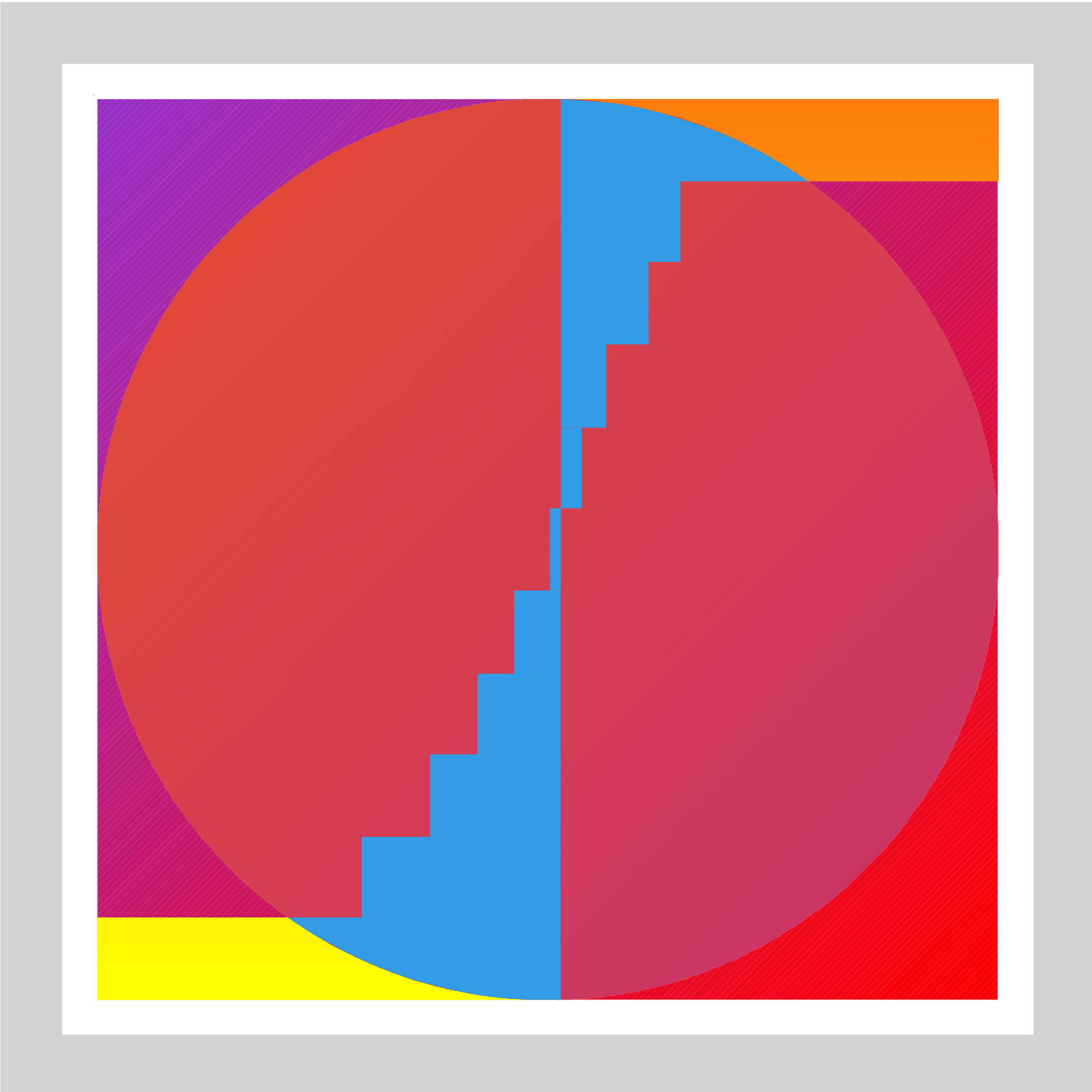
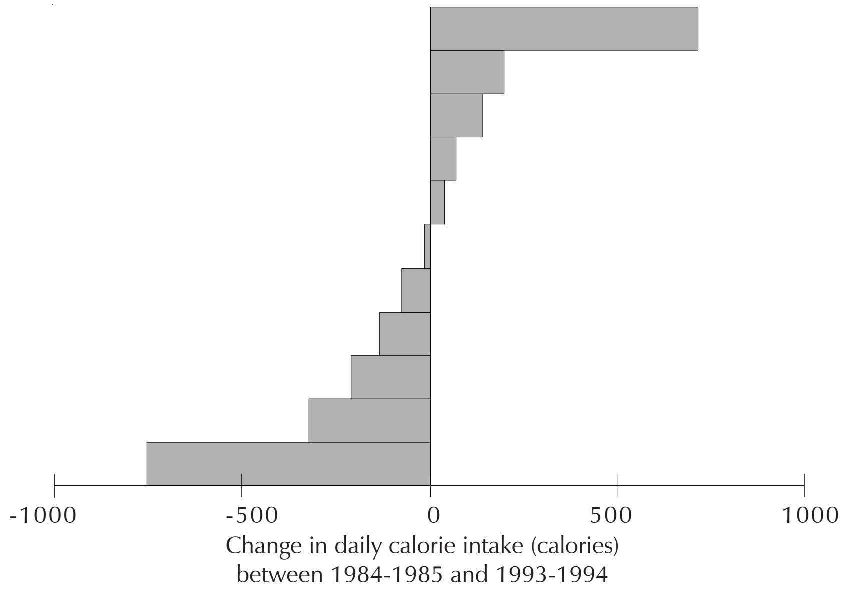
UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

THE LEAST DEVELOPED COUNTRIES
1997 REPORT

UNITED NATIONS



Per Capita Food Availability in Selected LDCs between 1984-1985 and 1993-1994

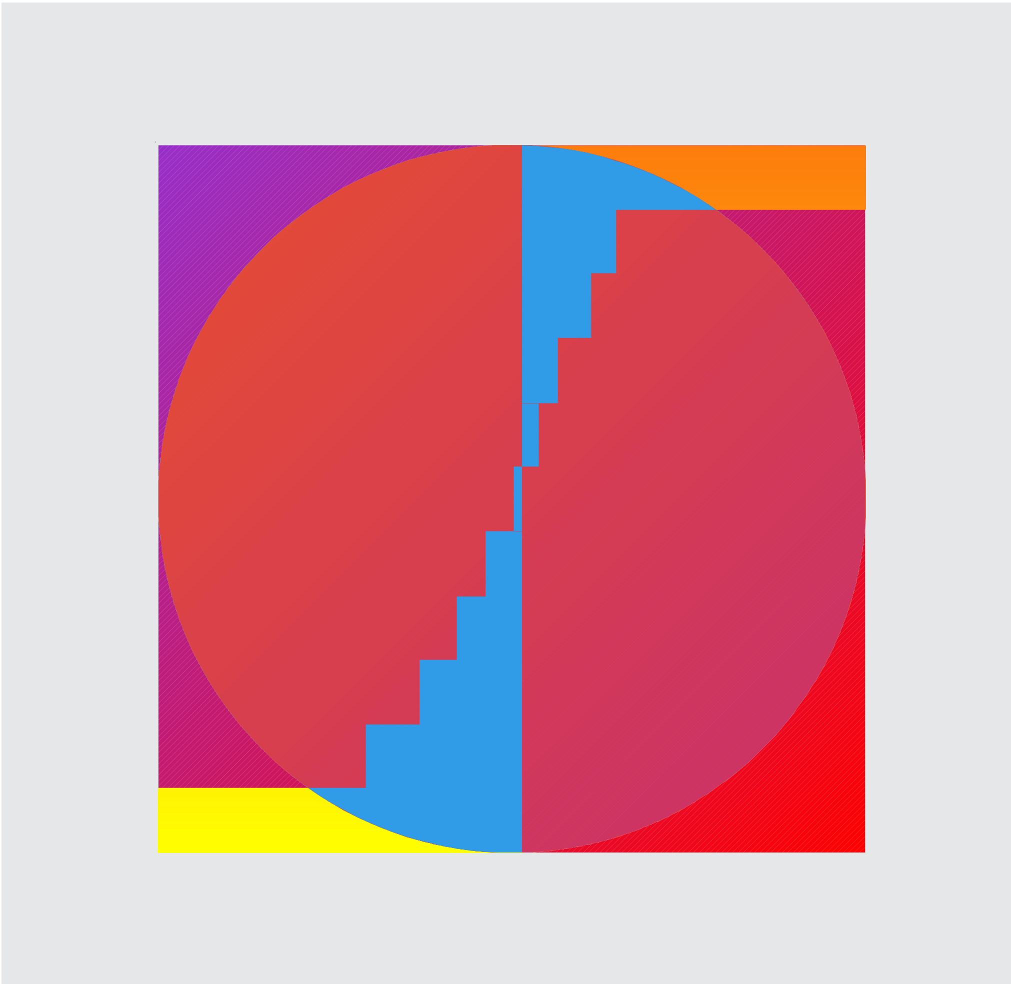


This year's Report examines two separate but related issues – agriculture and economic regress. Economic regress has an impact on agricultural performance, and one way in which this manifests itself is through a change in the amount of food people eat per day. The chart on the cover of this year's Report is based on data on per capita food consumption in selected LDCs. There has been a wide disparity in performance within the LDC group: for instance, while Burkina Faso has recorded an increase of around 700 calories per capita over the ten-year period, in some LDCs experiencing various forms of economic regress, daily calorie intake has fallen, in some cases by as much as 750 calories per person per day. For more information and the source data for the chart, see tables 9 and 12, on pages 66 and 130 of the Report, respectively.

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT
Geneva

THE LEAST DEVELOPED COUNTRIES 1997 REPORT

Prepared by the UNCTAD secretariat



UNITED NATIONS
New York and Geneva, 1997

Note

Symbols of United Nations documents are composed of capital letters with figures. Mention of such a symbol indicates a reference to a United Nations document.

The Overview from this Report can also be found on the Internet, in both English and French, at the following address:

http://www.unicc.org/unctad

TD/B/44/6

UNCTAD / LDC (1997)

UNITED NATIONS PUBLICATION

Sales No. E.97.II.D.6

ISBN 92-1-112410-7

ISSN 0257-7550

Foreword

The Least Developed Countries, 1997 Report is the thirteenth such Report, focusing the attention of the international community on the key developmental issues facing the least developed countries (LDCs), the most impoverished group in the world economy.

The Report is divided into three parts. Part One examines economic developments in LDCs during 1996 and discusses prospects for 1997; reviews recent developments in ODA flows and LDCs' external debt; examines the impact of recent economic reforms in LDCs and why the economic performance of some of these countries has improved while that of many others has not; and addresses commodity issues.

Part Two focuses on the agricultural sector in LDCs. It reviews the impact of their agricultural policy reforms, the major constraints on sustainable agricultural development, and the likely effects of changes in the international trading system on LDCs' agriculture.

Part Three considers the circumstances of a number of LDCs whose performance as regards certain economic and social indicators over the past decade has been significantly worse than average. These "economies in regress" often experience a progressive deterioration in the State's capacities to carry out basic functions, such as the maintenance of law and order and the provision of essential services, and present a particular challenge to those concerned with their development.

The Report this year has a number of functions. It is the principal background document for the annual review, by the Trade and Development Board, of progress in the implementation of the Programme of Action for the LDCs for the 1990s. Additionally, it will serve as a background document for the High-Level Meeting on the Integrated Initiatives for Least Developed Countries' Trade Development convened last year by the Ministerial Conference of the World Trade Organization in Singapore. This meeting, to be held in Geneva on 27 and 28 October 1997, will directly address the concerns and circumstances of the least developed countries in the post-Uruguay Round context, and is a welcome sign that the specific issues facing LDCs are finally moving up the international agenda.

The Report is intended for a broader readership of governments, policy makers, researchers and all those involved with LDCs in particular and development policy in general. For that purpose, it has been redesigned and updated to make it more accessible, readable and informative. The statistical annex has been re-examined and overhauled, bearing in mind the particular constraints on the gathering and interpretation of economic and social data from LDCs. Data are ultimately only as reliable as the national statistical offices that provide them, and a variety of factors affect the institutional capacity of LDCs to deliver adequate statistics. Thus, the quality and timeliness of the data will vary considerably between LDCs, and even between different years within the same country. In the light of this, the number of tables has been reduced so as to provide a more concise, accurate and realistic description of the current state of LDCs.

UNCTAD's commitment to LDCs is part of an ongoing process. It has extended its operations to the Internet (http://www.unicc.org/unctad), making freely available a range of current information on LDCs, and providing a further gateway for feedback and comments. In partnership with governments, multilateral and bilateral organizations and agencies, NGOs and academics, UNCTAD hopes to be able to increase understanding of the issues and challenges facing LDCs at this crucial time. It is hoped that this Report will go some way to furthering that process.

The UNCTAD secretariat gratefully acknowledges the participation of the governments of the member States of UNCTAD, the organizations of the United Nations system, and other national and international bodies that have made valuable contributions to this Report.

Contents

Part One
Global Economic Developments and LDCs

Part Two
Agricultural Development and Policy Reforms in LDCs

Part Three

Economies in Regress: The Crisis of Governance, State Failure and Internal Conflicts in LDCs

List of Boxes

List of Charts

List of Text Tables

Explanatory Notes

The term "dollars" ($) refers to United States dollars unless otherwise stated. The term "billion" signifies 1,000 million.

Annual rates of growth and changes refer to compound rates. Exports are valued f.o.b. and imports c.i.f. unless otherwise specified.

Use of a hyphen (-) between dates representing years, e.g. 1981-1990, signifies the full period involved, including the initial and final years.

An oblique stroke (/) between two years, e.g. 1991/92, signifies a fiscal or crop year.

The abbreviation LDC (or LDCs) refers, throughout this report, to a country (or countries) included in the United Nations list of least developed countries.

In the tables:

Two dots (..) indicate that the data are not available, or are not separately reported.

One dot (.) indicates that the data are not applicable.

A hyphen (-) indicates that the amount is nil or negligible.

A plus sign (+) before a figure indicates an increase; a minus sign (-) before a figure indicates a decrease.

Details and percentages do not necessarily add up to totals, because of rounding.

Abbreviations

AHFSI	Aggregate Household Food Security Index
AMS	Aggregate Measurement of Support
CEMAC	Communauté économique et monétaire en Afrique centrale
CFA	Communauté financière africaine
c.i.f.	cost, insurance, freight
CRDB	Cooperative and Rural Development Bank
DAC	Development Assistance Committee (OECD)
DC	developing country
DES	dietary energy supply
DFIs	development finance institutions
DMEs	developed market economies
DRF	Debt Reduction Facility
ECOWAS	Economic Community of West African States
ESAF	Enhanced Structural Adjustment Facility
EU	European Union
FAO	Food and Agricultural Organization of the United Nations
FDI	foreign direct investment
FI	financial institution
FII	Food Inadequacy Index
f.o.b.	free on board
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GEF	Global Environmental Facility
GNP	gross national product
GSP	generalized system of preferences
HIPC	heavily indebted poor country
HYVs	high-yielding varieties
IDA	International Development Association
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
IMRs	infant mortality rates
MFA	Multi-Fibre Arrangement
MFN	most favoured nation
NGO	non-governmental organization
NTBs	non-tariff barriers
NTCs	non-traditional agricultural commodities
ODA	official development assistance
OECD	Organisation for Economic Co-operation and Development
R&D	research and development
RFI	rural financial institution
SACA	Smallholder Agricultural Credit Association
SADC	Southern African Development Community
SAF	Structural Adjustment Facility
SAPs	structural adjustment programmes
SMC	Singapore Ministerial Conference
SPA	Special Program of Assistance for Africa
SPS	sanitary and phytosanitary
SSA	sub-Saharan Africa

TBT	technical barriers to trade
T&V	training and visit
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme
UNHCR	Union Nations High Commissioner for Refugees
UNICEF	United Nations Children's Fund
UR	Uruguay Round
URA	Uruguay Round Agreements
URAA	Uruguay Round Agreement on Agriculture
WTO	World Trade Organization

Overview

Introduction

Important, and on balance encouraging, developments have taken place among the least developed countries in the mid-1990s. The determined efforts to implement economic policy reforms have led to improved economic performance in about half of the LDCs. The economic revival is most notable in Africa, where economic growth rates have risen to levels that, on average, involve modest increases in per capita output. Macroeconomic reforms, particularly exchange rate reforms, have played an important role in stimulating higher growth rates in many LDCs. Economic improvement has taken place despite the continued stagnation of aid flows to LDCs and the persistence of their external debt problems. Reduction of the external debt burden, together with an increase in aid flows, would provide strong support for the economic reforms currently underway in LDCs, and help ensure that the current revival is sustained. The recent economic performance of the LDCs and developments in external financing are reviewed in Part One of this Report.

While improved macroeconomic policy has been vital to the economic revival in many LDCs, sustaining the recovery and accelerating growth rates to levels at which substantial reductions in poverty can be achieved will require greater attention to institutional and sectoral reforms. In most LDCs, the area in which those reforms are likely to have their greatest impact is agriculture, an issue which is analysed in Part Two. Agriculture is the single most important sector in LDCs' economies in terms of its contribution to output, employment and incomes. Increasing productivity in agriculture, especially in smallholder agriculture, is essential if the living standards of the majority of the poor, who live in the rural areas, are to be raised, and if food security is to be enhanced. Agriculture is an important source of savings and foreign exchange. Development of the agricultural sector offers most LDCs their best prospects for accelerating GDP growth rates and for boosting and diversifying their exports. Also, it can give a crucial boost to the nascent manufacturing sector, by expanding the internal market for consumer goods and providing raw materials for processing industries. Agricultural reforms laid the foundations for the rapid growth and development of some of the most dynamic developing economies in Asia. The lessons of successful agricultural reform in Asia for the LDCs are analysed in the Report.

"For perhaps the first time, we are in a position to build a free and open world economy in which all countries can participate and from which all countries can benefit. For the first time, long cherished hopes of eradicating poverty seem attainable, provided that concerted political will is brought to the task."

Statement by the Secretary-General of the United Nations to the High-Level Segment of the 1997 Substantive Session of the Economic and Social Council (July 1997, SG/SM/97/138).

There has been a growing recognition in recent years of the crucial role played by institutions in economic development. The disparities in economic performance among LDCs are largely explained by internal factors, including the quality of governance. For a significant number of LDCs, the deterioration of the institutional structure of society, particularly state structures, has retarded development over a prolonged period. The economic and social regress afflicting these countries is examined in Part Three. The most extreme and damaging forms of regress are manifested in internal conflicts which have ravaged several LDCs. The Report argues that the international community cannot afford to ignore the problems of regress in LDCs: in addition to the obvious humanitarian considerations, the economic and social consequences of regress are huge, often with significant regional dimensions. The international community should give urgent attention to helping LDCs strengthen their institutional structures in order to prevent state collapse, facilitate a peaceful resolution of internal conflicts and rebuild war-torn societies.

Developments in LDCs and the world economy in 1996

Although growth rates for **the LDC group** fell in 1996 compared with 1995, growth has been relatively robust, and many LDCs have performed well enough to have recorded not only real increases in output, but also real increases in per capita income. There has been a very slight difference between the performance of African and Asian LDCs. The LDCs are an extremely heterogeneous group, however, and the most significant disparities in performance exist not at a regional but at a country level, with a difference of over 20 per cent between the highest and lowest GDP growth rates for LDCs.

The future is looking decidedly brighter for LDCs in **Africa** than has been the case for quite some time. Many African countries, including LDCs, have experienced higher growth rates since 1994: 19 African LDCs have had growth rates in excess of 4 per cent, and 10 of those have had GDP growth rates higher than 5 per cent. There are indications that this trend is set to continue. In many countries, export production has been increased, inflation rates have been reduced and reform has been consistently well implemented since the 1990s.

LDCs in the CFA franc zone have benefited from the 1994 devaluation of the CFA franc. This overvalued currency had long stifled growth in the traded goods sector and had, to some extent, undermined the credibility and effectiveness of economic reform in the region. That all nine members of the CFA zone achieved positive growth in 1996 and that several CFA countries have also boosted production of cotton, their principal export crop, suggests that reforms have been successful. Other African countries (particularly in East and Southern Africa) have had good weather, and as a result, large increases in cereal production have been recorded. Unfortunately, however, many LDCs in Africa continue to be blighted by civil strife and political instability.

Asian LDCs have benefited from their location in the world's fastest-growing region. The recent dynamism of the larger Asian economies, in particular India and China, has spilled over into neighbouring LDCs. The average growth rate across the Asian LDC subgroup has thus increased, the output expansion in Cambodia and the Lao People's Democratic Republic having been particularly rapid. The largest LDC, Bangladesh, has not performed as well as might have been hoped. This is partly due to delays in the implementation of economic reforms.

These developments have taken place against a background of a modest overall growth in the **world** economy (with growth slightly higher than in 1995), though there has been a marked decrease in the expansion of world trade. Globally, Asia remains the fastest-growing region, despite the fact that the levels of increase have fallen slightly owing to a deceleration of export growth and a tightening of demand management in some countries. Against this background, the increases in growth in Latin America and Africa – up to 3.9 per cent from less than 3 per cent in 1995 – are all the more impressive.

In the short run, the external economic environment facing LDCs is expected to be fairly stable. Growth in the world economy is expected to remain steady during 1997, and the current sharp rise in tropical beverage prices will benefit many LDCs. Internal factors, however, are likely to be at least as important as the external environment in determining the economic performance of most LDCs. Reform programmes have been successfully implemented and savings and investment performance has improved, which suggests that the present LDC growth rates will be sustained for some time to come. Under these circumstances, peace, security and competent governance become crucial externalities if the economic recovery which has begun for some LDCs is to be sustainable and replicable throughout the LDC group.

The fact that growth rates have remained relatively strong in many LDCs is particularly encouraging in view of the unfavourable developments in non-oil **primary commodity** prices. Sluggish industrial activity in the major importing countries, oversupply and speculative trading exerted considerable downward pressure on prices. Thus, after a more or less stable first quarter in 1996 the combined dollar index of non-oil primary commodity prices steadily weakened during the remainder of the year; and from a 1990-1995 annual average growth rate of 2.6 per cent, it fell by -4.3 per cent in 1995-1996. Of particular concern to LDCs were declines in tropical food prices (15 per cent) and minerals (13 per cent). Precipitous falls in the prices of coffee and copper (over 20 per cent) were of special concern, although the fall in the price of coffee (26 per cent) was not as catastrophic as had been feared, because of low stocks and voluntary production ceilings set by the members of the Association of Coffee Producing Countries.

The decline in primary commodity prices draws attention to the vulnerability of many LDCs to trends on the world market. However, a few LDCs, such as Madagascar, have managed to **diversify** into areas with higher growth potential, and are beginning to reap the rewards of an active commodity diversification programme.

The fact of the only slight drop in LDC growth is encouraging also because of the trend towards **declining aid flows** to LDCs. In 1992, DAC member countries allocated 0.09 per cent of GNP to LDC development assistance. In 1995, that share had fallen to just 0.06 per cent, the lowest on record. This was despite record flow levels for all developing countries in 1995 (particularly private flows) and a commitment in 1990 at the Second United Nations Conference on LDCs to increase the aid flow level. LDCs have also suffered because the purpose of aid flows has shifted towards short-term emergency relief projects, away from longer-term development programmes.

LDCs' external debt burden continues to be a constraint on their capacity to accelerate development; it limits imports, and dampens prospects for larger private capital inflows. In almost half of the LDCs, outstanding debt continues to exceed GDP.

The most important recent development in debt relief for LDCs came at the annual meeting of the World Bank and International Monetary Fund in September 1996, with the endorsement of the **HIPCs initiative** – the heavily indebted poor countries initiative. This initiative provides a useful framework for implementing a strategy of burden sharing among all creditors to reduce the HIPCs' debt to a sustainable level. Debtor countries will have to show a record of good policy performance over a six-year period. Unfortunately, however, because of this requirement, few LDCs appear likely to benefit from the initiative in the first instance, far fewer than the original list of potential beneficiaries appeared to indicate. This delay will represent a lost opportunity for the revival of output growth in many LDCs.

Agriculture

Part Two of this Report discusses agriculture. Most LDCs have tended to neglect the agricultural sector despite its significant contribution to their GDP. This Report argues that to be able to attain and sustain high growth rates, LDCs will have to prioritize agriculture as part of their overall growth strategies. A dynamic agricultural sector will almost certainly lead to more broadly based and equitable development, given the huge importance of agriculture in LDCs as a source of food and livelihood for a large majority of the population.

There are four compelling reasons for LDC governments to prioritize the agricultural sector. *First*, enhanced agricultural growth will increase the incomes of the LDCs' rural populations, thereby contributing to poverty reduction and qualitative improvements in rural life. *Second*, increased rural incomes will expand domestic markets. *Third*, to maintain current levels of food consumption, agricultural growth and/or food imports must keep pace with prevailing high population growth rates. *Fourth*, a dynamic agricultural sector would provide the basis for agro-processing industrialization, which could enhance employment opportunities in both urban and rural areas.

A strong and well-developed agricultural sector is also a means to **broader developmental ends**. While there are marked differences in the experiences of the more advanced developing economies of Asia, a number of them, including Malaysia, the Republic of Korea and Thailand, significantly enhanced the efficiency of their agricultural sectors as a prelude to their industrialization drive. Indeed, in almost all these economies, progress in the manufacturing sector was preceded by steady growth in the agricultural sector, spurred on by investments in new agricultural technologies, combined with land reforms, particularly in the case of the Republic of Korea. To a large extent, increases in agricultural productivity and growth, and progress in tackling the basic problem of "entitlements" (i.e. poverty and food security), were a prerequisite for the push towards industrialization in the more advanced Asian developing economies.

Of course, there is always a danger that important differences will be papered over when one is extrapolating from one context to another. Nonetheless, the East and South Asian experience suggests certain lessons. One such lesson is that the correction of distortions in agricultural pricing is a necessary but not a sufficient condition for attaining high and sustainable agricultural growth rates: there are other **"non-price" factors** which must also be tackled simultaneously. In view of the scarcity of resources, LDCs may have to aim first at a dynamic agricultural sector, thus laying the foundation for a steady build-up into an industrialization phase.

A viable long-term agricultural strategy would include at least six main components:

- sound macroeconomic policies which emphasize *inter alia* trade liberalization and a realignment of exchange rates to realistic levels;
- a reduction in direct taxation of agricultural output, particularly of export crops;
- "appropriate" agricultural technology which allows productivity increases in an environmentally sustainable manner sensitive to the social and economic contexts of LDCs;
- programmes to alleviate constraints on the adoption of technological innovations (e.g. shortage of credit, and weak rural physical and social infrastructure);
- an efficient agricultural marketing system, including well-functioning markets for inputs and outputs;
- strengthened institutional support, e.g. extension services, research into staple or food crops, and soil and water management.

While private investment may be required in areas such as marketing of inputs/outputs, and credit provision, LDC governments must take the lead in providing other facilities, e.g. research and extension. Not only are such services "public goods", but also they are unlikely to be provided to any degree by the inevitably underdeveloped LDC private sector. This has implications for donors and the international community: almost all LDCs lack the necessary skills and resources to undertake the huge investments involved in implementing the strategy outlined above without external assistance. This underscores the need for enhanced financial and technical assistance.

Why is there agricultural stagnation in LDCs?

The long-term problems of LDC agriculture are partly explained by **historical factors**. Traditional production relations, rudimentary technology, the mode of access to, and ownership of, land, and a context of low and unreliable rainfall (particularly in African LDCs) have all played a part in the underdevelopment of the sector. The primary weakness of LDC agriculture, however, lies in **government policies** which have been inimical to the development of a strong agricultural sector. These include overvalued domestic currencies, state intervention in agricultural marketing, overtaxation of agricultural exports, and urban bias (the consequence of which is poor rural infrastructure and lack of basic facilities in rural areas). There has also been a **lack of political commitment** to an efficient institutional agricultural framework. Consequently, agricultural extension systems have proved ineffective and inefficient, and research into high-yielding varieties and environmental management has been negligible.

