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The Adequacy of Resource Flows to Developing Countries

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Joint Ministerial Committee
of the Boards of Governors
of the World Bank and the International Monetary Fund
on the
Transfer of Real Resources to Developing Countries
(Development Committee)
Washington, D.C., U.S.A.

Established in October 1974, the Development Committee is known formally as the Joint Ministerial Committee of the Boards of Governors of the World Bank and the International Monetary Fund on the Transfer of Real Resources to Developing Countries. The Committee's members, usually Ministers of Finance, are appointed in turn for successive periods of two years by one of the countries or groups of countries represented on the Bank's or the Fund's Board of Executive Directors. The Committee is required to advise and report to the Boards of Governors of the Bank and the Fund on all aspects of the broad questions of the transfer of real resources to developing countries, and to make suggestions for consideration by those concerned regarding the implementation of its conclusions.

The International Bank for Reconstruction and Development (IBRD) and its affiliate, the International Development Association (IDA), together constitute the World Bank. The International Finance Corporation (IFC) is another affiliate of the IBRD.

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Contents

The transfer of real resources to developing countries is at the heart of the Development Committee's mandate as set out in the parallel resolutions of the Boards of Governors of the Bank and the Fund under which the Committee was established in 1974. In recent years trends in the transfer of resources have been a standing item on the agenda of the Development Committee. In April 1988 the Committee discussed in depth the adequacy of resource flows to developing countries. These discussions were based on a report by the Bank which surveyed historical trends in net flows and net transfers of external finance from all sources, public and private, to all developing countries in the 1980s. The general conclusion of members was that larger financial flows to developing countries were required for economic growth, the alleviation of poverty, environmental protection, structural adjustment, and the resolution of debt difficulties. Members also emphasized that sound policies, a more supportive world economic environment, and improved prospects for export earnings would contribute toward increased resource flows.

In view of the wide interest in the subject, the Bank's paper, "The Adequacy of Resource Flows to Developing Countries," is now being made available to a broader audience.

Yves L. Fortin
Executive Secretary
Development Committee

September 1988

The Adequacy of Resource Flows to Developing Countries

This report begins by surveying the overall historical net flows and net transfers of external finance in the 1980s from all sources, public and private, to all developing countries. It does not propose to repeat the evidence, arguments, and recommendations made by the Task Force on Concessional Flows in 1985.[1] Rather, it updates the evidence and reviews recent developments in official concessional flows, official nonconcessional flows, and private flows to all countries since 1980.

The report next focuses on whether current capital flows are adequate to meet the requirements of three specific groups of developing countries. This task involves difficult judgments, as there are no entirely objective criteria for determining the adequacy of resource flows. An increase in the availability of resources enables a country to increase investment and consumption. External resource flows, if wisely used, enable the recipient countries to grow more rapidly and to improve the domestic allocation of resources—for instance, by directing funds to the alleviation of poverty. Despite the lack of objective criteria, an assessment of the required magnitudes of flows to the developing countries is necessary for analyzing the international economy.

The traditional method of estimating the adequacy of external flows of finance assumes a desired growth target for a country, estimates the available domestic saving at that growth rate, and

Note: This report was prepared by Ishrat Husain, chief of the Debt and International Finance Division, International Economics Department, World Bank.

1. *Report of the Task Force on Concessional Flows*. Development Committee pamphlet 7 (Washington, D.C., 1985); and *Aid for Development: The Key Issues. Supporting Materials for the Report of the Task Force on Concessional Flows*, Development Committee pamphlet 8 (Washington, D.C., 1986).

calculates the external resource requirement as a residual. This approach, known as gap analysis, has the advantages of being quantitative and of focusing on growth. Its disadvantages are that it ignores the other objectives of government policy, fails to emphasize the vigor with which domestic economic policy improvements are pursued, and tends to ignore the effect of price changes on the allocation of resources.

Gap analysis therefore must be supplemented by a more comprehensive view of the development process and of the reasons for international capital flows. Capital flows are needed to produce qualitative changes in the economic and social conditions of developing countries. They are needed to deal with the principal underlying issues of development, such as the fundamental problems of poverty, especially in the poorest countries, and the politically difficult process of structural adjustment, which inevitably involves large transitional costs. They may be needed to contribute to the solution of specific problems—for example, unemployment, declining food production, or the inability of countries to meet external debt-servicing requirements.

Accordingly, this report uses a variety of criteria to attempt to quantify the resource requirements of different groups of developing countries on the basis of certain underlying assumptions about the behavior of the world economy and about plausible targets for domestic economic performance. The report also examines recent changes in resource flows to developing countries and the corresponding changes in indicators of developing countries' economic performance.

Needs for and access to external resources vary greatly among developing countries, which include some countries that are now providing net resource flows to the rest of the world. For this reason, the resource requirements of developing countries are not discussed in the aggregate. Instead, this report focuses on three distinct groups of developing countries that face a potential shortfall in the availability of external resources during the next five years: the highly indebted countries, Sub-Saharan Africa (excluding Côte d'Ivoire and Nigeria, which belong to the highly indebted group), and low-income Asia. Together, the sixty-six countries covered under the three groups account for 72 percent of the aggregate gross domestic product (GDP) of all developing economies, 80 percent of the population, and 67 percent of the outstanding external debt.

The growing differentiation of developing countries made it necessary to assess the development objectives and resource requirements of specific groups separately. Some countries were omitted from the analysis because their great economic and financial diversity precluded easy categorization.

For example, countries such as Afghanistan, Iran, Iraq, Democratic Kampuchea, Lebanon, and Viet Nam that are devastated by war or other forms of strife will need substantial external support to reconstruct their economies, but in most cases the political or economic conditions for a reconstruction effort are not yet in place. Since recent basic economic information on these countries is lacking and not enough is known about their future parameters, we could not analyze their needs for resources.

The oil-exporting developing countries that are not highly indebted (including, among the most populous, Algeria, the Arab Republic of Egypt, and Indonesia) have a continuing need for external capital. These countries are also adjusting, sometimes very actively, to the recent decline and weak prospects of oil prices. To avoid a crisis they need continued reasonable access to private and, in many cases, public funds. Their situation needs to be watched closely, and their external financing requirements may have to be added to those of the highly indebted countries if the situation worsens.

The small island economies, particularly those in the Caribbean and Pacific regions, show relatively high levels of per capita income. Their dependence on foreign trade and tourism, however, makes them vulnerable to variations in world prices and to changes in income levels in the industrial countries. Many of them are also heavily dependent on aid. They thus face a special set of development constraints and issues because of their small size, openness, remoteness, and reliance on external forces. A careful estimation of their financing requirements would take a separate study.

At least three low-income countries that are eligible for IDA loans—Haiti, Laos, and Yemen Arab Republic—have external assistance needs that are no different from those of low-income Africa.[2] Their requirements, although small in absolute amounts, should therefore be added to those of low-income Africa and should be financed mainly out of official development assistance.

A few developing economies, especially in the East Asia and Pacific region and in Europe, have made rapid economic progress and may soon be on the threshold of becoming industrial countries. These countries are generating trade and current account surpluses, and their inclusion would introduce distortions into the underlying patterns.

Several middle-income developing countries such as Hungary, Jordan, Poland, Syria, Tunisia, Turkey, and Yemen PDR do not fall conveniently into any group. Each has a unique economic structure and financial outlook. Although some have external financing needs, the range varies widely, and it would not be helpful to lump such diverse countries in a single group to analyze their resource requirements. For them, a country-by-country analysis is in order.

Although the factors mentioned above and the limitations of time did not permit an in-depth analysis of the resource requirements of all developing countries, it is clear that the total resources in sight from all sources are inadequate for the resolution of financial difficulties in many countries.

The three groups have been chosen because of the specific development problems they face. Income levels in Sub-Saharan Africa and low-income Asia are so low that capital flows to those countries may be justified as an international effort to alleviate poverty. In addition, in the highly indebted countries and Sub-Saharan Africa per capita incomes have fallen significantly in the 1980s—by one-seventh in the former and by nearly a quarter in the latter. The prospects for resumption of growth in these countries are not promising, as per capita investment in Africa in 1987 was below the level of the mid-1960s, while in the highly indebted countries it fell back to the level of 1970.

Although income growth in low-income Asia has been impres-

2. Low-income Africa is defined as Sub-Saharan Africa excluding Botswana, Cameroon, Cape Verde, Congo, Côte d'Ivoire, Djibouti, Gabon, Mauritius, Nigeria, Seychelles, Swaziland, and Zimbabwe.

sive, these countries' efforts to improve the conditions of more than half a billion people living below the poverty line have not yet had much success. Most countries in this group have initiated domestic policy reforms, but for progress to be achieved within a reasonable time they require the support of the international community through the restoration of adequate external resources.

For the highly indebted countries the goal of adequate resource flows implies some reduction in the onerous debt-servicing burden so that the surpluses generated can be diverted to the resumption of adequate growth in investment, output, and consumption. For Sub-Saharan Africa it means debt relief for debt-distressed countries, acceleration of investment for the resumption of growth, and maintenance of structural adjustment programs. For low-income Asia adequate flows are needed to accelerate the significant progress made in recent years, set up and implement poverty alleviation policies and programs, and support efforts at economic liberalization.

An Overview of External Resource Flows

This report presents two sets of estimates—one based on the concept of net transfers (disbursements minus capital repayments minus interest) and the other on net flows (disbursements minus capital repayments only). These two concepts are then extended to reflect the impact of non-debt-creating resource flows—official and private grants, foreign direct investment, and portfolio investment not included under debt-creating flows.[3]

3. This estimate is derived by using the net flows and net transfer data from the World Bank's Debtor Reporting System (DRS) and adding OECD data on official and private grants and direct and portfolio investment data. An attempt was made to reconcile this estimate by starting with the OECD data and adding the financial markets data from the DRS. The latter calculations yield $109 billion for 1981 and $57.5 billion for 1986 at the same constant prices and exchange rates.

Data on resource flows other than official development assistance are beset with conceptual, presentational, and definitional problems. The two principal primary sources used in this report are the DRS and the OECD data bank. The OECD covers fifty-three countries, mostly smaller economies, territories, and dependencies, that are not included in the DRS. But since the DRS data pertain to debt-creating flows, it is assumed that debt flows to these fifty-three countries (with the exception of Iran and Iraq) may not be very large. Therefore the DRS data may understate the total volume, but only slightly.

When nondebt flows are added to net flows on long-term debt, the resulting estimate (aggregate net flows) is equal to the current account deficit, assuming an unchanged reserve position. Similarly, when nondebt transfers are added to net transfers on long-term debt, the resulting estimate (aggregate net transfers) is equal to the current account balance before interest payments. The concept of net transfers is discussed in the appendix.

The recognition that high levels of interest payments are an important constraint on economic growth in developing countries has led to the wider use of the net transfer concept in the analysis of resource flows to developing countries, since the net transfer figure is arrived at by deducting interest receipts as well as capital repayments from the gross value of the resource inflow. This controversial concept has been criticized because it mixes current account and capital account items and because it ignores earnings derived by the recipient country from the use of the borrowed funds. Its main advantage is that it measures the current cash flow arising from these transactions—an important consideration for the recipients who must manage them and also for the creditors. In addition, it measures the excess of goods and services produced by the country over goods and services currently available for its own consumption and investment. It must be realized, of course, that if funds are borrowed on commercial terms and if net transfers are always to be positive, then unless exports grow at least at the rate of interest, debt will grow steadily.

Finally, a word of caution: the proper assessment of the volume of resource flows to developing countries is greatly complicated by serious valuation problems. The measurement of resource flows, like that of other aggregates composed of nominal amounts denominated in a number of different currencies, is bedeviled by the difficulty of expressing meaningful totals in a single common unit. The analysis of year-to-year changes becomes problematic when, as in the past decade, significant swings take place in the exchange rate between the dollar and the currencies of other leading sources of capital flows. An attempt is made to compensate for this currency effect, but the result should not be regarded as being "in real terms."

The most dramatic event of the past five years has been an unprecedented reversal of financial flows to developing countries. That reversal has interrupted the momentum of growth in the developing world and has led to serious debt problems in many developing countries. During the five-year period 1978–82 net transfers of resources to developing countries through long-term lending amounted to $140 billion. During the five-year period 1983–87 the equivalent figure was a negative net transfer of around $75 billion.[4] For the highly indebted countries the comparison is still more stark: a net positive resource transfer of $65 billion for 1978–82 and a net negative resource transfer of $106 billion for 1983–87, or 2.8 percent of their aggregate GDP for the period. If nondebt flows (grants, direct private investment, and portfolio investment) are added, the picture improves, but not a great deal; the negative aggregate net transfers are reduced to $96 billion. These figures underscore the magnitude of the financial shock experienced by developing countries, and by highly indebted countries and Sub-Saharan Africa in particular, as they attempted to adjust to falling commodity prices and rising real interest rates.

Aggregate net transfers to developing countries as a group declined from $74 billion in 1981 to $3 billion in 1986. Aggregate net flows to developing countries were $114 billion in 1981 and only $51 billion in 1986—less than one-half in volume (see table 1).

