fresh funds to bring about a return to growth. It relied on a strategy of restoring normal creditor-debtor relations, through a combination of structural adjustment, rescheduling of debt, and additional official and private lending. While these measures were partly successful in containing the problem, it soon became clear that private banks were cautious in providing additional finance, and that growth in the concerned countries suffered. The hope that, with adjustment, debtor countries would be on their way to growing out of debt has been belied. It has now been recognised that in the absence of debt and debt-service reduction, even policy reform and a favourable international economic climate will not restore external viability in many highly indebted middle-income countries. Some countries sought to achieve such a reduction, albeit on a limited scale, by buying back debt at a discount. The Brady Initiative, which seeks to provide official financial support for market-based commercial debt-reduction programmes, takes this approach forward (see Annex 8 on pp.180-184). Five arrangements have so far been reached—with Mexico, Philippines, Costa Rica, Venezuela and Morocco - affecting a total of \$78 billion of commercial bank claims. While there are indications that the strategy may be bringing some of these countries nearer to restoring access to spontaneous capital flows, the overall impact remains limited. Progress is slow and it is proving difficult to add other countries to the list of beneficiaries. Negotiations are fraught with difficulty. Establishing market valuation of debt, the treatment of current and overdue interest payments and the degree of debt restructuring required are matters of contention. Debt arrears in Latin America, for instance, have been increasing and the debt problems of many indebted countries in this region—Brazil and Argentina among them—are no nearer resolution.

6.31 Many proposals for alleviating the debt problem have been made by prominent bankers, economists and politicians (see Annex 9 on pp.185-187). These proposals include the following elements: measures to strengthen economic growth and export performance; a special facility or a new multilateral institution to buy and then restructure outstanding bank debt; a menu of options for debt and debt-service reduction; and credit enhancement.

6.32 While elements of these proposals have been incorporated in some of the existing initiatives, we believe that further action is needed.

6.33 It is vital that any such action recognises the need for economic growth in the debtor countries. They must lower future costs, not raise them; they must change the debt profiles from short-term to longer-term; they must allow a healthy expansion of productive capacities rather than only a painful squeeze of already low consumption or investment levels; and they must provide for a continued increase in the lending of commercial banks.

6.34 To meet these objectives it will be necessary to expand the scope of the Brady Initiative by enlarging the resources committed to it; by making the associated adjustment programmes more growth-oriented; and by improving the modalities for reaching agreement between the debtor country, the commercial banks and the World Bank and the IMF. We also believe that considerable relief can be provided through the commercial banks forgiving the portion of debt written down by them in their balance sheets. Similarly, much guaranteed export credit has been tacitly written off by creditor governments and a formal concession would involve no new funding. The reduction of debt overhang in this manner will contribute to the restoration of external viability and resumption of commercial lending to developing countries.

6.35 We also see merit in increased use of 'debt for nature' swaps and 'debt for equity' conversion, even though they need to be implemented keeping in view the domestic conditions. There is also merit in the establishment of a new mechanism such as the proposed International Debt Refinancing Facility (see Box 6.2 on p.82). Because this must have a developmental orientation, it could work primarily under the World Bank's leadership, with IMF cooperation.

### Official Bilateral Debt

6.36 With regard to the official bilateral debt of the low income countries, prospects for external viability remain very bleak for many countries, despite the action taken so far. The Toronto Initiative has brought very limited benefit. It has been suggested that the Indonesian debt agreement of 1970, which provided substantial debt relief of up to 57 per cent, constitutes an appropriate model for the treatment of sovereign debtors, particularly those for whom a large proportion of their debt is owed to official bilateral creditors. More recently, the United States has written off 70 per cent, and other Paris Club creditors 50 per cent, of Polish debt. The Paris Club has also written off 50 per cent of Egypt's debt. These write-offs, largely motivated by political reasons, provide

significantly more relief than the 33 per cent usually written off under the Toronto terms for the poorest countries.