State intervention in agricultural input supply, processing and marketing has created many distortions and inefficiencies in agricultural trade. **High levels of protection** for domestic industry, under import substitution industrialization policy, have increased the cost of manufactured inputs. Administered prices, for various crops whose marketing is controlled by government, are often insufficient to cover total costs of production, and agricultural exports are discouraged by heavy explicit taxation and overvalued domestic currencies. The net effects of these policies are reduced profit margins, insufficient incentives to adopt new technologies and a low level of private sector investment in agriculture, all of which have significantly impeded the growth of LDC agriculture.

Possible impact of the Uruguay Round Agreement on LDC agriculture

The Uruguay Round of GATT trade negotiations, which initiated a programme of agricultural trade liberalization, was predicted to have significant consequences not only for the resolution of the problems mentioned above, but also for more general agricultural development in LDCs. However, analysis of the impact of the Uruguay Round on traditional export commodities (which constitute the bulk of LDCs' agricultural exports) suggests that the **effects are likely to be modest**. This is mainly because the Uruguay Round Agreement on Agriculture (URAA) proved to be less comprehensive than had been expected when negotiations began; and while significant reforms of the rules governing agricultural regimes in developed countries have been carried out, the degree of overall trade liberalization achieved has been rather limited.

LDCs have considered the potential for vertical diversification into processed agricultural products. Such diversification offers a real opportunity to develop endogenous capacity and is far more profitable than the export of raw agricultural goods. Unfortunately, moves in that direction tend to be restricted by tariff escalation and the Agreements on Sanitary and Phytosanitary (SPS) Measures, and on Technical Barriers to Trade (TBT). There are two main reasons for this. First, despite the general reduction in tariff escalation, a number of product chains important to developing and least developed countries are still subject to considerable tariff escalation. Second, only those LDCs that can access the necessary technical assistance to enable them to meet the high standards set under the SPS and TBT Agreements will be able to take advantage of the increased transparency of the rules governing the application of sanitary and phytosanitary standards.

Fortunately, there were a number of **concessions to LDC agriculture** in the URAA, in addition to the special and differential treatment clauses incorporated into the various Agreements of the Uruguay Round itself, and the provisions in favour of LDCs in the Marrakesh Ministerial Decisions. These provisions collectively suggest that there is significant scope for the adoption of support measures to ensure that the impact of world market price volatility on domestic markets is mitigated.

Overall, the major obstacle to development in the LDC agricultural sector is not a lack of demand for produce, but rather the fact that there are severe institutional and macroeconomic **impediments to an increase in supply**. Thus, the LDCs most likely to derive the greatest benefits from the URAA are those which undertake the necessary adjustments to their production structures in order to ease their supply-side constraints and implement outward-oriented policy measures. The success of this is partly dependent on the willingness of the international community to provide the necessary financial and technical assistance to support such reforms. Under these circumstances, LDCs currently implementing structural adjustment programmes are likely to have some advantage over the others.

Food security

Although food security is primarily a problem of access by individuals or households to food (entitlements), agricultural growth – and especially food production – has a significant impact on food security in LDCs. This is because the majority of the food-insecure live in rural areas, earn a substantial share of their income from agriculture, and obtain at least some of their nutritional requirements directly from their own food production. On the basis of the most widely available measure of food security at the national level (the daily per capita energy supply, or calories per day), very few LDCs meet even the barest **minimum levels of food consumption** necessary for ensuring that all of their populations have access to adequate nutrition. Daily energy supplies are very low in more than half of the LDCs for which data are available, and in many LDCs access to food has become more difficult since the mid-1980s. The main reason for chronic inadequate nutrition is widespread poverty, household or individual incomes being insufficient to enable people to command access to their daily food needs. (In LDCs, however, poverty and food insecurity are often associated with internal conflict; these are explored in further detail below.)

Equitable income growth is essential for reducing chronic food deficiency in LDCs. As the majority of the poor are rural farmers, policies which promote agricultural and rural development will also enhance food security by raising incomes and reducing poverty. This is demonstrated by Burkina Faso, which has made significant progress in improving food security through rural development. Furthermore, LDCs should put in place mechanisms to protect the food security of individuals and households in the event of adverse shocks such as droughts by protecting the productive assets and livelihoods of vulnerable groups. Recently, however, the most significant threat to the food security of the populations of LDCs has come not from deficiencies in agricultural policy, but rather from complex emergencies caused by internal conflict. Therefore, the most effective policy for increasing food security in certain LDCs is the promotion of peace.

The environment-agriculture nexus

Sustainable agricultural development in LDCs is inextricably linked not only with food security issues but also with environmental concerns. The greatest level of environmental degradation in LDCs is to be found in those areas where population pressure, poverty and food insecurity are intense. Although many of the arguments in the 1987 Brundtland Report, which focused the attention of the international community on the links between poverty and environmental degradation, have been the subject of some controversy, the central thesis that **poverty and environmental degradation** are linked has been conceded.

Two broad groups of causes of rural environmental degradation in LDCs have been identified which link the most severe environmental problems in many of these countries to the agricultural sector. The first group – systemic causes – relates to the context in which farming is carried out, including a combination of policy and market failures, social and political instability, and population pressure. The second group – "technical" causes – relates to the use of "inappropriate technology" within a context of shortage of suitable agricultural land which has led to encroachment on marginal and fragile lands and to the overuse of open access resources.

The absence of any simple solution reflects the complexity of the problem. A traditional response to agricultural land degradation has been to increase the area of land under cultivation, thus increasing the extent of environmental destruction. Unless resources can be used more intensively and sustainably, environmental degradation will almost certainly continue in many LDCs, particularly in the more densely populated areas of Ethiopia, Madagascar and Uganda, and in the Sahelian countries. Any policy package to stem environmental degradation will be largely dependent on external resources, either through transfers or through training, since most LDCs have neither the expertise nor the financial capacity to tackle by themselves the complex links between environmental and agricultural priorities.

Rural credit

A serious impediment to private investment in yield-enhancing and environmentally sound agricultural technologies in LDCs is the **limited supply of formal agricultural credit**. Despite extensive policy efforts to enhance rural credit supply in LDCs, rural financial markets remain very poorly developed, with the majority of the rural population, including small farmers, having very limited access to formal sector credit. The extension of credit by governments at subsidized interest rates has failed to promote rural development for several reasons, in particular because much of the credit disbursed was channelled to the larger farmers or richer sections of the rural population and repayment rates were very low. Recent financial reform programmes implemented in many LDCs are directed at liberalizing financial markets with a view to improving financial intermediation. These programmes have also involved attempts to establish innovative rural financial institutions (RFIs) to serve the needs of small farmers and the rural poor.

Policy should emphasize the creation of **financially sustainable RFIs** rather than attempts to directly control resource allocation in financial markets. This includes designing appropriate mechanisms for delivering financial services to the rural poor and smallholders, adequate incentives for managers and staff, training of staff, safeguards against abuse by insiders, as well as the legal and regulatory framework governing rural financial markets. If RFIs are allowed to allocate and price rural credit according to commercial criteria, this should increase efficiency and reduce the extent to which the benefits of cheap credit are usurped by larger farmers using political and social influence.

It is crucial that government and donors support the development of innovative RFIs capable of serving the rural poor. These institutions are likely to require significant levels of subsidy and probably technical assistance, especially in the early stages of their operation when their costs will be high because of staff training, high rates of default due to lack of knowledge about borrowers and to the inexperience of staff, and high outreach costs. Costs should fall over time as the RFI gains both experience and more detailed knowledge of its client base, and as the number of borrowers and the average loan size increase. Also, efforts should be made to assist the development of existing informal and semi-formal financial institutions, such as savings and loans companies and credit unions. Further assistance for the poorest borrowers, who do not possess suitable collateral, may be offered through group lending schemes.

It is important that governments resist the temptation to write off loans disbursed by government-sponsored or government-owned RFIs (such loans having been written off in several LDCs), since this practice merely encourages borrowers to default. The prevailing social, economic and geographical conditions in most LDCs make the development of efficient rural financial markets difficult, but with appropriate policy measures, carefully tailored to local conditions, access by small farmers and the rural poor to financial services can be improved.

Economies in regress

Development has proved elusive for a significant number of LDCs during the last 10 years. In fact, these countries have experienced regress: their economies have declined, social conditions have worsened markedly, and they have become increasingly marginalized from the mainstream of the world economy. Regress is not the result of a temporary cyclical economic downturn but is a chronic process with important structural characteristics, particularly the degradation of state and social institutions. In the worst cases of regress, the entire state apparatus has disintegrated amid civil strife.

Part Three of this Report examines the nature, extent and developmental consequences of regress and state failure for the LDCs concerned, for their regional partners and for the wider international community. It emphasizes the need for effective policies to tackle regress in LDCs, and the important role which LDCs' regional partners and the international community can play. It recognizes that many of the problems faced by economies in regress are highly complex and intractable, and that international action has not always been successful. Nevertheless, it argues that the international community and regional partners cannot afford to ignore these problems and that there are concrete measures which can be taken to address them. External assistance can help to prevent state collapse in LDCs where institutional deterioration is not too advanced. In countries afflicted by internal conflicts, the regional and international community can play a vital role in brokering peace and supporting the reconstruction of social and economic structures necessary for development.

UNCTAD's interest in this subject arises because regress has major consequences for development in LDCs, for their regional partners, and for the development strategies pursued by aid donors and the international community. Just as we have learned from the experience of successful development in DCs, so it is important to draw lessons from those countries in which development has been retarded, in order to devise appropriate policies.

The nature of regress: Institutional decline and state failure

Regress in LDCs is manifested in the deterioration of a range of **economic and social indicators**, including per capita output, food availability, access to education, health status and war-related mortality and displacement. For example, between 1980 and 1994, 22 LDCs suffered falls in per capita GDP – measured in constant price dollars – of more than 10 per cent, and 12 of them had falls of more than 20 per cent. Moreover, as was argued in *The Least Developed Countries, 1996 Report*, many of the LDCs have become marginalized from the mainstream of the world economy, particularly from international trade and investment flows. Even inflows of international aid have fallen dramatically for some LDCs, because of the collapse of state structures through which aid can be disbursed and utilized. In many of these economies, private investment is deterred by political instability, lack of security and the disintegration of physical infrastructure.

Regress is not confined to LDCs – it has afflicted non-LDCs in Africa, and countries in South-East Europe and Central Asia – but severe regress and state failure have been more prevalent among the LDC group than elsewhere.

Regress is a **heterogeneous phenomenon** encompassing varied and often complex processes. There are important differences between individual LDCs in terms of the nature of regress, its scale and its causes, which means that generalizations are not always appropriate. Nevertheless, the deterioration of political and social institutions – the state and civil society – appears to be central to the process of regress in most cases. In particular, a crisis of governance characterizes most of the economies in regress. The State's capacities to provide essential public services, to maintain security throughout its territory, to mediate between competing interests, and to provide a stable economic and legal framework for the growth of the private sector and civil society have been severely eroded. The State's revenue base has also contracted in many cases. Regress is best understood as a process in which the deterioration of state capacities, the weakening of civil society and economic decline interact to reinforce one another, fuelling a downward spiral of economic, social and political decline.

Internal conflict

The most extreme cases of regress involve armed internal conflict. Over one-third of the countries in the LDC group have experienced some form of violent civil strife since 1980, with high (predominantly civilian) mortality, the displacement of large numbers of people from their homes and livelihoods, and the destruction of infrastructure and productive assets. In many countries, agriculture has been particularly badly affected because farmers have been driven from their land by fighting. Problems persist even after the fighting has ended. One major obstacle to the resumption of normal economic activity, for example, is the presence of anti-personnel mines on agricultural land. Not surprisingly, countries afflicted by internal conflicts have recorded a markedly worse economic performance than those that have remained peaceful. Complex humanitarian emergencies – famines and other humanitarian crises caused primarily by internal conflicts – have occurred in several LDCs and have attracted widespread international concern and, in some cases, intervention by the international community.

Implications of regress

While state failure, the deterioration of social institutions and internal conflict have become major obstacles to development in many LDCs, their consequences often extend beyond international borders. The destabilizing effects of refugee flows, disruption of transport routes, the spread of ethnic conflicts, increased banditry, drug trafficking and the undermining of investor confidence can encompass entire regions. The civil war in Mozambique, for example, caused economic losses to the other countries of the Southern African region which are estimated to have amounted to approximately 7 to 8 billion dollars a year during the 1980s. There are obvious humanitarian motives for some form of action by the international community and regional partners to help LDCs tackle these problems. In addition, the magnitude of the potential economic costs of state collapse and internal conflicts indicates that huge benefits could accrue from effective international action to ensure peace, stability and the maintenance of effective state structures. The international community cannot afford to ignore the problems of regress, nor can it afford to delay effective action until regress has degenerated into a humanitarian crisis. Moreover, regress is **not an irreversible process**: the experience of several LDCs, including Uganda, has demonstrated that peace can be restored and that economies and state structures can be rebuilt, even after prolonged and devastating civil war.

How can the international community assist economies in distress?

While the need for international assistance is evident, there are few obvious or easy solutions to the problems of regress. Policy responses should reflect the particular circumstances of individual countries. However, because institutional decline – and especially the deterioration of state capacities – is a major factor in most cases of regress, providing support for the building and strengthening of institutions is clearly an important area in which the international community can play a positive role.

Preventing state collapse

In the majority of LDCs the State has not collapsed, but in many countries there has been a significant decline in state capacities to provide basic economic and social services, as noted above. In some of these countries, further deterioration might eventually lead to state collapse. A priority for the international community, therefore, should be to help these LDCs **strengthen the State** (and elements of civil society where necessary) before further institutional deterioration threatens more serious consequences.

The international community should provide financial and technical assistance to strengthen state capacities in these LDCs. Assistance can take the form of training of personnel, funding to ensure that public servants receive adequate salaries, the provision of equipment, and technical assistance to expand the State's revenue base. The training and education of the army and police in order not only to enhance their technical capabilities, but also to foster the development of an ethos of civic loyalty and responsibility, would be especially valuable in many countries.

The international community should also provide assistance and incentives to **support democratization in LDCs**. It should assist in the creation of political, bureaucratic and legal structures which enhance transparency and accountability, strengthen the linkages between the government and the people, and encourage popular participation in politics. The objective must be to foster the development of States that are democratic and embrace all sections of society, and at the same time are able to provide the basic public goods and services essential to economic and social development. It is encouraging that more democratic forms of government have been introduced in a number of LDCs in recent years. Democracy is not meant to be a panacea for all the economic problems of regressed economies, but non-democratic governments have a very poor record in LDCs, and democratic political structures are more likely to be conducive to the long-term management of complex social and ethnic conflicts. International agencies can play a valuable role in monitoring the evolution of state and social institutions in LDCs so that timely assistance can be given to prevent institutional decay.

Reconstructing war-torn economies

A number of LDCs are currently recovering from major civil wars, having managed to put in place a political settlement of the conflict. The primary challenges facing these countries are to consolidate peace, integrate former combatants into civilian life, rehabilitate productive capacity and infrastructure, revive the economy, and rebuild state and civic institutions. Reconstructing war-torn economies is a difficult but not impossible task. In view of the destruction of the economic, human and natural resource base of these countries, reconstruction will require the international community to provide major financial and technical assistance programmes.

Conclusions

The key message of this part of the Report is that urgent action by the international community to help LDCs tackle the widespread problems of economic and social regress, state failure and internal conflicts in LDCs should be a priority. The potential human and economic costs of regress are enormous, and not confined to the regressed economies themselves. Effective action to tackle these problems will require the investment of substantial resources by the international community to strengthen institutions and state structures in LDCs, support peace-keeping, provide humanitarian assistance and rebuild war-torn economies.

Throughout this process, the international community must pay attention to the actual situation in these countries, nurturing and reorienting indigenous capacity where possible. This will require an extended policy engagement, and demand a high level of resource deployment. Although these costs may seem high, they are quantifiable and can be planned for, unlike the almost certainly higher costs imposed by continued conflict and regress. It is in the long-term interests of all parties to try to reverse regress – and with a broad, well-funded, politically balanced and sensitive policy package, there is every hope that, in time, regressed States will be back on a path to sustainable development.

If effective policies to tackle regress are to be designed, a comprehensive, multi-disciplinary analysis of the causes and dynamics of regress is essential. Such an analysis should focus on drawing from the experience of regressed economies the relevant lessons for the policies and strategies of LDC governments, donors and international organizations.

R. Ricupero

Rubens Ricupero
Secretary-General of UNCTAD

Part One

Global Economic Developments and LDCs

Recent Developments and Outlook

Chapter I

A. Introduction

World output growth accelerated from 2.4 per cent in 1995 to 2.8 per cent in 1996. This happened despite higher oil prices and a marked deceleration in the volume growth of world trade – from 10 per cent in 1995 to 4.6 per cent in 1996. Growth in developing countries (DCs) increased from 4.8 per cent in 1995 to 5.6 per cent in 1996, with a notable acceleration of growth in Africa, where economies expanded on average at the rate of 3.9 per cent, compared with less than 3 per cent the previous year. The economies of Asian DCs continued to expand vigorously, although the average growth rate was lower than in 1995.

Growth among LDCs was relatively robust in both Africa and Asia, although growth rates declined in the former in 1996. GDP growth in the 33 African LDCs was estimated to have averaged 4.6 per cent in 1996 (compared with 5.4 per cent in 1995), while the average growth rate of the Asian LDCs rose slightly – to 4.8 per cent in 1996 (see table 1).

The prospects for continued growth in the world economy in the short term are reasonably good. There is little evidence of the type of serious macroeconomic imbalances (increasing inflation, fiscal deficits, etc.) that usually precede and signal economic downturns. There were substantial decreases in median inflation rates in DCs, and especially the economies in transition. Moreover, long-term interest rates have declined in a number of major developed countries, and this should facilitate increased investment.

Among developed market economies (DMEs), DCs and transition economies there were significant disparities in growth performance – disparities due partly to cyclical factors (i.e. countries at different stages in their economic cycles), partly to differences in policies, which are often magnified by globalization, and partly to longer-term structural trends.

TABLE 1: GDP REAL GROWTH RATES
(Percentage per annum)

	1990-1994	1995	1996
All LDCs	3.1	5.2	4.7
African LDCs	2.9	5.4	4.6
Asian LDCs	3.9	4.6	4.8
Memo items:			
Developed market economy countries	1.6	2.0	2.3
Developing countries	4.6	4.8	5.6
World	1.6	2.4	2.8

Source: UNCTAD secretariat calculations, based on Economic Commission for Africa, 1997, Asian Development Bank, 1997, and IMF, 1997.

B. Developed market economies

Output growth averaged 2.3 per cent in the DMEs in 1996, compared with 2 per cent the previous year. Japan enjoyed an economic recovery in 1996: GDP growth of 3.5 per cent, the highest since 1991, was boosted by a depreciation of the yen, an expansionary fiscal stance and very low domestic interest rates. The United States experienced its fifth consecutive year of economic growth, with an output rise of 2.5 per cent in 1996, higher than the rate recorded in 1995. This prolonged expansion has reduced unemployment levels in that country to almost 5 per cent. The strength of the economy contributed to an appreciation of the dollar and a substantial rise in equity prices.

Very weak rates of economic growth and high unemployment continued to affect the larger economies of continental Europe.

The United Kingdom, which was in the fourth year of its cyclical upturn, recorded a growth rate of 2 per cent in 1996, compared with 2.4 per cent the previous year. Growth was driven by buoyant domestic demand. In contrast, growth was sluggish in the larger European Union (EU) countries of continental Europe, where domestic demand remained relatively weak for a variety of reasons, including fiscal retrenchment and a lack of consumer and business confidence. Output growth rates in 1996 declined in Germany, France and Italy to 1.4 per cent, 1.3 per cent and 0.7 per cent respectively. The importance of these economies was reflected in a slowdown in overall EU growth – from 2.4 per cent in 1995 to 1.5 per cent in 1996. Interest rates were reduced in most EU countries in order to stimulate demand and to offset the impact of the fiscal restraint required to enable countries to meet the Maastricht convergence criteria for the planned single currency. More buoyant economic conditions prevailed in some of the smaller EU countries: Finland, Greece, the Netherlands, Portugal, and especially Ireland. Outside the EU, the Swiss economy failed to recover from what has become a very prolonged recession.

Because of a combination of weak output growth, structural and technological changes, and rigidities in labour markets (such as employment regulations which increase the cost of employment), unemployment remains a major economic and social problem in the EU, exceeding 10 per cent of the workforce in Belgium, France, Germany, Ireland and Italy, and over 22 per cent in Spain. Unemployment rates increased once again in both France and Germany in 1996.

In the Asia-Pacific region, Australia's growth rate rose to 4 per cent, while that of New Zealand fell to 2.7 per cent.

Inflation was very subdued in most of the DMEs despite a 20 per cent rise in crude oil prices: consumer price inflation averaged 2.4 per cent in 1996, compared with 2.6 per cent the previous year. Inflation rates were below 4 per cent in 1996 in most of the DMEs, with the exception of Greece. They are likely to remain at these moderate levels in 1997. The prevalence and the persistence of low inflation in the DMEs are due to a number of factors: weak demand growth leading to excess capacity in many countries, particularly in continental Europe; supply-side changes, which have removed some of the rigidities in other economies, allowing them to grow faster and for longer without stimulating inflationary pressure on wages and prices; and the anti-inflationary credibility which monetary authorities have earned since the 1980s. In both the United Kingdom and the United States, monetary policy has recently been tightened recently in response to concern that, after prolonged expansions, capacity constraints and continued strong demand growth have begun to exert greater upward pressure on wages and prices.

C. Central and Eastern Europe

There were wide disparities in economic performance among the countries of Central and Eastern Europe. Several of these countries, mainly those of the former USSR, have suffered a severe and prolonged contraction in their economies during the 1990s. This contraction appears to have at least eased in Russia and Ukraine, although output growth rates were still negative in 1996. Output in the Russian economy declined by 2.8 per cent in 1996, compared with 4 per cent the previous year, while output in the Ukrainian economy fell by 10 per cent in 1996 following a 12 per cent contraction in 1995.

The economic recovery in most of the Eastern European countries had begun in 1993/94 and the majority of them achieved positive output growth rates in 1996, although there was great variation between countries. Growth rates were highest in Albania (although its economy will have been badly damaged by the violent social unrest which began in early 1997, triggered by the collapse of pyramid savings schemes), the Slovak Republic and Poland. There were large falls in GDP in both Bulgaria and Moldova.

Inflation rates fell substantially in most of the economies in transition. The median consumer price inflation rate fell from 46 per cent in 1995 to 24 per cent in 1996, and although 10 countries had inflation rates of more than 100 per cent in 1995, only three had inflation rates of this magnitude in 1996.

D. Developing countries

Output growth rates in DCs were stronger in 1996 than in 1995 – GDP growth averaged 5.6 per cent compared with 4.8 per cent – and while the Asian DCs continued to record the highest growth rates by a substantial margin, there was a narrowing of the regional disparities in growth rates due to a small decline in the latter in Asia combined with an acceleration in each of the other regions.

African developing countries

African countries achieved a considerable improvement in their economies in 1996, manifested in higher output growth and export earnings, and lower inflation. GDP growth rose from 2.8 per cent in 1995 to an average of 3.9 per cent in 1996. Output growth in Africa had been stagnant throughout the early part of the 1990s but began to pick up in 1994. The acceleration in 1996 suggests that the continent's recovery has started to gather some momentum. The impact on poverty and employment, however, is likely to be limited unless growth rates accelerate further.

As a group, African developing countries experienced an improvement in their economies in 1996, with higher output, higher export earnings and lower inflation.

African export earnings rose by almost 9 per cent in 1996, boosted by higher oil prices and increased levels of production of oil and several other important export commodities. The economic recovery has been accompanied by a reduction in consumer price inflation rates in Africa: the average inflation rate fell to 25 per cent in 1996, down from 32 per cent in 1995 and 37 per cent the previous year.

Several factors contributed to the strengthening of growth rates in Africa in 1996, although higher commodity prices were not a factor in most countries: with the exception of crude oil, the prices of most of the export commodities of major importance to Africa fell in 1996. The return of good weather, following droughts, facilitated recovery in the agricultural sector; output is estimated to have expanded by over 5 per cent, with very strong growth in cereal production, especially in North and Southern Africa. There were also production increases in some of the major export crops: coffee, cocoa and tobacco. Both oil and mineral production increased in a number of African countries as a result of recent investments which have been stimulated by, *inter alia*, buoyant mineral prices and the enactment of legislation strengthening legal guarantees and rights for investors.

The economies of the Communauté financière africaine (CFA) franc zone were given a stimulus by the CFA franc devaluation of 1994, which boosted the competitiveness of their traded goods sectors (see box 1). Output growth rates rose sharply in the CFA zone following devaluation: from 2.6 per cent in 1994 to 4.7 per cent in 1995 before falling to 4.1 per cent in 1996. Inflation rates had risen in these countries after the CFA devaluation, but by the end of 1996 inflation had fallen sharply – to 6 per cent from 15 per cent in 1995.

Much of the recovery achieved in Africa since 1994 is attributable to the delayed impact of economic policy reforms, which many African countries first began to implement in the 1980s. The reforms have brought about more competitive exchange rates, a reduction in macroeconomic imbalances (especially lower fiscal deficits and lower inflation) and greater opportunities for the private sector due to market liberalization. Although private investment rates remain low in Africa, there was an increase in net FDI inflows in 1996 to over $5 billion, the highest level recorded during the 1990s.[1]

Asian developing countries

Asian developing countries remain the strongest-growing economic group in the world, though output growth rates decreased slightly and there was a marked slowdown in export growth rates.

Asian DCs (excluding China) registered an average GDP growth rate of 6 per cent in 1996, down from 6.4 per cent in 1995. Despite the slowdown, Asia remains the most dynamic region in the world economy. Growth decreased in the largest economies, e.g. China, India, Indonesia and the Republic of Korea, as well as in Malaysia, Singapore and Thailand, although China was still able to achieve an increase of almost 10 per cent in its output. The Philippines and Pakistan registered higher growth in 1996 than in 1995. The Pacific island DCs, a group which includes several LDCs, experienced a recovery in 1996, with growth of 2.8 per cent following a decline of 1 per cent the previous year. Regional inflation rates fell from an average of 11.8 per cent in 1995 to 6.6 per cent in 1996, as a result of more restrictive demand management policies in several Asian DCs.

There were two main reasons for the slowdown in the region. First, exports, which had expanded very rapidly in 1994 and 1995 (at over 20 per cent per annum), grew much more slowly (at around 5 per cent) in 1996. The decline in export growth rates was most marked in China and Thailand, but was not confined to those countries. The slowdown in export growth has been attributed to several factors: stagnation in the global electronics market (which is an important sector for Asian exporters); appreciation of real effective exchange rates in Asia due to the nominal appreciation of the dollar (to which many Asian DC currencies are linked), combined with relatively high domestic inflation; and a loss of comparative advantage among Asian exporters in labour-intensive products (Asian Development Bank, 1997, pp. 10-18).

The second reason for the decline in growth rates in the region was that several countries, especially in South-East Asia, implemented more restrictive fiscal and monetary policies to dampen excessive rates of monetary and domestic de-

Box 1: The impact of currency devaluation on the economies of LDCs in the franc zone

In January 1994, the 14 African member countries of the franc zone collectively agreed to a currency devaluation. The CFA francs used by seven countries in the West African CFA franc zone and six countries in the Central African CFA franc zone were devalued by 50 per cent against the French franc, while the Comorian franc was devalued by 33 per cent. One aim was to redress the loss of competitiveness of the traded goods sectors of the franc zone African countries, to restore external viability and macroeconomic balance, and to strengthen the credibility of their economic policies. The other aim was to strengthen the two CFA franc zone monetary unions by enhancing the momentum of economic integration.