A precipitous decline in private bank lending after 1982 accounted for the greatest portion of the change in the volume of flows. New private bank lending is now concentrated in only twenty creditworthy countries, mainly in Asia, while many highly indebted countries are making net transfers to the creditor banks. Almost all new private bank lending to highly indebted countries since 1982 has been concerted, or nonvoluntary. By 1986 official development finance, bilateral and multilateral, was providing about 70 percent of the net flows to developing countries—almost twice the proportion in 1980. Official development assistance (ODA)[5]

4. Current U.S. dollars are used throughout unless otherwise specified. A billion is a thousand million.

5. Official development assistance (ODA) is defined as net disbursements through bilateral and multilateral agencies of grants and loans to developing countries at concessional terms—that is, the grant element is at least 25 percent.

Table 1. *Long-Term Net Aggregate Flows and Net Transfers to Developing Countries, 1980–87*
(billions of U.S. dollars; 1985 prices and exchange rates)

Item	*1980*	*1981*	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*[a]
A. Net flows on long-term debt	58.8	74.2	65.9	53.8	46.0	33.9	20.4	28.2
B. Official grants[b]	13.7	13.0	12.4	12.7	15.0	16.5	15.7	15.0
C. Direct private investment	10.1	16.3	12.2	9.0	11.5	6.5	9.8	9.8
D. Portfolio investment[c]	1.6	1.4	0.4	0.2	0.3	1.2	1.0	1.0
E. IMF purchases (net)	2.1	5.9	6.0	11.4	5.1	0.3	−1.5	−4.2
F. Other private flows[d]	4.0	3.6	3.0	2.8	3.6	5.5	5.6	5.0
Aggregate net flows (A + B + C + D + E + F)	90.3	114.4	99.9	89.9	81.5	63.9	51.0	54.8
G. Net transfers on long-term debt	28.5	34.0	17.6	7.0	−7.4	−20.8	−25.0	−21.8
Aggregate net transfers[e] (G + B + C + D + E + F)	60.0	74.2	51.6	43.1	28.1	9.2	5.6	4.8

Notes: This table does not include capital flight estimates (discussed in the text).

a. Preliminary estimates subject to revision.

b. Excludes technical assistance.

c. Non-Bank.

d. Includes private nonvoluntary grants.

e. Does not include data on dividends or on remittances made abroad by developing countries on foreign direct and portfolio investment.

Sources: A and E, World Bank, *World Debt Tables 1987–88 Edition* (Washington, D.C., 1988); B, C, and F, DAC chairman's report 1987, Statistical Annex.

from the countries of the Organisation for Economic Co-operation and Development (OECD) increased at 3.6 percent a year in volume over this period, but as aid from the members of the Organization of Petroleum Exporting Countries (OPEC) fell significantly, global ODA stagnated. The explanation for the current relative dominance of official finance is that a significant number of developing countries has lost creditworthiness in the private capital markets.

Multilateral sources now account for about one-fourth of aggregate net flows to developing countries, up from 10 percent in 1980. In addition, developing countries drew about $30 billion from the IMF between 1980 and 1986 and currently have outstanding drawings of about $37 billion.

Official export credits made or guaranteed by export credit agencies (ECAs) have been an important source of financing for developing countries since 1960. A boom in ECA lending followed the first oil shock and continued until the debt crisis erupted in 1982. Since then this source has almost disappeared as a net provider; it accounted for 2 percent of net flows to developing countries in 1986, compared with 14 percent in 1980.

Foreign private investment has, on the whole, been a minor part of resource flows to developing countries. Foreign direct investment flows were about the same volume in the mid-1980s as in the early 1970s.

These swings in the volume and origin of resource flows have had many consequences for developing countries. An upswing in private debt flows in the past fifteen years created lasting effects of a totally different order of magnitude from the effects of an increase in ODA, with its high grant element. The outcomes included per capita consumption and investment levels that were financed out of the extraordinary foreign savings of the 1970s and were clearly unsustainable in the longer run and a shift of total interest payments in many countries to a substantially higher level that represents a new and significant constraint on expansion. The initial impact of these private flows and their continuing legacy clearly vary widely from country to country but are more dominant in the highly indebted countries.

The general picture of resource flows and transfers is incomplete without a discussion of capital flight, which has aroused growing concern because it leads to a net loss in the total real resources available to an economy for investment and growth. Capital flight diverts domestic saving away from domestic real investment and toward foreign financial investment. Further, it has adverse fiscal consequences, since the income earned by the capital is usually not taxed by the originating developing economy and indeed may have left the country in large part to evade taxation. Some creditors are therefore reluctant to provide funds that might simply end up financing capital placements abroad.

The definition and measurement of capital flight have serious limitations both conceptually and empirically, as capital flight is in fact a form of capital export from the developing countries and is interwoven with other kind of outflows. Serious attempts have been made recently to capture the magnitude of this phenomenon. Estimates from an IMF study[6] suggest that capital flight in the countries with debt-servicing problems amounted to an average $9.3 billion a year during 1983–85—a significant reduction from $20.7 billion for 1979–82, but enough to finance 8 percent of exports of goods and services of these countries. In recent years capital flight has slowed, primarily as a result of policy improvements in the countries.

Official Development Assistance

The great fluctuations in the world economy and the dramatic changes in the availability of external financing for developing countries seem to have had relatively little effect on the level of ODA to developing countries, which, in constant U.S. dollars, has been nearly stagnant in the 1980s (table 2). The average level for 1980–86 was $27 billion, at 1985 prices and exchange rates, and no single year differed from that average by more than about 7 percent.

The fluctuations in total levels of ODA were caused by several, not always related, factors. The decrease in 1982 occurred at a time of falling output in the industrial countries and decreased oil revenues in the main OPEC contributors of ODA. The jumps in ODA levels

6. IMF, "World Economic Outlook. A Survey by the Staff of the International Monetary Fund" (Washington, D.C., October 1987), table A42.

Table 2. *Official Development Assistance to Developing Countries, 1980–87*
(billions of U.S. dollars; 1985 prices and exchange rates)

Source	*1980*	*1981*	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*[a]
Bilateral	22.4	23.2	20.9	19.9	21.4	22.3	22.0	20.4
DAC	11.8	12.5	12.8	12.7	14.0	15.7	15.3	14.2
OPEC	8.1	7.2	4.4	3.8	3.7	2.9	3.0	2.7
CMEA	2.2	3.0	3.1	3.1	3.2	3.5	3.4	3.2
Other	0.4	0.5	0.5	0.3	0.4	0.2	0.3	0.3
Multilateral	5.4	5.4	5.3	5.4	5.7	6.2	5.7	5.3
Total	27.8	28.6	26.2	25.3	27.1	28.5	27.7	25.7

Note: Figures exclude technical assistance grants.
a. Preliminary estimates subject to revision.
Source: OECD/DAC.

in 1984 and 1985 were manifestations of the response to the special needs of Sub-Saharan Africa for emergency relief and structural adjustment. During 1986, the most recent year for which data are available, ODA increased by about 19 percent in nominal dollars, largely as a result of exchange rate changes. In adjusted dollars it fell slightly. Within the total, there has been a slight upward tendency since the early 1980s in multilateral flows and in bilateral flows from the OECD Development Assistance Committee (DAC) and the Council for Mutual Economic Assistance (CMEA). This increase has compensated for a decline from the 1980 peak in the substantial flows (in relation to gross national product—GNP) from OPEC countries.

Bilateral flows from DAC countries have remained the largest and most strongly growing component of total ODA. By 1986 their total level in constant 1985 prices and exchange rates was almost one-third above the 1980 level. The DAC countries' share in total ODA rose from 43 percent in 1980 to 56 percent in 1986. At the same time, the flow of official aid from OPEC fell both absolutely and relatively. OPEC's share in total ODA declined from an extraordinary 30 percent at the opening of the decade to less than 11 percent in 1986. Even at the reduced 1986 level, however, OPEC's average ODA/GNP ratio was 0.95 percent, almost three times the OECD average. (ODA/GNP ratios, as defined here, include technical assistance grants.) The volume of ODA provided by CMEA is relatively modest, although since 1980 it has been steadily increasing; its share in the world total rose from 8 percent in 1980 to 12 percent in 1986. Virtually all ODA from CMEA countries consists of bilateral flows to a handful of countries with close ties to CMEA members.

Important changes also occurred on the recipient side of ODA. The share of low-income Africa in total ODA rose and that of low-income Asia declined. The shift in favor of Africa was most visible in the case of multilateral aid agencies, while the absolute amount of increase was larger for bilateral flows, which are approximately twice as large as flows from multilateral institutions. Low-income Africa's share in the assistance of multilateral aid agencies went from 28 percent in 1980 to 34 percent in 1986, and its share in bilateral flows rose from 11 to 15 percent. In both cases the increase in the share of resource flows to low-income Africa was accompanied by a drop in the share of, mainly, low-income Asian countries. This occurred despite the emergence of China as an important recipient of multilateral flows.

The ODA estimates presented in tables 1 and 2 and in the rest of this pamphlet exclude technical assistance grants. Technical assistance accounts for roughly one-quarter of the bilateral ODA reported by DAC member countries. Of this, about 60 percent represents the costs of sending experts and volunteers to developing countries. The exclusion of technical assistance facilitates the comparison with balance of payments data because technical assistance is not normally captured in the transfers or services items in the recipient country's balance of payments.

In spite of stagnating ODA flows, the relative importance of ODA as a net provider of resources to developing countries has risen considerably because of the collapse in the value of flows from private sources. Under such circumstances the prospects for ODA are of crucial importance. A recent survey by the DAC Secretariat suggests that growth in ODA may fall to about 2 percent a year or less during the next few years.[7] If it can be assumed that the

7. OECD, *Efforts and Policies of Members of the Development Assistance Committee* (Paris, December 1986), p. 51. See also OECD, "Draft Press Communiqué on 1987 Financial Flows to Developing Countries. Note by the Secretariat" (Paris, June 6, 1988).

decline in OPEC aid has run its course, global ODA will thus increase at about 2 percent a year during the next few years. If the stated goals for ODA volume are achieved, an average GNP growth of 2.5 percent for DAC countries could bring about a 3 percent increase in ODA over the next five years. Such an outcome would just match the average rate of real ODA growth in 1980–86 and would raise the average ODA/GNP ratio for DAC from 0.35 percent to 0.38 percent, back to the level reached in 1982.

Nonconcessional Official Flows

Nonconcessional official flows consist mainly of lending from bilateral and multilateral sources on terms that do not qualify as ODA. In most instances these flows may still be at terms considerably better than those available on the commercial market. The IMF has also been an important provider of nonconcessional resources to developing countries. In 1987, however, the Fund's net purchases amounted to −\$5.5 billion in current dollars, and net transfers after including charges were −\$8.1 billion.

MULTILATERAL DEVELOPMENT BANKS. Nonconcessional official flows from multilateral development banks have been the most rapidly growing source of external funds for developing countries in the 1980s. The volume (at constant 1985 prices and exchange rates) of net nonconcessional flows by these institutions was \$6.1 billion in 1986, about 35 percent higher than at the beginning of the decade. Measured in relation to other flows, nonconcessional flows from multilateral development banks were 11 percent of net flows to developing countries in 1986, compared with 5.0 percent in 1980.

During the first half of the 1980s the share of project lending in net flows from multilateral development banks declined and the share of lending to support adjustment programs rose. Adjustment loans by the World Bank have accelerated, and they accounted for the entire increase in disbursements in 1986. The Asian Development Bank and the African Development Bank have also initiated nonproject lending, and the share of adjustment loans in their total lending, although still marginal, has started to rise in recent years.

Of the multilateral development banks, the African Development Bank and the Inter-American Development Bank have shown the most rapid growth in lending compared with the early 1980s. Both more than doubled their average net flows (in current dollar terms) in 1984–86 compared with 1980–82. Net flows from the World Bank were about 75 percent higher than in 1980; net flows from the Asian Development Bank were up by only 15 percent. There appears to have been a shift recently, and the World Bank and the Asian Development Bank have shown the strongest growth in commitments. Commitments by the Inter-American Development Bank declined in 1985–86.

Nonconcessional resource flows from multilateral development banks have increasingly been concentrated in a small group of middle-income countries. A rise in the share of low-income Asia in total nonconcessional commitments (from 6.6 percent in 1980 to 9.4 percent in 1986) has brought about a small shift toward low-income countries in the overall composition of nonconcessional commitments in the 1980s. Lending by multilateral development banks to low-income countries in Africa has fallen to an almost negligible share (1.3 percent) of the banks' nonconcessional commitments, reflecting the impact of the increasingly pressing debt problems of this group. This decline, however, is more than compensated by an increase in concessional lending to low-income Africa, particularly by the World Bank. Net flows from IDA to low-income Africa have almost quadrupled, from $393 million in 1980 to $1.3 billion in 1986. Net transfers from IDA show the same trend; they rose from $379 million in 1980 to $1.24 billion in 1986. The fifth replenishment of the African Development Fund will also contribute to increased resource flows to low-income Africa.

Continued progress in adjustment efforts on the part of borrowers and continued moves by the regional development banks to associate a greater share of lending with these efforts should make possible a resumption in the growth of net lending by the multilateral development banks. Future growth in lending by the World Bank and the Inter-American Development Bank will depend in the near term on the conclusion of arrangements for increases in their capital bases. The fall of the dollar has eroded the World

Bank's ability to lend. Future growth of lending and possibly the ability to sustain current lending levels will require prompt approval of the Bank's general capital increase.[8] The situation for the Inter-American Development Bank is even more critical, as negotiations on a capital increase have become inactive. The recent tripling of the capital base of the African Development Bank, the sixth replenishment of the European Investment Bank, and the special program of assistance by the European Community, however, are noteworthy initiatives for accelerating resource flows in the coming years.