6.37 The Trinidad and Tobago terms, proposed by Britain at the Commonwealth Finance Ministers Meeting in September 1990, seek to provide substantial relief for countries undertaking adjustment. This initiative constitutes a major advance (see Annex 8 on pp.180-184). The terms entail simultaneously writing off two-thirds of a nation's debt and rescheduling the remainder over 25 years. In addition, the future course of repayments would be calculated to reflect an assessment of the country's ability to pay. We strongly urge adoption of the terms by the Paris Club creditors. We feel that the initiative should also be on the agenda of the 1991 Western Economic Summit with a view to reaching an agreement. We also welcome the debt write-offs so far agreed (listed in Annex 8) and endorse the proposal made by Jan Pronk, the Netherlands Minister of Development Cooperation, at the Second UN Conference

### **Box 6.2**

#### **Debt Refinancing**

The increasing recognition that developing countries cannot repay the whole of their external debt reinforces the case for establishing a mechanism for debt refinancing which mobilises official resources. Several proposals have been made, which essentially involve debt purchase/conversion and take advantage of the discounts available in the markets. Some of these are given below.

James Robinson III (President of American Express) (1988) has proposed the establishment of an Institute of International Debt and Development to purchase existing loans at secondary market prices. The Institute would be an entity jointly operated by the World Bank and the IMF, with seed capital and contingent financial support from the major industrial countries.

Percy Mistry (Oxford University) (1987) has recommended the setting up of a Debt Restructuring Facility (DRF), as a World Bank affiliate, to issue long-term (25-30 years) bonds to be exchanged at a significant discount for developing country debt held by commercial banks. The DRF would be capitalised by the OECD countries at \$30 billion (with a 10 per cent paid-in component) and would operate with a gearing ratio of 10:1, so that it could issue bonds up to a value of \$300 billion.

on the Least Developed Countries (Paris, September 1990), to forgive all official debt—export credits and ODA—of the Least Developed Countries.

### Multilateral Debt

6.38 Debt owed to multilateral institutions presents special problems for a number of countries carrying heavy burdens. Very little has, however, been done to tackle this aspect of the debt problem. It has been argued that the unique role of the Fund as a cooperative institution, and the revolving nature of its resources, prevent it from undertaking any debt and debt-service reduction involving obligations to itself. It has also been argued that the financial standing of the multilateral development finance institutions would be compromised if there was any rescheduling of debt owed to them. The fear is that they would lose their AAA credit

Dr Arjun Sengupta (formerly Executive Director, IMF) (1988) has suggested the establishment of an IMF Debt Adjustment Facility (DAF). Commercial banks could exchange a portion of their loans to eligible debtors for low-interest bonds issued by the DAF. The remainder of the debt would be written off. The debtor would also be expected to adhere to a new growth-oriented policy package that would be designed to upgrade the country's credit rating and attract new investment and lending.

Dr Mahbub Ul Haq (UNDP) (1984) has called for the formation of an IMF Debt Refinancing Subsidiary to provide resources for extending maturities and reducing interest payments to a specific proportion of export earnings, so as not to stifle growth.

The African Development Bank (S.G. Warburg & Co) (1987) has recommended the issuing of long-term (20-25 years) securities for the full face value of the loans, but carrying below-market interest. A Redemption Fund would be established for the securities issued, into which the debtor country would undertake to make annual payments of an amount sufficient to accumulate at maturity to the total of the securities outstanding.

### Reference

Miller, Morris, 'Revolving Global Debt Crisis' (UNDP Policy Discussion Paper, 1989).

rating, thereby constraining their capacity to mobilise resources in capital markets and increasing the cost of their funds.

6.39 There have, however, been two narrowly circumscribed initiatives to alleviate the burden of multilateral debt. A portion of International Development Association (IDA) reflows is now set aside to help offset a part of the IBRD interest payment obligations of countries which were formerly eligible for IBRD loans but have now regressed to IDA resources only. In 1990, supplementary IDA credits were provided to offset a part of the annual IBRD interest payment of eleven countries which were pursuing IDA-supported adjustment programmes. We recommend that additional concessional resources are found to cover the whole of the IBRD interest payments of all IDA-eligible countries. A similar facility may also be extended by regional development banks.

6.40 In addition, the IMF has introduced a strengthened strategy for dealing with members in arrears—the new 'rights approach'. Under this scheme, a member's arrears are frozen when it embarks upon a Fund-monitored programme. The member is expected to be at least current during the Fund-monitored programme period and 'rights' are accumulated by implementing the programme. Countries are expected to receive assistance to meet the import needs and payments to the Fund through Paris Club rescheduling, Consultative Groups or support groups. At the end of the programme the country would have accumulated rights to future access to Fund resources, enabling it to clear the past 'frozen' arrears. The 'rights approach' is part of a collaborative effort to provide countries with support, in terms of policy advice and financing, to help them resolve their economic and financial difficulties. For the approach to succeed, the countries concerned will need adequate and timely bridging finance from the donor community to sustain the reform process. It is noteworthy that the 'rights approach' implicitly recognises the principle of refinancing obligations to the Fund. We believe that this approach should be extended to tackle the burden of multilateral debt in general.