The devaluation gave LDCs in the franc zone the opportunity to stimulate domestic production of exports and import substitutes, improve the balance of payments, and allocate scarce resources more efficiently. In addition, it enhanced access to international financing facilities and gave an impetus to regional trade. However, it also presented difficulties: it had inflationary implications and increased the burden of servicing external debt for governments and enterprises. To enhance the opportunities, and alleviate the negative consequences, of the devaluation, a set of adjustment policies (or so-called accompanying measures) were implemented, including monetary and credit policies, as well as wage, producer and consumer price policies. Significant international support also helped to ease the adverse effects of devaluation. The LDCs benefited from debt cancellation by several bilateral creditors (mainly France), substantial and concessional reschedulings by Paris Club creditors, and increased bilateral assistance (mostly from France) and stand-by arrangements, as well as, later on, from the Enhanced Structural Adjustment Facility arrangements of the International Monetary Fund. The initial impact of devaluation was to raise domestic prices, but monetary and credit restraint subsequently reined in inflation, reducing it from 32 per cent in 1994 to 12 per cent in 1995 and about 6 per cent in 1996. This enabled the real exchange rate to depreciate and strengthened external competitiveness, particularly in agriculture, where the share of labour in total costs is relatively high and the share of imported inputs is low.

The devaluation also enabled producer prices for exports to be raised by between 50 and 100 per cent, stimulating increased production of export crops. During 1994-1996, the franc zone LDCs' exports increased by about 20 per cent and imports by 16 per cent. This reduced their trade deficit from an average of 6.5 per cent of GDP in 1993 to an estimated 3.7 per cent of GDP in 1996. However, the impact of the devaluation has been uneven among the different countries of the franc zone. Unlike the economies of the LDCs that are cotton exporters (Benin, Burkina Faso, Chad, Mali and Togo), Niger's economy has not received a strong impetus from the devaluation: the economy has a very limited range of exportable goods, and world prices for uranium, the country's main export, remain depressed.

The real growth rates of the nine LDCs in the franc zone rose following devaluation. Average GDP growth rose from 1 per cent per annum during 1990-1993 to 4.3 per cent in 1994, 5 per cent in 1995 and 4.2 per cent in 1996. The economies of these countries have expanded more rapidly during the last three years than at any time since the 1970s. Gross domestic savings appear to have increased from 3 per cent of GDP in 1993 to about 8 per cent in 1996. Gross domestic investment increased from 15 per cent of GDP in 1993 to 19 per cent in 1996. There were also some improvements in the fiscal balance.

In some LDCs the devaluation exacerbated the deterioration in living conditions and contributed to social unrest. Strikes occurred in Chad and Equatorial Guinea, civil unrest in the Central African Republic and a coup d'état in Niger.

As a result of the devaluation, trade within the African area of the franc zones has increased rapidly as the products of the franc zone countries have become more competitive *vis-à-vis* non-area imports. The governments of the CFA franc countries have tried to accelerate the process of subregional integration within the framework, established in 1994, of the two groupings: Union économique et monétaire ouest africaine (UEMOA) in the West African region of the zone, and Communauté économique et monétaire en Afrique centrale (CEMAC) in the Central African region of the zone. The subregional integration effort aims to promote consistency in macroeconomic policies, facilitate the emergence of broader markets and encourage labour and capital mobility. One of the important conditions for intensifying the momentum provided by the devaluation, with the objective of transforming the two monetary unions into full-fledged economic unions, is the creation of "safety nets" for the LDCs in the zone, especially the land-locked countries, to protect some of their industries which have survived until now largely because of import barriers.

mand growth in the face of widening current account deficits and asset price inflation. Current account deficits, financed partly by borrowing on the international capital markets, were exacerbated by the export slowdown, and there were concerns that these deficits were too large to be sustainable. Problems also began to emerge in the banking and financial sectors of some of the Asian countries, notably Indonesia, the Philippines, the Republic of Korea and Thailand, because of non-performing loans and declines in asset prices.

Western Hemisphere developing countries

Output growth in the Western Hemisphere DCs recovered in 1996 after falling sharply the previous year when the economies of several countries in the region were disrupted by financial market instability. Average GDP growth rates of 3.2 per cent were estimated for 1996, as compared with the 0.5 per cent for the previous year.

Several countries, particularly the countries of the Southern Cone and Mexico, achieved strong export growth, which contributed to the higher GDP growth rates achieved in 1996. The Mexican economy rebounded, after the contraction it suffered in 1995, with growth of 5 per cent in 1996, while growth exceeded 4 per cent in both Argentina and Uruguay in 1996. Demand restraint had slowed economic growth in Brazil since 1994, but the economy began to pick up again in the second half of 1996, and growth of 3.2 per cent was recorded for the year as a whole. Chile continued to record impressive growth rates: GDP expanded by 7.2 per cent in 1996.

DCs in the region also succeeded in reducing inflation, with average consumer price inflation rates falling to 20 per cent in 1996 from 36 per cent in 1995, as a result of tighter monetary and fiscal policies.

E. Least developed countries

Preliminary estimates indicate that GDP growth rates in the LDCs for which data are available averaged 4.7 per cent in 1996, compared with 5.2 per cent the previous year. This figure excludes several countries afflicted by internal conflicts, from which reliable data are not available. Were these countries to be included, average growth rates would probably be lower. There was a fall in the growth rate of African LDCs, from 5.4 per cent in 1995 to 4.6 per cent in 1996, and a slight increase in that of the Asian and Pacific island LDCs from 4.6 to 4.8 per cent.

African LDCs

Several African LDCs have generated strong growth rates over the last few years as a result of consistent implementation of economic policy reforms.

The 4.6 per cent growth rate estimated for the African LDCs in 1996 implies that per capita output rose for the second consecutive year, following a very long period in which per capita output levels declined. But there were significant disparities in performance between individual African LDCs (as well as between individual non-African LDCs). A number of African LDCs which have consistently implemented economic reforms and avoided serious political instability and civil strife have begun to generate consistent growth rates which enable significant increases in per capita incomes: this group includes Cape Verde, Lesotho and Uganda. In contrast, LDCs which have been unable to resolve serious internal conflicts, maintain political stability and consistently implement necessary economic reforms have experienced, at best, continued economic stagnation and, at worst, economic collapse.

The economic performance of African LDCs in 1996 was shaped by factors similar to those discussed above in the context of African DCs, i.e. the positive impact of economic reforms, the devaluation of the CFA franc and more favourable weather for agriculture, especially in East and Southern Africa.

The recovery of the agricultural sector from drought in 1995 contributed to economic growth in countries such as Ethiopia, Malawi, Mozambique and Zambia. Ethiopia recorded a record grain harvest for the second year in succession. But localized droughts reduced harvests in parts of Cape Verde, Eritrea and Somalia, necessitating increased food imports or food aid, while the effects of civil strife disrupted agricultural production in parts of Burundi, the eastern part of the Democratic Republic of the Congo, Liberia, Rwanda, Sierra Leone, Sudan and Uganda.

Output growth in the nine LDCs which are members of the CFA franc zones is estimated to have averaged 4.2 per cent in 1996, lower than the 5 per cent estimated for 1995.[2] All the CFA zone LDCs achieved positive GDP growth in 1996, and all except Chad, Mali and Togo registered an acceleration of growth rates over the 1995 levels. Growth rates of 5 per cent were estimated for Benin and Burkina Faso. The 16 per cent growth in the economy of Equatorial Guinea was largely attributable to the expansion of oil production in that country. As noted above, the economies of the CFA zone countries were stimulated by the devaluation of the CFA franc in 1994, especially because of the boost this gave the traded goods sector (see box 1). Production of cotton, a major export commodity of several of the CFA zone countries, expanded vigorously in Benin, Burkina Faso, Chad, Mali and Togo in 1995/96, contributing to the significant rise in export earnings which all five of these countries have recorded during the last two years.

The devaluation of the CFA franc in 1994 gave a strong boost to export and GDP growth in the CFA zone LDCs.

Outside the CFA zone, the economies of several of the LDCs which have been consistently implementing economic reforms for a number of years continued to make progress in 1996, with growth rates of 4.5 per cent or more recorded in Lesotho, Malawi, Mauritania, Uganda and the United Republic of Tanzania. These countries also improved the performance of their economies in terms of export earnings and lower inflation rates, or consolidated gains made in 1994/95. The United Republic of Tanzania reached agreement with the IMF in late 1996 on a new Enhanced Structural Adjustment Facility loan. This is expected to prompt donors to increase aid and debt relief, providing further support for the country's economic recovery.

African LDCs in which major civil conflicts have recently been halted have begun to embark on the process of economic recovery. These include Angola, Ethiopia, Mozambique and Rwanda, all of which were also able to achieve relatively robust rates of output growth in 1996.

In contrast to the welcome improvements in the economies of many of the African LDCs, several of them were badly affected by internal conflicts. The conflicts in Burundi, the Democratic Republic of the Congo, Liberia, Somalia and Sudan had destructive effects on those countries' economies, although little data are available to quantify this. Burundi suffered in 1996 its fourth consecutive year of economic contraction. Political instability also had adverse economic effects in the Central African Republic.

Asian LDCs

The average growth rate of the Asian LDCs rose slightly in 1996, but remained significantly lower than the regional average for DCs. Buoyed by strong growth in agriculture, Bangladesh grew at 4.7 per cent in 1996, compared with 4.5 per cent in 1995, which was relatively low by regional standards, but was able to reduce consumer price inflation from 6 to 3 per cent. An acceleration of growth in Bangladesh has been impeded by delays in the implementation of economic policy reforms.

Economic growth has been very robust in the Lao People's Democratic Republic over the last three years, although it was accompanied by a sharp rise in inflation and a widening trade deficit. GDP growth of 6.9 per cent was estimated for 1996, compared with 7.2 per cent in 1995. Poor weather for agriculture contributed to a reduction in output growth in Cambodia from 7.6 per cent in 1995 to 6 per cent in 1996. Growth also slowed in Myanmar – from 9.8 per cent in 1995 to 6 per cent in 1996 – despite good harvests. Good weather for agriculture facilitated a marked acceleration in Nepal's growth rate, from 3.4 per cent in 1995 to 6.1 per cent in 1996. Bhutan's economy grew by 4.7 per cent in 1996, compared with 6.5 per cent the previous year.

Among the Pacific and Indian Ocean island LDCs, there was robust growth in 1996, in excess of 6 per cent in Maldives and 4 per cent in the Solomon Islands.

Haiti

Haiti, the only LDC in the Western Hemisphere, experienced an economic slowdown in 1996, with GDP growth falling to 2 per cent from 4 per cent the previous year. The lack of political consensus regarding economic reforms and associated delays in aid disbursements, combined with continued social unrest and insecurity, adversely affected the economy.

F. Short-term prospects for the least developed countries

There is reason to be cautiously optimistic about prospects for the majority of LDCs, not least because of promising price forecasts for relevant primary commodities and an increasing momentum of economic growth.

Forecasts of short-term prospects are generally difficult to make with any degree of confidence. This is particularly true for LDC economies, which are especially vulnerable to unpredictable exogenous shocks (such as bad weather or price fluctuations on world commodity markets). Furthermore, these economies often suffer from structural impediments, such as high and variable transport costs (see box 2), which complicate analysis of near-term economic prospects. Nonetheless, there are grounds for cautious optimism for African LDCs, at least for those countries which are able to avoid civil strife and political instability. This optimism is based on several factors. First, world prices for tropical beverages rose steeply in the first half of 1997, and this will provide a major boost to export earnings, government revenue and domestic savings in many African LDCs. Second, the good weather which is forecast for 1997 should allow favourable agricultural harvests. Third, the economic recovery in many of the African LDCs, which has resulted from the sustained implementation of economic reforms, has begun to develop some momentum over the last two years. The commitment to reforms which governments in the region have demonstrated should enhance confidence among private sector business and provide a stimulus to investment. Private investment rates in Uganda, for example, climbed above 10 per cent of GDP in 1996. Several other LDCs have begun to attract major foreign investment in the mining and oil sectors: these include Angola, Equatorial Guinea and even the Democratic Republic of the Congo (despite the recent turmoil). As these investment projects come on stream, they will provide an important addition to foreign exchange earnings and a stimulus to growth in those countries over the medium term.

The Asian LDCs have the considerable advantage of being located in the most economically dynamic region of the world. Provided that they can contain macroeconomic imbalances, deepen their economic reforms and avoid political

Box 2: The impact of high transit transport costs on the economies of land-locked developing countries

The impact of high transport costs on the foreign trade of land-locked countries has two distinct aspects. First, land-locked countries incur high costs because of the sheer distance involved in transporting goods from ports to their destination. One very rough measure of the relative size of the potential transit cost burden to a land-locked country is the length of the shortest route from the country's capital or other main city to the nearest seaport. In Afghanistan, Chad, Niger, Zambia and Zimbabwe, these distances are in excess of 2,000 kilometres. Such distances exacerbate the effects of problems such as inefficiency in transit and inflated costs of transport inputs. These problems are also faced, to a lesser degree, by certain large coastal developing countries when transporting goods to inland markets. The second aspect of increased transit transport costs applies exclusively to land-locked countries, and arises from the necessity to cross international boundaries. Border crossing increases freight charges since it involves the transaction costs of dealing with at least two governments.

Although further study is required in order to reveal the extent and nature of the effect of high transport costs in any given context, certain determinants seem, a priori, very significant. First, the lack of adequate physical infrastructure is a clear and direct determinant of higher transport costs. The absence of a robust and safe road and rail network hugely increases the cost (and insurance premiums) of transit. Second, companies with monopolies on the transportation of goods charge inflated prices for their services, and are often protected by the State. Third, formal and informal institutional interference, such as difficult and arbitrary regulation and the frequent stopping of transports at checkpoints, reduces the efficiency of transits. Fourth, there is a lack of intraregional cooperation between governments in the development of mechanisms to reduce transaction costs. Finally, the existence of "protective" policies, such as taxes on fuel or on imported lorries or goods wagons, indirectly - but again clearly - affect transit costs.

Significantly, analysis of the costs and benefits of transit routes often reveals that costs arise in one country (the transit country) while benefits accrue to many countries (including land-locked ones). This suggests that transit transport improvement projects are best handled in a regional framework, so that project priorities and financing arrangements can accurately reflect all the costs and benefits, as well as being sensitive to the payment capacities of all beneficiaries.

At a regional level, the greatest increases in efficiency and reduction in real costs are likely to come through a holistic effort to improve a range of institutional, procedural, regulatory, managerial and other non-physical dimensions of the movement of goods across borders. These issues have, to some extent, been tackled through the development of a range of sophisticated techniques for facilitating trade movements and customs procedures and for simplifying documentation requirements, assisted by international bodies such as UNCTAD. Such techniques will need to be integrated into a wider strategy to reduce the burden on already impoverished LDCs.

instability, the prospects for accelerating economic growth over the medium term must be favourable, at least for the mainland countries.

G. Salient features of recent trends in the commodity economy of relevance to the LDCs

World prices of LDCs' non-oil exports fell sharply in 1996.

Non-oil primary commodity price developments were on the whole very unfavourable to LDC exports in 1996. Sluggish industrial activity in the major importing countries, oversupply and turmoil due to speculative trading exerted considerable downward pressures on prices. Thus, after a more or less stable first quarter the combined dollar index of non-oil primary commodity prices started to weaken quite steadily during the remainder of the year and the declines were very steep for the non-oil commodity groups of interest to LDC exports: tropical food prices recorded a fall of over 15 per cent, while the prices of minerals fell by almost 13 per cent and those of agricultural raw materials by nearly 10 per cent (see table 2). On an individual commodity basis, the declines were particularly significant for coffee and copper (see below).[3]

TABLE 2: PRIMARY COMMODITY PRICES FOR DEVELOPING COUNTRIES
(Annual average growth rates, percentages)

	1985-1990	1990-1995	1995-1996
All food index	3.2	3.3	1.5
Tropical beverages	-9.2	8.4	-15.7
Food	8.6	1.4	6.9
Agricultural raw-materials	6.2	3.5	-12.2
Minerals, ores and metals	8.2	0.2	-12.7
Combined index (in terms of current dollars)	4.9	2.6	-4.3
Coffee (composite indicator price)	-11.7	14.1	-26.3
Tea	0.6	-4.3	8.9
Copra	-9.8	13.7	11.5
Tobacco	5.4	-4.9	15.1
Cotton	10.6	1.5	-7.9
Jute	-6.4	-2.2	24.2
Copper	13.4	2.0	-21.8
Crude petroleum	-4.0	-5.2	20.7

Source: UNCTAD, *Monthly Commodity Price Bulletin*, various issues.

The major exception to this bleak picture was petroleum prices, which rose quite steadily throughout the year and by December averaged over $23 a barrel,[4] i.e. almost $6 higher than the level prevailing 12 months earlier. Low levels of inventories and robust demand growth due to a long cold winter contributed to buoy oil markets. The steady rise in oil prices also reflected continued production restraint by OPEC member countries and shortfalls in supply from non-OPEC sources. Additionally, the much delayed resumption of oil exports from Iraq (under Security Council resolution 986) led to speculative purchases and higher prices. On current trends, however, prices can be expected to weaken in the near future because of oversupply, but there is major uncertainty regarding growth of non-OPEC production, which suffered from technical problems during 1996.

It is testament to the progress of LDCs that much growth in 1996 occurred against a background of generally unfavourable primary commodity prices.

In sharp contrast to oil prices, the prices of other major commodities of export interest to the LDCs dropped very sharply in 1996. Thus, throughout much of 1996 expectations of a large coffee crop coming from Brazil contributed to weakening prices despite a tight supply situation, which was itself a result of Brazil's low level of exports following damage to plantations due to frosts and drought during the summer of 1994. On average, coffee prices declined by some 26 per cent in 1996. On the whole, however, prices were less volatile than expected thanks to both low stocks, especially in consuming countries, and the export ceiling adopted by the Association of Coffee Producing Countries (ACPC). But there were diverging trends in coffee prices, as these fell more for robusta than for arabica because of the large supply increases in the former type of coffee. The more favourable arabica price movements owed much to the ACPC's self-imposed export quotas, which contributed to limiting supplies. Robusta supplies, on the contrary, were plentiful, because of considerably expanded production by major suppliers. Supplies from Uganda, for example, had been growing rapidly thanks to increased planting of new high-yielding varieties. In fact, producers were responding to market liberalization policies which brought about an increase in their share of the export price. In the near future, ample supplies can be expected to weaken prices further; but much will depend on expectations concerning Brazil's crop, which may well fall short of last year's level. Over the longer term, concerns about low earnings encouraged a number of producers to explore the gourmet market more thoroughly. Thus, much hope was attached to increases in the sales of specialty coffee, and producers have been encouraged lately by the noticeable increases in consumption in major markets, especially the United States, where gourmet coffee accounted for the bulk of these increases.

Copper prices were particularly volatile in 1996, with a pronounced downward trend during most of the year. In fact, prices sometimes plunged abruptly in a matter of hours. The consequences of a major Japanese company's losses due to unauthorized trading compounded the already weak market trends caused by oversupply and moderate demand growth. In particular, the expectations of a large stock disposal by Sumitomo added pressures to the prevailing sluggish market trends. On account of improved consumption and lower stocks, however, prices recovered somewhat towards the end of the year, but there is a risk that they may weaken again in the coming months as demand is expected to slow down considerably, especially in North America, while demand in Western Europe may continue to be very sluggish and to grow only moderately in East Asia. Despite the low prices, investments with expected high future production continued, especially in Latin America.

Cotton prices were also declining quite steadily throughout 1996; their recovery towards the end of the year was very modest and for the year as a whole averaged about 8 per cent lower than in 1995. Production by traditional growers is expected to decline on account of low prices and competition for planting area by other, more remunerative crops, but large increases in production may be forthcoming from other growers, including those in West Africa, where many countries in the CFA zone were still adjusting to the recent devaluation. Increases in production were also expected in Southern Africa and Australia, and thus the consumption-production gap can be expected to narrow in the near future.

LDCs such as Madagascar have made substantial progress in diversifying their exports.

Repeated gyrations of primary commodity export prices are a constant reminder that highly commodity-dependent economies are most exposed to market vagaries and the concomitant instabilities in foreign exchange earnings. Their national incomes also suffer from sizeable losses due to deteriorations in the terms of trade. The least developed countries are no exceptions. In recent years, however, a few have demonstrated an ability to break away from past practices and to diversify into more promising export activities with high potentials for growth and development. One notable example is Madagascar, whose agricultural policy is geared to improving the quality and at the same time limiting the growth of output of those export crops which are faced with quotas or long-term demand problems. The country is also investing in the development of new export crops, such as oilseeds, soybeans and cashew nuts. Moreover, its fishing exports, which include lobster, prawn and shrimp, are also thriving. Thanks to its fast rate of expansion, especially since the mid-1980s under the stimulus of foreign direct investment, seafood, especially prawns, has become an important foreign exchange earner. The industry can be expected to continue its rapid expansion, provided that additional refrigeration facilities are forthcoming and transport problems are solved. Another promising new activity is the processing of agricultural products, which was supported on the demand side by both the domestic market and the market in the neighbouring islands.

The erosion of earnings from main export commodities, especially coffee, has prompted Uganda to renew efforts to diversify. An example of its successful drive is the fast-growing exports of fish, which have overtaken the exports of the traditional cotton and tea industries in terms of foreign exchange earnings. This is an activity whose full growth potentials remain to be exploited, since as of 1995 only nine of the country's 20 industrial fish-processing plants were operational. On the whole, the country's performance in non-traditional exports, i.e. those other than coffee, cotton, tea and tobacco, has been most remarkable. Not only have exports of maize and beans been doing well, but also there is in general a promising future for the country's food crop exports to regional markets such as neighbouring Kenya. Moreover, these exports are particularly attractive to producers as cash crops because of their higher farm-gate returns compared with returns on traditional export crop production in a situation of low global prices.

Uganda's food producers appeared to have benefited considerably from favourable regional trade arrangements, especially the Common Market for Eastern and Southern Africa, and the concomitant growing importance of regional food markets. The rapid rate of expansion of the country's other non-traditional exports, including fish and fish products, cattle hides and sesame, should be a stimulus for further diversification.

Good weather boosted harvests in 1996, but food insecurity continues to threaten many countries in sub-Saharan Africa and some LDCs in Asia.

In sharp contrast to the major declines in their export prices, least developed countries' import prices, especially those of grains, rose considerably in 1996, particularly during the first half of the year. The price increases during 1995-1996 were particularly rapid after three seasons of relative stability. Grain prices rose in response to concerns about crop prospects in some major producing countries and about the low global stocks. For importing countries, the higher prices had meant larger import bills and strained balances of payments. Increases in grain prices, however, do not always have a complete pass-through to local markets. The extent of domestic price responses depends, among other things, on the degree of import dependence, domestic supply conditions, changes in exchange rates, and trade policies in general. But the 1995-1996 cereal price increases did give rise to sharp increases in local currency prices, i.e. the actual prices paid by consumers in many developing countries. They were most pronounced in Latin America. In Africa, however, the only country where the price of wheat rose markedly was Sudan, whose food production also suffered from the adverse effects of insecurity and floods.[5] In most developing countries, the domestic supply situation played a preponderant role in mitigating the recent price increases and the smaller price increases were in fact observed in countries with good harvests. This was particularly true of African countries where cereal harvests were normal or above normal in 1995/96. To counter the imported inflation due to higher grain prices, offsetting measures were also widely adopted by governments which rely mostly on trade-related measures, e.g. increased import quotas and/or tariff reductions. In some countries, consumer subsidies were also increased to soften the impact of price rises. Although grain prices started to ease during the second half of 1996 as the extent of the increase in grain production became more certain, prices – especially those of wheat and maize – still averaged more than half again as high as those prevailing in 1995. Stocks were still low by historical standards, and the risk of some rebound in grain prices due to an unforeseen increase in import demand or an unfavourable crop outlook still exists.

Notwithstanding the low incidence of recent grain price inflation, severe food shortages continued to threaten many countries in sub-Saharan Africa and some least developed countries in Asia despite a general improvement in food supplies in 1996.[6] Their causes are diverse and include civil strife, devastating floods and crop failures. While overall food supplies for the 1996/97 season have improved in sub-Saharan Africa, some 40 per cent of the population is chronically undernourished. The food supply outlook remains particularly precarious in several parts of the Great Lakes Region, where the flows of refugees have put considerable pressure on the already fragile food situation in the region. The presence of large refugee camps also adversely affects agricultural production, and agricultural activity suffers as well from the uncertain security situation in the whole area. Assistance continued to be needed in Burundi, the Democratic Republic of the Congo and Rwanda. The food security situation remains critical in parts of West Africa where pockets of famine have developed following a sharp reduction in food production and serious disruption of relief distributions. At the same time, natural disasters, including floods and insect damage, continued to devastate cereal crops elsewhere, especially in Somalia. There was some recovery in food production thanks to the beginning of the peace process in Sierra Leone, but production levels in that country remain below the pre-civil strife average. Despite good harvests, large population displacement will require substantial imports into Angola and Mozambique. Food production prospects were also uncertain in many LDCs in Asia. In particular, shortages of farm inputs continued to affect food production in Afghanistan, while in Yemen a large number of people are in need of relief assistance. The food situation is also precarious in the Lao People's Democratic Republic, where severe floods have caused considerable damage to crops.

The vulnerability of certain African and Asian LDCs to food shortages is exacerbated by natural disasters and complex emergencies.

At the global level, cereal production recovered significantly in 1996, thus leading to a substantial replenishment of aggregate carry-over stocks, but these may still remain below minimum safe levels for the foreseeable future. All in all, another good cereal crop in 1997 is needed for global food security.

Notes

1 IMF, 1997, p. 63.
2 Data from the Economic Commission for Africa (1997).
3 Owing in part to the fact that the upvaluation of the dollar export prices of manufactures rose only marginally in 1996.
4 Average of Dubai, United Kingdom Brent and Alaska N Slope crude prices. See UNCTAD, 1997.
5 See FAO, 1996, p. 23.
6 The African countries facing exceptional food emergencies included Angola, Burundi, Chad, Eritrea, Ethiopia, Kenya, Liberia, Mauritania, Mozambique, Rwanda, Sierra Leone, Somalia, Sudan and Zaire. See FAO, 1997.

References

Asian Development Bank (1997). *Asian Development Outlook, 1997 and 1998*, Hong Kong, Oxford University Press for the Asian Development Bank.
Economic Commission for Africa (1997). *Report on the Economic and Social Situation in Africa, 1997*, Addis Ababa, ECA.
Economist Intelligence Unit (1996). *World Outlook 1997*, London, EIU.
FAO (1996). *Food Outlook*, November, Rome, FAO.
FAO (1997). *Food Supply Situation and Crop Prospects in Sub-Saharan Africa*, No. 1, Rome, FAO.
IMF (1996). *World Economic Outlook*, October, Washington, D.C., IMF.
IMF (1997). *World Economic Outlook*, May, Washington, D.C., IMF.
United Nations (1997). *Economic and Social Survey 1997*, New York, UN.
UNCTAD (1997). *Monthly Commodity Price Bulletin*, January, Geneva, UNCTAD.