EXPORT CREDITS AND GUARANTEES. One of the most dramatic changes in the financing picture of developing countries has been the sharp fall, to almost negligible levels, in net export credit lending and the reduction in interest subsidization after an agreement among OECD countries on a system that requires export credit rates automatically to follow market interest rates. An element of competitive subsidy nevertheless remains through the provision of mixed credits—that is, the association of an aid grant or concessional loan with a loan at commercial rates.

In 1980 export credits contributed 10 percent of total net flows to developing countries. Although gross flows continued to be substantial ($25 billion from the OECD in 1985), net flows have declined severely since 1980. In 1986 net flows were −$1.3 billion.

The dramatic decline in export credits since 1981 has been a result of both supply and demand factors. On the supply side the heavy losses incurred by most of the export credit agencies were the principal factor behind the restraints on extension of new credits to a number of countries. Debt reschedulings, in particular, impose heavy costs on many export credit agencies (which must compensate insured exporters when scheduled payments are not met) and inhibit their ability to extend credits. Many ECAs responded to the onset of heightened debt-servicing difficulties by sharply restricting new export credit cover to minimize their ex-

8. The Bank's general capital increase was approved by the Executive Directors on February 19, 1988, and 77 percent had been subscribed by member countries by April 27, 1988.

posure. Traditional policies in some agencies called for a considerable period to elapse—in some cases, years—before cover could be reinstated following a debt rescheduling. On the demand side, financial stringency has led to sharp cutbacks in purchases of the kinds of capital equipment that ECAs usually financed, and lower market interest rates and low export credit subsidies have made export credits less attractive to exporters. Although export credit cover policies have tended to become more flexible, an early revival of demand by developing countries for investment goods is not expected.

Coordinated international efforts are being undertaken to help ensure that export credit policies support other efforts to address the debt and development problems of the most indebted developing countries. Recently the ECAs have achieved greater harmony in their cover policies. Cover policies also appear to have become more closely aligned with country performance in adjustment programs, and a more open stance has emerged for countries with adjustment programs that are supported by international institutions, even if these programs involve debt rescheduling. This has been helped by more intensive consultations among ECAs, governments, and the international institutions. The importance of adhering to internationally agreed public investment programs has been recognized, and some ECAs have reopened cover sooner for projects that are of high priority and are incorporated within adjustment programs supported by the World Bank and the IMF.

Private Flows

COMMERCIAL BANK LENDING. Among private sources of capital, net flows from the banking sector experienced the largest fall in absolute terms; annual flows declined by $22.6 billion (79 percent) between 1980 and 1986. Only the decrease in the volume of export credits was more dramatic in relative terms. During the three years preceding the outbreak of the debt crisis (1980–82) the level of net capital flows remained largely unchanged in spite of clearly deteriorating general economic conditions and rising interest rates. It was only after the debt crisis started that significant declines began. In 1983 total net flows from the banking sector fell by 15 percent, and during the next three years they fell by 28 percent, 44 percent, and 38 percent respectively.

The evolution of commercial bank lending and, in particular, the growing reluctance to lend to nonoil developing countries are illustrated by changes in outstanding claims of banks in the reporting area of the Bank for International Settlements (BIS). Between the end of 1982 and the end of 1985 the total volume of claims increased by almost \$61 billion, or 21 percent, to \$357 billion. Most of the increase represented concerted or administered lending connected with debt reschedulings or lending to creditworthy borrowers among the newly industrialized countries (NICs). Between December 1985 and the end of June 1987 commercial bank claims on nonoil developing countries went up by a mere 5 percent, or \$17.6 billion. But the actual increase in lending was estimated at only \$4.4 billion; the rest represented valuation changes brought about by the fall in the international value of the U.S. dollar.

Net private bank lending is now concentrated in only twenty creditworthy countries, mainly in Asia, and with few exceptions the highly indebted countries are not receiving new money. Consequently the share of the highly indebted countries in the total volume of net flows from the banking sector plunged from 64 percent in 1982 to 18 percent in 1986.

The profitability of commercial banks and their willingness to provide new money was directly affected by the large provisions against developing country loans that the banks made in the recent past. Many banks are now increasing their provisions to still higher levels. In effect, provisions act as a disincentive for new lending to the problem debtors, but they do not preclude further commitment of new money under rescheduling agreements (as the August 1987 agreement with Argentina demonstrated). In the longer run, loan loss provisions may have a favorable impact on other options because they allow the banks to consider solutions, including debt write-downs, interest capitalization schemes, and debt-equity swaps, that recognize losses and discounts on their loans to developing countries.

Most commercial bank lending in the near future is likely to be directed to the fifteen or twenty developing countries that are still considered creditworthy. The prospects for resumption of voluntary lending by the commercial banks to the highly indebted countries that badly need these flows will depend on the speed with which creditworthiness is restored in these countries. But the restoration itself will depend on adequate financial flows, strong domestic adjustment policies, and a favorable international environment.

PRIVATE DIRECT AND EQUITY INVESTMENT. According to recent OECD data, net direct investment flows to developing countries fell from a peak of $17 billion in 1981 to $9 billion in 1983 and then fluctuated between $6.5 billion in 1985 and an estimated $12 billion in 1986. Similar trends were reported for Latin America by the Inter-American Development Bank in its *Report on Economic and Social Progress in Latin America for the Year 1987.*[9] According to that study the highest level of direct investment flows to Latin America was in 1981 ($7.5 billion). These flows bottomed out in 1983–84 at $3.4 billion and picked up in 1985. Comparison of the two sets of data implies that the bulk of the decline in net direct investment flows to developing countries was in Latin America.

Direct investment flows are highly concentrated in a small number of countries that have large domestic markets or are endowed with natural resources that constitute a good base for export-oriented production. According to an IMF study, by the end of 1983 four countries (Brazil, Malaysia, Mexico, and Singapore) accounted for nearly half of the stock of foreign direct investment in nonoil developing countries.[10]

There are several plausible reasons for the declining trend in the level and share of direct investment in developing countries and for the redirection of this investment. The slowdown of foreign direct investment in general and the growth of flows into the United States may have diverted some investment away from developing countries. Other factors are the generally weak market situation for mining and minerals, where foreign direct investment has been concentrated in the past; the growing indebtedness and the ensuing

9. Inter-American Development Bank, *Economic and Social Progress in Latin America. 1987 Annual Report* (Washington, D.C., 1987), p. 458.

10. IMF, *Foreign Private Investment in Developing Countries.* Occasional Paper 33 (Washington, D.C., 1985).

adjustments within developing countries; and, in some countries, restrictive policies toward foreign investment. Most repayments of direct investment consist of current flows rather than capital flows and do not burden the country's balance of payments as much as do external debt obligations. This is because the returns on investment tend to vary in the same direction as fluctuations in the country's GDP. But it is evident that, given the relative magnitudes of direct investment and bank sector flows, the principal effect of even a substantial increase in foreign direct investment would be to develop industrial potential rather than to reduce the debt burden significantly in the near term.

Foreign direct investment is small in relation to total domestic and foreign investment. During 1973–80 foreign direct investment constituted less than 1 percent of total investment in forty-one developing countries for which figures are available. Although foreign direct investment has been relatively small so far, the reduced availability of official assistance and the drying up of commercial lending make direct investment an attractive source of financing for developing countries.

There seems to be a correlation between economic performance and foreign direct investment. Among developing countries only the countries of the Association of South East Asian Nations (ASEAN), the Asian NICs, and such countries as Chile, Colombia, and Turkey are able to attract foreign investors at present. The countries that badly need foreign investors to fill the financing gap and undertake investment—the highly indebted countries—have witnessed a slowdown in these flows. The introduction of the Multilateral Investment Guarantee Agency (MIGA) may improve foreign direct investment flows, but the history of these flows indicates that they are not likely to play a significant role in the provision of external resources to highly indebted countries until the debt crisis is successfully resolved. It should also be noted that some highly indebted Latin American countries have not yet joined MIGA.

Direct investment may have some advantages for recipients over borrowing from commercial banks. The IMF study referred to above points out that, unlike interest payments, income payments are unlikely to rise during periods of negative external economic shocks. The estimated annual rate of return on direct investment is positively (albeit weakly) correlated with the host country's annual rate of growth of GDP and exports.

The volumes of nondebt portfolio investment are extremely modest when compared with other forms of resource flows to developing countries. According to OECD statistics, portfolio investment, defined as the residual in private flows (after excluding export credits and direct and banking sector investments) peaked in 1980 at $1.8 billion. The overwhelming share of these flows was directed to middle-income countries that are not highly indebted. In the longer run, however, these portfolios have the potential to be a growing source of external capital, given the development of local stock markets, the relative success of investment funds (for example, the Korea Fund), and interest in debt-equity swaps and in various other forms of securitization of commercial bank debt.

As for the likely prospects for direct foreign investment in the next five years, recent trends suggest that sound macroeconomic policies, prudent economic management, a favorable regulatory and tax environment in the host countries, and differentials in relative costs of production help to attract foreign investors. Although debt-equity conversions may be able to induce some flows, it is not highly likely that the Sub-Saharan African countries and the highly indebted countries will be the target of foreign direct investment in the near term. Low-income Asian countries, particularly China, offer favorable prospects at present. But as can be seen from the data in table 1, the combined share of direct and portfolio investment in aggregate net flows to the developing countries during 1982–87 has been, on average, only 13 to 14 percent. Thus popular expectations about what private foreign investment flows can accomplish in the short run appear optimistic.

PRIVATE VOLUNTARY ORGANIZATIONS. ODA flows through private voluntary organizations have increased substantially in recent years and are now about $4.7 billion—almost 10 percent of total ODA. Private grants to developing countries originate mainly from two sources: funds raised by private voluntary organizations through their own efforts and grants to private voluntary organizations from official aid agencies. *Status Report on Concessional Flows: 1986*[11] shows, however, that the funds have largely been provided by official aid agencies. The contribution of official aid to private voluntary organizations now constitutes about one-third of the total of private grant disbursements—up from 3 percent a decade ago.

Private voluntary organizations have much to contribute, especially in reaching the grass roots with programs in social sectors, agriculture, and rural development. But their limited administrative capacity makes it unlikely that they will become a significant source of substantial new funding.

The Adequacy of External Resource Flows to Three Groups of Countries

Highly Indebted Countries

The group of highly indebted countries consists of seventeen middle-income countries that have been the subject of attention since at least 1985. They are Argentina, Bolivia, Brazil, Chile, Colombia, Côte d'Ivoire, Costa Rica, Ecuador, Jamaica, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela, and Yugoslavia. These countries account for one-third of the developing countries' GDP but for more than 40 percent of their outstanding debt.

TRENDS IN RESOURCE FLOWS. The trends in resource flows to the highly indebted countries reflect the movements in their debt indicators, which hardly improved during 1982–87. The stock of outstanding debt grew two-thirds during 1980–86, and both the debt-GNP ratio and the debt-export ratio almost doubled. Total actual debt servicing accounted for 39 percent of the countries' exports in 1986; that ratio was 32 percent in 1980 (table 3). Interest-to-export ratios have eased only marginally and only because of rising arrears.

11. Development Committee pamphlet 9 (Washington, D.C., 1986).

Table 3. *Debt Indicators: Highly Indebted Countries*

Item	*1980*	*1982*	*1986*	*1987*[a]
Total external debt (billions of U.S. dollars)[b]	284.6	383.5	456.3	485.3
Debt-GNP ratio	33.1	45.6	59.6	58.0
Debt-export ratio	174.5	254.2	335.6	317.9
Debt service ratio	32.0	43.9	39.1	34.1
Interest as percentage of exports	16.0	26.9	25.3	21.4

a. Estimated.
b. Excludes IMF.

The volume of net flows to highly indebted countries has declined precipitously, from $49 billion in 1981 to an average of $7 billion during 1985–87 (table 4). The only source of financing that has shown any perceptible increase is net flows from multilateral institutions, which increased 35 percent during 1982–87 in constant prices and exchange rates. The picture is even bleaker if the volume of net transfers is examined. In 1981 there was a positive net transfer of $23 billion, but negative net transfers started in 1982, accelerated, and averaged about $24 billion a year in 1985–87.

The composition and terms of external debt of the highly indebted countries and the worsening debt indicators reflect the difficulties that they face. The share of commercial banks and other private creditors in their external debt outstanding in 1986 was close to 70 percent, compared with 18 percent held by official bilateral creditors. The remaining 12 percent represents the claims of multilateral institutions, including the IMF. Variable interest rate claims represent 69 percent of their total long-term debt. The changes in the debt indicators were discussed above.

The highly indebted countries that have embarked on adjustment programs and domestic policy reforms have received strong financial support from the World Bank and the IMF. But, except for Argentina and Mexico, the commercial banks did not provide new money during 1986–87 to accompany this support. Repayments of principal and interest by the highly indebted countries to the financial markets exceeded the disbursements they received by more than $18 billion in 1986 and $14 billion in 1987. Meanwhile the World Bank increased its adjustment lending disbursements to the highly indebted countries by over 40 percent in 1986 compared with 1985 and by another 30 percent in 1987. The highly indebted countries' efforts to adjust domestically are being thwarted by inadequate external financing.

