Aid, private capital flows and external debt: a review of trends

Chapter

2

A. Introduction

As the last chapter has shown, the central accumulation processes of the LDC economies are dominated by external sources of finance. In the long term, if economic growth can be successfully sustained, it is reasonable to expect that domestic resource mobilization will be considerably strengthened, and it is important that policy efforts seek to accelerate this process. But for the immediate future, the basic policy issue which must be addressed in relation to financing development in LDCs is whether external finance is both sufficient for, and supportive of, economic growth, poverty reduction and sustained development. In addressing this question, it is helpful first to consider the sources of external finance and the form they take. The possible sources of finance include, on the one hand, official capital flows in the form of grants or loans, provided by bilateral and multilateral aid agencies, packaged with or without technical assistance, and on the other hand, private capital flows from banks, capital markets, companies and individuals, which take the form of short- and long-term loans, acceptance of company and government bonds, and portfolio and direct investment. These capital inflows may or may not be debt-creating, and net capital outflows generated by residents may also reduce total resources available for finance, offsetting net capital inflows generated by non-residents.

This chapter describes trends in the scale and composition of long-term net capital inflows into the LDCs (section B), and examines in more detail trends in aid (section C), and in private capital inflows (section D). Section E describes trends in external debt stocks and debt service payments, whilst section F focuses on the aggregate net transfers to the LDCs, including the role of debt relief and accumulation of arrears on debt service in maintaining positive net transfers to the LDCs.

Long-term net capital inflows into LDCs as a whole have declined by about 25 per cent in nominal terms since 1990.

Each of these types of flows has different developmental implications. But the purpose of this chapter is not to address this, but rather to set the stage for the subsequent chapters. Definitions of some of the key terms used in the chapter, and data sources, are set out in box 2.[1]

B. Trends in long-term net capital inflows

1. Scale of long-term net capital inflows

Long-term net capital inflows into LDCs as a whole have declined by about 25 per cent in nominal terms since 1990. According to World Bank statistics, the level of such inflows was $10.4 billion in 1998, down from a peak of $14.2 billion was reached in 1991 (table 12). The decline is sharper in real terms. If the import price index of LDCs is used to deflate current values (i.e to express them in terms of their purchasing power over foreign goods), long-term capital inflows

Box 2: Definitions and data sources for international capital flows

Different institutions and writers use different terms to refer to different categories of international capital flows. The analysis in this chapter focuses mainly on what the World Bank in its publication *Global Development Finance* refers to as *aggregate net resource flows*. This consists of net resource flows on loans with a maturity of more than one year (loan disbursements minus principal repayment), net foreign direct investment (FDI), portfolio equity flows and official grants. Short-term debt flows are excluded from consideration. Within the text, the term *long-term net capital inflows* is used interchangeably the term with *aggregate net resource flows*. The term *aggregate net transfers* refers, again following the World Bank convention in *Global Development Finance*, to aggregate net resource flows less interest payments and profit remittances.

Data on aid flows are published by the OECD in the *DAC Development Report* and by the World Bank in *Global Development Finance*. The term *official development assistance* is used by the OECD to refer to "grants and loans to countries and territories on Part I of the DAC list of Aid Recipients (developing countries) which are: undertaken by the official sector; with the promotion of economic development and welfare as the major objective; at concessional financial terms (if a loan having a grant element of at least 25 per cent) (OECD, 2000: 262)". The grant element of loans is calculated using a discount rate of 10 per cent. The World Bank uses the term *concessional flows* to refer to grants and loans (those that are directly developmental in intent as well as those that are trade-related) with at least a 25 per cent grant element (using a discount rate of 10 per cent). This excludes technical cooperation grants, which are included in ODA. Differences in data sources, coverage and the way in which debt forgiveness is treated also lead to different estimates of official flows[1].

The present chapter uses *Global Development Finance* data to describe trends in the scale and composition of long-term net capital inflows. Trends in total aid flows and their use are examined on the basis of OECD data, but the analysis of the relative importance of official sources in long-term net capital flows and of the relative importance of different kinds of concessional flows in official capital inflows is based on World Bank sources and definitions.

Ideally, analysis of capital flows should encompass both the acquisition (and sale) of domestic assets by non-residents and the acquisition (and sale) of foreign assets by non-residents (see UNCTAD, 1999: box 5.1). Information on capital outflows is available in the IMF *Balance of Payments Statistics*. Unfortunately, the sample of LDCs with good balance-of-payments statistics makes it difficult to generalize about capital outflows.[1]

Finally, the reader should be aware that the statistical annex to this Report has been prepared from the same data sources as in past years in order to ensure that the figures in the annex are fully compatible with those of earlier Reports. Tables 19 to 29 of the statistical annex, on financial flows, net ODA and debt, are all based on OECD/DAC sources, which diverge somewhat from the World Bank figures used in the present chapter.

[1] For full discussion of these differences, see World Bank (1999: 78-80).

Table 12: LDCs: Long-term net capital inflow by type of flow, and aggregate net transfers, 1988–1998
(in million dollars)

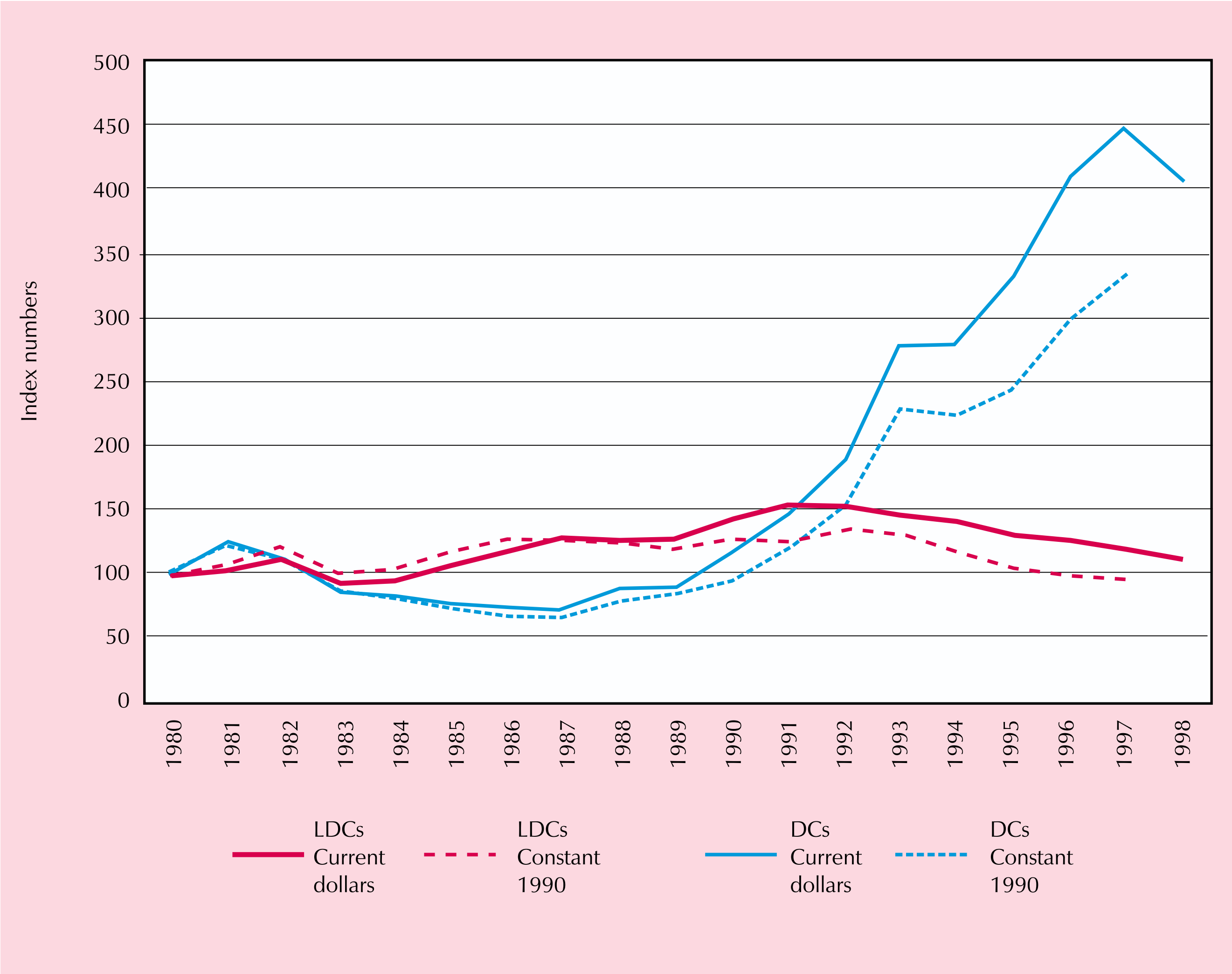
	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Aggregate net resource flows	12 100	11 978	13 388	14 214	14 157	13 563	13 124	12 253	11 760	11 145	10 403
Official net resource flows	10 850	11 025	12 607	12 283	12 290	11 285	12 138	11 193	9 969	9 078	9 054
Grants[a]	6 207	6 276	8 322	8 886	8 683	7 992	9 140	8 725	6 674	6 379	6 984
Other official flows	4 643	4 749	4 285	3 396	3 607	3 293	2 998	2 469	3 295	2 698	2 070
Private net resource flows	1 249	953	782	1 931	1 867	2 278	986	1 061	1 791	2 067	1 274
Net FDI	279	517	83	1 799	1 460	1 748	849	1 078	1 809	1 425	1 593
Portfolio equity flows	-	-	-	-	-	-	77	49	40	8	27
Net private debt flows	970	436	699	132	407	530	60	-67	-58	634	-345
Interest payments, total	1 693	1 567	1 492	1 565	1 145	1 260	1 265	1 705	1 399	1 431	1 452
Profit remittances on FDI	405	516	675	583	668	684	708	723	674	739	773
Aggregate net transfers	10 504	10 323	11 653	12 451	12 645	11 894	11 394	10 432	9 867	9 182	8 376