Recent Trends in Development Finance and External Debt

Chapter 2

A. Introduction

There have been important changes in external financing for the developing countries as a whole since the beginning of the 1990s, notably with private investment increasing significantly, and total resource flows growing steadily. Flows to all developing countries reached a new record level in 1995. These developments, however, have hardly affected the LDCs at all. In their case, resource flows have remained stagnant in current dollar terms so far throughout the 1990s, and diminished in real terms. There has been no perceptible increase in private financing flows, with the contribution of private capital remaining modest in volume and fluctuating significantly. For LDCs, dependence on official development assistance (ODA) continues unabated, and the overhang of external debt servicing obligations continues to be an important drain on resources.

The share of aid to LDCs in the combined GNP of the donor countries which are members of the OECD's Development Assistance Committee (DAC) dropped from 0.09 per cent in 1990 to 0.06 per cent in 1995, in stark contrast with the aid targets and commitments adopted at the Second United Nations Conference on the LDCs in 1990, which indicated a significant increase in assistance to these countries during the current decade. This development follows the decline in overall ODA supply over this period. In addition, emergencies and humanitarian assistance needs (in both LDCs and other crisis areas) have diverted the attention of the international community and have apparently crowded out support for regular development programmes in LDCs. Meanwhile, LDCs' financing needs remain high because of the urgent need to overcome structural constraints and low human development.

A number of LDCs are now emerging from periods of civil strife and unrest, and have engaged in programmes of rehabilitation and reconstruction, and others are undertaking renewed efforts to implement structural adjustment and reform programmes in cooperation with the international financial institutions. As the creditworthiness of many LDCs is affected by their debt problems and as their general debt-servicing capacity is limited for a variety of reasons, most of these countries continue to have very limited access to private capital markets for the time being. Consequently, external assistance will need to be in the form of ODA. While the aid targets set in 1990 have become difficult to reach, the possibility of setting "aid recovery targets" – with the objective of regaining the ground lost during the first half of the decade – should perhaps be considered. Moreover, efforts to relieve LDCs' debt burden need to be undertaken without delay, in order to allow those countries to reap benefits from their economic reform programmes and the favourable developments in the world economy.

Securing an adequate share of available ODA resources, enhancing aid effectiveness and lessening aid dependence over time are major challenges confronting the LDCs in the future. Measures in this area need to go hand in hand with efforts to increase external receipts through enhanced export-earning capacity and to mobilize domestic resources for development and investment. Apart from mobilizing and managing traditional ODA flows, the following would be key elements in a comprehensive external financing strategy for LDCs:

- calling on non-traditional donors;
- creating the conditions for increasing foreign direct investment (FDI) and equity investment flows;
- significantly reducing the debt-servicing burden.

This chapter reviews total resource flows to LDCs; the implementation of ODA targets for LDCs and the outlook for aid; trends in ODA flows; resource mobilization for individual LDCs; and the external debt situation of these countries and new initiatives in the area of debt. Box 3 – on the aid programme of the Republic of Korea – describes the experience of one non-traditional (or "emerging donor") country, while issues relating to foreign private investment in LDCs are discussed in box 4.

B. Resource flows

Total resource flows and net transfer of resources to LDCs

The pattern of external financing for the LDCs stayed broadly unchanged throughout the first half of the 1990s. ODA from the DAC donor countries continued to account for nearly all the flow of external resources to LDCs. Net ODA flows from OPEC countries and agencies, which accounted for 7 per cent of total ODA flows in 1985, steadily diminished in relative importance and became negligible after 1991.

Despite record levels of financial flows to developing countries, LDCs have experienced a fall in real terms.

Table 3 summarizes available information on long-term resource flows and the net transfer of resources to LDCs. Throughout 1990-1994, the net transfer of resources (including technical assistance), according to these figures, remained substantial and relatively stable at a level of $14 to $15 billion annually in current dollar terms. However, in real terms, there has been a marked decline in ODA and in total flows, particularly in 1995 (see annex table 19). Moreover, this level of resource transfer was maintained only through exceptional financing in the form of debt relief and the accumulation of payments arrears on external debt – that is, through lower than scheduled debt service payments by many LDCs. In 1995, the level of inflows was maintained largely as a result of increased assistance to Zambia, after the completion of its rights accumulation programme with the IMF. However, after payments of arrears and debt service by that country, it appears that the aggregate net transfer of resources declined sharply and for the first time this decade fell below the level of $14 billion.

In 1995, new resource flows from DAC sources to LDCs consisted exclusively of ODA, such flows reaching a level of $16.6 billion. As there was a net outflow of non-concessional resources from LDCs totalling $0.6 billion, the recorded total flow of external resources to LDCs amounted to $16 billion on a net basis. Other official flows have diminished in importance as DAC countries as well as international financial institutions have shifted to providing mainly concessional finance to the LDCs. Consequently, repayments on past loans tend to offset any

Table 3: Net flow and net transfer of resources to LDCs, 1990-1995
(Billions of dollars)

	1990	1991	1992	1993	1994	1995
ODA grants (including technical assistance) (A)	11.7	12.8	12.5	11.9	12.6	12.6
Net ODA loans (B)	4.6	3.5	4.1	3.3	3.6	4.0
Net ODA (C = A + B)	16.3	16.3	16.6	15.2	16.3	16.6
Other official flows, net (D) (excluding IMF)	0.7	-0.0	0.0	0.3	0.3	-0.1
Private export credits, net [a] (E)	-0.5	-0.4	0.1	-0.6	-1.1	-0.4
Other private capital flows, net [a] (F)	0.6	0.3	0.3	1.0	0.6	-0.1
Total private (G = E + F)	0.2	-0.0	0.4	0.4	-0.5	-0.5
Total net flow of resources (C + D + G)	17.2	16.3	17.0	15.8	16.1	16.0
Interest payments on long-term debt	-1.8	-1.7	-1.3	-1.2	-1.3	-1.9
Net purchases under IMF non-concessional facilities	-0.5	-0.3	-0.2	-0.1	-0.0	-0.5
Net transfer of resources [b]	14.9	14.3	15.5	14.5	14.8	13.6
Memo item:						
Net accumulation of arrears on debt service payments	4.6	4.6	4.0	4.9	5.6	3.6

Source: UNCTAD estimates, based on data from the OECD, IMF and World Bank.
a From OECD/DAC countries.
b Excluding profit remittances on FDI.

new inflows. There has also been a consistent outflow on account of private export credit over the past decade. Trends in aggregate private flows to the LDCs from DAC sources, especially as regards investment flows, are largely determined by transactions with a few countries (notably Angola and Liberia), and flows tend to fluctuate from year to year. Direct investment flows from DAC countries to LDCs as a group amounted to only $0.1 billion in 1995 (see chart 1.A and annex table 19).

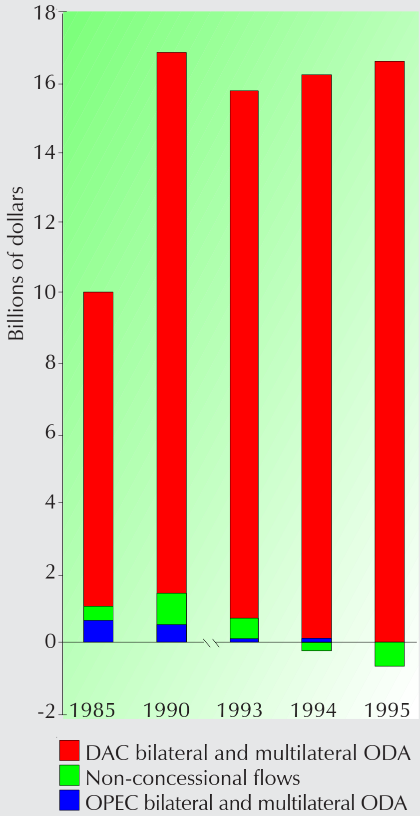
Information on resource flows to and from LDCs is not fully comprehensive. In particular, table 3 provides only partial information on resource flows from sources other than DAC countries and multilateral agencies mainly financed by them, and on private capital flows. Data on flows of development finance from OPEC countries and agencies are no longer available on a systematic basis as in earlier years. Neither are data currently available on grants from non-governmental organizations, which are important actors in development cooperation, and on ODA and other economic cooperation between LDCs and the former countries of the Council for Mutual Economic Assistance as well as other developing countries. A number of more advanced developing countries have set up their own aid programmes, with LDCs amongst others as potential beneficiaries. Moreover, other developing countries may be an important source – actual and potential – of private investment for LDCs. The UNCTAD database on foreign direct investment flows, which is based mainly on balance-of-payments data, indicates considerably higher flows of FDI to the LDCs than do the DAC figures, e.g. a net inflow of $1.1 billion in 1995 (of which $0.4 billion was to Angola). On the other hand, available information also points to substantial profit remittances from LDCs. Attracting non-DAC flows to LDCs and promoting foreign private investment to these countries should be given priority in view of the sluggish outlook for ODA from DAC countries and the need to ensure LDCs' external financing needs over the longer term.

Implementation of ODA targets and ODA outlook

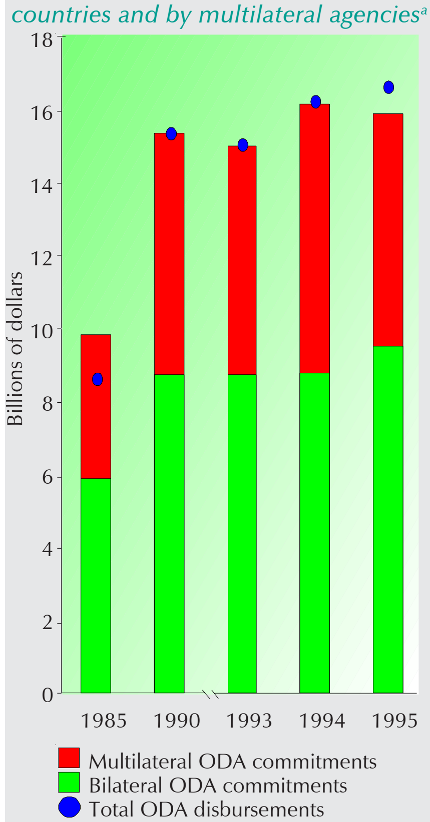
The trends in resource flows to the LDCs described above reflect the decline in ODA, particularly after 1992. Until that year, the share of overall ODA (bilat-

Chart 1: The flow of external resources to LDCs, 1985-1995

A: Total external resource flows by origin



B: Total ODA disbursements and commitments by DAC member countries and by multilateral agencies[a]



Source: UNCTAD secretariat, based on OECD data.
a Multilateral agencies mainly financed by DAC member countries.

eral disbursements to developing countries as a whole[1] and contributions to multilateral organizations) in the GNP of the DAC member countries had stayed stable over a long period, and disbursements were growing steadily in current dollar terms. Overall ODA peaked at $61 billion in 1992, representing 0.33 per cent of the combined GNP of the DAC countries that year. This share fell to 0.30 per cent in 1993 and 1994, and to 0.27 per cent in 1995, the lowest ratio recorded since the United Nations adopted in 1970 the overall ODA target of 0.7 per cent of donor countries' GNP.

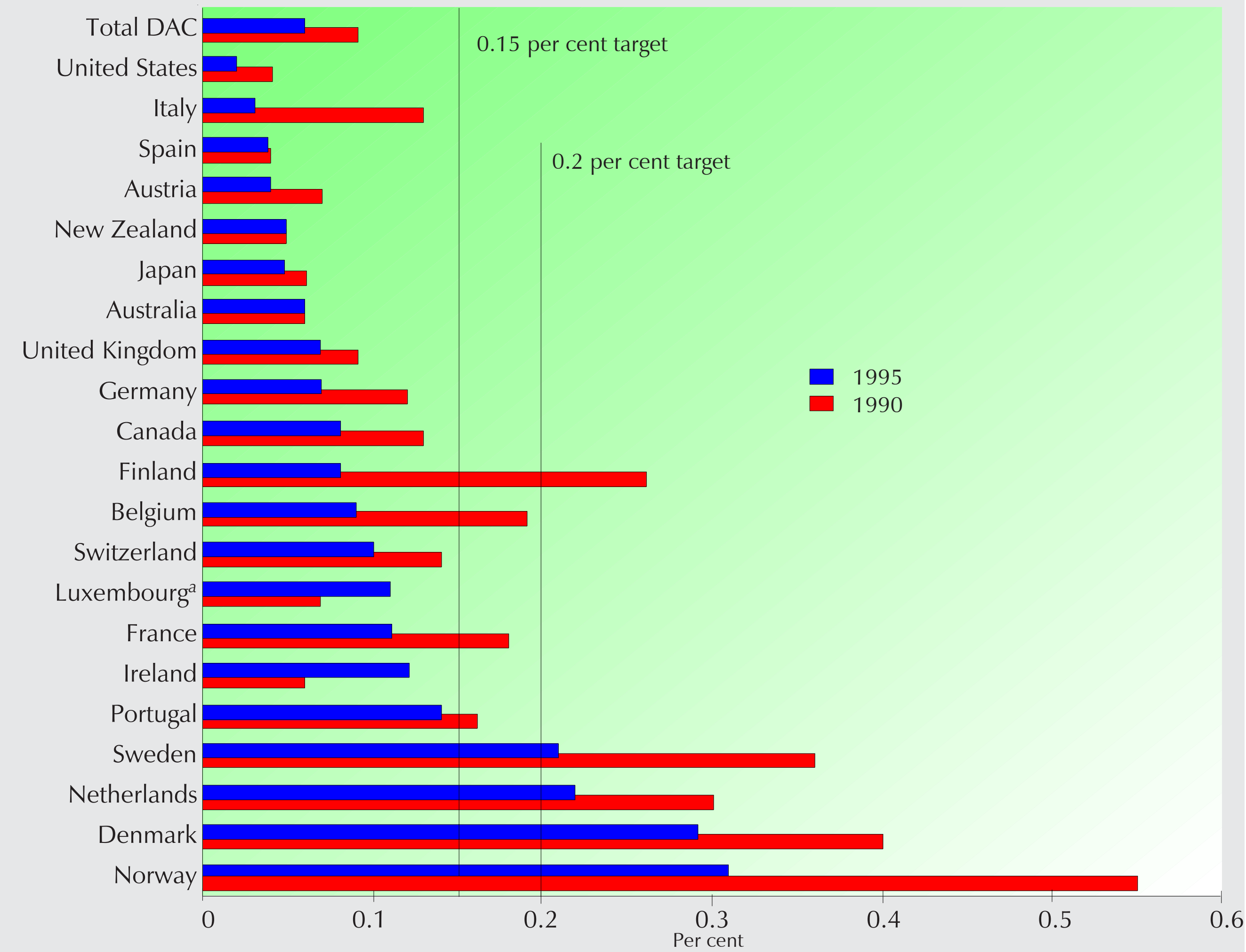
Although policy statements repeatedly emphasize the aid needs of the poorest countries, in practice little action seems to have been taken to protect aid allocations to the LDCs or to shift resources to them. On the contrary, LDCs' share in DAC countries' total aid programmes, which was 27 per cent a decade ago (in 1984-1985), fell to 22 per cent in 1995 (down from 23 per cent in 1994).[2] The share of aid to LDCs in the combined GNP of the DAC countries also contracted significantly during the first half of the 1990s. From the "peak year" of 1992, when it was 0.09 per cent, it has fallen steadily – to 0.08 per cent in 1993, 0.07 per cent in 1994 and only 0.06 per cent in 1995.

The commitment by the international community, particularly the developed countries, to enhance aid to LDCs in order to achieve a significant and substantial increase in the aggregate level of external support to these countries, was one of the key provisions in the Programme of Action for the LDCs for the 1990s adopted by the Second United Nations Conference on the LDCs in Paris in 1990. To this end, a set of alternative aid targets and commitments were adopted to encourage donor countries to increase their efforts and improve their aid performance *vis-à-vis* the LDCs. But since 1990, a number of major international and humanitarian crises, global economic downturn, and domestic preoccupations and budgetary pressures in a number of the donor countries, have dominated aid policies. Collectively, donors have failed to meet the special aid targets and commitments for LDCs set in the Programme of Action.

Few of the DAC donor countries have improved their performance with regard to the aid targets for LDCs since 1990; in most of these countries, the share of aid to LDCs in terms of GNP ratio was lower in 1995 than in 1990.[3] Ireland and Luxembourg were the only DAC countries to improve their aid performance *vis-à-vis* the LDCs in terms of GNP ratio since 1990.[4] However, four DAC countries continue to meet the 0.20 per cent target – Norway (the top performer with an aid to LDCs/GNP ratio of 0.31 per cent in 1995), Denmark, the Netherlands and Sweden. In terms of volume, Japan, which is already the largest donor with regard to developing countries as a whole, is now also the largest aid donor to the LDCs. Its ODA contribution to them has steadily increased throughout the first half of the decade, reaching a level of $2.5 billion in 1995. Japan is followed by the United States (formerly the largest source of ODA to LDCs), France and Germany, all of which contributed over $1.5 billion in ODA to LDCs in 1995, either bilaterally or through multilateral channels. Among the smaller donor countries, Ireland, Luxembourg and New Zealand in particular were consistently expanding their aid programmes for LDCs in volume terms over the first half of the 1990s (annex table 22).

A reversal of the current trend in donor performance with regard to LDCs will require both a recovery in overall ODA and more determined efforts to reorient aid programmes towards the needs of the poorest countries. The outlook for overall ODA is still uncertain, as budgetary pressures are likely to remain strong in major donor countries and perhaps even intensify as a result of budgetary targets in the context of the establishment of the European Monetary Union. On

CHART 2: ODA TO LDCs FROM DAC MEMBER COUNTRIES, 1990 AND 1995
(Percentage of donor's GDP)



Source: UNCTAD secretariat, based on OECD data.
a Values refer to 1990 and 1994.

the other hand, more favourable economic prospects in the OECD countries over the longer term could contribute to renewed ODA growth. In his latest annual report,[5] the DAC Chairman suggested that "if overall fiscal deficits are mastered, governments can maintain or rebuild a strong and persuasive rationale for a growing development assistance effort".[6] Technical factors (e.g. the scheduled increase in contributions to international financial institutions following recent replenishment agreements) should also promote some recovery of aid flows in 1996. However, in view of the developments during the first half of the 1990s and the gloomy short-term outlook for ODA in general, achievement of the aid targets set in the Programme of Action seems far beyond reach. It may be more realistic to think in terms of "aid recovery targets" for the second half of the decade in order to regain the ground lost over the first half. In operational terms, this could be translated into each donor country's aiming as a priority at bringing back its ODA to LDCs to the relative levels achieved in 1990. Regaining a 0.09 per cent share of DAC donors' GNP would mean substantial additional resources for the LDCs, compared with the mid-decade situation.

In practice, the volume of aid that donors provide to LDCs appears not to be primarily influenced by global aid targets, but more by the policies and performance of recipient countries. Conditionalities for the provision of aid have increased, with, for instance, the dimension of "good governance" becoming an integral part of the economic programmes required for regular development co-operation. Together with reduced ODA availability, this means that LDCs have to compete for aid resources on the basis of economic policy performance as well as political reform efforts, poverty reduction programmes and fulfilment of other conditions required by donors. In this respect, it should be noted that a number of LDCs have made and are making considerable efforts to rebuild their economies after periods of civil strife and unrest, while others are implementing structural adjustment and reform programmes with new commitment and determination. These efforts need to be supported by enhanced donor cooperation and recovery of aid flows.

Recent trends in ODA disbursements and commitments to LDCs

Latest figures for DAC member countries show that ODA as a proportion of GDP has never been lower.

As noted above, total DAC ODA flows (disbursements) to LDCs in 1995 reached a level of $16.6 billion, slightly up from the previous year in current dollar terms. However, measured in constant dollars (see annex table 19), there was a drop in LDCs' ODA receipts of some 8 per cent. Multilateral aid from agencies mainly financed by DAC countries has assumed a more important role in ODA flows to LDCs since the beginning of the decade, its share in DAC total ODA to these countries having increased from 40 per cent in 1990 to 46 per cent in 1995. In current dollar terms, it rose from $6.1 billion to $7.7 billion. During the same period, bilateral aid from the DAC countries to LDCs fluctuated around a level of $9 billion. The increase in multilateral aid flows has, however, largely cushioned variations in bilateral aid. The latter is now mostly in the form of grants.[7]

In 1995, total bilateral aid from DAC countries decreased to $8.9 billion – i.e. down by some $0.4 billion from the previous year – despite the fact that most DAC countries in 1995 broadly maintained or even increased their bilateral programmes with LDCs in current dollar terms. The overall decline in bilateral disbursements to LDCs in 1995 was due mainly to a drop in aid from the United States, as compared with a record level of disbursements by this country the previous year. The decrease in bilateral aid in 1995 was again more than compensated by an upswing in multilateral aid, most of it due to a $1 billion increase in net funding under the concessional structural adjustment facilities of the IMF, notably since Zambia's rights accumulation programme was completed (as discussed above) in December 1995. Disbursements under other multilateral programmes also increased (e.g. those of the European Union), as did net disbursements from International Fund for Agricultural Development (IFAD), while disbursements from the International Development Association (IDA) and some agencies mainly providing emergency-related aid (UNHCR and the World Food Programme) contracted.

In view of the importance of multilateral aid in financing LDCs' economic reform and development programmes, adequate funding of the soft windows of the international financial institutions and of grant-based development funds and programmes (notably those of the European Union and the United Nations) is critical for this group of countries. After protracted negotiations, agreement was reached in March 1996 on the eleventh replenishment of the IDA, followed a couple of months later by agreement on a financing package for the African Development Fund which will allow renewed lending on concessional terms from the African Development Bank after a suspension of such lending for two and a half years. However, both of these replenishments were lower than initial estimates of resource requirements. New donor contributions to the replenishment of the Asian Development Fund as initially agreed in January 1997 will also be substantially lower than under the previous replenishment, although the level of planned operations is expected to be maintained in dollar terms through non-donor resources (principally reflows). The difficulties in reaching these agreements and continued budgetary constraints in the main donor countries point to continued uncertainties about future multilateral assistance capacities. New commitments by multilateral agencies to LDCs have already been reduced since 1992 (chart 1.B).

As can be seen in chart 1.B, trends in DAC disbursements to the LDCs have, over the past decade, closely followed trends in new aid commitments. It is significant that during the last three years commitments have tended to fall to the level of or below disbursements.

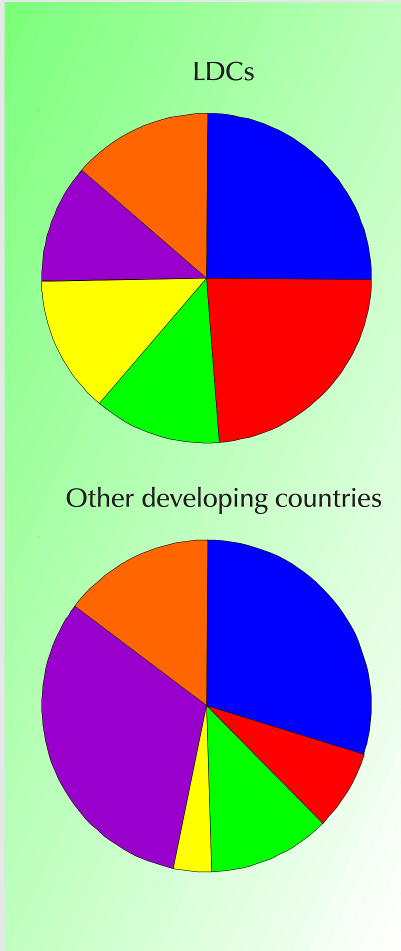
Another noticeable feature is the substantial share of emergency assistance and food aid in bilateral ODA. In 1995, food aid together with emergency assistance accounted for 24 per cent of bilateral ODA commitments (see chart 3). This was mainly due to the fact that the number of countries involved in civil war and strife increased during the first half of the decade. While overall ODA remains stagnant, concerns have been raised about a possible diversion of aid from development purposes to emergency programmes.

Against the background of a general decline in ODA, it is sometimes argued that the stagnation of aid to the LDCs results from the fact that many of these countries have been or are in a situation of civil war and strife, which has disrupted the development cooperation process. However, an analysis of ODA trends in three different groups of LDC recipients (those not affected by war and with a relatively strong economic performance, those not affected by war and with sluggish growth and those involved in war and civil strife) shows that ODA is stagnant or declining for all groups. For the first group, comprising 11 LDCs not affected by civil war and strife and with a relatively strong economic performance, ODA is tending to decline. The second group, comprising 21 LDCs not affected by civil war and strife and with sluggish growth, have seen their ODA increase. However, if the particular case of Zambia, which as seen earlier received a substantial increase in aid in 1995 under new arrangements with the IMF, is excluded, ODA is tending to decline in that group as well. Finally, the third group – comprising 16 LDCs affected by civil war and strife – recorded only a marginal increase in ODA from 1991 to 1995, with a peak in 1994 (see chart 4).

It thus appears that the only group which did not see a declining trend in ODA is the third group. This lends some support to the assertion that there has been a diversion of aid to LDCs towards emergency assistance programmes.

Data on the composition of multilateral aid similar to those presented in chart 3 are not available. However, UNHCR and the World Food Programme, whose activities were largely emergency-related in 1995, together provided $1.1 billion in assistance to the LDCs, representing almost 15 per cent of total multilateral disbursements in these countries in that year. In 1994, seen as the peak year for emergency assistance overall, the corresponding amount disbursed by these two agencies in LDCs and their share of multilateral aid were even higher (the latter close to one-fifth of total multilateral assistance to the LDCs). Substantial amounts for emergency aid can also be assumed to have been spent under other multilateral programmes.

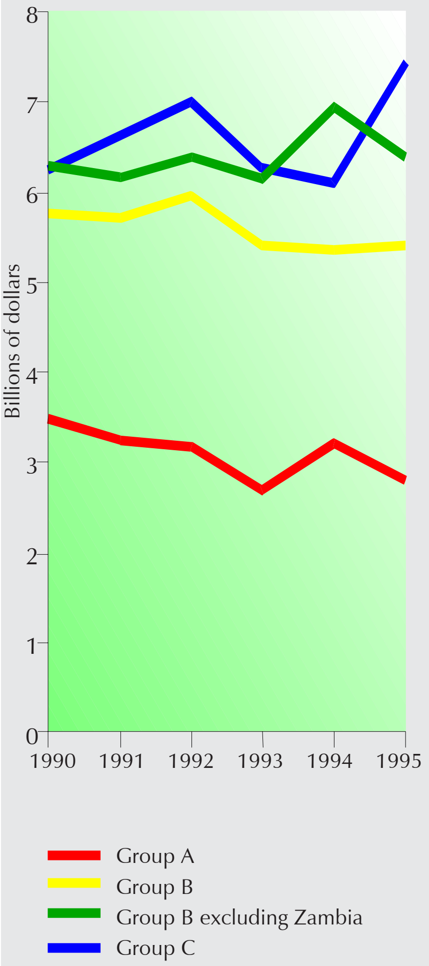
CHART 3: BILATERAL ODA COMMITMENTS BY PURPOSE, 1995



- Social infrastructure and services
- Emergency/food aid
- Production sectors
- Action relating to debt
- Economic infrastructure and services
- Multisector/programme assistance/other

Source: UNCTAD secretariat, based on OECD data.

CHART 4: TOTAL ODA NET, 1990-1995



Source: UNCTAD secretariat, based on OECD data.
Note: Categorization based on analysis in UNCTAD, 1996a, pp. 8-9.
Group A: Strong-growth LDCs (11): Bangladesh, Bhutan, Cape Verde, Chad, Guinea-Bissau, Lao People's Democratic Republic, Lesotho, Maldives, Nepal, Solomon Islands and Tuvalu.
Group B: Stagnant LDCs (21): Benin, Burkina Faso, Central African Republic, Comoros, Djibouti, Equatorial Guinea, Gambia, Guinea, Kiribati, Madagascar, Malawi, Mali, Mauritania, Myanmar, Niger, Samoa, Sao Tome and Principe, Uganda, United Republic of Tanzania, Vanuatu and Zambia.
Group C: Civil strife and war-affected LDCs (15): Afghanistan, Angola, Burundi, Cambodia, Democratic Republic of the Congo, Ethiopia, Haiti, Liberia, Mozambique, Rwanda, Sierra Leone, Somalia, Sudan, Togo and Yemen.