Because of a relatively lower proportion of official bilateral debt, reschedulings by the Paris Club have not been as important in relation to the stock of debt as in the case of Sub-Saharan Africa. The total amount of debt rescheduling provided by the Paris Club to Latin American countries during 1980–87 was $18.6 billion out of a total outstanding debt of $455 billion in 1986. Commercial banks' restructurings, however, have affected $81 billion in debt.

ECONOMIC PERFORMANCE. To compensate for this dramatic reduction in their access to commercial lending and for the sudden dearth of external funds, and to improve poor domestic economic performance, many highly indebted countries undertook stabilization measures and significant domestic adjustments. The results vary from country to country (depending on whether the country has embarked on an adjustment program) and in some cases from year to year, but the overall record in achieving trade surpluses is impressive. During 1982–87, however, even the adjusting countries endured serious hardships that still persist. Policy reforms were designed to generate trade surpluses and to reduce current account deficits. Gross domestic savings of the highly indebted countries in 1986 were a healthy 22 percent of GDP, and gross domestic investment was 19 percent, which yielded a positive resource balance of 3 percent of GDP. In 1982 the resource balance was −2.5 percent.

The cumulative trade surplus generated by these countries during 1982–87 amounted to $160 billion, or $32 billion a year, on average. The account deficits for the group decreased by more than 50 percent, from an average $40 billion in 1981–82, or 3.2 percent of GDP, to about $16 billion in 1986, or 1.7 percent of GDP (table 5). Incentives were provided for exports, and significant expansion was achieved in noncommodity exports despite an overall decline in the volume of world trade. Export volume increased 1.4 percent a year during this difficult period.

Real domestic absorption was curtailed by compressing imports

Table 4. *Long-Term Aggregate Net Flows and Net Transfers to Seventeen Highly Indebted Countries, 1980–87*
(billions of U.S. dollars; 1985 prices and exchange rates)

Item	*1980*	*1981*	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*[a]
A. Net flows on long-term debt	26.6	42.3	34.2	21.3	15.8	6.4	4.2	12.4
B. Official grants[b]	0.3	0.3	0.5	0.5	0.7	1.2	0.9	1.2
C. Direct private investment	4.4	4.7	3.0	0.2	2.0	−0.5	1.1	2.3
D. Portfolio investment[c]	0.4	0.3	0.3	0.0	−0.1	−0.2	−0.4	n.a.
E. IMF purchases (net)	0.6	1.4	2.3	6.5	3.4	1.7	0.2	−1.1
F. Other private flows[d]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	n.a.
Aggregate net flows (A + B + C + D + E + F)	32.3	49.0	40.3	28.5	21.8	8.6	6.0	14.8
G. Net transfers on long-term debt	8.2	17.7	3.8	−7.4	−17.7	−26.1	−20.3	−13.8
Aggregate net transfers[e] (G + B + C + D + E + F)	13.9	24.4	9.9	−0.2	−11.7	−23.9	−18.5	−11.4

n.a. Not available.
a. Preliminary estimates subject to revision.
b. Excludes technical assistance.
c. Non-Bank.
d. Includes private nonvoluntary grants.
e. Does not include data on dividends or on remittances made abroad by developing countries on foreign direct and portfolio investment.
Sources: A and E, World Bank, *World Debt Tables 1987–88 Edition* (Washington, D.C., 1988); B, C, and F, DAC chairman's report 1987, Statistical Annex.

Table 5. *Economic Performance Indicators: Highly Indebted Countries*

Item	*1965–73*	*1973–80*	*1980–87*
Annual average growth rates			
Real GDP	6.8	5.4	1.0
Export volume	4.1	3.1	1.4
Import volume	9.2	7.2	−6.2
Investment	8.3	6.3	−4.8
Per capita consumption	4.2	3.0	−1.6
Real domestic absorption	7.3	5.7	−1.0
Current account balance (as percentage of GDP)	−2.3[a]	−3.2[b]	−1.8[c]

a. 1970.
b. 1980.
c. 1987.

and reducing investment. Since 1983 the volume of imports has continuously declined, by 8 percent a year, and in 1986 it reached a level 40 percent below that of 1980. The investment ratio fell from 25–28 percent in the early 1980s to 17–18 percent in 1986–87 as the rate of investment declined by 5 percent a year. Correspondingly, net investment fell from about 16 percent of GNP to about 7 percent, significantly constraining these countries' growth. Some countries succeeded in reducing public sector deficits, although more could have been done. The government budget deficit as a proportion of GDP for the highly indebted countries was estimated at 0.7 percent in 1986 as against 5.6 percent in 1982. Deficits were reduced in Argentina from 18.8 percent of GDP in 1982 to 3.1 percent in 1986, in Chile from 3.8 to 1.4 percent, and in Colombia from 7.6 to 4 percent. The annual rates of inflation were also controlled in several of the highly indebted countries, but results have been uneven.

The decline in investment has been particularly severe in Côte d'Ivoire, Nigeria, Peru, Philippines, and Uruguay; gross investment as a proportion of GDP has declined by more than 10 percent a year since 1980, to the point that there is now a severe erosion of the capital stock. Interest payments, despite the marked decline in international interest rates, represented about 4–6 percent of the GDP of highly indebted countries in 1986.

This inevitable adjustment entailed serious social and political costs. Only in a few countries such as Chile has economic recovery been sustained. In the group as a whole per capita incomes are actually one-seventh lower than at the start of the decade. In the long run this strategy is clearly unsustainable, as it mortgages both future economic growth and the country's return to creditworthiness.

The effects of economic stagnation and import compression are being felt not only in the adjusting countries themselves but also in the industrial countries. The impact on the U.S. economy was particularly strong. Although exports by the United States to other areas are rising, exports to Latin America fell by 26 percent in five years, from $42 billion in 1981 to $31 billion in 1986. During these five years the imports of the four largest debtors—Brazil, Mexico, Argentina and Venezuela—fell by one-third to one-half.

RECENT INITIATIVES. Despite concern in the international community about the debt overhang issue, there is no international consensus on the appropriate course of action. Some initiatives have been taken with the intention of finding a lasting solution to this problem, but the results have been at best mixed.

The solution proposed by U.S. Secretary of the Treasury James A. Baker at Seoul in 1985 implied contributions by both creditors and debtors and assumed a favorable world economic environment. The main assumptions underlying the Baker initiative were that banks were to increase lending; governments in industrial nations were to avoid protectionist measures and keep national GNP growing at a healthy rate; debtor nations were to undertake structural reforms to increase the efficiency and competitiveness of their economies; and multilateral development banks were to increase gross disbursements to debtor countries.

Most of these goals have at best been only partially met in the past two years. Although the World Bank and the IMF have accelerated their efforts to help countries formulate adjustment programs and to disburse significant amounts in support of these programs, new long-term money from commercial banks to the fifteen countries covered by the Baker plan is nowhere near the target. A troubled international economy has not helped. Growth rates for the OECD countries in the 1980s were lower by a third than in the 1970s. Expansion of world trade volume is off by half. The U.S. economy grew 6.4 percent in 1984 in the rebound from the 1982 recession, but growth rates declined sharply subsequently. The October market crash has led to downward revisions in growth forecasts for OECD countries. Although Japan has recently stimulated its domestic economy, European growth remains low, and trade barriers are not being dismantled.

As noted above, the debtors have made substantial headway since 1982 in carrying out trade adjustments. Reschedulings of existing debt and new money from commercial banks have become progressively more difficult to arrange, however, and new long-term lending by commercial banks has virtually disappeared. Short-term trade-related financing has generally continued uninterrupted. The Nigerian rescheduling and new money agreements were consummated after an interval of one full year and the Mexican after six months. The rise in oil prices offset to a limited extent the damage from nondisbursement of commercial new money in these countries, but debtor countries are not always so fortunate. The highly indebted countries with adjustment plans face a crisis of confidence concerning the feasibility of the growth-oriented adjustment strategy. Their difficulties in assembling appropriate financing packages are causing some wariness and fatigue.

As the "new money" strategy of commercial banks has come into question recently, there have been other significant developments to supplement this strategy. In May 1987 Citicorp decided to raise its extraordinary provisions against potential losses on its portfolio of loans to developing countries. The large money center banks and regional banks in the United States were quick to follow Citicorp's lead, as were large banks in Canada and the United Kingdom. Industry estimates suggest that the provisions of continental European banks against loans to problem debtor countries ranged from 30 to 70 percent at the start of 1987. This significant shift in the position of commercial banks reflected a recognition that the true value of the outstanding debt owed by some developing countries was less than the original book values that the banks had been carrying on their balance sheets for five years or so. Most of the large banks have made loan loss provisions that amount to 25–30 percent of their exposure, and the international banking community is better positioned than it was five years ago, but no consensus has emerged as to how or whether this provision should be passed on to developing countries. Policy-based lending may be a necessary condition for the resumption of voluntary private lending, but it may not by itself be a sufficient condition.

Options such as debt-equity swaps and exit bonds have also been used as a mechanism for debt retirement. About $6 billion is estimated to have been converted in this way during 1985–87. These are valuable contributions, but to date they remain marginal against the need for an early and substantial reduction in the outflow of resources from the highly indebted countries to ensure adequate financing for adjustment.

A number of Latin American debtors showed interest in exploring the option of buying back some of their debt at a discount and thus reducing the present value of the debt stock. The Mexican government, in a plan developed by Morgan Guaranty in cooperation with the U.S. Treasury, invited tenders for exchanging its debt through a new offering of Mexican bonds that had U.S. Treasury zero-coupon securities as collateral. The response by the creditor banks to this plan fell short of expectations. Only $1.1 billion of the Mexican debt was retired—far less than the $5 billion–$10 billion targeted by the Mexican authorities and Morgan Guaranty. Although 139 banks in eighteen countries participated in the auction, half of the bids were rejected as insufficiently attractive. Bids to retire $3.66 billion were accepted at an average discount of 67.77 cents on the dollar, and new bonds worth $2.56 billion were offered in exchange.

The Mexican plan did not completely achieve its objective, but it did further the idea that reducing the present value of existing claims is a useful item on the menu of options. It became possible for a debtor country to take advantage—albeit on a limited scale—of the discounts at which these loans are traded in the secondary market. The plan at best served as an exit vehicle for small regional banks that wanted to sell off their loans to the highly indebted countries and get out of the international lending business. For the large money center banks the plan was wrongly focused on principal and failed to address the larger problem of interest payments. The quality of the risk on the principal was improved by securing the principal with U.S. Treasury bonds, but the dominant interest risk remained unprotected.

The recent experience with the Bolivian debt buyback has also created an interesting precedent for the poorer debtor countries. Bolivia bought back almost half its foreign commercial bank debt ($308 million) at an average price of 11 cents for a dollar. The cash to buy back the debt was donated by a group of rich countries. Of the $308 million, $268 million was sold for cash and $40 million for twenty-five-year bonds, denominated in the local currency, that can be used for investments in Bolivia.

Sub-Saharan Africa

A paper entitled "Proposals for Enhancing Assistance to Low-Income Countries Facing Exceptional Difficulties,"[12] prepared jointly by the IMF and the World Bank and concerned primarily with low-income African countries, was discussed by the Development Committee in September 1987. Since then positive developments have taken place that affect the outlook for external resources available to low-income African countries through 1990.

TRENDS IN RESOURCE FLOWS. The volume of external resources available to Sub-Saharan African countries declined sharply after 1980. Unlike the situation in the highly indebted countries, however, the net resource transfer on long-term debt has remained positive, and the trade balance has remained negative. Net transfers on long-term debt (based on actual repayments of principal and interest) reached a low of $1 billion in 1985, down from $3.9 billion in 1980, before recovering to $1.4 billion in 1986. Net transfers (on the same basis) are estimated at about the same level in 1987. The long-term net transfer data do not include interest on short-term debt—approximately $350 million a year for 1985–87—or transactions with the IMF. Aggregate net flows in 1986 were $6.3 billion, 23 percent lower than the 1980 level. Preliminary estimates indicate some increase in 1987. Net flows from the

12. To be published as *Proposals for Enhancing Assistance to Low- Income Countries That Face Exceptional Difficulties,* Development Committee pamphlet 16 (Washington, D.C., forthcoming).

Table 6. *Long-Term Net Aggregate Flows and Net Transfers to Sub-Saharan Africa (Excluding Côte d'Ivoire and Nigeria), 1980–87*
(billions of U.S. dollars; 1985 prices and exchange rates)

Item	*1980*	*1981*	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*[a]
A. Net flows on long-term debt	5.1	4.6	4.3	4.2	2.9	2.3	2.7	3.0
B. Official grants[b]	2.7	2.7	2.7	2.7	3.1	4.0	3.5	3.1
C. Direct private investment	0.4	0.8	0.7	0.2	0.1	0.2	0.2	0.5
D. Portfolio investment[c]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	n.a.
E. IMF purchases (net)	0.4	1.2	0.6	1.1	0.5	0.1	−0.2	−0.5
F. Other private flows[d]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	n.a.
Aggregate net flows (A + B + C + D + E + F)	8.6	9.3	8.3	8.2	6.6	6.6	6.2	6.1
G. Net transfers on long-term debt	3.9	3.3	3.1	2.9	1.5	0.9	1.4	0.7
Aggregate net transfers[e] (G + B + C + D + E + F)	7.4	8.0	7.1	6.9	5.2	5.2	4.9	3.8

n.a. Not available.

a. Preliminary estimates subject to revision.

b. Excludes technical assistance.

c. Non-Bank.

d. Includes private nonvoluntary grants.

e. Does not include data on dividends or on remittances made abroad by developing countries on foreign direct and portfolio investment.