6.41 These approaches do not however respond to the lower middle-income countries facing high proportions of official debt—bilateral and multilateral. Relief granted to Poland points the way for the Paris Club to recognise the need for debt and debt-service reduction. In the case of multilateral debt, an interest subsidy fund under the IMF would allow these countries credit from the IMF on concessional terms, thus increasing their debt-servicing capacity and encouraging the adoption of adjustment measures. A similar arrangement could be considered by the World Bank though a 'Third Window' type of facility on terms between those offered by IDA and IBRD.

## Debt: Appraisal of Present Initiatives

6.42 Despite the relief measures introduced so far, the debt problem is getting worse, not better. Total debt has risen to over \$1,300 billion, the highest since 1983. In a number of cases scheduled debt-service payments far exceed the debtor countries' current capacities to pay, and several of them are accumulating arrears. Few are in a position to attract voluntary capital flows. The present arrangements are inadequate to support a return to viability. Additional action is therefore required.

6.43 We believe that the approaches to the debt problem should be comprehensive and governed by equitable burden sharing. There is a case for official creditors providing relief to middle-income countries, commensurate to that expected from commercial creditors; and for commercial creditors to match the terms official creditors are offering to low-income countries. And for each debtor country, there should be a collective attempt to assess its debt-servicing capacity in the medium term, and tailor its debt-restructuring in the light of that capacity. The Trinidad and Tobago terms propose such an exercise in relation to bilateral official debt of low-income countries; we see the need for a wider application of such a course of action. This would be facilitated by the establishment of country-specific fora, analogous to the present Consultative Groups, in which both commercial and official creditors come together to discuss debt restructuring and equitable burden-sharing arrangements.

6.44 One way of assisting debtor countries across the board could be through an allocation of Special Drawing Rights (SDRs). This would increase their debt-servicing capacity, without running excessive current account surpluses and transferring real resources to the creditor countries. Further relief can be provided if the SDRs allocated to the creditor countries are placed in a Trust Fund to be used for various debt and debt-service reduction operations. In the present circumstances, we note that the Managing Director of the IMF believes that an SDR allocation would contribute substantially to stability in the international monetary system.

6.45 We are aware that action aimed at debt and debt-service reduction raises the possibility of moral hazard, whereby countries might attempt to create the conditions for debt restructuring and discounts on the market. While these concerns are not unreal, we believe that there are significant real costs which seem likely to deter the adoption of such a course of action by any country. Confidence, once disrupted, takes time to be restored. The economic dislocation caused by such a course of action could also be considerable.

6.46 There is also much concern in the industrial countries about the use of public monies for purposes of debt reduction, when authorities there are under pressure to economise. There are, however, strong grounds for using official resources for this purpose. In the 1980s, with the shift away from reliance on fiscal instruments in demand management, monetary policy has become the main instrument for economic stabilisation. This shift has led to historically high interest rates in world capital markets, with adverse implications for developing country debt; there are good grounds, therefore, for mobilising official resources to mitigate this effect. Furthermore, we believe that the case for supporting debt reduction is incontrovertible if development is accepted, as it must be, as an integral part of global peace and security. No development is possible, in large parts of the world, without a significant reduction in external debt.

#### *Private Flows*

6.47 As we have noted, the sharp contraction of private flows fully accounts for the decline in net transfers to developing countries. It is imperative, therefore, to find ways of making investment in developing countries attractive once again. For many countries such a recovery is likely to be a slow process and will depend crucially on the success of sustained efforts at macro-economic and structural adjustment.

6.48 While there was some revival in foreign direct investment in developing countries during the second half of the 1980s (it totalled about \$22 billion in 1990), these flows were largely concentrated in a few countries, particularly in Asia and the Western Hemisphere. Bank lending, where it was not a reflection of the accumulation of arrears or a part of debt-restructuring packages, was also concentrated in a few countries which continued to enjoy good credit standing. Foreign investment, bank credits and export credits have generally moved together, reflecting market perceptions of a country's credit-worthiness and its investment climate.