RESOURCE MOBILIZATION FOR INDIVIDUAL LDCS

At the individual country level, consultative and aid groups and round-table meetings are important mechanisms for resource mobilization and aid coordination, including at the sectoral level. Nineteen LDCs (typically among those with large populations) had or have consultative or aid group arrangements co-sponsored by the World Bank, while most others have had recourse to UNDP-supported round-table meetings since this aid coordination process was set up on a broader scale following the first United Nations Conference on the LDCs in 1981. As an increasing number of LDCs implemented structural adjustment programmes during the early 1990s, the country review mechanism was revived in a number of countries which had stayed outside the process during all or most of the previous decade (e.g. Burkina Faso, Ethiopia and Sierra Leone).

Most of the consultative and aid groups for countries which have been implementing Structural Adjustment Facility (SAF) and/or Enhanced Structural Adjustment Facility (ESAF) programmes met regularly during the first half of the 1990s, and six of them were convened during 1996 (see table 4). In addition, the first meeting of a new consultative group – the successor to the International Committee on the Reconstruction of Cambodia – was held in Tokyo in July 1996. The consultative group for Ethiopia was convened in Addis Ababa in December 1996, the first such meeting to take place in Africa. The country review process has been much more irregular in round-table countries, especially in Africa, where slippages in the implementation of structural adjustment programmes and political instability have inhibited the process in some countries, and among the smaller countries (such as in the Pacific), where other types of aid coordination and mobilization mechanisms may suffice. The two round-table meetings held in 1996 in Geneva – for Rwanda and Sierra Leone – focused on rehabilitation and recovery after periods of civil strife. (A regular meeting of the consultative group for Sierra Leone was held in March 1997.) Round-table activities in 1996 also included special donors' meetings (such as for Burundi in June) and sectoral meetings held in the recipient countries, while a number of round-table meetings for Asian and African LDCs have been planned for 1997. The first of these, for Bhutan, presenting the country's new five-year development plan covering the period 1997-2002, was held in January 1997. Round-table meetings for Djibouti and the Lao People's Democratic Republic were scheduled for May-June 1997.

Experience indicates that once agreement has been reached on the convening of meetings, and if programmes have been well prepared and presented, these meetings are generally successful in eliciting donor support. Substantial pledges were made at the consultative and aid group meetings held in 1996, ranging from $500 million for Cambodia to $2.5 billion for Ethiopia. In some cases, a notable increase in donor support was implied. Funding pledges for Rwanda at its June 1996 round-table meeting amounted to $617 million, while over $200 million was obtained for the implementation of the "quick action" components of Sierra Leone's National Resettlement, Rehabilitation and Reconstruction Programme.

As suggested in the discussion above, competition for scarce aid resources is likely to remain keen for the foreseeable future. In this respect, consultative and aid group and round-table meetings can play a crucial role in presenting LDCs' case to development partners and mobilizing support for their economic and development programmes. A number of other developing countries as well as countries in transition also use this format for dialogue and coordination with donors and for raising finance. Many LDCs, however, are still left out of this ef-

TABLE 4: CONSULTATIVE AND AID GROUPS AND ROUND-TABLE MEETINGS, 1990-1996[a]

	1990	1991	1992	1993	1994	1995	1996
Countries with consultative and aid group arrangements							
Bangladesh	♦	♦	♦	♦	♦	♦	♦
Cambodia			♦[b]	♦[b]	♦[b]	♦[b]	♦
Eritrea					♦		
Ethiopia			♦		♦		♦
Guinea	♦						
Haiti	♦	♦	♦[c]		♦[c]	♦	♦[c]
Malawi	♦		♦	♦	♦	♦	
Mauritania					♦		
Mozambique	♦	♦	♦	♦		♦	♦
Nepal	♦		♦				♦
Sierra Leone					♦		♦[d]
Somalia	♦						
Uganda		♦	♦	♦	♦	♦	♦
United Republic of Tanzania		♦	♦	♦		♦	♦
Zambia	♦	♦	♦	♦	♦	♦	
Round-table meetings							
Angola						♦	
Benin			♦				
Bhutan			♦			♦	
Burkina Faso		♦		♦		♦	
Burundi			♦				
Cape Verde			♦			♦	
Central African Republic		♦			♦		
Chad	♦						
Comoros		♦					
Gambia	♦		♦		♦		
Guinea-Bissau					♦		
Lao People's Democratic Republic			♦		♦		
Lesotho						♦	
Maldives		♦			♦		
Mali					♦		
Rwanda			♦			♦	♦
Samoa	♦						
Sao Tome and Principe			♦				
Tuvalu	♦	♦					
Yemen			♦				

Source: Information from UNDP and the World Bank.
Note: The list of consultative and aid groups and round-table meetings held prior to 1990 can be found in UNCTAD, 1995, table 22.

a There were no meetings during 1990-1996 for the Democratic Republic of the Congo, Madagascar, Myanmar and Sudan (countries with consultative group arrangements) or for Afghanistan, Djibouti, Equatorial Guinea, Kiribati, Liberia, Niger, Solomon Islands, Togo and Vanuatu (round-table countries).
b Ministerial Conference on Rehabilitation and Reconstruction of Cambodia (1992), co-chaired by UNDP, and the International Committee on the Reconstruction of Cambodia (1993 to 1995).
c Caribbean Group for Cooperation in Economic Development.
d Round Table Conference on Sierra Leone's National Resettlement, Rehabilitation and Reconstruction Programme.

Box 3: Development cooperation between other developing countries and LDCs: The case of the Republic of Korea

The Republic of Korea is perhaps the outstanding example of an "emerging donor" with the potential for making a significant contribution to ODA, which could supplement the aid resources provided by the traditional donor countries. It already provides substantial amounts of non-ODA finance and private investment to other developing countries. Moreover, it has its own development experience of much interest to LDCs and other developing countries, and lessons to share with them.

(a) The current ODA programme of the Republic of Korea

The Republic of Korea has two main institutions dealing with ODA. The Export-Import Bank of Korea administers concessional development loans through the Economic Development Cooperation Fund (EDCF), established in 1987, under the supervision of the Ministry of Finance and Economy. The Korea International Cooperation Agency (KOICA) was established in 1991 under the authority of the Ministry for Foreign Affairs, and administers bilateral grant aid.

Total ODA disbursements amounted to $116 million in 1995, corresponding to 0.03 per cent of the GNP of the Republic of Korea in that year. In absolute terms, the Republic of Korea's ODA effort compares with the aid programmes of Ireland and New Zealand. Bilateral aid increased to $71 million in 1995, accounting for some 60 per cent of total ODA. Seventy per cent of bilateral aid was in grant form, and project-type aid and technical cooperation accounted for most grant aid. KOICA technical cooperation activities include dispatch of experts, volunteers and doctors. Also, assistance is provided to NGOs from the Republic of Korea engaged in projects in developing countries. Disbursements of development loans amounted to $21 million in 1995. Telecommunications, transport and energy have been the main sectors benefiting from EDCF loans.

In 1995, 20 per cent of bilateral assistance was allocated to LDCs, with total grants and loans to these countries amounting to $14.1 million. The aid programme covers most of the LDCs; in 1995, support was provided to 42 of them. About one-third of disbursements to this category of countries went to Asian LDCs and two-thirds to African LDCs. Relatively small amounts were spent in each country. Only Bangladesh, Myanmar, Sudan and Uganda received more than $1 million; Myanmar and Uganda are among the top ten recipients of the Republic of Korea's aid. These two countries were both granted development loans in 1995 for the building of telecommunications networks.

The Republic of Korea has also made important contributions to a number of multilateral institutions and programmes of interest to the LDCs, notably ESAF, IDA, UNDP, the African Development Fund and the Asian Development Fund.

(b) The development experience of the Republic of Korea

The Republic of Korea has transformed its economy from a rural, less developed country to a modern society in just one generation. Consequently, it has the potential to provide other countries with intermediate technology and share with them its own experience of development, including in particular human resources development, which is considered to have been a key factor in its economic growth. Moreover, the country has in its recent history had to confront and overcome many severe problems which are familiar to many LDCs and currently impeding their development: the colonial heritage, lack of natural resources, high density of population, deep-seated poverty, civil war (1950-1953), authoritarian rule (1961-1979) and subsequent transition to civil government. Annual per capita income rose to over $10,000 in 1995.

It is also interesting to note that the Republic of Korea has itself been a major aid recipient, with foreign assistance contributing significantly to its development. Since its independence from Japan in 1945, grants totalling $4.8 billion have been provided to it, mostly in the form of bilateral assistance. From 1953 to 1962, such aid financed 71 per cent of total imports and 80 per cent of total fixed investment. During this period, the country established the basis for its industrialization later in the 1960s and the 1970s. It is a country that has successfully broken out of aid dependency.

(c) Challenges for future development cooperation

Such an economic and historical background gives the Republic of Korea the opportunity to play a unique role in development cooperation, and the country intends to enhance both the volume and the quality of its ODA. In 1995, it already increased its loan commitments considerably, to $168 million. In addition, the terms and conditions of loans have been improved and they now correspond broadly to DAC standards. The payment period has recently been lengthened to 29 years including a grace period of nine years.

The Republic of Korea is still in the early stages of development cooperation as a donor and in the process of formulating an ODA policy appropriate to its political and economic situation. Nonetheless, it is already the third or fourth largest ODA donor (following Saudi Arabia and Kuwait, and in 1994 preceding Greece) among non-DAC donor countries. Since it has the eleventh largest GNP in the world and a fast-growing economy, its ODA could expand significantly as long as the economy continues to prosper, and the country could aspire to becoming a major donor in the near future. However, it still needs to resolve a number of problems before being able to join the donor community as a full-fledged member. Above all, long-term basic principles regarding ODA volume and composition, priority areas and main recipient countries need to be developed, with efforts being made at the same time to build the support of public opinion for development assistance.

fective aid coordination process and urgently need the support of the lead agencies – the World Bank and the UNDP – in setting up programmes and preparing for country review meetings.

Donors have become more selective in their allocation of aid, and place increasing emphasis on recipient country performance. A legitimate government established through democratic processes and political stability have in a sense become the first condition for the provision of aid; like private capital, ODA tends to shy away from countries where conditions are unstable. Donor support is in practice largely tied to economic programmes agreed with the Bretton Woods institutions. In addition, donors have concerns such as poverty reduction, promotion of popular participation and gender equality, and protection of the environment, to which LDCs have to respond.

C. External debt

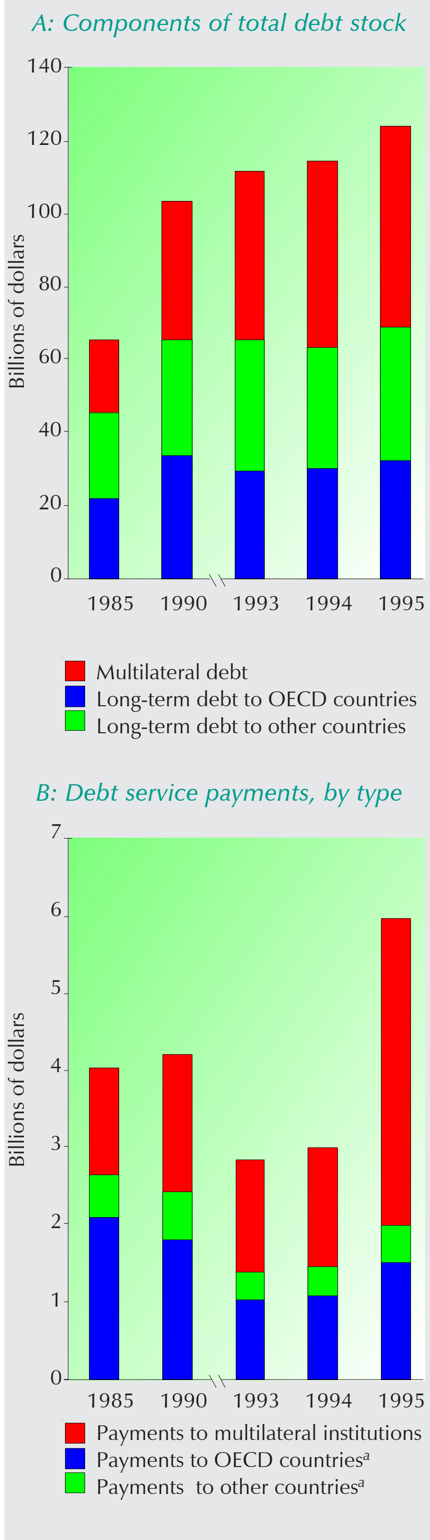
Recent trends in LDCs' external debt situation

The external debt situation of the LDCs remains a matter of serious concern. With scheduled debt service payments estimated to be in the order of one-third of the aggregate export earnings of LDCs,[8] external obligations clearly exceed many of these countries' capacity to pay. As a consequence, they have accumulated massive payments arrears. The bulk of LDCs' debt arrears are accounted for by countries affected by civil war and strife, but a number of other LDCs typically experiencing stagnant growth and whose export earnings have increased little have also been unable to fully meet their obligations. The debt overhang compounds the pressures on LDCs attempting to implement structural adjustment programmes, and tends to inhibit growth as well as dampen prospects for private capital inflows. In many of the LDCs, external debt-servicing obligations also place an inordinate burden on government revenue.

LDCs' external indebtedness continues to grow. Partial debt relief measures, such as Paris Club restructuring of debt (see below) and the forgiveness of ODA claims by a large number of donor countries, have not been sufficient to remove the debt overhang of the LDCs. Between the end of 1990 and the end of 1995 the debt stock increased by some $20 billion, or 18 per cent, to $135 billion. Most of this increase has been due to new concessional lending by the international financial institutions, mirroring increased multilateral assistance to these countries and, to a large extent, support extended for policy reform processes in the LDCs. LDCs' total multilateral debt increased from $38 billion at the end of 1990 to $55 billion at the end of 1995. Long-term debt to bilateral creditors, however, increased by only $3 billion over the same period. Debt to OECD and OPEC countries decreased slightly over this period as a whole, as a result of limited new lending and of debt relief operations. At the end of 1995, loans from multilateral institutions represented just over 40 per cent of LDCs' total external debt, outstanding ODA loans from OECD countries 14 per cent and bilateral long-term non-concessional credits from these countries 9 per cent. Claims by non-OECD countries constituted over one-quarter of LDCs' total debt. Short-term debt amounted to 8 per cent (see chart 5 and annex table 27).

Actual debt service payments by the LDCs, which had reached $5.8 billion in 1989, fell steadily during the next four years, and remained far below scheduled debt service. Correspondingly, the debt service ratio for the LDCs as a group decreased, from 29 per cent in 1989 to 14 per cent in 1993 and 1994. This re-

Chart 5: External debt and debt service payments of LDCs, 1985-1995



Source: UNCTAD secretariat, based on OECD data.
a Payments on long-term debt only.

Box 4: Issues relating to foreign private investment in LDCs

In addition to traditional foreign direct investment by transnational companies, other channels to facilitate private investment in LDCs merit exploration. Over the past decade, venture capital and portfolio equity investment funds have sought out off-the-beaten track "emerging markets" in ever-growing numbers. The number of emerging market equity funds soared from only 10 in 1984 to 1,435 in 1996. The LDCs, however, have so far largely failed to benefit from this trend. To date, inward investment funds have been set up for only six of them.

Surveys of investors' market selection process point to a number of factors which are taken into consideration by investors when they invest in emerging markets:

- Macroeconomic and political stability is invariably the precondition for foreign investment, as it provides a stable environment for the promotion of risk capital investment in high-risk ventures. In particular, stable exchange rates will protect investors from exchange risk;
- High growth potential: experience has shown that most equity investment funds are concentrated in markets with high growth potential;
- Ease of capital income repatriation: investors should be assured that the income and capital gains of their investments can be easily repatriated. In that respect, foreign exchange control is a major impediment to foreign investment;
- Legal transparency and adequate investors' protection;
- Adequate financial information and reporting disclosure;
- Exit mechanisms: portfolio equity investors are interested in the financial returns on their investments and therefore prefer to invest in more liquid instruments. The usual exit mechanism for divestment is the stock exchange; hence the existence of liquid stock exchanges is an advantage. However, in the case of venture capital investment, other exit mechanisms can be used: secondary or "trade sale" of the investor's shares to another investor or company, or repurchase of the investor's shares by the entrepreneur of the investee firm, as allowed by contractual agreements;
- In countries which have a stock market, investors also look at such factors as market liquidity (as measured by ratios of market capitalization to money supply) and the volatility of the stock market.

On one hand, the LDCs still need to improve the environment for investment and develop capital markets in order to attract more private foreign investment. On the other hand, existing investment opportunities need to be better known. UNCTAD, in collaboration with the United Nations Industrial Development Organization, organized a pilot seminar in Geneva in June 1997 on the mobilization of the private sector to encourage foreign investment flows to the LDCs. The objective of this seminar was to show potential investors the opportunities in these pre-emerging markets, as well as to discuss what the LDC governments themselves can do to improve their investment climate. The following key issues were considered:

- the suitability of various forms of innovative financing arrangements (country funds and venture capital funds) for the mobilization of foreign risk capital for investment in LDCs;
- prospects for and constraints on foreign investment in LDCs;
- identification of investment opportunities in LDCs, by country and by sector;
- conditions for the creation of investment funds for LDCs and identification of technical cooperation activities.

flects payment difficulties, as debt service actually paid fell short of scheduled debt service. Aggregate debt service payments by the LDCs increased to $6.4 billion in 1995, mainly because of repayments and clearance of arrears by Zambia as this country completed its rights accumulations programme with the IMF. However, debt service payments by other LDCs also increased. As a group they paid $3.7 billion in external debt service, compared with $2.9 billion in 1994. Excluding Zambia, debt service on multilateral debt made up just over 40 per cent of debt service payments by LDCs in 1995.

The improvement in payments performance in 1995 was broadly in line with the growth in LDCs' exports that year. Excluding Zambia, the debt service ratio (calculated on actual payments) increased only marginally, from 13 per cent in

1994 to 14 per cent in 1995. There is so far little sign of any fundamental improvement in LDCs' debt situation nor any indication of significant decline in outstanding debt for individual LDCs (as could be expected, since they have received large amounts of new concessional multilateral lending, while debt relief has been partial and involved relatively small amounts). In terms of debt to GDP ratios, improvement or stabilization reflecting stronger economic growth can be observed for some LDCs over the last couple of years, but in others this ratio has continued to grow. Overall, LDCs' debt burden is still unsustainable. In a significant number of LDCs, outstanding debt continues to exceed GDP (see annex table 29). Most of these countries have been included in the category of heavily indebted poor countries (HIPCs). A few LDCs have staggering debt to GDP ratios: 544 per cent in the case of Sao Tome and Principe, and 364 per cent in the case of Mozambique. Only a handful of LDCs did not accumulate excessive external debt and avoided payments arrears and debt reschedulings (see table 5).

TRADITIONAL DEBT RELIEF SCHEMES

Various debt relief schemes continue to be implemented. Since December 1994, the Paris Club has applied Naples terms to the reschedulings of bilateral official debt of the poor and heavily indebted countries. Those terms offer a reduction of up to 67 per cent of the present value of debt; some countries had the stock of debt reduced and have thus exited from Paris Club reschedulings. By mid-1997, a total of 19 LDCs had secured such restructuring of their debts under Naples terms. Four of the agreements concerned reduction of eligible debt stocks (in the case of Benin, Burkina Faso, Mali and Uganda). All the LDCs apart from Guinea have benefited from a debt reduction of 67 per cent in net present value terms (table 5 and annex table 30).

There is so far little sign of any fundamental improvement in LDCs' debt situation, nor any indication of a significant reduction in their outstanding debt.

The benefit of debt reduction under the Naples terms is reduced by the strict definition of eligible debt applied by the Paris Club. Thus, ODA debt is not reduced, but is rescheduled over a long period (30 or 40 years, including 12 to 16 years of grace, at interest rates at least as favourable as the original rates). Post-cut-off-date debt is not considered. Sometimes the practice of "topping up" is not applied to some categories of debt which had previously been rescheduled on concessional terms.

Relief on obligations to Paris Club creditors alone cannot solve LDCs' debt problems. Action is also required on other components of their debt. The only general scheme for providing debt relief on multilateral debt has so far been the "fifth dimension" programme of the IDA, under which supplemental allocations have been provided to help offset interest due on outstanding debt contracted in the past on IBRD terms. A few LDCs continued to benefit from this programme in World Bank fiscal year 1995/96, but the amounts involved have been relatively modest. Buy-backs of commercial debt have been undertaken under the IDA Debt Reduction Facility (DRF). Two new such operations for LDCs – for Ethiopia and Mauritania – were completed in 1996. A few others were still in preparation. Bilateral donors have contributed to the funding of DRF buy-backs, as well as helping some LDCs with their multilateral debt service payments.

While various schemes and mechanisms are available in dealing with LDCs' bilateral official debts to OECD countries – notably within the Paris Club as discussed above, and through ODA debt forgiveness, from which most LDCs have benefited – LDCs' outstanding obligations to non-OECD creditors have long been the "neglected part" of their debt. Little has been done in this respect in terms of elaboration of specific policy recommendations and setting up mecha-

Table 5: LDCs: Debt indicators and debt relief measures

Country/Group[a]	Outstanding debt, end 1995 ($ million)	Ratio of total debt to GDP 1995 (%)	Ratios (to 1995 total exports)[b] of: Total debt service (%)	Multilateral debt service (%)	Paris Club agreements under London or Naples terms	SPA eligible 1995	SAF/ESAF support 1990-1995	HIPC-eligible[c] 1996
Severely indebted LDCs								
Afghanistan	5 454	..	..	..				
Angola	9 738	262	13	0				•
Burundi	1 237	116	31	23		•	•	•
Cambodia	1 986	72	1	0	1995		•	
Central African Republic	1 052	93	7	7	1994	•		•
Dem. Rep. of the Congo	10 356	..	..	..				•
Equatorial Guinea	258	153	3	2	1992, 1994	•	•	•
Ethiopia	4 882	92	18	8	1992, 1997	•	•	•
Guinea	3 234	88	24	10	1992, 1995, 1997	•	•	•
Guinea-Bissau	842	328	67	54	1995	•	•	•
Liberia	1 535	..	4	0				•
Madagascar	3 863	121	12	6	1997	•	•	•
Malawi	2 234	152	25	15		•	•	
Mali	2 876	118	16	8	1992, 1996	•	•	•
Mauritania	2 294	215	22	11	1993, 1995	•	•	•
Mozambique	5 350	364	40	11	1993, 1996	•	•	•
Myanmar	6034	..	18	3				•
Niger	1 724	93	22	9	1994, 1996	•	•	•
Rwanda	1 073	95	28	24		•	•	•
Sao Tome and Principe	245	544	..	..		•	•	•
Sierra Leone	931	113	28	11	1992, 1994, 1996	•	•	•
Somalia	2 141	..	..	..				•
Sudan	10 310	..	25	10				•
Togo	1 405	111	7	5	1992, 1995	•	•	•
Uganda	3 406	60	22	17	1992, 1995	•	•	•
United Republic of Tanzania	5 767	160	18	12	1992, 1997	•	•	•
Yemen	9 459	197	6	3	1996			•
Zambia	6 181	152	227	210	1992, 1996	•	•	•
Moderately indebted LDCs								
Bangladesh	15 988	55	15	6			•	
Benin	1 728	..	8	6	1991, 1993, 1996	•	•	•
Burkina Faso	1 560	67	18	11	1993, 1996	•	•	•
Chad	954	84	6	5	1995, 1996	•	•	•
Comoros	239	105	..	..		•	•	
Gambia	448	117	14	9		•	•	
Haiti	827	40	32	30	1995			
Lao People's Democratic Republic	2 211	126	7	3			•	•
Samoa	163	107	8	6				
Less-indebted LDCs								
Bhutan	107	35	7	1				
Cape Verde	222	..	10	5				
Djibouti	299	60	6	2				
Eritrea	13	..	..	..		•		
Kiribati	10	23	5	5				
Lesotho	1 238	120	27	12			•	
Maldives	190	70	3	1				
Nepal	2 489	59	8	5			•	
Solomon Islands	239	67	12	1				
Tuvalu	0	..	..	..				
Vanuatu	298	165	23	1				
Total	**135 090**	**102**	**23**	**15**				

Source: UNCTAD secretariat, based mainly on information from OECD and the World Bank.

a As classified by the World Bank (1997).

b Exports of goods and services.

c Countries identified as potentially eligible under the HIPC initiative on the basis of initial assessment of debt sustainability.

nisms to deal with the problems. However, new attention was given to this debt in the context of the HIPC initiative (see below). In October 1996, UNCTAD organized a seminar on debt owed to non-OECD official creditors; while this seminar specifically dealt with sub-Saharan African debtor countries, the problems described were largely similar to those of other LDCs with important outstanding obligations to non-OECD creditors.

Donors have become more selective in their allocation of aid, and place increasing emphasis on recipient country performance. Like private capital, ODA tends to shy away from countries where conditions are unstable.

The Russian Federation and the Arab bilateral and multilateral financial institutions are the largest non-OECD creditors. The Russian Federation has assumed the claims of the former USSR. As shown by the study commissioned by UNCTAD for the seminar,[9] arrears on non-OECD debt have tended to escalate in the 1990s while the flow of new finance has sharply declined, as a result of the collapse of the USSR and the changed financial situation of the Arab oil-exporting countries. Although priority was given to the servicing of debt owed to multilateral financial institutions and rescheduled debt owed to Paris Club creditors, LDCs continued to service their debt to non-OECD creditors. Payments actually made to this group of creditors in 1995 amounted to 13 per cent of LDCs' total debt service payments (excluding payments by Zambia). Non-OECD creditors have also offered debt relief to LDCs in different forms and with varying degrees of concessionality. For instance, bilateral Arab institutions have cancelled large amounts of debt and arrears. In other cases, the question has been rather one of tolerating arrears. Further efforts are needed to normalize relations with non-OECD creditors and restructure debt owed to them, both to restore normal relations for economic cooperation and to reduce LDCs' overall debt burden to sustainable levels. The UNCTAD seminar explored various ways in which this could be achieved, such as Paris Club-comparable rescheduling, buy-backs, debt conversion and cancellations. (On LDCs' debt to the Russian Federation, see box 5).

The HIPC initiative

A major step towards addressing the debt problems of the poorest countries in a comprehensive way was taken at the annual meetings of the World Bank and the IMF in September 1996, with the endorsement by the international community of the initiative in favour of the heavily indebted poor countries (HIPCs). This initiative is based on the premise that "sustainable development requires sustainable debt". It represents a commitment to reduce to sustainable levels the debt burden of an eligible country that has successfully completed a period of strong policy performance. A total of 29 LDCs are included in the group of 41 countries that have been identified as HIPCs.

The HIPC initiative builds on the existing mechanisms for providing debt relief, particularly the Paris Club (using the Naples terms as the starting point for debt relief measures). Other bilateral and commercial creditors are required to provide treatment comparable to that provided by the Paris Club. Where existing mechanisms would not permit the achievement of sustainability upon completion of a first stage of adjustment and reform, enhanced action under a second stage is envisaged, including a deepening of relief in the Paris Club and action by multilateral creditors. Paris Club creditors have indicated a willingness to provide debt reduction of up to 80 per cent in net present value terms on a case-by-case basis during the second stage. Multilateral creditors will also provide additional support and relief. Specifically, the World Bank has established a HIPC Trust Fund for financing the scheme and earmarked $500 million as its own initial contribution to the fund; and in early 1997 the IMF Executive Board agreed on the modalities of IMF participation in the initiative through the ESAF.