Source: UNCTAD secretariat estimates based on World Bank, *Global Development Finance 2000* (CD-ROM).
a Excluding technical cooperation.

into LDCs are now back to the level of 1980 (chart 24). Moreover, in per capita terms, real capital inflows were down to $17 per person in 1997. This constitutes a drop of 39 per cent since 1990.

The downward trend in the 1990s represents a reversal of the trend in the 1980s, which, after the slump associated with the debt crisis, rose between 1983 and 1991. This is in complete contrast to what has happened in other developing countries. After the debt crisis, capital inflows into such countries took much longer to recover than inflows into LDCs. Thus, by 1989, whilst capital inflows into LDCs were 40 per cent above their 1983 level in nominal terms, capital inflows into other developing countries were only 5 per cent above their 1983 level. However, between 1990 and 1997, capital inflows into other developing countries increased by 285 per cent in nominal terms and 247 per cent in real terms, whilst they declined in LDCs (chart 24). Most LDCs were less affected than other developing countries by the impact of the Asian financial crisis on capital flows. But the steady downward trend in long-term net capital inflows into LDCs has continued.

CHART 24: LONG-TERM NET CAPITAL INFLOWS INTO THE LDCS AND OTHER DCS, 1980–1998
(Index numbers, 1980=100)



Source: As for table 12.
Notes: 1. For definition of net capital inflows, see box 2.
2. The deflator used to estimate real aggregate net resource flows is UNCTAD's unit price of imports index.

2. Composition of long-term net capital inflows

The downward trend is the result of declining aid flows, coupled with the failure of most LDCs to attract sufficient private capital inflows to offset the decline. Other developing countries are increasingly relying on international flows of private capital as a key component of their development strategy. But whilst private capital inflows into other developing countries have, with some violent gyrations, grown exponentially in the 1990s, they have been increasing very slowly in most LDCs.

A historical perspective shows that LDCs have always been more dependent than other developing countries on official financing. This was apparent in the period from 1975 to 1982, when private capital constituted only 13 per cent of long-term capital inflows into LDCs in comparison with 55 per cent in other developing countries (chart 25). But this difference has been accentuated, particularly in the 1990s. In LDCs the share of official finance in total capital inflows increased to about 89 per cent of long-term flows in the period 1983–1989 and has remained at that level in the 1990s. At the same time, the share of official finance in total capital inflows into other developing countries has become progressively smaller. With the surge in private capital flows in the 1990s, private capital inflows have come to account for over 80 per cent of the aggregate net capital inflows into these countries in the 1990s.

The downward trend in long-term net capital inflows is the result of declining aid flows, coupled with the failure of most LDCs to attract sufficient private capital inflows to offset the decline.

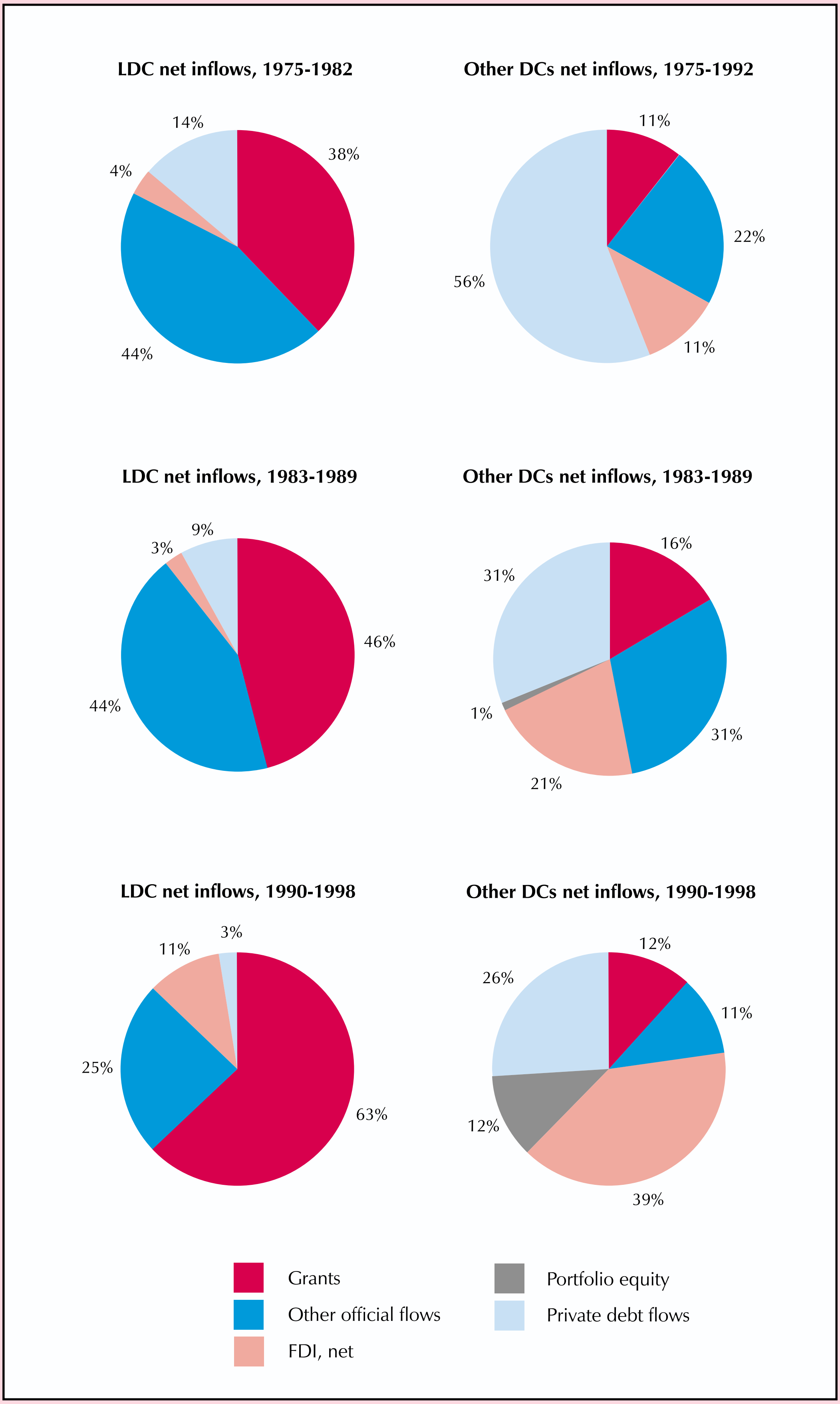
The small share of private capital in aggregate long-term capital flows to LDCs represents a general pattern. In the period 1990–1998, private flows constituted on average over 10 per cent of annual inflows into only 13 countries. Three of those countries (Angola, Equatorial Guinea, and Myanmar) are oil or gas exporters and four (Vanuatu, Solomon Islands, Maldives and Samoa) are island economies. The other six are Cambodia and the Lao People's Democratic Republic in Asia, and the Gambia, Lesotho, Liberia and Uganda in Africa (chart 26).