6.49 We believe that a major challenge facing the world today is how to enable a wider set of countries to attract such flows. As noted earlier, macro-economic stability, an improved role for markets, and financial sector and trade policy reform, will mobilise domestic savings, and could encourage the return of flight capital and attract greater foreign private capital flows, with one reinforcing the other. The experience of East Asian countries in attracting foreign direct investment in the 1980s can be attributed to their comparative success in avoiding high inflation and maintaining an investment climate, good infrastructure and services.

6.50 Wide-ranging action on several fronts is necessary to attract private flows. It includes the establishment of investment approval procedures, exchange control and legislation related to the repatriation of capital and dividends, the tax regime, labour laws, and human resource and physical infrastructure development. Of these, the development of an educated and skilled workforce is particularly important so as to provide the managerial and technical skills necessary to attract foreign investment. In the final analysis, it must also be recognised that all the policy changes and special incentives are by themselves inadequate. There must also be an appropriate environment, in terms of attitudes towards private enterprise in general, and foreign investment in particular. In many instances, this entails challenging entrenched positions and vested interests within the polity and bureaucracy, and developing a positive view of the role of private enterprise in development. While host countries could be selective about foreign investment and expect foreign investors to transfer technology, develop national procurement and reinvest profits where appropriate, these issues need also to be seen in terms of attracting foreign financing.

6.51 We also believe that much can be done by the international community to promote private capital flows to developing countries. It can, for example, encourage the promotion of insurance against non-commercial risks for foreign investors. The official agencies can also play a catalytic role by attracting private capital co-financing, and by providing guarantees. The World Bank has already undertaken significant initiatives in this context, for example the Multilateral Investment Guarantee Agency, expanded co-financing and the Excel Export Credit Programme. We believe that these initiatives deserve support. They also suggest lines of approach for further initiatives. Above all, there is scope for action to fill the gap in knowledge that exists in many countries on how to attract private flows. A number of international organisations provide technical assistance in this area, but a great deal more can be done.

6.52 Portfolio investment through single country or multi-country funds has become another important vehicle for inflows of capital. Over the past five years, some 50 developing country funds have been launched, raising over \$5 billion for investment in emerging markets. While these funds are geared mostly to investment in the successful economies of Asia, there is scope (such as the Commonwealth Equity Fund is trying to exploit) for a wider group of countries to attract equity flows. Such funds benefit the host country by augmenting capital, encouraging the development of domestic financial markets, and attracting a whole new class of institutional investors. There is increasing scope also for Funds (venture capital and other investment vehicles) providing, through equity

issues, development capital for business expansion. All these innovative ways of securing foreign investment should be fully considered.

6.53 We also believe that special efforts are needed to seek new opportunities to tap financial flows among the developing countries and from their migrants, as well as to repatriate flight capital. The pre-requisites for attracting such flows are similar to those needed to mobilise other forms of private finance. The rate of return and security of investment are more important determinants of the location of funds than subjective factors such as patriotism or familiarity with one's country. What is needed is a sense of security and opportunities for investment.

### *Official Flows*

6.54 While a significant revival in private financial flows to developing countries from the present depressed levels will be beneficial, it is also very evident that the aid agenda has expanded to new areas (such as needs on account of environment and poverty alleviation) and official flows must be increased to cater for this expansion. In addition, the number of countries that have lost market access or cannot afford to borrow on market terms has increased. Financing required for reconstruction and rehabilitation in the Middle East and post-apartheid South Africa also argues for further expansion in official flows. As against these expanded needs, a few countries which have received development assistance in the past no longer require it (for example South Korea). However, the headroom created by this will be nowhere near enough to accommodate the enlarged aid agenda. Many countries will have severe difficulty in sustaining their reforms and making meaningful progress towards improving the living standards of their people without a significant increase in official flows. For many low-income countries, aid flows remain the major source of external finance.

6.55 Official flows can also play a critical role in enabling countries to create the climate necessary to attract private capital flows. At a time when private capital is costly and cannot be made available on any long-term basis, aid flows can be a source of leverage in providing at the World Bank a 'Third Window' type of facility, on terms which fall between those of commercial lenders and IDA. Expanded financial flows can also be secured through schemes of interest subsidy and co-financing.

6.56 We believe that there is value in multilateral institutions, such as the World Bank and Regional Development Banks, playing an enhanced role in the provision of official finance. They act as useful intermediaries in tapping private capital for development finance. These institutions have built up considerable professional expertise in assessing the needs

of developing countries, and in the provision of technical assistance. They also carry the assurance that aid flows will be untied, and more stable.