Box 5: LDCs' debt to the Russian Federation

A number of LDCs have substantial outstanding obligations to the Russian Federation – for example, Afghanistan, Angola, Cambodia, Ethiopia, the Lao People's Democratic Republic, Mozambique and Yemen. It is clear that the problems of the debt overhang of these countries, and of other LDCs which also owe debts to the Russian Federation, cannot be resolved without addressing this component of their external debt.

(a) The scale and classification of the debt

At the end of 1995, LDCs' debt to the Russian Federation was estimated at over $31 billion, close to one-fifth of total developing country debt to that country.[10] Of the 25 LDCs with outstanding obligations to it, 19 are African countries ($14 billion owed) and six are Asian countries ($17 billion owed). Russian statistics distinguish between loans for civilian supplies, often called economic debt, and loans for special supplies, often called military debt. Both economic debt and military debt have concessional and commercial components. The distinction between economic and military debt and between debt on concessional and on commercial terms is made for many but not all LDCs. On the basis of available information, the share of economic debt in LDCs' total debt to the Russian Federation may be put at about one-third, and the share of concessional debt at about three-quarters of their total debt to that country.

(b) Available debt relief mechanisms

A radical debt relief programme was proposed by the former president of the USSR in his address to the forty-third session of the General Assembly of the United Nations in December 1988, whereby the USSR would be prepared to declare a moratorium up to 100 years on the servicing of LDCs' bilateral debt and, in a number of cases, to write off such debt. This proposal has not been implemented owing to economic difficulties following the collapse of the Soviet Union, which have since the early 1990s modified the Russian position on the debt relief issue. On the one hand, the Russian Federation has continued to work with debtors towards finding solutions to problems relating to outstanding debt (including the reconciliation of debt data), to reschedule debts and, whenever possible, to facilitate payment of debt service in goods. On the other hand, with the increase in payments arrears, it has also taken some steps towards more innovative and mutually beneficial debt relief measures, such as debt-equity conversion, sale of debts to private companies and buy-backs at a discount by debtor countries.

Payments in goods have risen sharply as a proportion of total debt service paid to the Russian Federation – from 19 per cent in 1992 to 88 per cent in 1994. However, this development is chiefly accounted for by transactions with larger, non-LDC debtor countries.[11] Payments in goods have virtually ceased as far LDCs are concerned, mainly because of the liberalization of trade flows in both the Russian Federation and debtor LDCs and a switch in that country's imports to consumer goods rather than the primary products which are LDCs' principal exports. There are nevertheless some recent examples of payments of debt service in goods by LDCs. One was the agreement in the early 1990s with the Lao People's Democratic Republic, which applied to close to 10 per cent of that country's outstanding debt to the Russian Federation. Another example is the agreement with the United Republic of Tanzania in 1994 (involving no more than 1 per cent of its debt to the Russian Federation).

As regards debt-equity conversions, two such deals with LDCs are known. One has been undertaken with the United Republic of Tanzania and the other with Madagascar, covering 6 per cent and 10 per cent respectively of these countries' debts to the Russian Federation. They have financed Russian companies' participation in various investment projects. As to the sale of debt to foreign companies, an interesting precedent arose when all of Uganda's outstanding debt to the Russian Federation, both economic and military debt, was sold in 1992 to a Swiss trading company at 12 per cent of face value. These claims were included the following year in the buy-back of Uganda's commercial debt funded by the IDA DRF. There have been other attempts to provide debt relief by using the mechanism of buy-backs by debtor countries. In 1994, the Russian Federation and Zambia reached agreement on a buy-back of all of the latter's outstanding debt to the former at 10 per cent of face value, i.e. on terms identical to those of the DRF operation for Zambia the same year. Lack of funding has, however, delayed implementation of the agreement.

In essence, the innovative debt relief mechanisms described above have provided treatment comparable to - or in some instances even better terms than - debt restructuring in the Paris Club framework. However, these transactions taken together have applied, at the best estimate, to no more than 2 per cent of LDCs' total outstanding debt to the Russian Federation. More extensive use of payments in goods and of debt conversion has been constrained for the time being by a number of factors, notably debtors' limited export capacity and the lack of counterpart funds in local currency. Moreover, disagreement between debtors on the one hand and the Russian Federation on the other hand about classification of military debt and, most important of all, about the conversion rate for the rouble has so far been the main stumbling block to a resolution of the debt owed to the Russian Federation.

The eventual participation of the Russian Federation in the Paris Club as a creditor would not by itself solve the problems of conversion rate and debt reconciliation. However, its participation would channel the debt renegotiation process into a more transparent framework and reduce transaction costs. This framework could facilitate agreement with debtors on questions relating to the volume and valuation of claims, and the classification of debts as concessional and non-concessional, as well as on the appropriate mechanisms for debt relief.

During the first stage of implementation of the HIPC initiative, debtor countries are required to establish a first three-year track record of good performance under IMF-monitored economic programmes, Paris Club creditors agreeing to a flow rescheduling on current Naples terms during this period and other bilateral and commercial creditors providing at least comparable treatment. At the end of the first stage, debtor countries will reach the "decision point". By that time, if a Paris Club stock-of-debt operation under Naples terms is sufficient for achieving a sustainable external debt situation in three more years, the country concerned can request an exit stock reduction from the Paris Club. If debt sustainability analysis shows that such an operation would not be sufficient, the country may become eligible for HIPC assistance. It would need in principle to establish another three-year track record of good performance before reaching the "completion point". In the interim period, the Paris Club would be expected to provide more concessional debt reduction, up to 80 per cent in net present value terms; similar treatment would be requested from other bilateral and commercial creditors; and donor countries and multilateral institutions should also provide enhanced support. The World Bank would provide IDA grants and supplemental HIPC IDA allocations during this second stage.

Multilateral debt relief proper would be extended only at "completion point", again provided that the debtor country had met performance criteria. At this point, a stock-of-debt operation in the Paris Club would also take effect. It is foreseen that the World Bank would provide assistance through the HIPC Trust Fund, and the IMF through a special ESAF grant or loan which would be paid into an escrow account and used to cover debt service to the IMF. The six-year performance period would be implemented flexibly case by case, with the possibility of giving countries credit for already established track records in the first stage, and of shortening the second stage for countries which already have sustained periods of strong performance. Support under the HIPC initiative would remain available to countries embarking on IMF- and World Bank-supported programmes before 1 October, 1998. A comprehensive review would be held by then to decide whether to extend the initiative.

The HIPC initiative is a breakthrough. For the first time, a comprehensive scheme is being set up to address the poorest countries' debt problems which recognizes the need for multilateral debt relief.

Debt sustainability analysis is a key step in the implementation of the HIPC scheme. Such analysis would be prepared jointly by the World Bank and the IMF, in collaboration with the debtor country concerned. It would lead to recommendations concerning country-specific debt sustainability target ranges and required action (e.g. amounts of debt relief to be provided at the "completion point"). Target ranges for sustainable debt levels have initially been defined by the Bretton Woods institutions as 200 to 250 per cent for the debt to exports ratio expressed in net present value terms and as 20 to 25 per cent for the debt service to exports ratio. An additional criterion is a ratio of present value of debt to government revenue of 280 per cent (together with additional conditions related to a ratio of government revenue to GDP of 20 per cent and a ratio of exports to GDP of 40 per cent). Debt sustainability analysis would also take into account country-specific "vulnerability factors", such as the concentration and variability of exports, external debt in relation to GDP, the resource gap, the level of international reserves and the burden of private sector debt.[12]

A solution for LDCs' debt problems in sight?

The HIPC initiative represents a major breakthrough. For the first time, a truly comprehensive scheme is being set up to address the poorest countries' debt problems, and it is clearly recognized that multilateral debt relief is also required. The Bretton Woods institutions themselves have been major actors driving the initiative forward, and other multilateral organizations and donor countries have also indicated their willingness to contribute. However, overall eligibility criteria, conditionalities and the operational definition of debt sustainability will determine the benefits which LDCs will ultimately derive from the HIPC initiative. From the way the implementation of the scheme is currently shaping up and on the basis of information about the timetable envisaged, it seems that far fewer LDCs are likely to benefit than the original list of HIPCs appeared to indicate and that few will do so before the year 2000.

The concept of "debt sustainability" is a welcome development in the analysis of LDCs' debt situation.

The foreign exchange constraint as measured by debt-to-exports and debt service ratios is not the only constraint on the debt-servicing capacity of the LDCs and other HIPCs. The budgetary constraint can be as severe, and in the countries belonging to the CFA franc zone it is even the primary one. In some of the HIPC LDCs, scheduled public-sector external debt service weighs very heavily in the budget. For instance, payable debt service corresponded to over 150 per cent of 1995 government revenue in Madagascar (and over 70 per cent of expenditure), almost 80 per cent of revenue in the United Republic of Tanzania (over 50 per cent of expenditure), and close to 50 per cent of revenue in Zambia (over 30 per cent of expenditure).[13] Such a high level of debt service will reduce the amount of resources available for financing essential public services and social programmes for poverty reduction. From this perspective, taking the fiscal burden of debt explicitly into account in setting HIPC targets for sustainable debt levels is a welcome development, although the envisaged indicator remains somewhat restrictive, particularly since it is associated with two other conditions.

There is still scope for refining the concept of debt sustainability. Target ranges for debt levels are currently set in terms of net present value, a concept which is perhaps not the most accurate measure of debt overhang and the debt-servicing capacity of debtor countries. However, net present value does take into account the varying concessionality of debts, and would be the relevant concept for burden-sharing among creditors. As a general consideration, criteria and target ranges should be flexible enough to take into account different debt situations, and avoid the risk of excluding from the initiative those countries that truly need some degree of debt reduction. There could be merit in adopting common thresholds for debt overhang, as well as foreign exchange and fiscal constraints, instead of ranges of threshold values, e.g. common thresholds for debt service ratio of 20 per cent and ratio of public external debt service to budgetary revenue of below 28 per cent. Such simple benchmarks would at the same time make the process of implementation of the HIPC initiative more tractable and its impact easier to monitor. The incorporation of human and social development factors into the concept of debt sustainability would also be important, especially for the LDCs.[14]

Consideration should also be given to the problems which LDCs and other HIPCs may be facing – in practice – in applying the methodology of debt sustainability analysis, and to their requirements for technical assistance in this respect. They should be able to participate as equal partners in the process of implementing the HIPC initiative. There is certainly a need to strengthen LDCs' capacity to undertake such analysis and appraise the implications of debt relief; and more generally, LDCs and other HIPCs will have to build up their capacity to elaborate future financing and borrowing strategies in the context of their overall macroeconomic policy and development objectives.

Among the HIPC front runners, i.e. the first group of four HIPCs for which debt sustainability analysis was undertaken, there are two LDCs – Burkina Faso and Uganda – which have both secured Paris Club stock-of-debt restructuring. Uganda is the first HIPC to have sustainability analysis completed, and to reach the "decision point" (in April 1997). The "completion point" has been set for one year later, i.e. April 1998. Burkina Faso has a shorter track record of structural adjustment than Uganda, and a somewhat longer period of performance under the second stage of the HIPC initiative will possibly be required for it. Benin and Mali have also in principle exited from the Paris Club through stock-of-debt operations, and can be regarded as having already concluded the first stage of the HIPC initiative. Ethiopia and Mozambique are other LDCs which have been mentioned as early candidates for relief under the scheme.

Four other LDCs – Guinea, Madagascar, Niger and the United Republic of Tanzania – have recently agreed on new arrangements with the IMF and secured debt restructuring on Naples terms in the Paris Club in late 1996 or early 1997. Other HIPC LDCs had ESAF agreements in effect at the time of the adoption of the HIPC initiative, and their current arrangements expire in the second half of 1997 (Sierra Leone and Togo) or in the course of 1998 (Chad, Guinea-Bissau, Mauritania and Zambia). In their case, the benefits to be expected hinge on their performance and the successful conclusion of new arrangements with the IMF. Even if these countries could enter the second stage of the HIPC initiative in 1998, it seems unlikely that they could reach "completion point" before the year 2000.

Unfortunately, reluctance on the part of creditors means that, at most, only six LDCs will obtain debt relief by the end of the century.

It seems, therefore, that four to six LDCs at most could obtain additional debt relief under the HIPC scheme during the current decade, unless the scheme is applied flexibly case by case and periods of performance required for eligibility for relief are shortened. Delaying the implementation of debt relief may diminish the costs for creditors and donors, at least in the short term. The real cost of delays in its implementation will, however, be lost opportunities for economic development and reduced welfare for the population in the LDCs and other HIPCs.

The current focus on the HIPCs should not leave aside the debt problems faced by other LDCs which have not been included in this category. Eight of the latter have been classified by the World Bank as either severely or moderately indebted, although they are not HIPCs, and their situation also needs to be kept under review.[15] The debt relief requirements of non-HIPC LDCs should also be met, and they should be given assistance, as needed, in formulating appropriate financing and borrowing strategies.

There is merit in establishing a link between debt relief and poverty reduction. Such a link should not take the form of benchmarks or additional conditionality, which would add to budgetary pressures on the debtor countries. Debtor countries and their creditors could agree that resources released through exceptional debt relief be allocated to social and human development programmes. This would address donor and debtor concerns about poverty reduction, and perhaps also appeal to public opinion in the countries financing debt relief operations. Models for possible mechanisms are provided by the debt funds set up by Uganda and Bolivia (not an LDC, but one of the HIPCs) to channel contributions to debt relief. Such mechanisms could be of interest in particular to those LDCs that are not included in the HIPC category or are not primary candidates for HIPC relief.

Notes

[1] ODA recipients on the DAC list of developing countries.
[2] OECD, 1997, Statistical Annex table 39.
[3] Performance in relation to the aid targets for LDCs is measured by taking into account bilateral aid disbursements plus imputed contributions through multilateral institutions.
[4] Data for Luxembourg available only up to 1994.
[5] OECD, 1997.
[6] *Ibid.*
[7] The grant element of ODA commitments to LDCs had reached 98 to 99 per cent by 1995 for the DAC countries as a whole.
[8] See UNCTAD, 1996a, Part One, chapter II, section D.
[9] UNCTAD, 1996b.
[10] *Ibid.*
[11] *Ibid.*
[12] For the objectives and details of the HIPC initiative, see e.g. IMF, 1997.
[13] *Ibid.,* table 2.
[14] For a discussion of debt sustainability, the use of the net present value concept, eligibility criteria and target ranges, and of social and human development factors, see UNCTAD, 1997, forthcoming.
[15] Among them, Gambia, Haiti and Malawi are considered to have exited from the Paris Club. Four of the others have not rescheduled their debts in this framework.

References

IMF (1997). *Debt Relief for Low-Income Countries and the HIPC Initiative,* Working Paper WP 97/24, Washington, D.C., IMF.

OECD (1997). *Development Co-operation, Efforts and Policies of the Members of the Development Assistance Committee, 1996 Report*, Paris, OECD.

UNCTAD (1995). *The Least Developed Countries, 1995 Report* (TD/B/41(2)/4) (United Nations publication, Sales No. E-95.II.D.2), New York.

UNCTAD (1996a). *The Least Developed Countries, 1996 Report* (TD/B/42(2)/11) (United Nations publication, Sales No. E-96.II.D.3), New York and Geneva.

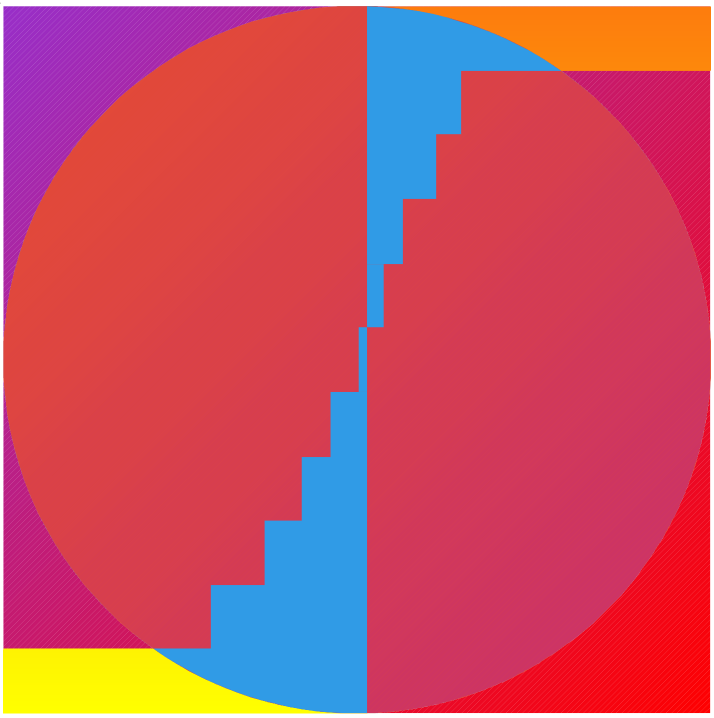
UNCTAD (1996b). "Reducing sub-Saharan Africa's debt to non-OECD official creditors" (UNCTAD/GID/Misc.42), Geneva.

UNCTAD (1997). *Trade and Development Report, 1997*, Geneva, forthcoming.

World Bank (1997). *Global Development Finance, 1997*, Washington, D.C., World Bank.

Part Two

Agricultural Development and Policy Reforms in LDCs



Agricultural Development in LDCs

Chapter
1

An Overview Of The Issues

A. Introduction

Agriculture is the most important economic activity in LDCs. In the early 1990s this sector provided about a third of the gross domestic product (GDP) of all LDCs, and employed more than two-thirds of the labour force. However, agricultural production has not kept pace with population growth in LDCs: in 1990-1994 agriculture had an annual average growth rate of 2 per cent, which was far less than the annual average population growth rate of almost 3 per cent. Food imports and food aid have thus been significant in meeting the shortfall between domestic agricultural production and food requirements in many LDCs. In 1990-1993, LDCs' food imports averaged 3.6 per cent of GDP, increasing to almost 5 per cent over the same period for African LDCs, which form the bulk of the LDC group (UNCTAD, 1996).

The inefficiency and low growth of much of LDC agriculture are explained by a combination of factors, including traditional production relations, rudimentary technology and insecure land tenure arrangements within a context of low and unreliable rainfall, particularly in African LDCs. In addition, LDC governments over the past decades have pursued policies which discouraged innovation and investment in agriculture. These include overvalued domestic currencies, intervention in agricultural marketing (e.g. price controls which keep food prices low for urban consumers, and inefficient crop marketing boards), overtaxation of agricultural exports, and urban bias (the consequence of which is poor rural infrastructure and lack of basic facilities in rural areas) (Harrison, 1990; Cleaver and Donovan, 1995; Borlaug and Dowswell, 1995). Increasing agricultural production on a sustainable basis in LDCs will require radical changes in farming systems, improvements in land tenure systems, introduction of technological innovations, institutional development, reversal of past policies, and measures to tackle land degradation and associated environmental problems as a matter of urgency.

Economic policies in many LDCs proved detrimental to their agricultural sectors. The result has been stagnation of agricultural production.

The chapters in this part of the Report address various aspects of the agricultural issues in LDCs, and draw policy conclusions based on country-specific experiences. This part of the Report is eclectic in its approach, bringing together several issues which have importance for a wide range of LDCs. These include the global context, environmental concerns and the importance of institutions such as rural credit markets to agricultural development. In all, there are five chapters, which deal with the specific issues set out below.

The *Uruguay Round Agreement* (URA) has significantly altered the international context for agricultural trade. The Agreement on Agriculture restricts the use of trade-distorting agricultural policies, particularly in the developed countries, and seeks to enhance the transparency of international agricultural trade through the conversion of all non-tariff measures, including quantitative restrictions, into tariffs. The implications of these and other aspects of the URA for LDC agriculture are examined in chapter 2.

The debate on *food security* has been significantly transformed by Sen's seminal work (1981), which questioned food availability decline (i.e. decline in food stocks) as the major cause of famines. Food security issues are at present analysed from the viewpoint of "entitlements", i.e. the ability of households or individuals to command access to food. Chapter III discusses the ramifications of agricultural policy reforms for LDCs' food security, in particular the ramifications of those policies necessitated by structural adjustment programmes (SAPs) and the URA.

The debate on the *environmental effects* of agriculture is ongoing, and is sometimes controversial (see, for example, Leach and Mearns, 1996), but much of the research suggests a link between agricultural activities and environmental degradation, especially in LDCs. The agriculture-environment nexus is the focus of chapter 4.

Among several factors identified as limiting the supply response of agriculture to price changes, one frequently cited is the problem of the supply of credit, which has persisted despite much-publicized attempts by governments to come to grips with it. This Report continues the debate, drawing particularly on new developments in the area of rural finance and UNCTAD's ongoing research into the impact of recent financial sector reforms in LDCs. The penultimate chapter analyses the issue of *rural finance* and suggests some pragmatic ways of increasing the supply of credit to farmers in LDCs.

The final chapter explores the *policy implications* for LDC agriculture of the analyses in chapters 1 to 5, and particularly the implications of the relative success of agricultural development in the more advanced developing countries of South and East Asia. The present overview briefly examines the causes of agricultural stagnation in LDCs and summarizes some relevant policy recommendations.

B. Causes of agricultural stagnation in LDCs

Sluggish growth in per capita agricultural production in LDCs (see table 6 and chart 6) can be explained by a variety of factors. The most important of these are socio-economic structures which determine prevailing farming systems (see box 6), environmental factors (discussed in chapter 4 of this part of the Report), the macroeconomic policy framework, rudimentary technology, paucity of credit, inadequate public investment in rural physical and social infrastructure, and weaknesses in institutional infrastructure.

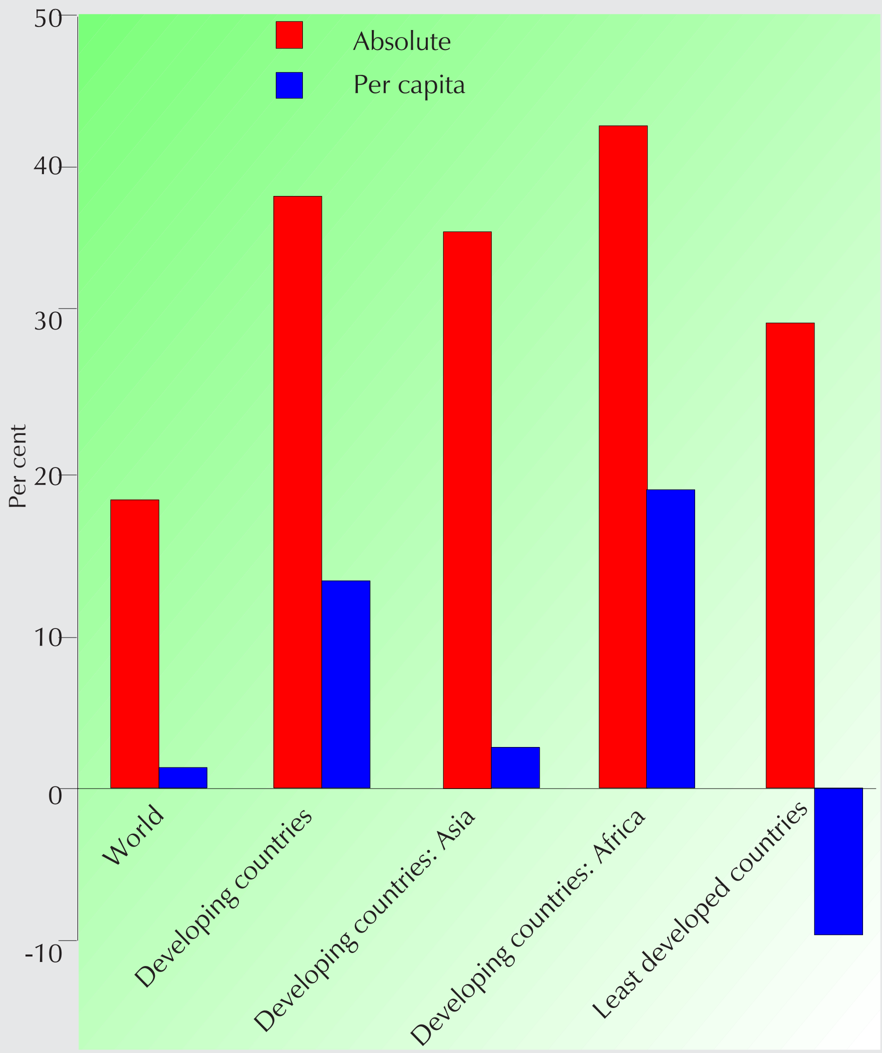
TABLE 6: AGRICULTURAL PRODUCTION INDICES

(Averages, 1989-1991=100)

	Absolute		Per capita	
	1984-1985	1994-1995	1984-1985	1994-1995
World	90.3	107.1	99.3	99.8
Developing countries	84.5	116.6	94.7	107.1
Developing: Africa	81.4	110.7	95.4	97.5
Developing: Asia	83.4	119.4	92.7	110.6
Least developed countries	90.9	118.3	104.3	94.3

Source: FAO, 1995.

CHART 6: ABSOLUTE AND PER CAPITA CHANGES IN AGRICULTURAL PRODUCTION BETWEEN 1985 AND 1995, IN LDCS AND THE REST OF THE WORLD



Source: UNCTAD, based on FAO, 1995.

Unlike in developing countries as a whole, per capita food production in LDCs has actually fallen over the past ten years.

SOCIO-ECONOMIC STRUCTURES

The organization of farming activities in LDCs (see box 6), particularly the mode of access to land, has retarded agricultural development in a number of LDCs. Research from outside Africa suggests that insecure land title can be a disincentive to long-term investments in land, as well as restricting access to credit (Harrison, 1990, p. 55). While traditional land tenure systems may have provided considerable security of tenure historically (Cleaver and Donovan, 1995, p. 7), they do not guarantee individual titles, and deny farmers the right to use farms or lands as collateral to secure loans to finance new investments.[1] Also, long-term investments which could improve yields and limit land degradation are discouraged. The rights of tenant or migrant farmers (i.e. non-community members) are even less secure and thus less conducive to long-term agricultural investment.

Rules of inheritance also militate against agricultural innovation and investment. These rules, which necessitate the division of a deceased person's farm(s) among numerous heirs, have often reduced farms to sizes which are too small – or where the deceased had several farms, to scattered plots which are too far

Box 6: LDCs' farming systems

Three main elements characterize the farming systems prevailing in LDCs: indigenous land tenure systems, traditional production relations and rudimentary technology.

(i) Access to land

Different tenurial systems coexist to varying degrees in different LDCs or in different regions or even districts of the same LDC. Traditional land tenure systems coexist with private land ownership in several LDCs. In others, such systems have been supplanted by "state lands"; that is, the State owns all lands, as in the cases of the Democratic Republic of the Congo, Ethiopia (under the Mengistu socialist regime), Mauritania, the United Republic of Tanzania and Zambia, although occupier rights are recognized (Harrison, 1990, p. 55).

At the risk of over-generalization, it may be said that access to agricultural land in LDCs is primarily defined by tenurial arrangements which are specific to different land-owning communities (e.g. societies, tribes).[1] While several land tenure systems acknowledge individual land titles, particularly with the advent of modern statehood, many such systems in African LDCs are steeped in traditional notions of land use and management which vest "community lands" in the head of the community or land-owning group, who may be a king, a chief or a family head. The members of the community or group, defined by putative or real kinship relations, have only usufructuary rights to plots allocated to them - that is, the right to use the land, but not to dispose of it permanently to non-group members, whose access to land is regulated by customary rules and usage. Such rights may have become permanent over the years, especially in those African LDCs where market forces have penetrated these communities; but by and large, the notion of "community land", restrictions on individual land titling and traditional rules of inheritance have persisted in several African LDCs.