3. LDC share of long-term net capital inflows into developing countries

These trends in the scale and composition of capital inflows have had significant effects on the share of aggregate net resource flows, and of flows of specific types, going to LDCs. Given the reliance of LDCs on official flows, the LDC share of long-term capital inflows into developing countries actually increased in the 1980s, from 11 per cent to 18 per cent of total capital inflows into those countries. But since 1987, as private capital flows have surged and come to dominate total resource flows to developing countries and official flows have either stagnated or declined, the LDC share in aggregate flows has fallen equally dramatically. After peaking in 1987 at 18 per cent, the share has fallen to less than 4 per cent of capital inflows into developing countries (chart 27).

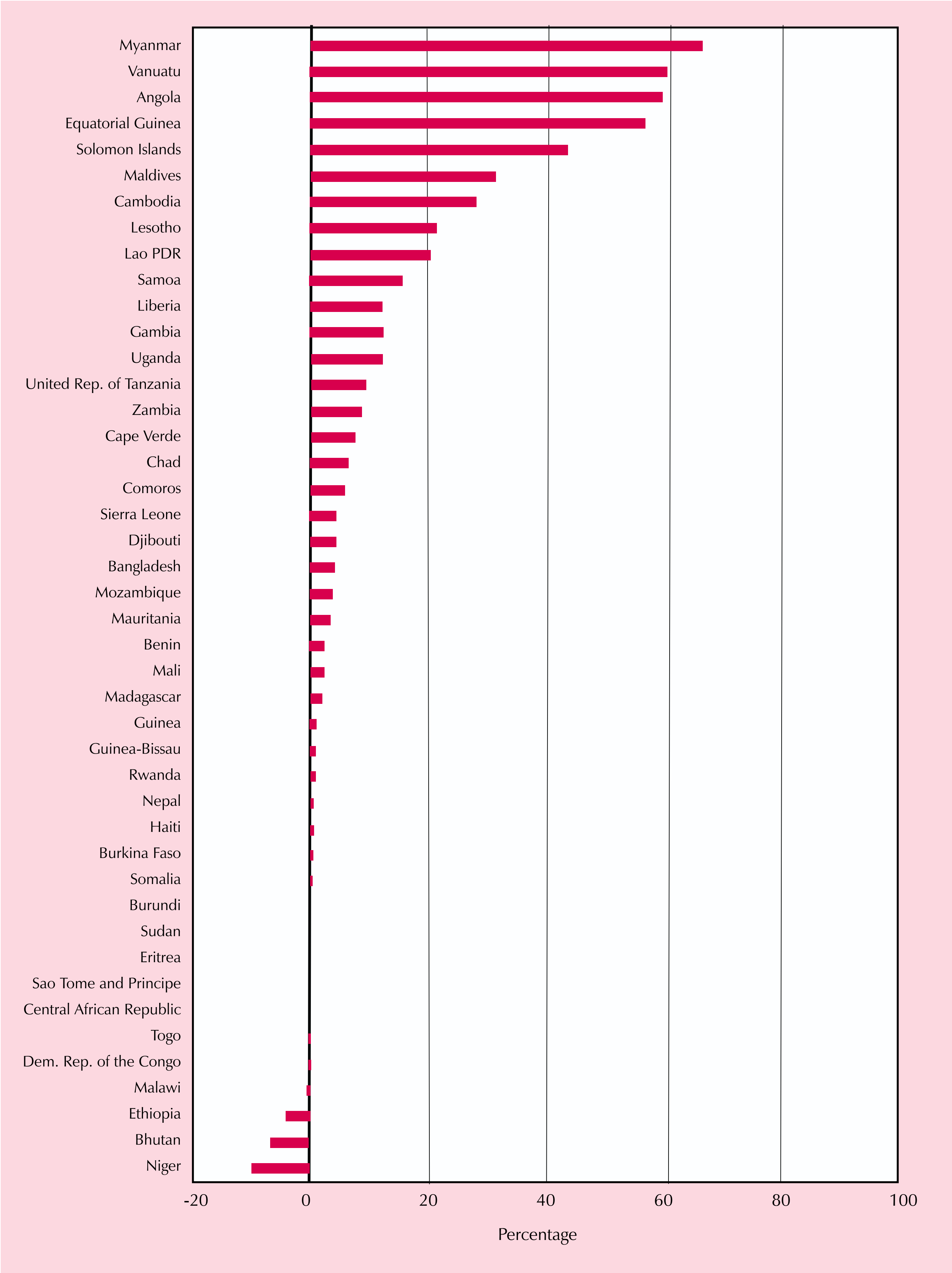
With regard to specific components of capital inflows, the share received by LDCs is highest for grants. The share of FDI received by LDCs fell from 3.6 per cent in the period 1975–1982 to 1.4 per cent in the 1990s. Moreover, LDCs are largely rationed out of portfolio equity flows and commercial loans without a government guarantee (table 13).

CHART 25: LONG-TERM NET CAPITAL INFLOW BY TYPE OF FLOW, 1975–1998: LDCs AND OTHER DCs
(Average annual percentage of aggregate net inflow)



Source and definitions: See table 12.

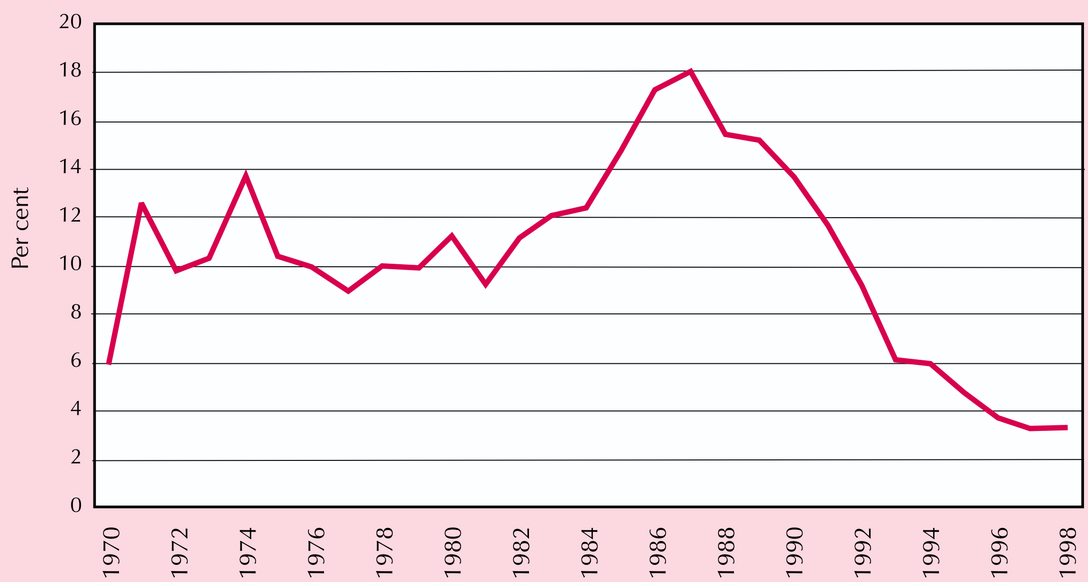
CHART 26: LONG-TERM PRIVATE NET CAPITAL INFLOWS INTO THE LDCS, FROM PRIVATE SOURCES, BY COUNTRY, 1990–1998
(Average annual percentage of aggregate net capital inflows)



Source: As for table 12.

Chart 27: LDCs' share of long-term net capital inflows into all DCs, 1970–1998

(Percentage)



Source: As for table 12.