6.57 It is, therefore, disconcerting that both the IMF and the World Bank have become recipients of net resources from developing countries at a time when the institutions have been called upon to assist members in formulating and financing painful adjustment programmes. The Fund's Articles of Agreement require it to ensure that policies associated with its financing programmes are not destructive of national or international prosperity but, rather, promote the development of productive resources as well as the maintenance of high levels of employment and real income in member countries. In line with this there has recently been some re-orientation of Fund programmes and conditionality policies and practices. More is needed in this respect (see Chapter 4). It is also important that policy on access to its resources responds to the needs of the widest possible range of members facing payments difficulties.

6.58 With respect to IMF facilities, there is a case for making greater use of the Extended Fund Facility (EFF), rather than consecutive stand-by arrangements, since recourse to the EFF would stretch out repurchases and reduce front-loading of programmes. It is disappointing that, despite modifications, the EFF has remained inaccessible to all but a few countries. It is also a source of concern that the Enhanced Structural Adjustment Facility (ESAF) has proved to be slow disbursing, with inordinate delays in the negotiation of programmes. Conditionality policies and practices have also proved to be a deterrent. The Compensatory Financing Facility, which was one of the most promising Fund facilities, has been diluted. The new Compensatory and Contingency Financing Facility (CCFF) is designed to provide members pursuing Fund supported adjustment programmes with broader protection against unforeseen adverse changes in external economic conditions. However, in practice, conditionality has increased and effective access to the Facility, particularly the compensatory financing element, has been tightened significantly. It is also disappointing that the CCFF continues to be effectively out of range for SAF/ESAF borrowers. We believe that access under the Facility should be enlarged and made less restrictive.

6.59 We are concerned that net use of the Fund credit continues to be low. There seem to be two contributory factors: the high cost of Fund resources, and conditionality policies and practices. At a time when many adjusting countries cannot afford the high costs of using Fund resources, serious consideration should be given to lowering these costs by reducing the rate of remuneration to creditor countries and by arrangements for interest-subsidy to lower middle-income countries. There is also a need

to cast programmes in a longer time-frame and pay greater attention to the economic growth objective and distributional issues.

6.60 It is important that the World Bank Group plays a more positive role in mobilising new financial flows to developing countries through its direct lending, equity participation and catalytic role. It is a matter of serious concern that a number of countries are likely to experience negative transfers with the Bank in the years ahead. The Bank Group's programmes must not be hampered by problems of capacity. In this respect, we believe there must be early agreement on a substantial capital increase for the International Finance Corporation (IFC). An increasing number of developing countries are emphasising the role of the private sector in the development process, and the IFC is expected to play an important role in supporting the transformation to market-driven economies in Eastern Europe. We also believe that the competing claims on the Bank's concessional resources cannot be resolved satisfactorily without an expansion of IDA resources. In this connection, we call on some of the more prosperous developing countries which have not yet contributed to IDA's resources to do so.

6.61 As noted earlier, developing countries will face considerable competition for aid and official finance in the 1990s. A major effort will have to be made to overcome the financial stringency that has confronted much of the developing world in the last decade. The broader view that we advocate sees development as a sine qua non for global security, which as a public good is the joint responsibility of the whole community of nations. There is, therefore, a need to develop appropriate burden-sharing mechanisms to meet the various financial claims built into achieving a stable world. The developed world has been talking about reaching the agreed UN target for ODA of 0.7 per cent of GNP over two decades; far from moving towards this target, ODA as a proportion of GNP has been declining in recent years. We believe that the opportunity of realising a peace dividend and application of a part of it to development aid should enable the developed countries to reverse this trend. Given the political will, it should be possible for the developed countries to double their ODA and reach the agreed UN target by the end of the century. While some countries (Denmark, Netherlands, Norway and Sweden) have already exceeded this target, there are some major donors which have not yet even reached half the target (see Box 6.3 on p.92). At a minimum, the rise in ODA from DAC member countries should not fall below their GNP growth. We feel that the more prosperous developing countries should contribute to development assistance in a significant way. Within the overall flow of official finance, there is need for greater transfers on a grant basis, as many countries cannot shoulder any further interest-bearing debt. We also believe that there must be a

significant increase in food aid. The current annual flow of food aid, at 10-11 million tons, falls short of requirements.