Sources: A and E, World Bank, *World Debt Tables 1987–88 Edition* (Washington, D.C., 1988); B, C, and F, DAC chairman's report 1987, Statistical Annex.

IMF turned negative in 1986 as large purchases made in the early 1980s began to come due. Nondebt flows have offset part of the decline in net transfers on long-term debt, as official grant aid has risen in dollar terms. Direct and equity investment is small in these countries and has contributed little to the availability of external resources. Consequently, aggregate net flows (table 6) to Sub-Saharan African countries (excluding Côte d'Ivoire and Nigeria) have declined by almost 50 percent, from $9.3 billion in 1981 to $6.3 billion in 1986.

Much of the increase in ODA grant disbursements in 1985–86, which appears to have continued in 1987, mirrored the depreciation of the dollar against other leading currencies. European countries and, recently, Japan are important sources of concessional aid to Africa. The actual purchasing power of 1986 and 1987 bilateral grant disbursements was probably about the same as in 1985; the 1985 grant aid data also include a large amount of extraordinary food aid for Africa.

To distinguish the peculiar problems of low-income Africa, a separate estimate of resource transfers to these countries has been prepared (table 7). The trends for these countries no longer differ from those for Sub-Saharan Africa as a whole except for the composition of their long-term debt, over three-quarters of which is owed to official bilateral and multilateral creditors.

Nonconcessional official bilateral creditors and private creditors have become net recipients of funds, measured on a net transfer basis, from Sub-Saharan Africa. The main component of nonconcessional bilateral lending to Sub-Saharan Africa has been export credits. The debt owed to export credit agencies by Sub-Saharan African countries has risen, even though new resources have not been provided to Africa, as commercial banks and other guaranteed creditors have been reimbursed for payments in arrears on loans guaranteed by these agencies. Creditor data indicate that fully 40 percent of commercial bank loans to Sub-Saharan Africa (excluding Côte d'Ivoire and Nigeria) carry external guarantees. Export credit agencies now largely limit their activities to debt reschedulings and short-term credit. The reschedulings normally lead to increases in the country's debt stock, as much of the interest coming due is capitalized each year. Twenty-one Sub-Saharan African countries

Table 7. *Long-Term Net Aggregate Flows and Net Transfers to Low-Income Africa, 1980–87*
(billions of U.S. dollars; 1985 prices and exchange rates)

Item	*1980*	*1981*	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*[a]
A. Net flows on long-term debt	3.9	3.5	3.0	2.9	2.0	1.9	2.1	2.6
B. Official grants[b]	2.3	2.3	2.3	2.2	2.5	3.4	3.1	2.9
C. Direct private investment	0.2	0.3	0.2	−0.2	0.1	0.1	0.0	0.0
D. Portfolio investment[c]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	n.a.
E. IMF purchases (net)	0.4	1.0	0.5	0.9	0.4	0.2	−0.2	n.a.
F. Other private flows[d]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	n.a.
Aggregate net flows (A + B + C + D + E + F)	6.8	7.1	6.0	5.8	5.0	5.6	5.0	5.5
G. Net transfers on long-term debt	3.0	2.7	2.3	2.2	1.2	1.0	1.2	0.9
Aggregate net transfers[e] (G + B + C + D + E + F)	5.9	6.3	5.3	5.1	4.2	4.7	4.1	3.8

n.a. Not available.
a. Preliminary estimates subject to revision.
b. Excludes technical assistance.
c. Non-Bank.
d. Includes private nonvoluntary grants.
e. Does not include data on dividends or on remittances made abroad by developing countries on foreign direct and portfolio investment.
Sources: A and E, World Bank, *World Debt Tables 1987–88 Edition* (Washington, D.C., 1988); B, C, and F, DAC chairman's report 1987, Statistical Annex.

have rescheduled debt through the Paris Club a total of sixty-six times since 1975. An estimated $4 billion of interest due or in arrears to export credit agencies has been capitalized over that period. Capitalized interest represents an estimated 20 percent of the total nonconcessional long-term debt of these twenty-one countries.

Private creditors—which provided $1.2 billion, or 16 percent of total net long-term resource flows, in 1980—have become inactive in low-income Africa, except in providing a stagnant amount of short-term trade credit. Many countries of low-income Africa are not meeting the contractual payments due under their existing long-term bank loans. Unlike the Paris Club, commercial banks have generally resisted rescheduling interest payments. Since there is little immediate prospect of a profitable long-term business relationship with the countries of low-income Africa, the banks have also resisted providing new money as a substitute for partial interest capitalization.

Multilateral concessional flows and transfers have increased in recent years. These flows and bilateral ODA have offset part of the decrease in commercial flows to low-income Africa. IDA, in particular, has picked up the slack, providing larger dollar amounts of faster-disbursing loans, especially in connection with the Special Facility for Africa. Net flows from IDA to low-income Africa were about $1.3 billion in 1986, up more than 50 percent from 1985, and accounted for more than 20 percent of the total net flow of long-term resources.

ECONOMIC PERFORMANCE. The current plight of the countries of low-income Africa is graphically illustrated by the 9 percent decline in their per capita output since 1980; the decline was 16.6 percent in the countries that are perceived as debt-distressed. Although the volume of exports from Sub-Saharan Africa grew at 1 percent a year during 1980–87 (see table 8), the volume of exports from low-income Africa declined by 3 percent. Similarly, import volume for low-income Africa declined by 9 percent, compared with 1.3 percent for Sub-Saharan Africa as a whole. The latter trend reflects both the fall in export earnings and the reduced inflow of external capital. Investment rates for Sub-Saharan Africa declined continu-

Table 8. *Economic Performance Indicators: Sub-Saharan Africa (Excluding Côte d'Ivoire and Nigeria)*

Item	*1965–73*	*1973–80*	*1980–87*
Annual average growth rates			
Real GDP	4.0	2.5	2.2
Export volume	5.1	1.8	1.2
Import volume	4.0	3.0	−1.3
Investment	6.8	0.3	−1.0
Per capita consumption	0.0	0.1	−1.7
Real domestic absorption	3.7	2.9	0.8
Current account balance (as percentage of GDP)	−3.3[a]	−10.1[b]	−8.2[c]

a. 1970.
b. 1980.
c. 1987.

ously, and those for low-income Africa fell by 19 percent between 1980 and 1987. Per capita consumption declined by 1.7 percent a year for the continent as a whole and even more sharply for the low-income group.

The debt indicators for Sub-Saharan Africa (table 9) are a cause for alarm and have been worsening. The principal problem is the growing debt-servicing burden. In at least eighteen countries more than 30 percent of exports is preempted by debt service. The Paris Club has responded quickly with longer-term reschedulings—fifteen to twenty years with grace periods of up to ten years—for several low-income African countries. The heads of government of the seven leading industrial nations recommended after their Venice summit meeting that rescheduling terms for the poorest countries be greatly extended, with wider consideration given to interest rate relief.

But interest rate relief has not been easy to achieve. Bilateral ODA usually carries concessional interest rates and long repayment terms, and the relatively small amounts of debt service on ODA are normally rescheduled at the original concessional interest rates. It is the nonconcessional bilateral export credits, which account for 50 percent of scheduled debt service, that have proved problematic because of legal, statutory, accounting, and budgetary complexities. The export credit agencies raise these loans through market bor-

Table 9. *Debt Indicators: Sub-Saharan Africa (Excluding Côte d'Ivoire and Nigeria)*

Item	*1980*	*1982*	*1986*	*1987*[a]
Total external debt (billions of U.S. dollars)[b]	40.8	48.0	69.4	65.1
Debt-GNP ratio	56.5	62.7	65.1	59.7
Debt-export ratio	204.2	318.8	338.8	248.5
Debt service ratio	23.8	34.7	30.0	29.2
Interest as percentage of exports	11.4	18.0	15.2	13.8

a. Preliminary estimates subject to revision.
b. Excludes IMF.

rowing and cannot easily absorb the losses implicit in lower lending rates. Budget transfers from governments could ease the process but have been difficult in many countries because of budgetary stringency. There is a danger that such transfers might come from existing aid budgets.

Another problem in many of these countries is the general accumulation of arrears. Once a debtor country has accumulated a large volume of arrears to all creditors, the normal channels for regularizing debt service are blocked. Debtor countries should always attempt to avoid this situation, but for countries already deeply in arrears that have adopted serious adjustment programs, some way around the problem must be found. The recent initiatives by some industrial countries to clear the arrears accumulated by African countries that have adjustment programs is therefore welcome and should be carefully considered by other donor groups.

RECENT INITIATIVES. The background paper prepared jointly by the IMF and the World Bank for the September 1987 meeting of the Development Committee outlined the efforts by low-income African countries to adjust to the difficult external economic climate of the 1980s. Significant areas of progress included exchange rate reform, improved fiscal management, reform of public enterprises, agricultural price incentives, and changes in wage policy. In most cases these adjustment efforts have continued and have been strengthened; in a few countries, notably Sudan and Zambia, where the adjustment effort had wavered or had not yet begun, new economic reform programs are being put in place.

The paper suggested methods for closing these gaps. The World Bank outlined a program for addressing the financing needs of the debt-distressed low-income African countries which envisioned (a) a higher share of IDA 8 commitments and a higher share of quick-disbursing adjustment lending to go to debt-distressed countries (half of IDA 8 would go to low-income Africa); (b) official bilateral and multilateral concessional cofinancing of adjustment operations; and (c) where necessary, concessional debt relief or an equivalent increase in concessional aid to reduce the debt burden. The IMF reviewed the need for an enhancement of the Structural Adjustment Facility (SAF), to be available to all IDA-eligible countries but primarily to low-income Africa. Progress has been made with most of the components of the World Bank program and with the SAF enhancement.

The World Bank's Special Program of Assistance, which was proposed at a meeting with donor countries in July 1987, has moved forward. IDA 8 is projected to provide $400 million a year toward closing the external financing gap of debt-distressed low-income African countries. In December 1987 bilateral donors, the European Community, the African Development Bank, and others committed $6.4 million in quick-disbursing grants and concessional loans to support the cofinancing component of the World Bank's program. These commitments, which are made available by redirecting committed funds from other countries and shifting funds from project aid to quick-disbursing program support, are projected to make about $1 billion a year in additional external resources available to debt-distressed African countries in 1988–90.

The IMF's Structural Adjustment Facility was established in March 1986 to provide support to low-income IDA-eligible countries with protracted balance of payments difficulties. The funds, about $3.7 billion, were to be drawn from reflows of IMF Trust Fund loans financed by IMF gold sales in the 1970s. Originally the support available from the SAF amounted to up to 47 percent of the borrowing country's IMF quota over three years; in 1987 the ceiling was raised to 63.5 percent of quota. The funds are repayable over ten years, with a five-year grace period. The interest rate is one-half of 1 percent. Through February 1988 twenty-three SAF programs were initiated, eighteen of them in Africa. Commitments to date total SDR1,191 million, of which SDR897 million was to African countries, and disbursements have been SDR644 million, of which African countries have received SDR530 million.

The Venice summit meeting endorsed the IMF proposal for additional funds for the SAF. In December 1987 the Enhanced Structural Adjustment Facility (ESAF) was established, adding an expected \$8.4 billion to the resources available to countries eligible for the SAF. Access limits are expected to be increased to 250 percent of quota, with provision for somewhat higher access in exceptional cases. The terms will remain the same as for the SAF, subject to the availability of interest subsidy contributions from donor countries.

Another significant development is the increasing willingness of bilateral creditor governments to forgive the debt of low-income African countries. Preliminary estimates show that \$1.8 billion, or almost 15 percent of Sub-Saharan African concessional debt outstanding in 1986, was forgiven by sixteen creditor country governments during 1979–86. The initiatives taken by a number of governments in 1987 have not yet been tabulated.

Low-Income Asia

This group of countries consists of Bangladesh, Burma, China, India, Maldives, Nepal, Pakistan, and Sri Lanka.

TRENDS IN RESOURCE FLOWS. Until 1982 net inflows of financial resources increased rapidly in low-income Asia. According to one study,[13] the annual compound rate of growth of external financial resources from all sources was 13 percent during the preceding fifteen years. The average size of annual net inflows in constant 1980 prices during that period was \$8 billion.

Low-income Asia received 20 percent of all official development assistance in 1975–76. The share had declined to 15 percent by 1981, and the latest estimates show that in 1986 the cumulative share of low-income Asia, excluding China, was only 14 percent.