Table 13: Official and private long-term net capital inflows[a] in the LDCs and Other DCs, 1975–1998

(Annual average)

	1975–1982			*1983–1989*			*1990–1998*		
	All DCs	LDCs	LDC share	All DCs	LDCs	LDC share	All DCs	LDCs	LDC share
	$ millions		*%*	*$ millions*		*%*	*$ millions*		*%*
Official net resource flows	26 291.9	5 828.5	**21.8**	37 962.1	9 454.6	**24.8**	48 325.2	11 107.9	**23.6**
Grants, excl. technical cooperation	9 160.4	2 666.0	**28.7**	14 806.4	4 895.8	**32.9**	28 536.8	7 976.1	**27.9**
Multilateral net flows	6 736.0	1 038.1	**15.3**	12 037.4	2 272.5	**18.9**	15 133.6	2 832.3	**20.5**
Bilateral net flows	10 395.5	2 124.4	**20.1**	11 118.3	2 286.3	**20.7**	4 654.9	299.5	**3.1**
Private net resource flows	42 566.8	1 184.5	**2.9**	32 747.6	1 119.8	**3.7**	176 310.4	1 559.5	**1.2**
Foreign direct investment, net inflows	7 194.8	256.3	**4.3**	13 266.7	281.4	**2.0**	91 724.2	1 315.9	**1.8**
Portfolio equity flows	23.5	0.0	**0.0**	595.9	0.0	**0.0**	26 715.0	22.3	**0.1**
Total commercial banks net flows	26 333.5	230.5	**1.5**	10 017.4	16.0	**-2.0**	22 332.9	98.7	**-2.5**
PPG[b], commercial banks net flows	18 369.2	196.8	**1.0**	11 065.0	10.7	**-1.5**	2 382.2	114.7	**-2.3**
PNG[c], commercial banks net flows	7 964.3	33.7	**0.5**	-1 047.6	5.3	**-0.5**	19 950.7	-16.0	**-0.2**
Total bonds net flows	2 001.7	-2.2	**-0.3**	1 901.4	0.2	**0.0**	31 085.9	-0.2	**0.0**
PPG[b], bonds net flows	2 001.7	-2.2	**-0.3**	1 883.3	0.2	**0.0**	17 413.4	-0.2	**0.0**
PNG[c], bonds net flows	0.0	0.0	**..**	18.1	0.0	**0.0**	13 672.4	0.0	**0.0**
PPG[b], other private creditors net flows	7 013.2	700.0	**10.8**	6 966.1	822.2	**11.8**	4 452.4	122.7	**-2.5**

Source: See table 12.
a Net flows are disbursments minus principal repayments.
b PPG flows are public and publicly guaranteed flows.
c PNG flows are private nonguaranteed flows.

C. Trends in aid flows

1. The scale and uses of official development assistance (ODA)

Aid flows to LDCs, as measured by the share of net ODA disbursements in donors' GNP, have almost halved in the 1990s. At the start of the decade, the total ODA of DAC countries to LDCs stood at 0.09 per cent of their combined GNP, whilst in 1998 it was down to 0.05 per cent. The latter ratio was the same as in 1997, but between 1997 and 1998 ODA to LDCs contracted as a proportion of GNP in 10 out of 21 DAC countries. As chart 28 shows, in 1998 only five countries met the special targets for ODA to LDCs as a percentage of GNP which had been set in the Programme of Action for the LDCs for the 1990s – Norway (0.34 per cent), Denmark (0.32 per cent), the Netherlands (0.21 per cent), Sweden (0.20 per cent) and Luxembourg (0.17 per cent). On the positive side, Belgium, Denmark, Italy, Luxembourg and the United Kingdom all improved their performance from 1997 to 1998. Moreover, in nominal terms, Japan remained the most important donor to LDCs in 1998 (with a net ODA contribution of over $1.5 billion), followed by the United States, Germany and France, which each contributed more than $1 billion ODA to the LDCs.

In real per capita terms, net ODA to LDCs has dropped by 45 per cent in the 1990s and is now back to the levels it was at in the early 1970s.

Annual gross ODA disbursements to LDCs in the period 1997–1998 were 23 per cent lower than during the period 1990–1995. Thirty-seven out of the 48 LDCs, including 29 of the 33 African LDCs, received lower annual gross ODA disbursements in 1997–1998 than in the period 1990–1995. Net ODA from DAC countries is estimated to have been $12.1 billion in 1998, down from $12.6 billion in 1997. The decline contrasts with the more positive developments in ODA to developing countries as a whole in 1998. Net ODA to all developing countries increased by almost $2 billion from 1997 to 1998, breaking the steady decline since 1995. For the LDCs, the decline in 1998 was the third year of uninterrupted declines, representing a reduction of more than $4.5 billion since 1995.

From a longer-term perspective, it is apparent that in nominal terms there was an increase in net ODA to LDCs in the second half of the 1980s. In fact, net ODA increased by 73 per cent in nominal terms over the period 1985–1990. The post-1995 decline reverses this trend, taking net ODA back to beneath the level it was at in nominal terms in 1987. In real per capita terms, net ODA to LDCs has dropped by 45 per cent in the 1990s and is now back to the levels it was at in the early 1970s (chart 29).

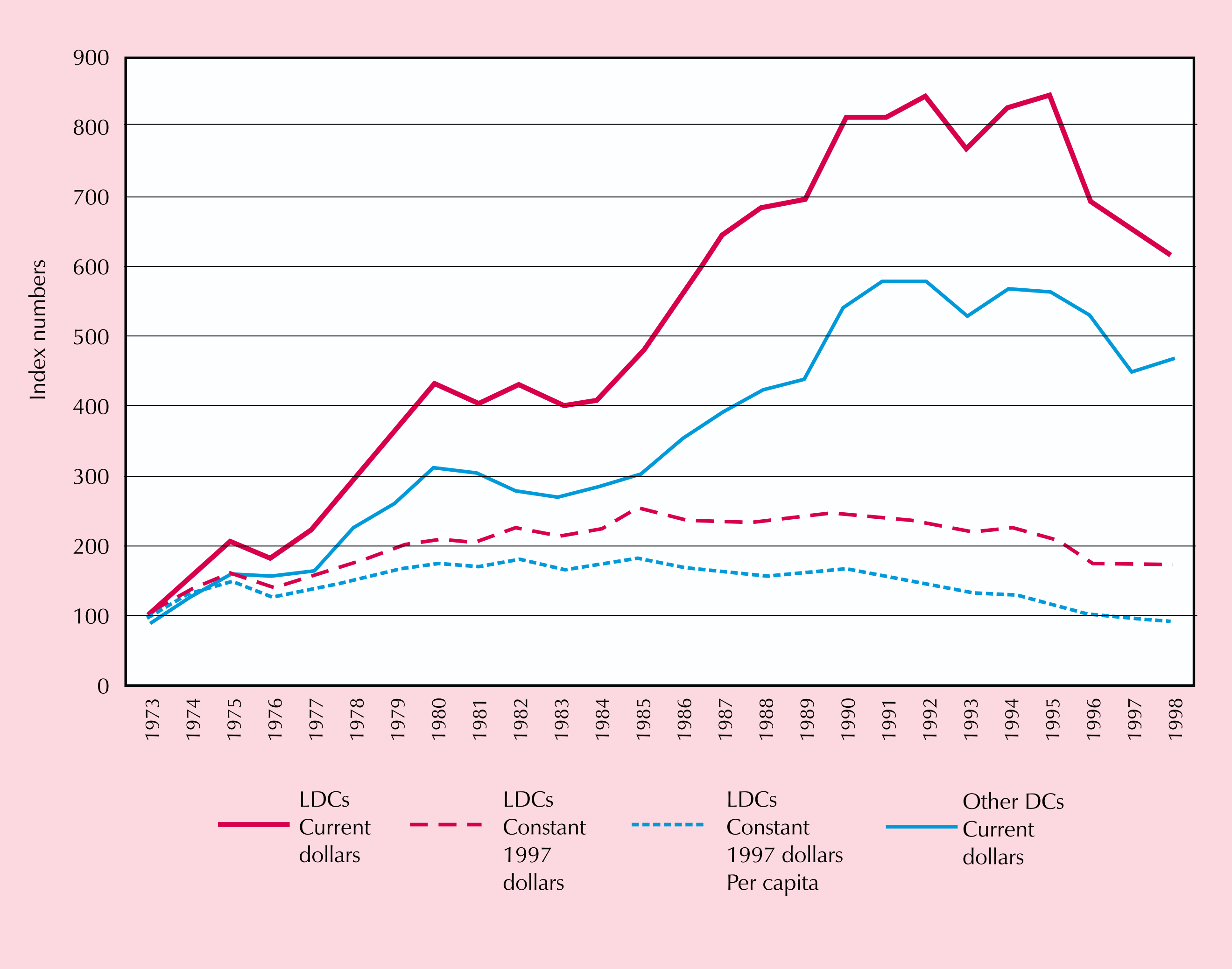
Together with the decline in ODA to LDCs in the 1990s, there has been a shift in the purposes to which ODA is committed. Table 14 gives a breakdown of net ODA commitments to LDCs by purpose since the early 1980s.[2] It shows that the proportion of ODA commitments devoted to social infrastructure and services has increased significantly, up from 14 per cent of ODA commitments in 1985–1989 to 33 per cent in 1995–1998. At the same time, commitments to economic infrastructure and services, productive infrastructure and multisectoral projects have fallen from 59 per cent to 39 per cent. The other significant feature of the 1990s is the increase in grants in the form of debt forgiveness and emergency aid. Indeed, the most rapidly growing segments of the shrinking ODA budgets during the 1990s have been emergency relief and debt forgiveness grants. In 23 of the LDCs, they accounted for 10 per cent or more of ODA grant commitments during 1995–1998, while 11 countries had levels of 25 per cent or more of their aid.