(ii) Production relations

The organization of farming activities assumes various forms in different LDCs, thus making generalizations difficult. However, two distinct modes of organizing such activities, which often coexist in the same community, can be identified.

Farming activities may be organized within the framework of household units, with acreage cultivated showing some correlation with household size. Under this arrangement, economic and household units are often coterminous, with farm work shared out among members of the household, usually headed by a male. Division of labour is, most often, gender-based or gender-sequenced, with females and males performing specific but related tasks. Commercial farmers may rely more on hired labour, especially during peak periods.

In most instances, however, the household may not act as a single economic unit. Responsibility for different crops or different varieties of the same crop (e.g. upland or swamp/irrigated rice) may be shared out among members along gender lines. Males may cultivate "cash crops" or crops for exports, while the females are responsible for food crops to meet the subsistence needs of the household. This type of arrangement generates different needs – extension, technological, etc. – among male and female farmers.

(iii) Technology

African LDCs in particular have not experienced the "Green Revolution" which significantly altered farming systems and increased productivity several times over in Asia. Farming technology is often rudimentary, consisting of the simple hand-held hoe, cutlass, and/or similar tools for clearing and digging the land and planting. Organic materials, such as compost, may be used to improve soil fertility, particularly in areas where animal husbandry is combined with crop farming, but there is little use of chemical fertilizer.[2] Only a small proportion of cultivated land is under irrigation in African LDCs: most agriculture is rain-fed, with annual output highly correlated with the amount and distribution of rainfall in a particular year. Agricultural growth in African LDCs has therefore been achieved by expansive, and not intensive, methods of farming – that is, by expanding acreage cultivated, rather than increasing productivity per acreage, which has become untenable under conditions of high population growth rates and increasing environmental degradation in many LDCs.

1 The discussion below refers to LDCs in which sedentary agriculture is predominant. Land-use rights in transhumant pastoralist societies are generally underscored by common property rights in grazing land and water resources.

2 Increases in per capita food production in East and South Asia over a 20-year period were attributed to fertilizer consumption, which increased fivefold. Over the same period sub-Saharan Africa recorded a decline in its per capita food production index, and the lowest fertilizer consumption rate, which was a fifth of Latin America's and only 5 per cent of East Asia's (Borlaug and Dowswell, 1995, p. 115).

apart – to justify any meaningful investment.[2] This is particularly the case in those LDCs facing shortages of cultivatable land because of high population growth rates (e.g. Burundi and Rwanda), mountainous terrain (e.g. Laos and Nepal) or environmental degradation (the Sahelian countries).

Macroeconomic policy framework

Agricultural investment has been discouraged by most LDC governments' past macroeconomic policies. Control of, and/or intervention in, input supply, agricultural processing and marketing, in the case of food crops to ensure cheap food for urban dwellers (for example, in Zambia), has created many distortions in agricultural trade. Supply of inputs has been inefficient and erratic – for example, fertilizers being delivered midway through the planting season – and high levels of protection for domestic industry, under import substitution industrialization (ISI) policies, have resulted in high costs of manufactured inputs. Administered prices, for various crops whose marketing is controlled by the government, are often insufficient to cover total costs of production,[3] thus further distorting the market. Moreover, agricultural exports are discouraged by heavy explicit taxation and overvalued domestic currencies (see e.g. UNCTAD, 1995, chapter II, section B; and chapter VI of this part of the Report).

Rudimentary technology

Because of the abundance of land and a general political neglect of the agricultural sector, few African LDC governments invested in yield-enhancing technology. Even where yield-improving technologies were available, land abundance in a number of LDCs, until relatively recently, combined with a scarcity of capital, dampened incentives to adopt them (Cleaver and Donovan, 1995, p. 4). As farmers could increase output simply by extending into virgin lands, there was little incentive to adopt intensive cultivation methods which required scarce capital for inputs such as fertilizer and seeds.

Farmers in LDCs have not adopted, on a wide scale, yield-enhancing agricultural technologies such as HYVs and irrigation.

High-yielding varieties (HYVs), which were pivotal in Asia's "Green Revolution", failed to spread in Africa mainly because of poor soils, low fertilizer application and poor management practices (Harrison, 1990, p. 57). Indeed, in view of much of Africa's low and unpredictable rainfall pattern, HYVs are unlikely to thrive without adequate irrigation facilities. Despite this, as noted by the World Bank, there has been little investment in irrigation agriculture – an important element in Asia's phenomenal agricultural growth – in sub-Saharan Africa (SSA). In cases where research investment was made, the resulting technology was unsuitable for the African LDCs' context, since it increased yield per unit of land, which is in abundance, by using increased quantities of relatively scarce labour and purchased inputs (Cleaver and Donovan, 1995, p. 4).

Credit constraints

Financial intermediation is very weak in most LDCs, especially in rural areas; these are not well served by formal sector financial institutions. Most farmers, especially small-scale farmers, are unable to access credit to finance land improvements, inputs or new technology (see chapter 6 of this part of the Report).

Inadequate public investment in rural infrastructure and social services

Most LDC governments have not adequately financed physical and social infrastructure such as roads, water, education and health in rural areas. Rural roads in LDCs are mostly dirt tracks, which are impassable during the rainy season. The cost of transporting farm produce to local or urban markets is thus prohibitive; this further reduces the profit margins of farmers, and constitutes a great disincentive to agricultural investments.

By contributing to poverty alleviation, enhanced agricultural growth will have a significant impact on large sections of the population of LDCs who derive their livelihoods from agriculture.

Research has shown that uneducated farmers may not be as receptive to new ideas and technology as educated ones. Also, rural farmers are likely to lose many days through illness when they need to be at their healthiest in order to prepare, plant and attend to their farms (e.g. at the onset of rains and during the rainy season when malaria is most prevalent in the tropics). The lack of health facilities unnecessarily prolongs illnesses which could be promptly treated if an efficient health delivery system were available. Lack of safe drinking water increases the incidence of diarrhoeal diseases. As observed by the World Bank, 10-20 per cent of people in poor countries, mostly smallholders in Africa and South Asia, are too malnourished or unhealthy to work even under conditions of improved incentives (cited in Lipton, 1987, p. 203).

Institutional weaknesses

Agricultural extension services have been unable to reverse the declining trend of per capita agricultural production in a number of LDCs because they are grossly inefficient and ineffective. High farmer/extension worker ratios are exacerbated by a lack of means of transportation to enable extension workers to visit farmers regularly. Extension activities are often concentrated among male farmers to the detriment of their female counterparts, who are estimated to produce about 70 per cent of Africa's staple food (Harrison, 1990, p. 69).

Agricultural research has had limited impact on LDC agriculture because it is accorded low priority by a number of governments, is biased towards commercial farmers and the export sub-sector, and has weak links with extension services. While some benefits of research have accrued to the emergent smallholder sub-sector, subsistence farmers have been largely bypassed.

Attempts by a number of LDC governments and donors to address the above problems have not always been successful, although considerable success has been achieved in reforming and improving the efficiency of agricultural extension systems in Côte d'Ivoire, Ghana, Kenya and Nigeria (non-LDCs), and in Benin, Burkina Faso, Malawi, Niger, Togo, Uganda, the United Republic of Tanzania and Zambia (LDCs) (Cleaver and Donovan, 1995, p. 12). Most often, however, external assistance to improve LDC agriculture has yielded limited results because donors compete with one other, and do not coordinate their activities, which sometimes overlap (Harrison, 1990, *passim*; Cleaver and Donovan, 1995, p. 5).

C. Towards a dynamic agricultural sector in LDCs

It is not realistic to offer a blueprint for resolving LDCs' low agricultural productivity: these countries have different social and economic characteristics, and are situated in different ecological and climatic zones. Actual solutions will vary for different LDCs, but a sustainable agricultural strategy for this group of countries must necessarily be multifaceted.

There are compelling reasons for LDC governments to prioritize the agricultural sector. By contributing to poverty alleviation, enhanced agricultural growth will have a significant positive impact on large sections of the population of LDCs who derive their livelihoods from that sector. Furthermore, to maintain current levels of food consumption, agricultural growth and/or food imports must keep pace with prevailing high population growth rates. A dynamic agricultural sector will guarantee improvements in the nutrition and health status of the populations of LDCs. Increases in rural incomes will lead to qualitative improvements in rural life and expand domestic markets.

Furthermore, a dynamic agricultural sector would provide the basis for agro-processing industrialization, which could enhance employment opportunities in both urban and rural areas. The combined knock-on effects on urban areas could be positive if improvements in rural life and enhanced job opportunities stemmed the flow of population from the rural to urban areas.

A dynamic agricultural sector will facilitate improvements in the nutrition and health status of the populations of LDCs and, by increasing rural incomes, will expand domestic markets.

It is widely acknowledged at present that correcting distortions in agricultural pricing is a necessary but *not sufficient condition* for attaining high and sustainable growth rates in LDC agriculture. This is because stabilization and structural adjustment programmes being implemented by most LDCs have had a limited impact on agricultural growth so far (see chapter 6 in this part of Report). Other "non-price" constraints on LDC agriculture must also be tackled as a matter of urgency. A viable long-term agricultural strategy in LDCs must address the following:

- macroeconomic policies;
- rudimentary agricultural technology;
- constraints on the adoption of technological innovations (e.g. insecurity of tenure, shortage of credit, and weak rural physical and social infrastructure);
- poor access to markets for inputs and outputs;
- weak institutional support (e.g. extension services).

Macroeconomic policies

The incentive framework for agriculture must be strengthened by formulating and implementing appropriate macroeconomic policies with direct and indirect consequences for the agricultural sector. This may require:

- *maintaining the exchange rate* at realistic levels, which will increase incomes, in terms of local currency, for farmers cultivating export crops, as well as boost demand for domestically produced import substitutes (which could benefit all farmers producing marketable surpluses) through expenditure-switching effects;
- *reduction in direct taxation of agricultural output*, in particular of export crops, in order to reduce the tax burden on farmers and increase incentives for private investment in the agricultural sector;
- *trade liberalization* to enhance access to, and lower the cost of, imported inputs and remove impediments to export trade.

Appropriate agricultural technology

Technological innovations must be "appropriate", taking into consideration the environmental, social and economic context of LDCs' agriculture. Such technology should:

- be relatively inexpensive and affordable for LDC farmers;

- not require major increases in labour per unit of output;
- yield high returns;
- not depend much on imports or efficient supply networks where these are lacking at present (see Harrison, 1990, pp. 56-57);
- not entail significant increases in risks;[4]
- be environmentally sustainable.

Constraints on agricultural modernization

Constraints on the adoption of agricultural technological innovations in LDCs must be addressed. The most important include the mode of access to land and insecurity of tenure, paucity of credit, and lack of social and physical infrastructure in rural areas.

Improved efficiency of markets for inputs and outputs

Efficient agricultural marketing systems must be established. This may involve the privatization of existing inefficient crop marketing boards, although this is not the only option. Monopoly powers of crop marketing boards should be revoked and their subsidization stopped; restrictions on the private sector's participation in agricultural trade should be eased; and the rural road network and general transportation facilities should be improved to facilitate the movement of agricultural produce from farms to markets. This, together with trade liberalization, should improve the efficiency of input and output markets.

Institutional support

The objectives of *agricultural research* need to be redefined to include:

- research into food crops and into the needs of smallholders, who predominate in the agricultural sector;
- strengthening the link between research and agricultural activities.

The *agricultural extension* system has to be overhauled:

- to improve the management and efficiency of the extension delivery system, for example through the training and visit (T&V) system,[5] the "contact farmer" approach or the pyramid training scheme;[6]
- to reverse the gender bias in extension services.

D. Conclusions

The fate of the agricultural sector is inextricably bound up with that of the wider economy: sound policies in the latter will have a beneficial effect in the former.

Addressing the sluggish growth of LDC agriculture cannot entirely be dissociated from recovery in LDC economies. Sound macroeconomic policies that ensure a healthy economy through efficient utilization of scarce resources will have significant beneficial effects on the agricultural sector. An efficient transportation network will improve the efficiency of domestic markets (for inputs and outputs); a good educational system should improve the educational level of farmers and enhance their receptiveness to new farming practices and technology; and efficient rural financial intermediation will improve farmers' access to credit to finance investments and new inputs associated with new technology. Similarly, supply of potable water and an effective health care delivery system will enhance the health and productivity of farmers.

Experience in some developing countries has shown that the private sector may be more effective and efficient than public sector institutions in the marketing of inputs, delivery of improved technology and provision of credit (Borlaug and Dowswell, 1995, p. 125). In LDCs, private investment may thus be required in some of these areas (marketing of inputs/outputs, credit provision, etc.), but LDC governments must take the lead in providing other facilities, considering not only their "public good" character but also the weaknesses of the private sector in several LDCs. "Public goods" such as research and extension, and social and physical infrastructure, will for the foreseeable future remain the responsibility of the public sector in LDCs.

A problem prevalent in LDCs is that areas where environmentally fragile land is farmed are subject to simultaneous population pressure, poverty and food insecurity, thus complicating any possible solution. Also, these areas are usually difficult to reach, and lack infrastructure and investment capital as well as technical expertise. They are usually not endowed with the necessary resources to produce marketable surpluses and are therefore frequently excluded from agricultural initiatives. There is thus a special role for governments in assisting and promoting rational and environmentally sustainable development in these areas.

LDCs will need external resources and expertise if they are to achieve sustainable agricultural development.

Countries that have increased agricultural output, and hence food security, have a track record of strong political emphasis on economic incentives for agricultural production, and investments in training, research and extension services. This underlines the importance of promoting research efforts to make available, and implement, new agricultural technology. The main tools to achieve this goal are:

- advice to, and support for, governments as regards giving higher priority to sound national agricultural policies and their adjustment to new international trade regimes, in particular the Uruguay Round Agreements;
- revitalization of national agricultural extension, training and research facilities, including national universities, with particular emphasis on creating capabilities for reaching resource-poor and female farmers;
- reorientation of national extension and research systems with the aim of creating more environmentally sustainable agricultural systems;
- close cooperation with the international agricultural research systems, particularly the Consultative Group on International Agricultural Research (CGIAR), to ensure a clear focus on production impacts on farmers' fields in international research efforts.

Without external assistance, almost all LDCs lack the necessary skills and resources to undertake the huge investments involved in the activities and policies suggested above, a fact which underscores the need for enhanced technical and financial assistance.

Notes

1 It should be noted, however, that banks are often reluctant to accept (private) land as collateral because it is not easily marketable.

2 The Food and Agriculture Organization reports that in Burkina Faso, each household has an average of 9.6 plots of land, with an average size per plot of 0.4 hectares (FAO, 1996, p. 111).

3 The difference between world market prices and administered prices was in most cases expected not only to protect farmers from the fluctuations in world market prices but also to fund subsidized inputs to farmers. However, both objectives were attained in only very few LDCs: administered prices in several cases represented a small percentage of world prices; subsidized inputs were almost always in short supply; and the inefficient distribution systems favoured large commercial and politically well-connected farmers to the extent that most smallholders lost out.

4 The rate of adoption of agricultural technology may also depend on government policies and extension services which limit the risk to farmers associated with the adoption of such technology (see chapter 6 of this part of the Report for a detailed discussion).

5 This involves fortnightly work plans and close supervision of extension workers to ensure that they visit farms. Regular training sessions for extension workers and their close links with research also ensure that they are regularly upgraded (see Pickering, 1989; Roberts, 1989; Harrison, 1990).

6 In the "contact farmer" approach, the extension worker concentrates efforts on one "contact farmer", who in turn is expected to disseminate knowledge gained to other farmers in his group (contact farmers may represent different socio-economic groups in the farm population). Under the pyramid training scheme, two or three national trainers train about 20 regional trainers; each of the latter trains another 20 trainers, who also train another 20, and so on (Harrison, 1990, p. 67).

References

Bindlish, V., R. Ernson and M. Gbetibouo (1993). *Evaluation of the T&V-Based Extension in Burkina Faso*, World Bank Technical Paper No. 226, Washington, D.C., World Bank.

Borlaug, N. E. and C. R. Dowswell (1995). "Mobilizing science and technology to get agriculture moving in Africa", *Development Policy Review*, vol. 13, No. 1, pp. 115-129.

Cleaver, M. K. and W. G. Donovan (1995). *Agriculture, Poverty, and Policy Reform in Sub-Saharan Africa,* World Bank Discussion Paper No. 280, Washington, D.C., World Bank.

FAO (1995). *FAO Yearbook*, vol. 49, Rome, FAO.

FAO (1996). *The State of Food and Agriculture*, Rome, FAO.

Harrison, P. (1990). "Sustainable growth in African agriculture", in *The Long-Term Perspective Study of Sub-Saharan Africa,* vol. 2, *Economic and Sectoral Policy Issues*, Washington, D.C., World Bank, pp. 48-73.

Leach, M. and R. Mearns (eds.) (1996). *The Lie of the Land: Challenging Received Wisdom on the African Environment*, Oxford, International African Institute.

Lipton, M. (1987). "Limits to price policy for agriculture: Which way for the World Bank", *Development Policy Review,* vol. 5, No. 2, pp. 197-216.

Pickering, D. (1989). "Agricultural extension and its linkage with agricultural research", in R. S. Nigel (ed.), *Agricultural Extension in Africa,* A World Bank Symposium, Washington, D.C., World Bank, pp. 1-6.

Roberts N. (1989). "The World Bank training and visit system in East Africa, in N. Roberts (ed.), *Agricultural Extension in Africa*, A World Bank Symposium, Washington, D.C., World Bank, pp. 19-24.

Sen, A. K. (1981). *Poverty and Famines: An Essay on Entitlement and Deprivation*, Oxford, Clarendon Press.

UNCTAD (1995). *The Least Developed Countries, 1995 Report* (TD/B/41/(2)/4) (United Nations publication, Sales No. E.95.II.D.2), New York.

UNCTAD (1996). *The Least Developed Countries, 1996 Report* (TD/B/42/(2)/11) (United Nations publication, Sales No. E.96.II.D.3), New York and Geneva.

Chapter 2

Opportunities for LDC Agriculture in the World Trading System and the Impact of the Uruguay Round Agreement

A. Introduction

The Uruguay Round of GATT trade negotiations covered several new areas, one of which was agriculture, for which it initiated a programme of trade liberalization. This chapter examines the consequences for LDC agriculture of the Uruguay Round Agreement on Agriculture (URAA). Four broad issues are examined: the impact of agricultural trade liberalization on the global market for traditional LDC export commodities; opportunities for LDC export diversification; the impact of the expected higher world food market prices on food production in the LDCs; and provisions in the Uruguay Round Agreement for increasing food production in the LDCs. The URAA, which directly impacts on agriculture, is summarized in the next section in order to provide a context for the discussion of these issues.

B. The Uruguay Round Agreement on Agriculture

The objective of the Uruguay Round was to achieve greater liberalization in international agricultural trade through enhanced transparency in three areas: market access, domestic support and export subsidies. Non-tariff barriers (NTBs), including quantitative restrictions, are to be replaced by tariffs which provide approximately the same level of protection. Tariffs resulting from this "tariffication process" and other tariffs on agricultural products (see below) are to be reduced by an unweighted average of 36 per cent over six years (1995-2000) by the developed countries, and by 24 per cent over ten years (1995-2004) by the developing countries (*market access*). All direct and indirect subsidies to agriculture are to be restrained (*domestic support*), and *export subsidies* are to be rationalized and cut down. LDCs, like other countries, are required to tariffy NTBs and bind their tariffs, but unlike the others, they are exempted from all reduction commitments (see table 7 for a summary of the URAA). "Agricultural products" as defined by the URAA exclude fish and fish products, forestry products and natural rubber, which together with minerals and metals are treated as industrial products (UNCTAD, 1996, p. 59).

Two other Agreements of the Uruguay Round – the Agreement on Sanitary and Phytosanitary Measures, and the Agreement on Technical Barriers to Trade – will also impact on international trade in agricultural products (see discussion below).

TABLE 7: SUMMARY OF SELECTED PROVISIONS IN THE URUGUAY ROUND AGREEMENT ON AGRICULTURE

Subject	Rules	Liberalization	Safeguards	Special treatment
Market Access	• Tariffication of all NTBs • Bind overall tariffs • No new NTBs	• Overall tariffs to be cut by 36 (24) per cent • Minimum tariff cut 15 (10) per cent	• Guaranteed current or minimum access • Protection against import surges	• No reduction by LDCs • Delayed tariffication
Domestic Support	• Specification of "amber" type and "Green Box" policies	• Reduce total outlays on "amber" policies by 20 (13.3) per cent	• "Green Box" policies can continue	• *De minimis* rule • Decoupled support payments excluded • Extra exemptions for developing countries and LDCs
Export Subsidies	• Commodity specific categorization of assistance • No new subsidies for other commodities	• Lower expenditure by 36 (24) per cent • Reduce volume by 21 (14) per cent	• Adherence to food aid rules • Export credit provisions and guarantees	• Developing countries' and LDCs' internal transport and marketing costs exempted

Source: GATT, 1994a, in UNCTAD, 1995a.
Notes: Figures in brackets refer to magnitudes pertinent to developing countries.
"Green Box" policies are those which have no, or minimal, trade-distorting effects.
"Amber" type policies are those with significant trade-distorting effects.

C. Impact on LDCs' commodity exports

The overall outlook for agricultural commodity markets in the 1990s is a slowdown in growth rates compared with the 1980s. The Uruguay Round is not considered to have changed that outlook to any significant extent.[1] Assessments by UNCTAD, FAO and other organizations show that, on the whole, the net impact of the Uruguay Round on commodity markets at the global level is likely to be modest. This is particularly the case for those primary agricultural commodities produced and exported by the LDCs, since protectionism was already relatively low for most of these commodities before the Uruguay Round. In the case of temperate-zone products, which are also produced and exported to a limited extent by the LDCs, e.g. vegetables, fruits and cereals, the effects of trade liberalization could potentially be greater, but by and large these products are not major export items of the LDC countries.

TRADITIONAL EXPORT COMMODITIES

Tropical beverages (coffee, cocoa and tea) are not import-competing products in the developed countries and their market access conditions were already relatively good before the conclusion of the Uruguay Round. Moreover, during the past 15 years or so, these commodities have suffered as a result of falls in real world market prices, largely because of a sizeable potential for increased output in major producing countries in the face of relatively inelastic import demand. These factors are likely to continue to influence the trends in these markets in the future, with the Uruguay Round playing a relatively minor role.

The global demand for *agricultural raw materials*, such as natural fibres, has been weak over the past two decades. These commodities have suffered more from the growth in the use of synthetic substitutes than from other factors. However, with increasing consumer awareness of environmental issues, they have the advantage of being "natural" products, and therefore the demand for them should hold up better. With virtually no or very low import duties already in most major markets, the direct impact of any further tariff reductions on these raw materials will be small. The demand for cotton textiles, however, is expected to be boosted with the lifting of the Multi-Fibre Arrangement (MFA) by 2004. Several LDCs, especially those in West, Central and East Africa, could benefit from this.

The world *banana* market is demand-driven, with very few import barriers in major importing countries other than the EU, where imports are regulated through tariff quotas.[2] As regards *sugar*, the Uruguay Round did not change much the import regimes in both the EU and the United States, the two largest markets. However, world market prices are projected to rise somewhat, mainly because of increased demand for sugar in the developing countries.

With the post-UR import tariff rates in the developed countries estimated to fall only modestly, from already low levels, the Uruguay Round is not likely to impact much on the global trade in and world prices of *hides and skins* as well as leather. However, the current trend in increased processing of hides into leather and further into products in the developing countries, in part due to cost advantages but also due to less restrictive environmental constraints, is expected to be sustained.

Non-traditional commodities

By contrast, world trade in several *non-traditional commodities*, such as fruits and vegetables, has increased relatively quickly in recent years. This trend is projected to grow further (see below), because of both trade liberalization and the expected continuation of world income growth over the medium term. As these commodities are also generally protected in many countries,[3] further trade liberalization offers potentially significant opportunities for trade in them.

One impact of trade liberalization, however, is the loss of preferential margins. The LDCs have preferential access to developed country markets for most agricultural commodities under various preferential trading arrangements, such as the Generalized System of Preferences (GSP) and the Lomé Convention. With the reduction in the most favoured nation (MFN) tariff rates following the Uruguay Round, the LDCs stand to lose in terms of the margin of preferences (i.e. erosion of preferences), with negative consequences for their market share. However, for most traditional primary agricultural commodities, notably tropical beverages and agricultural raw materials, the extent of tariff preferences is low, since imports in developed country markets are either free of duty or subject to very low tariffs. For these commodities, the LDCs would have to compete for market shares in developed countries on an equal basis with non-LDC exporters. For some other commodities, e.g. sugar and bananas, preferential margins for those that have market access will continue to remain high under present import arrangements.

A major challenge facing LDCs is the task of improving their competitive position in exports by overcoming supply-side constraints.

In summary, changes in market access conditions due to the Uruguay Round are not considered to contribute markedly to boosting global trade and world market prices of most traditional primary agricultural commodities exported by the LDCs. However, the impact will be felt in terms of some shifts in the location of production, as competition intensifies among exporters in a freer global trading environment. One major challenge facing the LDCs will therefore be to improve their competitive position in exports by overcoming supply-side and other related constraints.

D. Consequences of changes in world market prices for domestic food production

FAO assessments of the impact of the Uruguay Round on global food markets, based on the World Food Model, show relatively small impacts on production at the global level -world production of most food items[4] rising by an additional 1 to 3 per cent over their baseline volumes in the year 2000. However, there is some shift in production across regions or countries, with generally lower production in the developed countries of those commodities which have been subject to a high degree of protection in the past, and increased output in the non-subsidizing, low-cost producing countries, including some developing countries.

For the LDCs, the impact of the Uruguay Round on the production of basic food commodities was estimated to be positive, but very small, with outputs rising by an additional 0.2 to 1.5 per cent over their baseline volumes in the year 2000. In absolute terms, these amount to less than 100,000 tons, except for wheat and coarse grains. On the other hand, with increased domestic market prices as a result of higher world prices, domestic utilization contracts somewhat. Consequently, net imports fall slightly *ceteris paribus*.

In the FAO's World Food Model, as in other models of this type, three factors largely determine the assessed outcome of domestic production: the magnitude of price changes in international markets; the extent to which such changes are transmitted to domestic markets, transmission being greater where trade barriers are lower, domestic market distortions are fewer in number and other structural factors such as the transport network facilitate the transmission process; and supply elasticities. Of these, changes in world market prices and their transmission are the most directly related to the Uruguay Round.

For the LDCs, changes in world market prices are largely given, in view of their minor position in world trade. The LDCs were not required in the Uruguay Round to reduce their bound tariffs, and were modelled accordingly. Thus, with no tariff reductions, and given the higher world prices due to the Uruguay Round, domestic prices would normally rise. The impact of the Uruguay Round on real world market prices of basic foods is projected to be positive but modest, compared with the scenario without the Uruguay Round. UNCTAD's assessment based on the World Food Model shows positive price changes for basic food commodities ranging from 6 to 11 per cent in one scenario, and from 1 to 6 per cent in another. FAO projections based on a similar model also indicate positive price changes of 4 to 10 per cent (see UNCTAD, 1995b, Addendum, table 11, p. 15).

Supply elasticities (i.e. the extent of farmers' response to price changes) are also affected by supply-side constraints, or structural factors, such as transport and availability of other infrastructure and agricultural inputs. Since the values of the transmission elasticities as well as the supply elasticities are considered to be quite low for the LDCs, the impact of the higher world market prices generated by the Uruguay Round on food production in the LDCs is expected to be modest but positive.