13. G. Meier, *Financing Asian Development: Performance and Prospects* (New York: The Asia Society, 1986).

Table 10. *Long-Term Aggregate Net Flows and Net Transfers to Low-Income Asia, 1980–87*
(billions of U.S. dollars; 1985 prices and exchange rates)

Item	*1980*	*1981*	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*[a]
A. Net flows on long-term debt	6.5	4.2	5.2	4.5	6.3	8.2	7.8	5.2
B. Official grants[b]	2.3	1.9	1.8	1.7	1.9	1.6	1.6	1.9
C. Direct private investment	0.1	0.2	0.1	0.0	0.2	0.3	0.2	1.8
D. Portfolio investment[c]	0.0	0.0	0.0	0.0	0.0	0.3	0.5	n.a.
E. IMF purchases (net)	0.4	1.5	2.2	1.4	0.4	−0.4	−0.1	−0.9
F. Other private flows[d]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	n.a.
Aggregate net flows (A + B + C + D + E + F)	9.3	7.8	9.3	7.6	8.7	10.0	10.0	8.0
G. Net transfers on long-term debt	5.3	2.7	3.6	2.7	4.3	5.7	5.3	2.3
Aggregate net transfers[e] (G + B + C + D + E + F)	8.1	6.3	7.7	5.8	6.8	7.5	7.5	5.1

n.a. Not available.

a. Preliminary estimates subject to revision.

b. Excludes technical assistance.

c. Non-Bank.

d. Includes private nonvoluntary grants.

e. Does not include data on dividends or on remittances made abroad by developing countries on foreign direct and portfolio investment.

Sources: A and E, World Bank, *World Debt Tables 1987-88 Edition* (Washington, D.C., 1988); B, C, and F, DAC chairman's report 1987, Statistical Annex.

The level of official transfers to these countries has remained stagnant, implying a decline in real terms. Aggregate net transfers (including grants and direct investment) to low-income Asia were $8 billion in 1980 and $7.2 billion in 1986 (table 10). Development grants showed no significant change during these six years and hovered around $2 billion. Aggregate net flows from all sources amounted to an annual average of $10 billion in 1985 and 1986. These levels have been maintained primarily by large new borrowings by China, which was not an active borrower in the 1970s. Official development assistance to low-income Asia excluding China declined significantly during 1982–87.

During 1973–83 India was the second largest recipient of aid on a cumulative basis; total ODA receipts approximated $17 billion. Pakistan was fifth, with over $8 billion, and Bangladesh and Sri Lanka were significant recipients. IDA has been the main source of these low-interest loans. The relative share of India and China has been limited to 45 percent under IDA 7 and to 30 percent under IDA 8. Between 1960 and 1980 the low-income Asian countries (excluding China) received almost 60 percent of IDA. Low-income Asia's share of concessional funds from all multilateral sources was 18 percent in 1986 and has remained fairly stable at about $2 billion in volume since the beginning of the decade.

The World Bank has increased its lending to low-income Asia (excluding China) since 1982. The average level of net disbursements was $1.7 billion a year for 1982–87, which is much higher in real terms than for the earlier five-year period. The flow of capital from the Asian Development Bank to these countries increased threefold.

Net private flows to this group of countries have been modest, and only in the past few years have India and China increased their liabilities to private financial markets. By 1986 the share of private creditors in the aggregate net flows of low-income Asia had risen to almost 50 percent, from 20 percent in 1981. Private creditors now hold almost one-third of China's outstanding external debt and one-half of India's; in 1981 this source was negligible.

Net direct private investment from overseas has increased in the past few years both in China and in India, where expatriate Indians have been given incentives for bringing in nonrepatriable investment. Foreign exchange deposits in domestic banks by expatriate Indians and Chinese have also helped to finance current account deficits.

ECONOMIC PERFORMANCE. The economic performance of low-income Asia during the 1980s has been impressive. GDP has grown at more than 8 percent a year in real terms and per capita consumption at 4 percent a year (table 11). Investment has grown at 14 percent a year, import volume at 8.2 percent, and export volume at more than 8 percent. Real domestic absorption has risen rapidly without inflationary pressures or resort to large external borrowing. The only other group of countries that has surpassed this performance consists of the newly industrialized countries of Asia and the ASEAN countries.

Low-income Asian countries have raised their voluntary saving rates dramatically. Except for Bangladesh, Nepal, and Pakistan, the domestic saving rates in these countries are much higher than the average for developing countries. India has doubled its saving rate since the 1950s, and China is saving almost one-third of its income. In 1960 domestic savings financed on the average only slightly more than half of gross domestic investment in low-income Asia. By the early 1980s, 80 to 85 percent of gross investment was being financed by domestic savings in most of these countries, except for the three mentioned above.

Table 11. *Economic Performance Indicators: Low-Income Asia*

Item	*1965–73*	*1973–80*	*1980–87*
Annual average growth rates			
Real GDP	5.8	5.0	8.2
Export volume	2.2	4.9	8.4
Import volume	−0.1	10.3	8.2
Investment	8.3	7.3	13.6
Per capita consumption	2.4	2.9	3.9
Real domestic absorption	5.6	5.3	8.0
Current account balance (as percentage of GDP)	−1.1[a]	−2.0[b]	−1.7[c]

a. 1970.
b. 1980.
c. 1987.

Table 12. *Debt Indicators: Low-Income Asia*

Item	*1980*	*1982*	*1986*	*1987*[a]
Total external debt (billions of U.S. dollars)[b]	44.9	55.6	94.1	93.4
Debt-GNP ratio	9.0	11.3	17.4	15.7
Debt-export ratio	115.7	129.3	178.2	153.8
Debt service ratio	7.9	9.7	13.2	16.1
Interest as percentage of exports	3.2	3.5	5.3	6.6

a. Preliminary estimates subject to revision.
b. Excludes IMF.

Debt indicators for low-income Asia (table 12) are in sharp contrast to those for the highly indebted countries and for Sub-Saharan Africa. The ratios of total debt to GDP are relatively moderate, the debt-export ratios are below 2, and the debt service ratio remains modest. Interest as a proportion of exports has not changed significantly.

Debt service ratios for low-income Asia are gradually increasing and do not fully reflect variations among countries or the pressures building up because of the changing composition of debt. India's debt service ratio is projected to reach 27 percent in 1988 and Pakistan's 28 percent. China's ratio is still low as a result of the rapid expansion of exports. The increasing commercial orientation of China's external debt will also raise this ratio in 1990.

Requirements for External Resources, 1988–92

The requirements for external resources of these three groups will depend on domestic policy measures and on the world economic environment. It is of crucial importance that countries that require external financial support follow sound economic policies and embark on domestic policy reforms and adjustment where needed. The overriding assumption behind the projections in this section is therefore a continuing improvement in domestic policies. The projected requirements have been made plausible by imposing some constraints in each case: eventual restoration of creditworthiness in five to seven years for the highly indebted countries; the absorptive capacity consideration for Sub-Saharan Africa; and more gradual progress toward poverty alleviation and liberalization in low-income Asia. The assumptions about the world economic outlook during the next five years require elaboration and are spelled out below.

Assumptions Concerning the International Economic Outlook

The likely medium-term growth path of the world economy centers on a base scenario that assumes no significant improvement in the macroeconomic performance of the industrial countries. The main assumptions underlying this scenario are as follows.

- Fiscal policy in the United States will gradually become more restrictive. The federal budget deficit will broadly follow the targets set under the Gramm-Rudman-Hollings amendment, probably with some slippage.
- Further fiscal stimulation in Japan and the Federal Republic of Germany will be limited and will be sufficient only to maintain current growth trends in domestic demand.
- Monetary policy in the principal industrial countries will remain accommodating, and large increases in U.S. interest rates will be avoided.
- Structural reforms will continue in industrial countries, although there will be no significant change, and protectionism will persist but will not increase from its present level.

1988 will see a marked slowdown in the overall growth of the industrial countries. Under the policies described above, industrial countries will at best record a slowdown in 1989 and 1990, followed by a modest recovery in the early 1990s. Foreign exchange and financial markets will remain highly volatile, at least through 1990. This, together with further possible erosion of asset values in bond and stock markets, rising inflationary expectations, and the restrictive influence of fiscal contraction, will lead to a significant decline in domestic demand in the United States that will be only partly offset by increases in export demand brought about by the recent depreciation of the dollar. Growth in the other industrial countries and in the newly industrialized countries will also slow down, partly for endogenous reasons such as the lack of further fiscal stimulation but mainly because of the reduction of exports to the United States and the instability of financial markets. The growth recession in industrial countries, with GDP growth at about 1 percent below the trend since 1973, will lead to the elimination of the U.S. budget deficit and a contraction of the current account deficit, possibly to $50 billion, by about 1992. The current account surpluses of Japan and the Federal Republic of Germany will be reduced correspondingly.

This substantial reduction of imbalances among the principal industrial countries will set the stage for somewhat faster growth in the early 1990s. On the assumption that the macroeconomic policies of these countries are managed in a way that mitigates further disequilibriums in currency markets and interest rates and achieves some success in liberalizing trade, the momentum of the recovery could be maintained for the remainder of the decade. Investor and consumer confidence will improve in response to more stable financial markets, lower real interest rates, and the presumed absence of such major external supply shocks as a significant oil price increase brought about by disruption of production. As capital stocks are rebuilt, the capacity for noninflationary growth and for achieving a progressive decline in unemployment should also improve. Under these circumstances real GDP in industrial countries should be able to grow at least at the rate of the turbulent 1970s and 1980s and might reach an average of 3 percent a year as a result of more stable and supportive policies and a more favorable external environment in the next decade.

For the industrial countries the base scenario envisions painful adjustments in the near term because of slower growth and rising unemployment, but for the longer term it can be cautiously optimistic, since it permits a slight improvement over the growth trends of the past fifteen years. The scenario assumes that the industrial countries will succeed in skirting the main downside risks associated with significant disruptions in foreign exchange markets, a serious recession, rising inflation, or substantial increases in real interest rates (table 13).

For many developing countries, especially the highly indebted middle-income countries and the low-income countries of Sub-Saharan Africa, the near-term outlook remains unpromising. The

Table 13. *Real GDP and Other Variables in Industrial Countries, 1965–92*
(annual percentage change)

Item	*1965–73*	*1973–80*	*1980–87*	*1987–92, projected*
Real GDP	4.6	2.8	2.5	2.0
Inflation	5.2	8.2	4.1	3.9
LIBOR, (nominal annual average rate for dollars)	6.8	9.3	10.5	7.8

expected slowdown in export demand, the persistence of weak commodity prices, and the likelihood that the real cost of foreign debt will remain close to its present level will affect their economic growth. For the most vulnerable countries this may cause a continued erosion of per capita income and consumption and a worsening of the debt burden, at least through the early 1990s. Tensions may therefore persist between highly indebted countries and their creditors for some years to come. This increases the need for cooperative approaches in dealing with the debt overhang, through market-based debt workouts in the highly indebted countries where possible and through stepped-up debt relief for the poorest debtors.

Highly Indebted Countries

The level of capital inflows needed to support the growth-oriented adjustment programs of highly indebted countries far exceeds both what has been provided in the past several years and the financing expected to be available over the next few years. Total debt service is projected to absorb almost 8 percent of the GDP of these countries and interest payments about 4–5 percent. Domestic savings cannot realistically be expected to finance all the investment needed to achieve positive rates of growth of per capita income. But even countries that are pursuing effective macroeconomic adjustment are finding it difficult to attract voluntary flows of new private capital. A recent country-by-country study of highly indebted countries by World Bank staff indicated that these countries would require at least $11 billion–$12 billion of annual net long-term borrowing to generate a modest (2 percent) annual average growth in per capita consumption by 1992 and regain creditworthiness within the next five to seven years. Less than half of this amount is likely to be available from official bilateral and multilateral sources. The remainder must come from commercial banks in the form of increases in lending or decreases in claims, depending on the economic circumstances of the country and the willingness of creditors to provide new money. The implied rate of increase in bank claims, if all these funds were to be provided through new money, is low—less than the likely rate of increase in bank capital.

The requirements of the highly indebted countries (table 14) are predicated on a larger effort to mobilize domestic resources to reduce the size of fiscal deficits, a relatively more concerted strategy for expanding exports, and some marginal increase in import volumes, compared with the significant import compression during 1980–87. Despite these changes the import volume will remain 40 percent lower than the 1980 level, and per capita GDP will grow at an average of 1 percent for the group as a whole. Since some countries in this group, such as Brazil, Chile, Colombia, and Mexico, are likely to grow more rapidly than the average, the picture for other countries still looks dismal. The amount of financing likely to be available (table 14) is derived from disbursements from the existing pipeline of loans, grants, and direct investment and rescheduling of most of the principal repayments due (on the basis of historical experience). As was pointed out above, about one-half of the financing is expected to be provided by official and multilateral sources. Thus the residual gap to be financed from private sources such as commercial banks in the form of new money or other forms of relief is likely to average about $6 billion–$7 billion a year. This estimate represents the best judgment of World Bank staff but must be interpreted with some caution because the data are incomplete. If these requirements are not adequately met, severe payment difficulties may ensue, causing an unfavorable impact on growth, and the debt crisis may become critical.