CHART 28: NET ODA TO THE LDCS FROM DAC MEMBER COUNTRIES: 1990, 1994 AND 1998

(Percentage of donor's GNP)

Source: UNCTAD secretariat estimated based on OECD/DAC data.

CHART 29: NET ODA DISBURSEMENTS FROM DAC MEMBER COUNTRIES TO THE LDCS AND OTHER DCS, 1973–1998
(Index numbers, 1973=100)



Source: See chart 28.
Note: The deflator used to calculate net ODA disbursements in constant dollars is the OECD/DAC deflator.

TABLE 14: NET ODA COMMITMENTS TO THE LDCS, BY MAJOR PURPOSES, 1980–1998
(percentage of total commitments)

	1980–1984	1985–1989	1990–1994	1995–1998
Social Infrastructure	13.0	13.8	21.8	32.8
Economic, Production Multisector	58.8	58.2	50.1	39.0
Emergency and Debt	6.7	5.9	12.9	15.9
Programme Aid[a]	10.2	14.3	11.7	9.6
Other	11.3	7.7	3.5	2.8
Total	100.0	100.0	100.0	100.0

Source: See Chart 28.

a Programme aid excludes food aid.

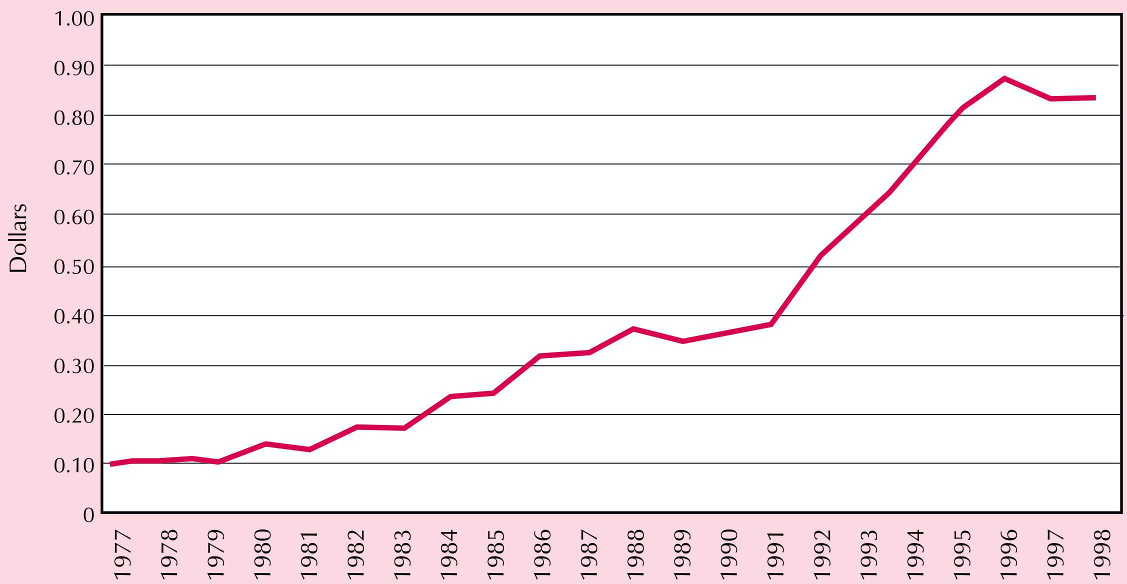
As chart 30 shows, per capita emergency aid increased sharply in the 1990s. In some countries this was related to the eruption or acceleration of armed conflicts or external intervention. Afghanistan, Burundi, Haiti, Liberia, Rwanda, Somalia and Sudan all experienced a sharp but temporary increase in emergency relief in the early 1990s for this reason. But an increasing number of LDCs became regular recipients of emergency aid in the 1990s. Between 1993 and 1998, an average of 40 of the 48 LDCs received some form of emergency relief each year, compared with an average 32 countries between 1983 and 1992 and 25 between 1973 and 1982. In 1998, debt forgiveness and emergency relief accounted for 35 per cent of bilateral ODA grant disbursements to the LDCs.

Between 1993 and 1998, an average of 40 of the 48 LDCs received some form of emergency relief each year, compared with an average 32 countries between 1983 and 1992 and 25 between 1973 and 1982.

Programme aid, excluding food aid, has remained at around 10–15 per cent of net ODA commitments since the early 1980s. Also, although it is not identified separately in the table, technical cooperation is an important component of ODA to LDCs. It has stayed steady at around 20 per cent of net ODA to the LDCs as a group since the early 1980s, with the proportion being considerably higher for some of them.

CHART 30: PER CAPITA EMERGENCY AID COMMITMENTS TO LDCs, 1973–1998

(Dollars per year)



Source: See chart 28.

Note: The actual commitments vary dramatically from year-to-year and therefore the graph uses a 5-year trailing average. For any given year, the numbers show the average annual commitments of that year and the previous 4 years.

2. The changing composition of long-term net concessional flows

There have also been major changes in the balance between multilateral and bilateral flows and also between grants and loans. Chart 31, which uses World Bank estimates of official net resource flows and their components, shows these changes for LDCs as a whole, and also for African, Asian and island LDCs. A number of trends are evident.

First, it is apparent that during the 1990s official long-term capital flows to LDCs were overwhelmingly concessional. This situation has prevailed in Asian LDCs since the early 1970s. However, during the period from 1976 to 1983, a key moment when the debt problem emerged, between 10 and 20 per cent of long-term official flows to African LDCs were non-concessional. The subsequent difference between African and Asian LDCs in terms of their external debt burden is related to the difference in official financing.

For LDCs as a whole, the relative importance of grants has increased whilst the relative importance of loans has declined.

Secondly, for LDCs as a whole, the relative importance of grants has increased whilst the relative importance of loans has declined. Grants constituted 41 per cent of total official net resource flows in 1981 compared with 77 per cent in 1998 for all LDCs. Grants had an increasing role in both African and Asian LDCs, but this role was more marked in the former, where it rose from 39 to 82 per cent of official net resource flows, than in the latter, where it was initially higher (49 per cent of official net resource flows in 1982) and rose less – to 62 per cent. For island LDCs, grants have constituted over 60 per cent of official net resource flows in almost all years since 1975.

Thirdly, for concessional loans, the relative importance of multilateral sources has increased whilst the relative importance of bilateral sources has declined. For LDCs as whole multilateral net concessional loans (excluding IMF loans) increased from 15 per cent of official net resource flows in 1982 to 28 per cent in 1998. The increase was sharpest in Asian LDCs, where net multilateral concessional lending constituted 43 per cent of official net resource flows in 1998 as compared with 23 per cent in African LDCs. Net bilateral concessional lending fell from 35 per cent of official net resource flows in 1982 to minus 1.4 per cent in 1998. This trend is apparent in African, Asian and island LDCs.

3. The economic importance of aid

A key feature of LDCs is that the size of aid flows relative to economic activity in the recipient economies is large. Some estimates of their relative size are set out in table 15, which measures ratios of net ODA to GNP, to gross domestic investment (GDI) and to imports of goods and services, as well as aid per capita, for the period 1996–1998. Estimates are presented for individual LDCs as well as averages weighted, respectively, by GNP, GDI, imports and population.[3]

From the table it is evident that there is a stark difference between the LDCs and other developing countries in terms of the role of ODA in their economies. For 1996–1998, the average ratio of net ODA to GNP (weighted by recipient GNP) for the LDCs was 9 per cent, compared with 0.4 per cent in other developing countries. In thirty-seven LDCs, aid-to-GNP ratios were equal to or higher than 9 per cent over that period. The weighted average ratio of net ODA to GDI (weighted by GDI) was 47 per cent, compared with 1.6 per cent in other developing countries. Moreover, the weighted average of net ODA to imports of goods and services (weighted by imports) was 30.5 per cent compared with 1.7 per cent in other developing countries.

CHART 31: THE COMPOSITION OF OFFICIAL NET RESOURCE FLOWS (ONRF) INTO THE LDCS, AFRICAN LDCS, ASIAN LDCS, AND ISLAND LDCS, 1970–1998
(Percentage)

Source: See table 12.