6.62 Not only is it necessary to increase the volume of ODA and to change its composition, there is a need for more effective use of such flows. There should be a further untying of commitments and relaxation of procurement procedures to improve the real value and speed of aid disbursements. We welcome the increasing role of the World Bank in aid coordination. But there is scope too for more coordination through Consultative Groups and for better internal administration. Project appraisal needs to be developed more intensively and internal priorities should be more rigorously applied. Donors should avoid promoting their own projects which simply aid their own exporters. They should increasingly put their assistance through the multilateral agencies, which have a better overall view of requirements and of the effectiveness of resource use.

## **Conclusion**

6.63 In conclusion, we believe there are a number of areas where concerted action is needed. More effective measures for debt relief have to be implemented and additional resources are needed for this purpose. There must be comprehensive and equitable burden-sharing arrangements among all creditors and debt must be restructured in relation to a country's debt-servicing capacity. It is also necessary to ensure that the emergence of new claimants on world savings (for example Eastern Europe, the Soviet Union) does not result in a diversion of official flows. It is vital that ODA is doubled by the end of the century to reach the UN target of 0.7 per cent of GNP and meet the expanded aid agenda which includes new needs on account of the environment and the spread of poverty. In this connection, every effort should be made to exploit the opportunities arising from the reduction in East-West tensions to cut military spending in both developed and developing countries and to ensure that a part of the resultant peace dividend is devoted to increase ODA. Developing countries for their part must pursue stable macro-economic policies and undertake structural reforms which will create the enabling environment necessary to make them creditworthy and attractive to investors, both local and foreign.

### **Box 6.3**

#### **Aid to Developing Countries from Member Countries of the Development Assistance Committee (DAC)**

Official development assistance (ODA) by DAC countries amounted to \$40.3 billion on average per year during 1980-82; by 1989, the latest year for which statistics are available, this stood at \$47.4 billion. (All figures at 1988 prices and exchange rates.) This represents a growth of 2 per cent per year.

As a proportion of their combined GNPs, however, ODA declined from an average of 0.37 per cent in 1980-82, to 0.33 per cent in 1989. The current DAC ODA/GNP ratio is below half the level of the UN target of 0.7 per cent adopted in 1968.

The average ODA/GNP ratios conceal wide diversity in performance among countries (see Table 6.3 on facing page). ODA by Norway, Sweden, Denmark, and the Netherlands exceeds 0.7 per cent of their respective GNPs; at the other end of the spectrum, there are seven countries—namely, Japan, Britain, Switzerland, Austria, New Zealand, Ireland and the United States—whose ODA/GNP ratios fall below the current DAC average of 0.33 per cent. The rest of the countries have a ODA/GNP ratio of between 0.33 and 0.70 per cent.

Changes in ODA/GNP ratios also reveal a mixed trend. On the one hand, Norway and Denmark increased their aid ratios during the 1980s by 0.15 or more percentage points of their respective GNPs; on the other, the aid ratios of all those countries (except Switzerland and Japan) which had an ODA/GNP ratio of less than 0.33 per cent in 1989, showed either stagnation or decline. The ratios of Austria and Britain declined by 0.08 percentage points or more during the 1980s.

**Table 6.3**  
**Changes in ODA/GNP Ratios of**  
**DAC Countries**

ODA/GNP Ratio, per cent, 1989	Country	Change in ODA/GNP Ratio During the 1980s <sup>1</sup>		
		Decrease > -0.02	Stagnant -0.02 - +0.02	Increase > +0.02
<u>Above 0.7</u>				
1.04	Norway			+0.16
0.97	Sweden		+0.02	
0.94	Denmark			+0.15
0.94	Netherlands	-0.07		
<u>0.33 to 0.7</u>				
0.63	Finland			+0.31
0.54	France <sup>2</sup>			+0.07
0.46	Belgium	-0.11		
0.44	Canada			+0.05
0.42	Italy			+0.19
0.41	Germany	-0.06		
0.38	Australia	-0.09		
<u>Below 0.33</u>				
0.32	Japan			+0.03
0.31	United Kingdom	-0.08		
0.30	Switzerland			+0.07
0.23	Austria	-0.10		
0.22	New Zealand	-0.05		
0.17	Ireland		-0.01	
0.15	United States	-0.05		

<sup>1</sup> Based on a comparison between the averages for 1980-82 and 1987-89.

<sup>2</sup> Excluding DOM/TOM.