The marginal domestic savings rates needed to close this residual gap vary among countries. Two-thirds of the countries have to generate marginal savings rates of more than 40 percent in the next

Table 14. *External Resource Requirements of Highly Indebted Countries, 1988–92*
(billions of current U.S. dollars)

	Item	*1988*	*1989*	*1990*	*1991*	*1992*
A1.	Exports of goods and nonfactor services	151.0	156.1	163.1	178.1	195.0
A2.	Imports of goods and nonfactor services	131.3	132.3	133.3	145.2	162.5
A.	Net resource balance	19.7	23.8	29.8	32.8	32.5
B1.	Factor income receipts	7.6	7.2	7.3	7.1	7.3
B2.	Factor income payments	50.3	49.6	50.3	49.5	49.8
	(Interest payments)	(43.3)	(42.3)	(42.6)	(41.7)	(41.6)
B.	Net factor income	−42.6	−42.3	−43.0	−42.4	−42.5
C.	Net private transfers	4.5	4.6	4.8	5.1	5.5
D.	Current account balance (excluding official transfers)	−18.4	−13.4	−8.4	−4.5	−4.4
E.	Amortization	−49.3	−58.1	−60.4	−60.9	−62.1
F.	Financing requirements (D + E)	−67.7	−71.5	−68.8	−65.4	−66.5
G.	Financing likely to be available	57.1	59.0	54.8	55.2	57.0
	Official transfers, net	1.0	1.0	1.0	1.1	1.2
	Long-term loan disbursements	52.4	54.2	49.8	49.8	51.1
	Direct private investment, net	3.7	3.8	4.0	4.3	4.7
H.	Financing gap (F − G)	−10.6	−12.5	−14.0	−10.2	−9.5

Note: The assumptions for this table are as follows.

Annual growth rates, 1988–92: GDP, 3.6 percent; per capita GDP, 1.2 percent; domestic absorption, 3.7 percent; real exports, 3.0 percent; import volume, 2.0 percent. Current account balance/GDP, −1.8 (1987); −0.5 (1991). Debt service ratio: 34 (1987); 50 (1992). Long-term loan disbursements: DRS and Bank staff projections. Official transfers: growth rate of 5 percent a year in nominal terms. Direct private investment: 30 percent increase during five years in nominal terms. Amortization and interest payments: projected from DRS.

five years, and half must generate marginal savings rates of more than 33 percent. These are formidable goals. Even under strong assumptions—that these countries are able to follow sustained adjustment policies over a number of years and that such high savings rates are achieved—the reduction in the external debt burden would be modest. Two-thirds of the sample countries would have debt close to or more than 50 percent of GDP, and almost half of them would have debt-to-export ratios of more than 200 percent in 1995.

These projections are based on the assumptions about the world economy that were given above. Lower OECD growth and lower growth in commodity prices will mean lower export earnings, which will, however, be partially offset by lower interest rates and, therefore, potentially lower debt-servicing costs. But the enormous size of the debt stock and the burden of debt servicing, despite repeated reschedulings in the future, do not augur well. What the debtor countries may gain from a lower London interbank offered rate (LIBOR) they will more than lose in the form of decreased export potential, as OECD demand will be less and commodity prices will be weaker in the near term. The net result will be larger current account deficits in highly indebted countries and reduced growth. The expected 1988 contraction in Latin America is likely to be especially sharp, and recovery there may be delayed.

Sub-Saharan Africa

The projections of external resource requirements for Sub-Saharan Africa (table 15) are based on the assumption that GDP growth will at least keep pace with the population growth rate. Per capita consumption in selected debt-distressed low-income African countries with adjustment programs is projected to increase at 1 percent a year. Thus the decline in per capita incomes witnessed during the past decade will be at least arrested and perhaps reversed in the early 1990s. Exports are projected to grow at 3.5 percent a year and import volumes at about 1 percent a year. Although the calculated resource requirements are large in absolute terms, they are modest in relation to needs and reflect the realities of the situation as now projected. In each year reschedulings of existing debt under the new terms of the Paris Club are assumed

Table 15. *External Resource Requirements of Sub-Saharan Africa (Excluding Côte d'Ivoire and Nigeria), 1988–92*
(billions of current U.S. dollars)

	Item	*1988*	*1989*	*1990*	*1991*	*1992*
A1.	Exports of goods and nonfactor services	24.2	24.7	25.9	27.8	29.9
A2.	Imports of goods and nonfactor services	28.8	28.7	29.4	32.4	36.4
A.	Net resource balance	−3.4	−4.0	−3.5	−4.6	−6.5
B1.	Factor income receipts	1.7	1.8	1.8	1.8	1.9
B2.	Factor income payments	5.5	5.7	5.6	5.4	5.3
	(Interest payments)	(3.1)	(3.6)	(3.6)	(3.5)	(3.4)
B.	Net factor income	−7.2	−7.9	−7.8	−8.2	−9.9
C.	Net private transfers	0.8	0.8	0.8	0.9	1.0
D.	Current account balance (excluding official transfers)	−6.4	−7.1	−6.5	−7.3	−8.9
E.	Amortization	−5.2	−5.5	−4.7	−4.2	−5.2
F.	Financing requirements (D + E)	−11.6	−12.6	−11.2	−11.5	−14.1
G.	Financing likely to be available	9.4	10.0	10.0	9.3	9.6
	Official transfers, net	3.4	3.6	3.8	4.0	4.3
	Long-term loan disbursements	5.8	6.2	5.9	5.0	4.9
	Direct private investment, net	0.2	0.2	0.3	0.3	0.4
H.	Financing gap (F − G)	−2.2	−2.6	−1.2	−2.2	−4.5

Note: The assumptions for this table are as follows.

Annual growth rates, 1988–92: GDP, 3.4 percent; per capita GDP, 0.2 percent; per capita consumption, 1 percent a year; domestic absorption, 3.0 percent; real exports, 2.7 percent; import volume, 1.0 percent. Current account balance/GDP, −7.7 (1987); −4.3 (1992). Debt service ratio: 27.3 (1987); 25.4 (1992). Long-term loan disbursements: DRS and Bank staff projections. Official transfers: assumed from the Special Program of Assistance for Africa. Direct private investment: doubling of net flows in five years. Amortization and interest payments: projected from DRS. Two-thirds of principal repayments due is assumed to be rescheduled. Of the additional disbursements under the Special Program of Assistance, $700 million is assumed to be grants and $300 million loans.

for the debt-distressed countries and for others with adjustment programs. It must be realized that these reschedulings will increase the debt burden for the low-income African countries beyond 1992, and therefore the relief will be only temporary.

The Enhanced Structural Adjustment Facility, the extra resources from IDA 8, and the increased bilateral concessional cofinancing of adjustment programs come close to filling the external financing gap, as defined above, during 1988–90 for selected debt-distressed countries with adjustment programs. At the first multidonor meeting of the Special Program of Assistance for debt-distressed low-income countries in Africa, in March 1988, the donor community discussed several actions needed to ensure that the financing gap of these countries will be covered. The substantial donor pledges of adjustment cofinancing need to be translated into firm commitments to support specific adjustment operations, and these commitments need to be disbursed much more rapidly than in the past. To raise disbursement rates, donors must simplify and harmonize their procedures and maintain flexibility in allocating their funds to the countries most in need. If additional new money cannot be disbursed rapidly enough, some countries may be forced to take less desirable measures to cover or reduce their financing gaps, such as rescheduling interest payments on hard terms, which would compromise their long-term prospects by reducing imports and growth.

Several Sub-Saharan African countries, including Somalia, Sudan, Zambia, and others not in the group discussed above, have not received much attention because they have not yet shown a strong commitment to adjustment or the ability to sustain adjustment programs. Some of them, however, are expected to embark on this path in the near future. To facilitate the success of these programs, additional external financing, as shown in table 15, will be required. The report by the United Nations Advisory Group on Financial Flows for Africa (the Wass report)[14] independently estimated a shortfall of at least $2 billion a year, approximately the same as the average annual financing gap identified in table 15.

14. *Financing Africa's Recovery: Report and Recommendations of the Advisory Group on Financial Flows for Africa* (New York, February 22, 1988).

The Wass report recommended debt relief and reductions amounting to $1 billion, with the remaining $1 billion to be provided through a further increase in bilateral flows.

Low-Income Asia

The strong development performance of low-income Asian countries, particularly China and India, has been triggered by the implementation of appropriate domestic policies together with a favorable international economic environment and prudent economic management. Capital flows at concessional terms also facilitated the easing of foreign exchange constraints.

The domestic policy environment in low-income Asia, particularly China, is undergoing a gradual liberalization. Market-oriented policies are replacing administrative and direct controls, and participation in international trade is increasing. The South Asian countries, which have heavily regulated economies, are recognizing the importance of private enterprise and the market price system as a means of improving the efficiency of their economic systems. Recent policy changes, either installed or in the offing, may reverse some of the earlier trends, but several countries still have further to go in adopting appropriate policies for raising their foreign exchange earnings and industrial output and improving the quality of national economic management. The most pressing problem for this group of countries remains the upgrading of the quality of life for the large segment of the population now living in poverty.

As was shown earlier, long-term capital flows—loans and grants from governments, multilateral institutions, and commercial banks—have been the main sources for financing current account deficits in these countries. China has been exceptional in generating current account surpluses, and only in recent years has it increased its use of borrowing. In the future, however, if China is to fulfill its growth targets, it can be expected continuously to increase its reliance on external finance.

The question now is whether the exceptionally high growth rates of the 1980s can be maintained. China is striving to quadruple the size of its economy between 1980 and 2000. India's seventh Five-Year Plan targets real GDP growth at 5 percent a year. As a result of the larger volume and harder terms of external capital flows during the first half of this decade, India's debt service ratio has risen to almost 27 percent. A relatively high level of external borrowing will be necessary to cope with the balance of payments consequences of the growth strategy.

The countries of low-income Asia are expected to maintain a high growth rate of GDP (about 5.8 percent a year during the next five years), but still higher growth rates will be required to raise their current low per capita income levels. The expansion in export volumes will be somewhat below the 1980–87 level but still higher than the average for developing countries. Foreign trade regimes, domestic financial and industrial deregulation, and other liberalization measures are expected to improve the efficiency of capital. Allocation to social sectors is expected to be larger than the historical coefficients. A reduction in import intensity of output is likely to result in a lower import elasticity coefficient. The average resource requirements for the five-year period under this scenario are estimated at $4 billion–$5 billion a year (table 16). Commercial banks and other private sources would be willing to lend this amount to China, India, and Pakistan. But from the viewpoint of these countries it is not desirable to extend nonconcessional borrowing beyond the sum shown under long-term loan disbursements in the table, as under this scenario their future debt-servicing capacity will be seriously impaired. Both India and Pakistan are showing relatively high debt service ratios even with the present blend of concessional and nonconcessional flows. These ratios will worsen if the share of nonconcessional flows increases significantly. China's high export growth in recent years and restrictive import regime may not be sustainable over a long period and thus would require larger external borrowing than planned. The appropriate mix between concessional and nonconcessional lending is equally important for maintaining China's creditworthiness.

The amounts of financing likely to be available (table 16) represent disbursements from the existing pipeline plus disbursements from new loans that contain the debt service ratio within manageable limits. Under these assumptions the ratio is projected to increase from 15 to 16 percent. The additional resources projected for low-income Asia should preferably be on concessional or blend terms rather than market terms.

Table 16. *External Resource Requirements of Low-Income Asia, 1988–92*
(billions of current U.S. dollars)

	Item	*1988*	*1989*	*1990*	*1991*	*1992*
A1.	Exports of goods and nonfactor services	65.6	70.2	75.5	84.4	95.2
A2.	Imports of goods and nonfactor services	81.3	82.7	88.0	97.9	110.5
A.	Net resource balance	−15.6	−12.6	12.6	−13.5	−15.3
B1.	Factor income receipts	2.5	2.6	2.8	3.0	3.4
B2.	Factor income payments	5.0	6.1	6.8	7.5	8.7
	(Interest payments)	(4.3)	(5.3)	(6.0)	(6.7)	(7.7)
C.	Net private transfers	5.4	5.5	5.7	6.1	6.6
D.	Current account balance (excluding official transfers)	−12.8	−10.5	−10.8	−11.9	−13.9
E.	Amortization	−6.2	−5.7	−6.1	−6.8	−7.9
F.	Financing requirements (D + E)	−19.0	−16.2	−16.9	−18.7	−21.8
G.	Financing likely to be available	15.2	12.8	13.5	14.1	15.1
	Official transfers, net	2.0	2.2	2.4	2.7	3.0
	Long-term loan disbursements	11.0	8.4	8.8	9.0	9.6
	Direct private investment, net	2.2	2.2	2.3	2.4	2.5
H.	Financing gap (F − G)	−3.8	−3.4	−3.4	−4.6	−6.7

Note: The assumptions for this table are as follows.

Annual growth rates, 1988–92: GDP, 5.4 percent; per capita GDP, 3.7 percent; domestic absorption, 5.3 percent; real exports, 4.9 percent; import volume, 4.1 percent. Current account balance/GDP, −1.7 (1987); −1.3 (1992). Debt service ratio: 14.6 (1987); 14.8 (1992). Long-term loan disbursements: DRS and Bank staff projections. Official transfers: growth rate of 10 percent a year in nominal terms. Direct private investment: 15 percent increase during five years in nominal terms. Amortization and interest payments: projected from DRS.

The possible dangers to low-income Asia arise from the low growth prospects and increasing protectionist tendencies in the industrial countries. If the industrial countries do not overcome their budgetary deficits, unemployment, and trade imbalances, their growth will remain low. All forms of foreign capital for developing countries will then grow slowly, with only a small increase in aid. This would create a deteriorating trade environment for the low-income Asian countries just as they are beginning to make progress in liberalizing their economies. It is doubtful that liberalization could continue. The lower volume of net external capital flows would demand higher levels of trade surpluses. But slow growth in the OECD countries and rising protectionist trading policies would in turn make it difficult for low-income Asian countries to expand their exports and generate the kind of trade surpluses required to service their existing debt.