TABLE 15: AID[a] INTENSITY INDICATORS IN THE LDCS AND OTHER DCS, 1996–1998 AVERAGES

	Aid as per cent of GNP	Aid as per cent of GDI	Aid as per cent of imports (goods and services)	Aid per capita (current $)
Angola	9.3	23.2	6.4	33.4
Benin	11.0	61.8	29.8	41.6
Burkina Faso	15.8	57.6	52.2	37.6
Burundi	9.1	90.3	48.9	12.7
Central African Republic	12.2	179.7	49.5	37.0
Chad	14.6	97.6	42.7	32.7
Dem. Rep. of the Congo	2.7	32.7	6.9	3.2
Djibouti	18.6	198.2	31.1	140.8
Equatorial Guinea	9.0	8.5	3.9	63.6
Eritrea	18.5	62.9	24.5	38.3
Ethiopia	10.9	57.4	37.8	11.4
Gambia	9.4	48.9	12.0	31.7
Guinea	9.4	43.6	34.1	50.0
Guinea-Bissau	56.5	303.1	140.3	117.2
Haiti	11.5	114.1	40.6	48.9
Lesotho	7.2	14.0	7.6	43.5
Liberia	..	..	..	37.1
Madagascar	15.6	124.7	46.8	39.6
Malawi	19.8	158.2	34.9	41.3
Mali	16.5	75.4	43.3	41.3
Mauritania	22.4	112.3	40.2	93.0
Mozambique	30.2	146.3	77.0	57.7
Niger	15.2	144.9	59.8	29.8
Rwanda	21.1	135.6	78.8	47.2
Sierra Leone	17.2	206.0	61.1	28.9
Somalia	..	..	..	9.5
Sudan	2.4	..	6.7	6.8
Tanzania	13.6	83.7	40.8	30.0
Togo	9.3	60.2	16.4	31.6
Uganda	10.4	65.2	37.5	32.3
Zambia	15.8	101.2	29.4	55.6
Afghanistan	..	..	..	7.9
Bangladesh	2.7	13.1	14.6	9.4
Bhutan	17.5	33.4	32.9	81.1
Cambodia	12.1	62.3	26.9	32.5
Lao People's Dem. Republic	20.0	73.3	43.5	64.8
Myanmar	..	..	1.7	1.0
Nepal	8.3	36.0	23.1	17.9
Yemen	6.8	27.4	8.6	18.8
Cape Verde	24.6	61.6	39.8	294.6
Comoros	16.8	84.9	39.4	65.7
Kiribati	17.6	..	23.5	181.8
Maldives	9.9	..	6.6	108.3
Samoa	17.7	..	24.3	190.2
Sao Tome and Principe	94.0	202.3	179.0	263.7
Solomon Islands	12.5	..	16.6	104.4
Vanuatu	14.4	..	20.4	184.6
LDCs	9.0	47.3	30.5	21.0
African	12.0	70.6	37.0	26.8
Asian	4.6	22.6	18.6	11.5
Island	18.4	75.4	57.5	157.9
Other DCs	0.4	1.6	1.7	5.7

Source: UNCTAD estimates based on World Bank, *World Development Indicators 2000*.

a Definition (World Bank, WDI 2000): Aid is defined as the actual international transfer by the donor of financial resources or of goods or services valued at the cost to the donor, less any repayments of loan principal during the same period.

Differences are also apparent between African, Asian and island LDCs. The aid intensity ratios are highest for island LDCs, followed by the African LDCs.

D. Trends in private capital inflows

According to data contained in the World Bank's *Global Development Finance*, there was apparently no increase in private capital flows to LDCs between 1988 and 1998 (see table 12). But the figures are deceptive. A close look at them shows that the behaviour of long-term net private capital inflows into LDCs is dominated by oil and gas development in Angola, Equatorial Guinea, Myanmar and Yemen. These four countries received 80 per cent of annual private capital flows to LDCs during the period 1990–1994. If these countries are taken out of the sample, it is apparent that long-term private capital inflows have increased from $323.1 million per annum during the period 1990–1994 to $941.9 million during the period 1995-98. Average annual inflows in the late 1990s were higher than in the early 1990s for 29 out of 45 countries for which data are available. UNCTAD data also indicate higher net FDI inflows into the LDCs, and it may be that more accurate national monitoring of FDI and the proper classification of some current transfers as capital flows would show that private capital flows are even higher.[4]

Average annual private capital inflows in the late 1990s were higher than in the early 1990s for 29 out of 45 countries ...

However, although these trends are positive, large increases in private long-term capital inflows into LDCs are concentrated in just a few countries. In fact, about three fifths of the increase in private capital inflows between the early and late 1990s noted in the last paragraph have been concentrated in four countries – Cambodia, Lao People's Democratic Republic, Uganda, and the United Republic of Tanzania. Private capital generally accounts for such a small proportion of total capital inflows that even where private capital inflows have been increasing, they have been unable to offset the decline in official finance in most LDCs. As table 16 shows, there are only three LDCs in which the increase in net private capital inflows was sufficient to offset declining net official finance. Also, it is apparent that the LDCs are failing to attract certain types of private capital. In the early 1980s, long-term international bank finance to LDCs collapsed and it has failed to recover. These countries have also been bypassed by portfolio equity flows, with all the swings they generate, and by bond issues.

... Large increases in private long-term capital inflows into LDCs are concentrated in just a few countries.

Almost all the increase in long-term private capital inflows into LDCs has been driven by FDI inflows. A feature of FDI inflows into LDCs is their geographical concentration and it is this that underlies the geographical concentration of private capital flows to LDCs. This concentration of FDI flows lessened somewhat between the early and late 1990s, but not by much. Whereas about 75 per cent of net FDI inflows into LDCs was absorbed by four countries (Angola, Myanmar, Yemen and Zambia) during the period 1990–1994, the same proportion was absorbed by just eight during 1995–1998 (Angola, Bangladesh, Cambodia, Equatorial Guinea, Myanmar, Lao People's Democratic Republic, Uganda, and United Republic of Tanzania).

The economic significance of the private capital inflows into LDCs can be put in better perspective by expressing these flows as a percentage of GNP. If the oil economies are disregarded, private capital inflows constitute less than 1 per cent of LDCs' GNP over the 1990s (chart 32), compared with around 4 per cent for developing countries in general (see UNCTAD, 1999: table 5.1). Private capital inflows constitute more than 2 per cent of GNP in just a few economies. During the period 1990–1994, the only countries in which private capital inflows were more than 2 per cent of GNP were four small island economies (Maldives,

TABLE 16: DIRECTION OF CHANGE IN OFFICIAL, PRIVATE AND AGGREGATE NET RESOURCE FLOWS TO THE LDCS, BY COUNTRY, 1990 TO 1998

		Changes in official capital inflows		
		Increase	***Decrease***	
Changes in private capital inflows	***Increase***	**Bhutan** **Burkina Faso** **Cambodia** **Cape Verde** **Lao PDR** **Liberia** **Malawi** **Maldives** **Solomon Islands**	Bangladesh Benin Burundi Central African Rep. Chad Comoros Dem. Rep. of the Congo Djibouti Equatorial Guinea Ethiopia Gambia	Lesotho Madagascar Mali Mozambique Myanmar Nepal Sao Tome and Principe Togo **Uganda** **United Rep. of Tanzania** **Vanuatu**
	Decrease	**Eritrea** **Guinea** **Haiti** **Rwanda** **Sierra Leone**	Angola Guinea-Bissau Mauritania Niger Samoa	Somalia Sudan Yemen Zambia LDCs aggregate

Source: As in table 12.

Note: Countries which experienced positive change in aggregate net resource flows between 1990 and 1998 are highlighted in bold.