E. Opportunities for export diversification

Many of today's successfully diversified developing countries were at one time heavily dependent on primary agricultural commodities.

It is generally acknowledged that supply-side problems have historically played a dominant role in limiting export diversification by developing countries into non-traditional commodities and processed products. Indeed, many of today's successful developing countries with diversified agricultural export structures were at one time heavily dependent on primary agricultural commodities, e.g. Chile, Indonesia, Malaysia and Thailand. They achieved success while facing an external trading environment similar to that faced by all other developing countries. In some respects, that environment was worse for this group of countries, since by and large they did not benefit from preferential trading arrangements. Many LDCs failed to diversify their exports despite their having received some trade preferences from the developed countries. This failure has been attributed to several factors, including supply-side constraints as well as the cumbersome administration of these preferential schemes, which resulted in low utilization rates (for problems relating to the utilization of GSP schemes, see UNCTAD, 1993).

The Uruguay Round has opened up new opportunities for export diversification in agriculture, through *inter alia* across-the-board reductions in MFN tariffs on agricultural products; the reduction in tariff escalation, which favours processed exports; and the strengthening of trade rules, particularly those on sanitary and phytosanitary measures and technical barriers to trade.

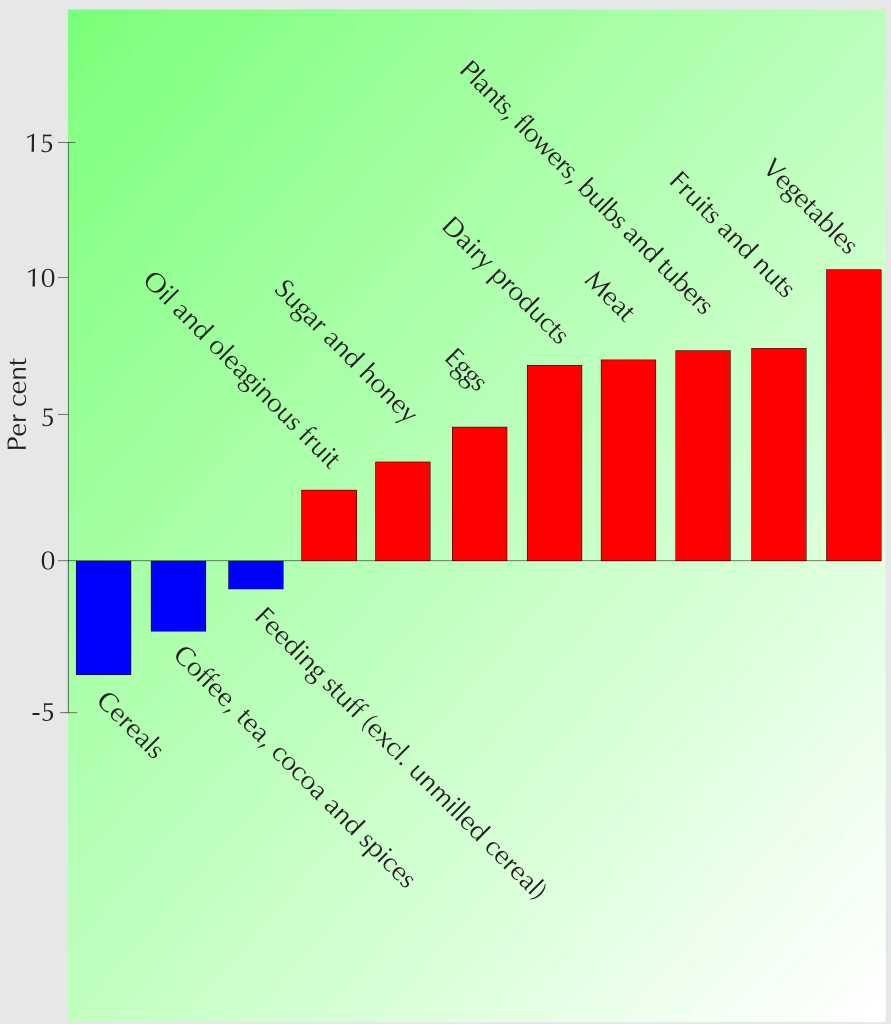
Export prospects in non-traditional agricultural products

While traditional primary commodities exported by the LDCs suffered from slow growth in world import demand and secular declines in real world prices, several non-traditional agricultural commodities (NTCs), particularly but not exclusively in the horticultural area, have been growing relatively fast in the world market and are becoming increasingly important for some developing and least developed countries, including Uganda and Zambia. For example, an FAO study (Koroma, 1997) on selected NTC exports to the EU, Japan and the United States estimated that their total global value, which amounted to 19 per cent of global agricultural imports in 1994, grew at a rate of almost 11 per cent per annum during 1985-1994, compared with about 6 per cent per annum for other agricultural imports.

Import data from members of the Organisation for Economic Co-operation and Development (OECD) also confirm that the annual growth rate of processed agricultural and NTC imports (fruits and nuts, vegetables, and plants/flowers) into the OECD countries for the period from 1980-1982 to 1990-1992 far exceeded that for traditional agricultural products (see charts 7 and 8). Import values of coffee, tea, cocoa and spices actually declined by 2.6 per cent per annum over that period (see table 8).

The more rapid import growth of NTCs is underscored by three factors: first, the consumer preferences associated with rising incomes in the industrialized

CHART 7: CHANGE IN TOTAL BASIC AGRICULTURAL IMPORTS OF OECD COUNTRIES (EXCLUDING INTRA-EU TRADE), 1980-1982 TO 1990-1992



Source: UNCTAD, based on FAO, 1996.

countries; second, the ability of certain developing countries to increase their capacity to supply commodities at competitive prices, mainly during the off-season for domestically produced fruits and vegetables in the importing countries; and third, the development of lower-cost transportation and communications, and the greater availability of production and marketing technology in developing countries.

According to the preliminary results of the FAO study mentioned above, some opportunities for an even greater growth in exports of NTCs by developing countries have been created by the reduction in tariffs under the Uruguay Round in the EU, the United States and Japan, which together account for over 60 per cent of the value of world trade in these commodities. In the EU and the United States, tariff rates for *selected NTCs* are to be reduced on average by about 20-40 per cent. The EU has granted duty-free access for nutmeg, mangoes and watermelons. In the United States, kiwi fruit currently has duty-free access. Japan does not apply any seasonal tariffs, and the *ad valorem* tariff equivalent rates for NTCs are to be reduced by between 15 and 60 per cent.

For *selected NTCs* as a whole, the combined value of imports in the above three markets in the year 2000 is projected to be nearly 10 per cent higher

TABLE 8: IMPORTS OF THE OECD COUNTRIES, EXCLUDING INTRA-EU TRADE
(Current $ million)

	1980-1982	1990-1992	Annual growth rate (%)
Basic agricultural products			
Meat	6 307	12 333	6.9
Dairy products	21	41	6.8
Eggs	81	127	4.6
Cereals	9 762	6 403	-4.1
Vegetables	2 306	4 670	7.3
Fruits and nuts	7 255	14 868	7.4
Sugar and honey	2 287	2 910	2.4
Coffee, tea, cocoa and spices	13 068	10 044	-2.6
Feeding stuff (excl. unmilled cereals)	7 111	9 800	3.3
Oil seeds and oleaginous fruit	7 583	6 799	-1.1
Plants, flowers, bulbs and tubers	1 006	2 690	10.3
Total imports of basic products	**56 787**	**70 683**	**2.2**
Processed agricultural products			
Meat	1 206	1 761	3.9
Dairy products	1 639	2 433	4.0
Eggs	57	69	2.1
Prepared cereal products	919	2 802	11.8
Vegetables	1 885	4 244	8.5
Fruits	2 572	6 304	9.4
Sugar and sugar preparations	2 925	1 937	-4.0
Coffee, cocoa and chocolate	2 210	3 116	3.5
Margarine and shortening	71	76	0.6
Edible products and preparations n.e.s.	874	2 817	12.4
Animal and vegetable oils (excl. fish oil)	2 996	3 816	2.4
Total imports of processed products	**17 350**	**29 374**	**5.4**
Total imports	**74 137**	**100 057**	**3.0**

Source: FAO, 1996, p. 8.
Note: n.e.s = not elsewhere specified.

Although traditional primary commodities exported by the LDCs suffered from slow growth in world import demand and secular declines in real world prices, non-traditional agricultural exports are becoming more important.

with the Uruguay Round Agreement than without it.[5] From $13.6 billion in 1994, the value of the *selected NTC* imports is projected to increase to $16.4 billion in 2000 without the Uruguay Round Agreement, and to $18 billion with it. These increases will naturally depend on the extent to which the agreed commitments under the Uruguay Round are implemented by the importing developed countries.

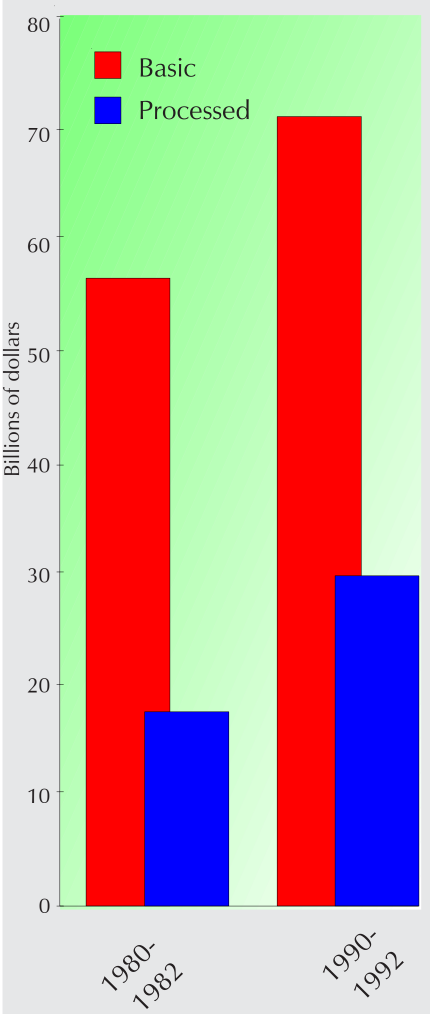
REDUCTION IN TARIFF ESCALATION

Another potentially beneficial effect of the Uruguay Round for the development of value-added industries in the LDCs is the reduction in tariff escalation.

Another potentially beneficial effect of the Uruguay Round for the development of value-added industries in the LDCs is the reduction in tariff escalation. Tariffs have generally been higher on processed agricultural products than on their primary commodities. This tariff wedge between a processed commodity (e.g. orange juice) and its corresponding primary commodity (e.g. oranges) is often referred to as tariff escalation and has been one of the obstacles for primary-product-exporting countries in their efforts to establish processing industries. The FAO has undertaken a detailed study of changes in tariff escalation as a result of Uruguay Round tariff concessions, examining the changes in the tariff structure of the EU, Japan and the United States for 226 agricultural processed commodities, which together account for 45 per cent of world imports of processed agricultural products (Lindland, 1997).

This analysis confirms earlier analysis by the GATT (1994b) and UNCTAD (1995b) indicating that tariff wedges have on the whole decreased, with both negative and positive tariff wedges converging towards zero. In the case of natural-resource-base products, the average tariff applied to semi-manufactures has been reduced to the same level (2 per cent) as for raw materials; and the tariff wedge on finished natural-resource-base products has decreased from a pre-UR level of 4.4 per cent to a post-UR level of 3.9 per cent (GATT, 1994b, p. 15). However, even after the full implementation of the Uruguay Round tariff concessions, high levels of nominal tariff escalation will remain for a number of commodity pairs (see UNCTAD, 1995b).

CHART 8: TOTAL BASIC AND PROCESSED AGRICULTURAL IMPORTS OF OECD COUNTRIES (EXCLUDING INTRA-EU TRADE), 1980-1982 AND 1990-1992



Source: FAO, 1996, p. 8.

The LDCs also export a range of processed products based on their traditional primary products, such as coffee extracts, cocoa pastes, crude vegetable oils and leather. However, the post-UR tariff rates on these products will be relatively low. As a result, reductions in the tariff escalation of these products would offer considerably fewer additional export opportunities. On the other hand, tariff escalation has been substantially reduced for many important processed commodities, not traditionally exported by the LDCs and which offer some export opportunities. These include cigarettes, some dairy products and certain animal feedstuffs in the EU; wine, and some dairy and meat products, in Japan; and orange juice and certain dairy products in the United States. The annual growth rate of processed agricultural products in the OECD during 1980-1982 to 1990-1992 – 5.4 per cent – is more than double the per annum growth rate for basic agricultural products of 2.2 per cent (see table 8). Additional export opportunities for LDCs look promising if this growth rate is sustained.

A number of product chains important to developing countries (e.g. cocoa, coffee, vegetables, fruits and nuts) are still subject to tariff escalation, despite the evidence of reduced escalation. Overall, tariff escalation appears to be common in Australia and New Zealand, although tariffs applied to processed products in those two countries are generally lower than OECD averages, and tariffs on basic products are often very low or zero (FAO, 1996).

Sanitary and phytosanitary standards play an increasingly prominent role in the case of processed products, especially foodstuffs. Arguably, these are more likely to be important determinants of market access for LDCs' processed products in the short to medium term than tariff escalation, and therefore deserve further analysis, particularly as regards assessing their diversification potential in the immediate future.

AGREEMENTS ON SANITARY AND PHYTOSANITARY MEASURES AND TECHNICAL BARRIERS TO TRADE

The Uruguay Round Agreements on Sanitary and Phytosanitary (SPS) Measures and Technical Barriers to Trade (TBT) are particularly important for export diversification by the LDCs. Whether processed or not, exports from LDCs will face relatively stringent human and animal health and other standards in the export markets, especially in the developed countries, where standards are high. In the absence of the SPS and TBT Agreements, these exports were vulnerable to unilateral trade restrictions, as many GATT disputes have shown.

Under the SPS Agreement, countries must base their SPS measures on international standards, guidelines or recommendations, where these exist, except as otherwise provided for in the SPS Agreement. Thus, transparency and science-based standards are encouraged and the SPS measures are to be applied in a non-discriminatory manner. The existence of these rules should encourage private investment in processing industries, a critical problem in the past. On the other hand, the LDCs may face the possibility of increased cost of production and lack of skills in meeting such standards. In this regard, there are provisions in the SPS Agreement for technical and financial assistance to help LDCs in their implementation of the SPS Agreement. LDCs should take advantage of such assistance.

Some of the most important determinants of market access for LDCs' processed products in the short to medium term are likely to be sanitary and phytosanitary standards.

F. Provisions for increasing food production in the LDCs

The Uruguay Round explicitly recognized the difficulties faced by developing and least developed countries in terms of their integration into the global trading system, and made several provisions for special and differential treatment for them. These include the special provisions of the Agreement on Agriculture for LDCs, the *Ministerial Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries* and the *Ministerial Decision on Measures in Favour of Least Developed Countries*. This section, however, focuses on selected provisions for the LDCs which are directly related to food and agricultural policies and to food security.

Provisions related to food production policies

The Agreement on Agriculture does not ban any specific production policy, either for developed or developing countries, not even those policies that have a production- and trade-distorting effect. Nevertheless, the current aggregate level of support associated with all such policies, i.e. the current Aggregate Measurement of Support (AMS),[6] should not exceed that provided in the Base AMS in the case of LDCs. However, nearly all the LDCs submitted a zero Base AMS (i.e. no support for agriculture) in their Schedules.[7] This limits their options for the use of production- and trade-distorting policies in the future (Konandreas and Greenfield, 1996, p. 437), except these policies falling into the Green Box category.

Although AMS-related support is limited for LDCs, provided that expenditures on price support policies are less than 10 per cent of the farm-gate value of production, such *de minimis* expenditures are in conformity with the URAA and not subject to reduction commitments. In practice, price support is often granted only to the marketed share of production in most developing countries, which implies that the per unit price support allowed under the *de minimis* provision can be significant for such countries.

In addition, an important provision is the Special and Differential Treatment under Article 6 (Paragraph 2), which includes a special category of production support policies specific to developing countries. These are agricultural input subsidies, generally available to low-income or resource-poor producers; widely available investment subsidies; and support to producers to encourage diversification from the growing of illicit narcotic crops. These important exemptions allow for considerable room to support agricultural producers.

A number of special measures are not applicable to LDCs, partly because they require an administrative capacity which seldom exists.

In addition to the exemptions listed in Article 6, Annex 2 of the Agreement (the Green Box) lists a number of domestic support policies that are exempted from reduction commitments. The Green Box policies are defined as having minimum market-distorting effects, and cover *inter alia* general services (e.g. research, pest and disease control, training, inspection, marketing and infrastructure), food security stocks,[8] domestic food aid, disaster relief, environmental programmes and regional assistance. However, a number of Green Box policies, especially those measures that entail decoupled income support to producers, are rare in LDCs. This is because, in part, they require an administrative capacity for designing and implementing targeted policies that is seldom available. Moreover, the extent of such policies is likely to be limited by budgetary constraints and not by the Agreement on Agriculture.

Provisions related to protecting domestic production from depressed world market prices and a surge in imports

A related concern of the LDCs is that a more open trade regime may render domestic production sectors more vulnerable to developments such as depressed world prices and/or a surge in imports, threatening domestic production, particularly of sensitive food commodities. A more open economy could also make domestic markets more volatile, hurting consumers, especially low-income ones. Before the Uruguay Round, countries could apply non-tariff measures such as import bans, and could usually vary import duties as well. Under the Uruguay Round, however, non-tariff measures are not allowed and the levels of ordinary tariffs should not exceed bound limits.

A majority of developing countries, including the LDCs, offered relatively high bound tariffs. This provides some flexibility in the sense that it allows a country to raise tariffs when it faces external threats such as those noted above. On the other hand, most developing countries and the least developed countries will not technically qualify for the use of the Special Safeguard Clause (which can be invoked in the event of depressed world prices and a surge in imports), as most of their products were not subject to the tariffication process (Valdes and McCalla, 1996, p. 425). Thus, in practice, whereas those LDCs which offered high ceiling bindings might have some protection, others which bound tariffs at lower levels may face difficulties from two sources. First, they cannot raise tariffs above the bound levels, and second, they do not have the option of recourse to the Special Safeguard Clause.

Another instrument of supply stability that is allowed by the Agreement on Agriculture is food security stocks. Although it is not clear whether these stocks could be used as an instrument for extensive price stabilization, they can be used to address specific food security objectives. The LDCs, as well as developing countries as a whole, are given some special treatment in the procurement and release of such stocks.

Provisions related to food import difficulties

The Uruguay Round also includes a provision aimed at providing some compensation to LDCs and net food-importing countries in the event that they face difficulties related to higher world market prices resulting from trade liberalization under the Uruguay Round. This is addressed under the Ministerial Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries. The Singapore Ministerial Conference (SMC) of the WTO endorsed a number of possible specific actions to be taken by WTO Members in relation to the implementation of the modalities of assistance under this Decision.

Provisions related to technical assistance to increase food production and agricultural exports

The Uruguay Round made provisions for technical and financial assistance in many areas. For example, the Ministerial Decision on Measures in Favour of Least Developed Countries states that "the LDCs shall be accorded substantially increased technical assistance in the development, strengthening and diversification of their production and export bases including those of services, as well as in trade promotion, to enable them to maximize the benefits from liberalized access to markets". Provision was also made in other Uruguay Round Agreements and Decisions for technical and financial assistance to improve *inter alia* LDCs' agricultural productivity and infrastructure, e.g. the Agreement on SPS, and the other Ministerial Decision referred to earlier.

The SMC adopted the WTO Plan of Action for LDCs, which includes measures in the areas of capacity building and market access. The preparatory process for a High-Level Meeting of LDCs and international development agencies to actualize the Plan is currently under way. If Integrated Technical Assistance programmes being envisaged as the outcome of the High-Level Meeting materialize, they should go a long way to enhancing the competitiveness and diversification of LDCs' agriculture and exports in general.

The role of trade as a key element in achieving world food security was given added prominence in Commitment 4 of the *World Food Summit Plan of Action*, whereby the Heads of State and Government pledged to strive to ensure that food, agricultural trade and overall trade policies are conducive to fostering food security for all through a fair and market-oriented world trade system. They agreed that the progressive implementation of the Uruguay Round Agreement as a whole would generate increasing opportunities for trade expansion and economic growth for the benefits of all participants, and therefore adaptation to the provisions of the various agreements during the implementation period had to be ensured. The Plan of Action calls for the full implementation of the Ministerial Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries, recognizing that some least developed and net food-importing developing countries may experience short-term negative effects in terms of availability of adequate supplies of basic foodstuffs from external sources on reasonable terms and conditions, including short-term difficulties in financing normal levels of commercial imports of basic foodstuffs.

G. Conclusions

The impact of the Uruguay Round on traditional export commodities, which constitute the bulk of LDCs' agricultural exports, is likely to be modest because the URAA turned out to be less comprehensive than was anticipated when negotiations began. Significant reforms of the rules governing agricultural regimes in developed countries were achieved, but the degree of trade liberalization attained was limited. For example, uneven product coverage and limited liberalization in sugar and meat will restrict horizontal diversification possibilities for LDCs such as Zambia.

While tariff escalation has decreased generally, considerable tariff escalation still exists for a number of product chains, in particular those important to developing and least developed countries. The SPS and TBT Agreements have increased the transparency of the rules governing the application of sanitary and phytosanitary standards. This should be to the advantage of LDCs, but only if they are able to access the necessary technical assistance to enable them to meet the high standards set under those Agreements. The potential for vertical diversification into processed agricultural products by LDCs is therefore likely to be restricted to some extent by tariff escalation and the SPS and TBT Agreements.

The URAA is not too restrictive for LDCs in terms of supportive policies for agriculture: the AMS, which is not product-specific, guarantees flexibility in domestic agricultural support policies as long as global commitments reflected in the individual country schedules are not exceeded. Thus, there is enough room for the use of consumption support policies and other measures to mitigate the impact of world market volatility on domestic markets.

The special and differential treatment clauses incorporated in the various Agreements of the Uruguay Round itself, and the provisions in the Marrakesh Ministerial Decisions, may ease the transition process for the LDCs if two conditions are met. First, there must be a willingness on the part of LDC governments to undertake the necessary policy reforms in compliance with the URAA. Second, there must be the willingness and capability on the part of developed countries to provide the necessary financial and technical assistance to LDCs in support of policy reforms, e.g. to provide complementary infrastructure and to increase agricultural productivity.

The ultimate long-term benefits for LDCs as a result of improved market access depend on whether financial and technical assistance by the developed countries to the LDCs materializes.

Those LDCs able to make the necessary adjustments to their production structures, overcome their supply-side constraints and implement outward-oriented policy measures will be better placed to respond positively to the new agricultural regime. Within this context, LDCs currently implementing structural adjustment programmes (SAPs) may have some advantage over the others. Nevertheless, the possible long-term benefits for LDCs depend on whether financial and technical assistance by the developed countries to the LDCs materializes, as well as on the pace and quality of implementation of the URAA by the developed countries – that is, on whether major importers implement agreed commitments in full and change their import regimes and domestic agricultural policies accordingly. This has yet to be demonstrated and is almost impossible to predict. Despite this, the accomplishments of the URAA are of great potential significance for international agricultural trade. First, it has brought agriculture under comprehensive, multilateral discipline for the first time. Second, it has transformed a multiplicity of pre-Uruguay Round barriers facing international trade in agricultural products into transparent, albeit high and bound, tariffs. Third, and most important of all, the escalating costs of domestic support and export subsidies that impeded the efficient allocation of resources by the international market have been brought under control (UNCTAD, 1995b, p. 6).

Notes

1 For UNCTAD's analysis of the evolution of the prices of and trade in commodities to be expected in the light of the results of the Uruguay Round, with particular emphasis on their implications for developing countries, including their diversification prospects, see UNCTAD, 1995b. For the FAO's medium-term outlook on agricultural commodity markets, also including the effects of the Uruguay Round, see FAO, 1995.

2 As yet, it is unclear how the recent ruling by the WTO that the EU banana quota system violates the Uruguay Round Agreement will affect developing countries that are beneficiaries of the system.

3 For an account of the EU trade regime for fresh fruits and vegetables, see Swinbank and Ritson, 1994.

4 These are wheat, rice, coarse grains, vegetable oils and fats, oil cakes, meat and dairy products.

5 The analysis is based on estimates of import demand price and income elasticities (including for competing domestic commodities), and projecting this demand to the year 2000, taking into account the reduced import tariffs as committed under the Uruguay Round.

6 The Aggregate Measurement of Support refers to annual total domestic, product-specific and non-product-specific expenditure in support of agricultural producers provided by policies not banned by the URAA. It includes the value of any market price support provided in the case of administered prices, estimated using external reference prices. "Base AMS" is the AMS calculated for the base period, 1986-1988, and "current AMS" is calculated for every year during implementation of the URAA.

7 The majority of developing countries (61 out of 71) reported zero AMS. Some of them felt that their policies qualify as Green Box policies (Konandreas and Greenfield, 1996, p. 437).

8 When purchases are made to build up food security stocks at administered prices above the external reference prices, this difference has to be accounted for in the country's current AMS. However, the difference between the release price and the external difference price is not required to be included in the current AMS.

References

FAO (1995). *The Impact of the Uruguay Round*, Rome, FAO.

FAO (1996). "The Uruguay Round and processed agricultural products", document submitted to the 123rd Session of the Committee for Agriculture, AGR/CA(96)23, November.

GATT (1994a). *Uruguay Round of Multilateral Trade Negotiations: Legal Instruments Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations Done at Marrakesh on 15 April 1994*, Geneva, GATT.

GATT (1994b). *The Results of the Uruguay Round of Multilateral Trade Negotiations: Market Access for Goods and Services*, Geneva, GATT.

Greenfield, J. and P. Konandreas (1996). "Introduction: An overview of the issues", *Food Policy*, vol. 21, No. 4/5, pp. 345-350.

Konandreas, P. and J. Greenfield (1996). "Uruguay Round commitments on domestic support: Their implications for developing countries", *Food Policy*, vol. 21, No. 4/5, pp. 433-446.

Koroma, S. (1997). *Prospects for Non-traditional Agricultural Commodities: A Case Study of the Likely Impact of the Uruguay Round on Imports by the European Union, the United States and Japan*, Commodities and Trade Division, Rome, FAO.

Lindland, J. (1997). *The Impact of the Uruguay Round on Tariff Escalation in Agricultural Products*, Commodities and Trade Division, Rome, FAO.

Swinbank, A. and C. Ritson (1994). *Implications of the Uruguay Round for European Union Trade with Third Countries with Special Reference to Fresh Fruit and Vegetable Trade with the Near East*, Document RNEA/807/EC/3, Commodities and Trade Division, Rome, FAO.

UNCTAD (1993). "The role of GSP in improving LDCs' access to market: Some recent developments" (TD/B/39(2)/CRP.7), Geneva.

UNCTAD (1994). *The Outcome of the Uruguay Round: An Initial Assessment*, Supporting Papers to the *Trade and Development Report, 1994* (UNCTAD/TDR/14) (Supplement) (United Nations publication, Sales No. E.94.II.D.28), New York.

UNCTAD (1995a). "Some perspectives on agricultural protectionism, diversification and economic growth" (UNCTAD/Com/68), Geneva.

UNCTAD (1995b). "The Uruguay Round and international commodity trade and prices" (TD/B/CN.1/30), Geneva, August.

UNCTAD (1996). *The Least Developed Countries, 1996 Report* (TD/B/42/(2)/11) (United Nations publication, Sales No. E.96.II.D.3), New York and Geneva.

Valdes A. and A. F. McCalla (1996). "The Uruguay Round and the agricultural policies in developing countries and economies in transition", *Food Policy*, vol. 21, No. 4/5, pp. 419-431.