Outstanding Issues

The years ahead present different difficulties for each group of countries studied in this report. The highly indebted countries must restore adequate growth and investment levels through the steady pursuit of adjustment programs. The Sub-Saharan African countries must continue more difficult and long-term adjustment programs to overcome basic structural problems that hinder long-term growth and development. The low-income Asian countries must continue the economic liberalization policies that have enabled them to achieve growth and must put in place policies and programs to alleviate poverty while avoiding an overly rapid buildup of external liabilities. If these objectives are not met, economic and social conditions are likely to worsen, with repercussions for the stability of international financial systems.

In each case the most important element in overcoming these difficulties is the mobilization of domestic resources. History has shown that domestic savings have been the main source of domestic investment in virtually all countries that have broken out of poverty. Yet external resources do have a role in economic development, as an important and valuable supplement to domestic resources. External resources—at appropriate terms and wisely used—

permit developing countries to grow faster than they otherwise could, with less sacrifice of current consumption.

Almost as important as the level of external resources is the effectiveness with which they are used. The Task Force on Concessional Flows, after carefully examining the evidence, concluded that most aid has been productive and helpful to development but that there is considerable room for improvement in the ways in which aid is provided by donors and used by recipients.[15] A further important factor is the stability of external resource flows. The recent decline in total resource flows from developed to developing countries was accompanied by a dramatic deterioration in economic conditions in a majority of developing countries.

The adequacy of external resource flows is measured here by comparison with previously set growth targets and the availability of domestic resources, given existing debt-servicing requirements. The net external requirements for the three groups of countries over the next five years were analyzed above. A large share of the additional resources needed for the resumption of growth in the highly indebted countries must come from private sources and the rest from public sources. The principal issue is who will provide the resources, in what form, and on what terms. For the other two groups, Sub-Saharan Africa and low-income Asia, the bulk of the resources required but not in sight must come from public sources and on concessional terms.

As in the past, future development performance will depend on the implementation of appropriate domestic policies and on the opportunities offered by the international environment, including international finance. Three main issues arise from the analysis in the preceding sections.

Increasing the Total Volume of ODA

Where will the additional resources come from if the volume of aid to the target countries is to be increased to the overall limit? A number of proposals envision directing part of the huge volume of savings from industrial surplus countries toward developing coun-

15. See note 1.

tries. At present this surplus is financing the deficit in the United States and is no longer available to the developing world. It may be feasible to at least increase the existing budgetary allocations for aid in the surplus countries to equal the DAC average, even though the surplus is being generated in the private sector and the government is running budgetary deficits. Another possibility is to approach the newly industrializing countries of Asia, which have in the past benefited from development assistance and are generating considerable trade surpluses, for contributions to assist less developed countries.

Another area that can be explored is the scope for redirecting existing aid flows. Low-income Asia and Sub-Saharan Africa receive about 38 percent of ODA at present and the highly indebted countries about 6–7 percent, whereas the share of non-debt-distressed middle-income countries is a high 56 percent. It may be possible gradually to raise the shares of low-income Asia and Sub-Saharan Africa to 60 percent over the next five years while reducing the share of non-debt-distressed middle-income countries to 30–40 percent. Of course, flows to some countries in the latter group are determined by security and political considerations, and it may be difficult to bring about such a sharp reversal in the direction of aid. A variant that could be explored is to direct the expected growth in ODA volume toward low-income Asia and Sub-Saharan Africa while maintaining the present levels for non-debt-distressed middle-income countries.

Increasing the efficiency of the delivery of aid and the effectiveness of its use can be equivalent to increasing the volume. Thus the restructuring of aid operations, improved aid coordination, faster disbursement, and the cancellation of capital projects that are no longer appropriate and viable under existing country conditions could be beneficial tools. Channeling more public funds through private voluntary organizations may improve the efficiency of delivery of assistance to specific target groups in the geographic areas where the private voluntary organizations are active, but it does not necessarily increase total aid volume.

The Task Force on Concessional Flows concluded that for greatest effectiveness a high level of ODA should be channeled through multilateral aid agencies. Some progress has been made in this respect during the past two years, but much still needs to be done. In addition to a significant expansion of IDA resources under the eighth replenishment, the soft loan funds of regional development banks require augmentation.

Balancing the Needs of Low-Income Countries

The commendable initiatives undertaken in 1986 and 1987 to help meet the financing needs of low-income Africa give the international community reason for satisfaction and for optimism about its ability to respond to the urgent needs of low-income Africa. The Bank's Special Program of Assistance for Africa, the Fund's ESAF, and increased bilateral assistance for Africa are expected to shift the allocation of aid and increase the overall aid volume to this particular group of debt-distressed African countries, at least for the next three years. If the assumptions of resource availability that underlie the Special Program of Assistance and the ESAF materialize, it is conceivable that the bulk of the short-term resource requirements of these countries could be met, on an aggregate basis. But it should be realized that this does not leave any room for maneuvering if the international economic climate is worse than projected—for example, if commodity prices decline more sharply than postulated or the demand for commodities is further reduced. And this projection does not take into account the requirements of other countries in Sub-Saharan Africa that are not eligible under these facilities. Given their size and investment needs, this residual group of countries will require at least $2.0 billion–$2.5 billion of additional external resources on concessional terms. Their market borrowing capacity has been impaired, but the success of their adjustment efforts is predicated on an adequate flow of external capital.

The present growth momentum in low-income Asia needs to be accelerated, as per capita incomes in these countries are still low and the faster growth is to be accompanied by a focus on poverty alleviation. If the target date for reducing the worst forms of poverty is to be advanced significantly—say, to 2000—additional resources over and above current flows will be required. It is also important to ensure that the terms of borrowing do not become excessively harsh and create adverse consequences for these countries' creditworthiness in the 1990s. The projects and programs that have proved to be closely correlated with poverty alleviation are mostly in soft sectors and are characterized by significant externalities. It is difficult to design, administer, and finance these projects on a criterion of full cost recovery, at least in the initial stages, as many beneficiaries are too poor to pay the full costs of the services. Most investment for the alleviation of poverty takes many years to bear fruit, and the appeal of these projects for private or nonconcessional providers of finance is therefore limited. At the same time, official concessional flows are increasingly being reoriented toward African countries for the reasons discussed above.

Many countries in low-income Asia, particularly China, are making progress in liberalizing their economies. It is doubtful that liberalization could continue without additional external resource flows. The lower volume of net external capital flows would demand higher levels of trade surpluses, but a slowly growing OECD and increasingly protectionist trade policies would make it difficult for these countries to expand their exports and generate the level of trade surpluses required to service their debt. The solution lies in an increase in ODA that will be adequate to meet the needs of both low-income Asia and low-income Africa.

How to meet the need for concessional assistance in low-income Asia while continuing to focus attention and resources on low-income Africa remains an issue. The low-income countries of Asia have utilized external resources effectively, performed well, and reduced their dependence on outside sources. But their progress toward improving the standards of living of the vast majority of their populations remains patchy. Some of these countries, such as China, are also making attempts to liberalize their economies. The transition can be orderly if adequate external resources at appropriate terms are available to allow imports of goods and services beyond the domestic capacity of these countries.

Reducing Negative Net Transfers from Highly Indebted Countries

To establish an adequate level of external resource flows to highly indebted countries, the level of negative net transfers will have to be reduced. If this is to be done in a way that maximizes the growth potential of these countries and minimizes the disruption to international financial markets, options must be found that are mutually acceptable to creditors and debtors. It may be possible, for example, to expand the menu of options by making more use of techniques currently on the list and by adding other imaginative approaches.

The solution to the problem of highly indebted countries lies in innovative case-by-case arrangements. Some will involve ways of providing new money in a more tractable manner than the current concerted lending approach. These arrangements are likely to involve options whereby the existing debt burden, which is mainly held by the commercial banks, can be significantly reduced. Selective use of public, and perhaps in some cases ODA, funds for debt buyback schemes of the type initiated by Bolivia could also be considered as an appropriate vehicle for this purpose.

The World Bank and the regional development banks have performed a useful role as financial intermediators between the world bond markets and these developing countries, only a small number of which can approach the markets for direct bond issues. The World Bank has made an important contribution by assisting these countries in formulating adjustment programs and by providing significant lending in support of those programs. Commitments by the Bank to the "Baker 15" countries exceeded $33 billion in fiscal 1981–87; almost half of this amount was committed in the three most recent fiscal years. Net disbursements to these countries have more than doubled since 1981. The key question is, to what extent and for how long can the multilateral development banks increase their exposure to countries to which international markets remain closed? Beyond a certain point, lending in such circumstances would affect the Bank's own standing in the credit market. Significant incremental lending by the Bank to these countries could only continue in the medium term in the context of sustained adjustment programs by the countries themselves and a general return to voluntary lending by the private sector. There is reason to believe that some borrowers are making good progress in improving the productivity of their economies. If voluntary lending shows no signs of revival in the next three to four years, the present momentum of activity by multilateral development banks may have to be slowed to preserve their preferred creditor status.

Another question is how the IMF can continue to play an effective role in reducing net negative transfers. Repayments to the Fund are becoming significant in the highly indebted countries and in Sub-Saharan Africa, where the current level of Fund charges and of repurchases from the Fund is about 7 percent of export earnings. Although, as discussed above, flows from the ESAF to African countries would, in all probability, offset the repurchases and charges, the question remains as to how to expand the use of Fund resources by the highly indebted countries while ensuring that they remain within the tolerable limits of their repayment capacity. It should be recognized that, in principle, the Fund provides temporary balance of payments support, that its resources are revolving, and that consequently after a period of prolonged use by a large number of countries substantial repurchases will inevitably have to be made. The Extended Fund Facility of the IMF has the potential to benefit the highly indebted countries together with other member countries. In recognition of the need for far-reaching programs of structural reform to restore balance of payments viability in many of these countries, the Executive Board of the Fund has held a preliminary discussion on the reconsideration of the Extended Fund Facility.

A crisis of confidence in highly indebted countries that are making serious adjustment efforts must be averted. Ways must be found for commercial banks to assure net financing to these countries so that they can service a portion of their interest payments in a timely fashion and keep down the growth of debt service. Developed country governments may wish to consider improving tax and regulatory practices that may be an impediment to commercial bank efforts. A final question is how the role of multilateral development banks in the workout packages can be strengthened.

Conclusion

This report does not repeat the calculations made by the Task Force on Concessional Flows in 1985, but it comes to the same conclusion: no matter what method of estimation is used, the needs for external resources of the three groups of developing countries are growing rapidly. For low-income Asia, if the maintenance of present growth momentum is to be combined with some modest inroads on poverty alleviation, an estimated \$4 billion–\$5 billion a year in additional concessional disbursements will be required. For Sub-Saharan Africa, the annual financing requirements of low-income debt-distressed countries—roughly \$2 billion—can be met if the pledged level of increased bilateral commitments, the IMF's SAF and ESAF, and an expanded IDA 8 are all made available. But the requirements of the remaining Sub-Saharan African countries—\$2 billion–\$2.5 billion a year—will not be met. Highly indebted countries will need \$10 billion–\$12 billion a year in additional financing or reduced debt service payments over the next five years to achieve a minimum rate of per capita GDP growth.

Appendix: The Concept of Net Transfers

The term net transfers describes the difference between disbursements of lending to a country and the service payments (interest and amortization) that the country makes during the same year on its debt. The term is not related to the "transfers"—official grants, gifts, and other unrequited flows—that are recorded in the balance of payments. "Net resource flows associated with long-term lending" would be a more accurate description of the concept, which must be interpreted carefully.

The net transfer associated with lending will be positive if, in a given year, debt grows faster than the average (nominal) rate of interest paid on it. One cannot infer that a positive net transfer necessarily aids a debtor country and a negative net transfer damages it. In particular, it cannot be presumed that a country is better off in the year of a positive net transfer, when a loan finances the importation of equipment, than in subsequent years, when the equipment is generating returns that exceed the service payments due but the net transfer is negative. Nevertheless, other things being equal (including returns from past investment), and without regard for the future debt service consequences of new loans, in a given year a country is better off with positive rather than zero or negative net resource inflows.

As countries develop, their ability to finance investment through domestic savings normally increases. When levels of development and the accompanying ability to generate resources domestically rise, net resource inflows can be expected to dwindle or even be reversed.

Concern over negative net transfers or net resource outflows arises in part because of the asymmetry between the relatively short term on which much commercial finance is lent to developing countries and the much longer gestation period of many of the investments financed. The success of such investment has depended implicitly on opportunities to refinance as debt service payments are made. A sudden shift from positive to negative net transfers may foil this expectation. Investment projects that are in progress and do not yet yield returns cannot generate net resource outflows, but their abandonment for lack of continued financing impairs future debt-servicing capacity. Sustaining continued positive net transfers, especially with short-maturity loans, involves large and rapidly growing gross borrowings, particularly if interest rates are also high. The associated practical difficulties can be insurmountable.

No one can seriously claim that positive net transfers should continue forever or that borrowers have any "right" to continued positive net resource flows. But concern over the declining and, for many large borrowers, negative net transfers since 1982 is legitimate because the direction of the flow was reversed when the borrowers' income levels were still relatively low and because the magnitude and abruptness of the reversal made the phenomenon difficult to handle.

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