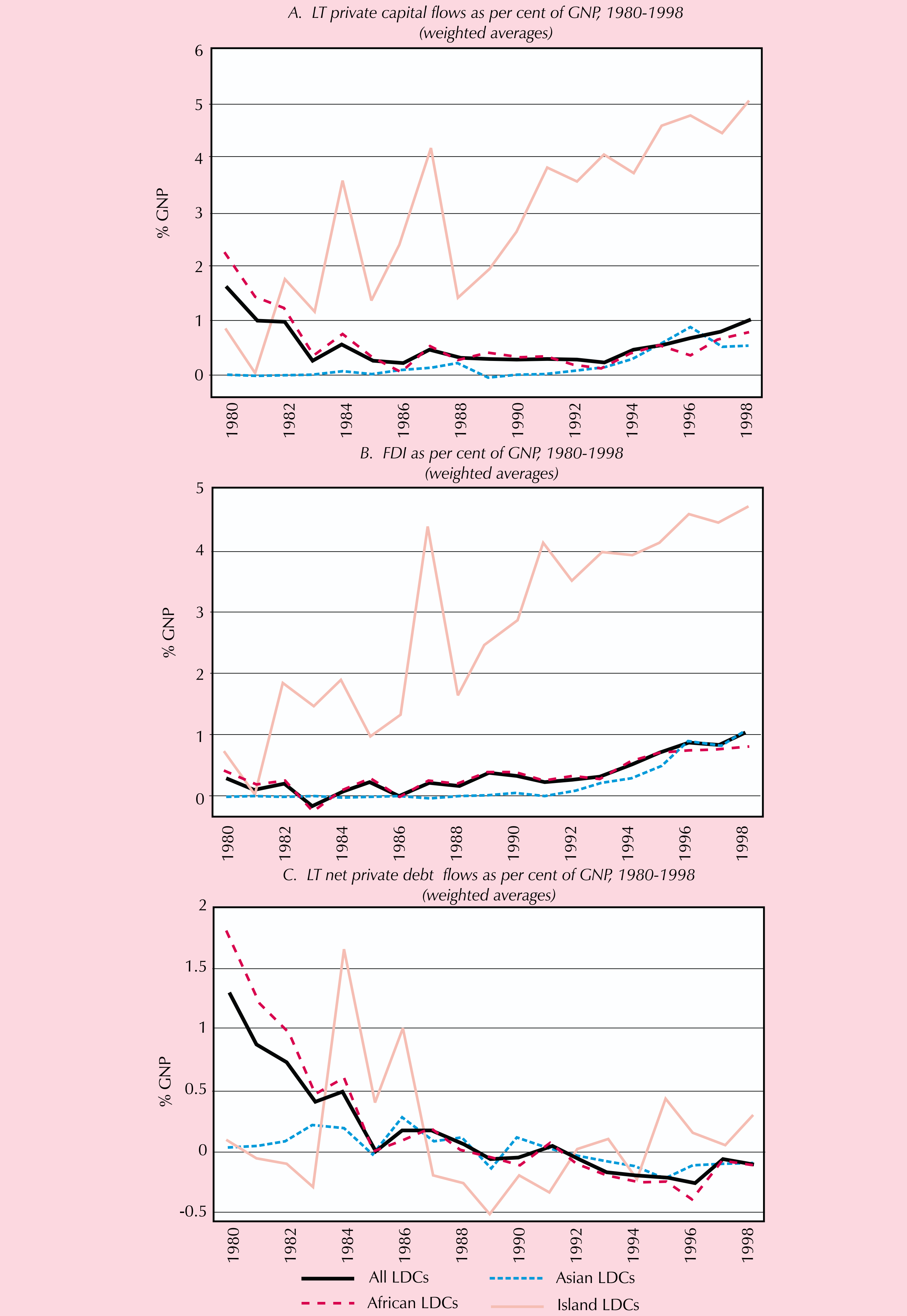
Samoa, Solomon Islands and Vanuatu), plus Zambia and the oil economies. In 1995–1998, 12 countries passed this threshold. These were the four small island economies, plus Angola and Equatorial Guinea, in all of which inflows remained above 2 per cent of GNP, together with Cambodia, Cape Verde, Lesotho, Lao People's Democratic Republic, Uganda, and the United Republic of Tanzania. Private capital inflows remained at below 1 per cent of GNP in 24 out of 40 countries.

Finally, the significance of long-term private capital inflows for LDCs can be put in perspective by comparing their scale with private current transfers, the main component of which is workers' remittances.[5] The developmental impact of these transfers is more uncertain than that of long-term capital inflows. Although they can make an important positive contribution to the current account of the balance of payments, they may be more oriented to consumption and housing investment than developing productive capacities, and they are subject to uncontrollable volatility, associated with the policies in the countries to which migrant workers have moved. But in the period 1995–1998, in spite of the increasing long-term private capital flows during the 1990s, annual inflows in the form of private current transfers exceeded long-term private capital inflows in two thirds (17) out of 25 LDCs for which data are available. Moreover, they constituted over 2 per cent of GNP in almost half of these countries.

E. Trends in external debt

External indebtedness began to be a problem in LDCs in the late 1970s, and following the second oil price shock, rising interest rates and economic recession in industrial countries in the early 1980s, the problem escalated. In 1976, only 2 out of 28 LDCs for which data are available had external debt-to-GDP ratios of

CHART 32: TRENDS IN PRIVATE CAPITAL INFLOWS INTO THE LDCS, AFRICAN LDCS, ASIAN LDCS, AND ISLAND LDCS, 1980–1998
(Percentage of GNP)



Source: See table 12. a Excluding Afghanistan, Angola, Equatorial Guinea, Eritrea, Kiribati, Liberia, Myanmar, Sao Tome and Principe, Somalia, Tuvalu and Yemen. *Note:* LT flows refer to long-term flows.

over 50 per cent and external debt-to-export ratios higher than 200 per cent, but by 1982 over half of the LDCs were in this situation, and by 1987 two thirds of the LDCs for which data were available had levels of indebtedness beyond these thresholds.[6] In that year, 19 LDCs had been to the Paris Club to reschedule their debts. Most of those experiencing debt problems were African LDCs, a fact which is related to patterns of external financing (box 3).

The debt problem has continued to linger on in the 1990s (tables 17 and 18). For LDCs as a whole, the nominal value of the total external debt stock rose from $121.2 billion in 1990 to $150.4 billion in 1998, according to World Bank statistics. This corresponded to an estimated 101 per cent of their combined GNP, up from 92 per cent in 1990. Half of this debt stock was concentrated in just six countries – Angola, Bangladesh, the Democratic Republic of the Congo, Ethiopia, Mozambique and Sudan – and in 23 out of the 45 countries for which

Box 3: Contrasting trends in external financing and external indebtedness in African and Asian LDCs

There is an important contrast between African LDCs and Asian LDCs in terms of the pattern of external financing, particularly during the critical initial period (1976-1982) when the external debt built up. Loans to African LDCs increased much more sharply than those to Asian LDCs in the 1970s; African LDCs were also more reliant than Asian LDCs on private loans; and the concessionality of official finance to African LDCs was lower than that to Asian LDCs. For every year between 1978 and 1991 (excepting 1984), the average interest rate on new official loans to African LDCs was double or more that on loans extended to Asian LDCs (see the chart below). Moreover, during every year of the critical period in which indebtedness grew in Africa (1979–1985) the interest rates on new official loans were more than 3 per cent, whereas (with the exception of one country, Yemen, in one year) they never exceeded this level in Asia.

Export credits played a major role in the build-up of the debt in African LDCs, increasing by 27 per cent a year in African LDCs between 1975 and 1979 (Krumm, 1985: table 5). Ambitious infrastructure projects were often externally financed on terms much shorter than the profile of returns, and many projects in productive sectors were ill-conceived and proved to be economically unviable. The role of ECAs in the build-up of the debt problem in low-income countries has recently been described as follows:

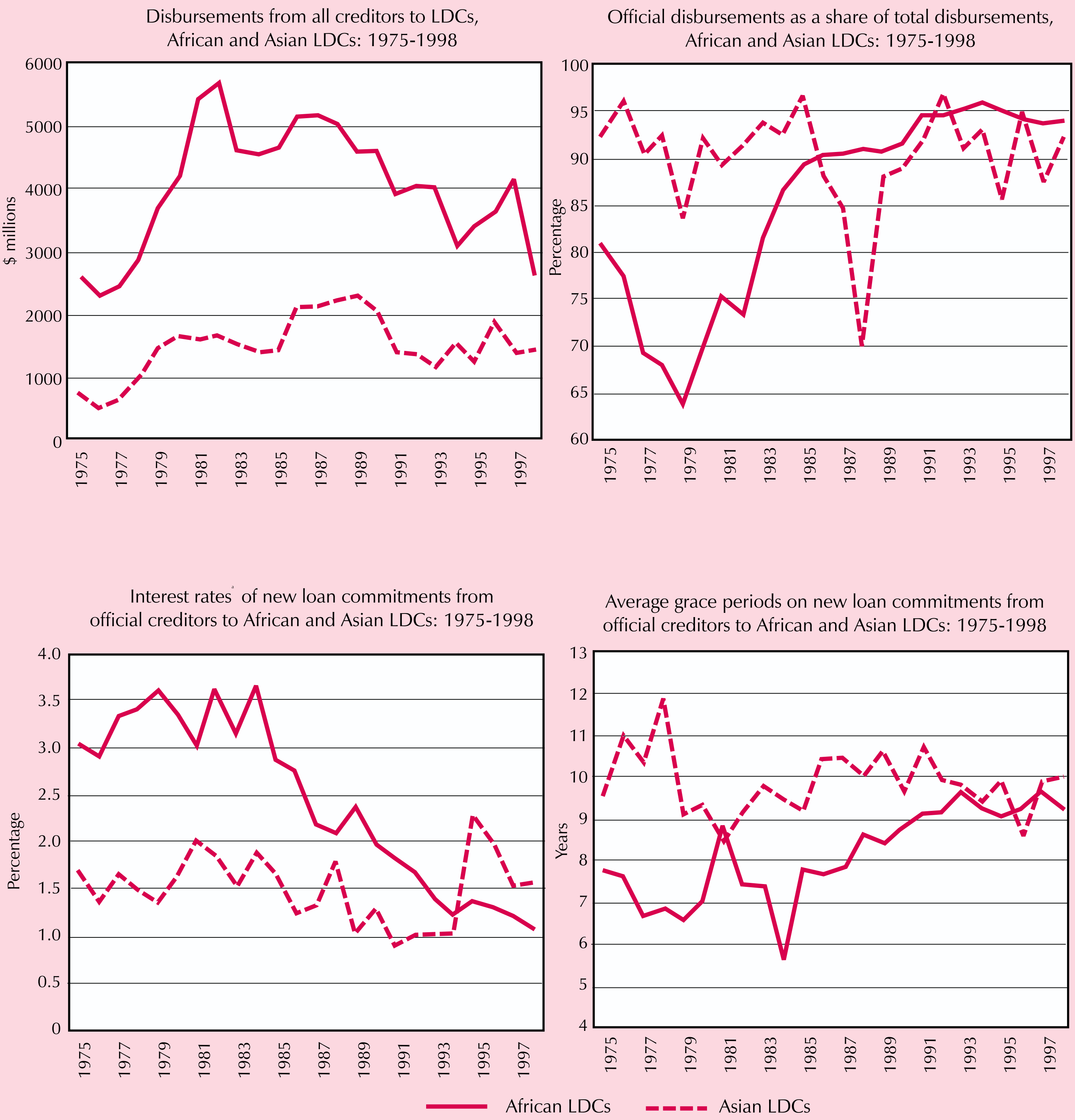
> From the creditor government perspective, the motivation for much of the commercial lending or guaranteeing of loans to LICs [low-income countries] during the 1970s and 1980s was the stimulation of their own exports, and the associated economic and industrial benefits of protecting or creating domestic employment, as well as the benefits of cementing diplomatic relations with the trading partners concerned. This was sometimes known as "national interest" lending. It was, by definition, a highly risky business, with a real possibility that eventually much of the debt would not be repaid. Industrial country governments were, however, willing to accept these risks. Most of the LICs were also aid recipients, and many official creditor governments saw the provision of commercially-priced export credit guarantees (a contingent liability, but not usually an immediate cost to the national budget) as a complement to direct grants and concessional Official Development Assistance (ODA) loans in their overall development cooperation policy (Daseking and Powell, 1999: 4).

When non-oil commodity prices declined and the concomitant terms-of-trade shock was magnified by the second oil price shock, debt-servicing capacity was seriously impaired. Debt management capabilities of LDCs were very low, and the domestic policy response to adjust to the new external economic circumstances was often slow. In many cases, this was encouraged by an assumption that commodity prices would recover. International commodity price forecasts in the early 1980s, which provided the basis for the expectations of Governments, donors and lenders, were excessively optimistic, being based on the impression that the debt problem was a transitory liquidity problem. For example, Zambia negotiated an Extended Fund Facility with the IMF in 1983 which assumed a 45 per cent increase in copper prices over four years. In the event, copper prices fell by about 12 per cent, leaving Zambia with a considerably higher level of mainly non-concessional debt and a lower than expected payments capacity (Brooks et al., 1998: 8).

The difference in provision of concessional finance to Asian and African LDCs was critical to their subsequent growth-and-debt trajectories. Most of the LDCs that began experiencing serious debt problems were African LDCs. With exception of Cambodia and the Lao People's Democratic Republic, and later Yemen, Asian LDCs have never experienced the level of debt distress of the African LDCs. In the 1990s, within the framework of policy reforms, the difference between African and Asian LDCs in terms of the concessionality of official finance has disappeared.

Box 3 (continued)

BOX CHART: AFRICAN AND ASIAN LDCS: SCALE, COMPOSITION AND TERMS OF LENDING, 1975–1998



Source: See table 12.

a Weighted by value of new loan commitments from official creditors.

TABLE 17: SCALE AND COMPOSITION OF THE LDCS' EXTERNAL DEBT, 1990 AND 1998

	Debt stocks						Principal and interest arrears[b]			
	Total debt stocks $ millions		Share of official[a] (incl.IMF) per cent		Share of multilateral[a] (incl.IMF) per cent		Share of total debt per cent		Share of official arrears per cent	
	1990	1998	1990	1998	1990	1998	1990	1998	1990	1998
Angola	8 593.8	12 172.8	21.4	26.5	0.7	2.3	8.1	22.2	19.6	25.8
Bangladesh	12 768.5	16 375.6	96.7	98.5	56.0	67.3	0.1	0.1	96.1	100.0
Benin	1 291.8	1 646.8	94.4	94.7	42.9	62.3	7.6	4.8	88.5	94.2
Bhutan	83.5	119.6	74.0	100.0	50.2	67.9	2.2	-	100.0	-
Burkina Faso	834.0	1 399.3	85.4	95.5	67.8	86.2	10.2	3.1	56.5	86.4
Burundi	907.4	1 118.7	97.5	98.1	77.5	84.1	0.0	5.0	100.0	99.5
Cambodia	1 854.4	2 209.7	92.5	98.0	1.5	15.5	26.9	43.4	99.9	100.0
Cape Verde	135.3	243.7	94.7	92.9	64.3	73.8	9.9	9.8	91.8	90.4
Central African Republic	698.5	921.3	91.5	90.8	70.5	69.6	5.5	16.7	85.6	92.5
Chad	524.1	1 091.4	92.7	96.3	69.2	80.4	4.2	4.3	79.5	95.5
Comoros	184.9	203.1	93.3	93.9	61.6	80.4	20.4	22.1	100.0	100.0
Dem. Rep. of the Congo	10 270.2	12 929.2	84.1	65.9	23.9	20.8	12.8	64.0	41.1	86.1
Djibouti	205.3	287.8	75.6	94.8	41.9	53.3	0.6	9.3	100.0	100.0
Equatorial Guinea	241.1	306.1	81.8	69.4	30.4	35.5	20.0	44.7	86.7	85.5
Eritrea	..	149.3	..	96.5	..	51.0	..	0.0	..	..
Ethiopia	8 634.3	10 351.8	91.6	90.6	14.8	26.4	3.2	56.0	84.3	95.7
Gambia	369.1	477.0	90.8	96.8	67.2	76.8	0.4	0.0	100.0	100.0
Guinea	2 476.4	3 545.9	88.7	90.9	29.5	51.2	9.9	16.0	87.3	96.7
Guinea-Bissau	692.1	964.4	87.1	92.0	40.3	44.0	20.6	25.7	94.3	99.8
Haiti	888.9	1047.5	83.4	97.2	59.3	82.9	7.5	0.3	41.1	100.0
Lao People's Dem. Rep.	1 768.0	2 436.7	99.9	99.9	15.5	41.7	0.1	0.0	100.0	100.0
Lesotho	395.6	692.1	90.8	90.9	77.4	75.4	1.1	1.8	56.8	44.4
Liberia	1 849.0	2 102.9	67.4	57.6	40.9	35.0	58.2	78.3	72.5	78.8
Madagascar	3 701.3	4 394.1	90.2	93.8	37.1	41.9	10.5	17.1	92.1	95.6
Malawi	1 558.2	2 444.0	91.1	97.9	77.2	85.6	1.6	2.1	63.7	75.0
Maldives	78.0	179.9	77.2	81.9	41.7	62.9	0.0	0.0	..	..
Mali	2 466.9	3 201.5	96.9	94.1	39.1	55.0	2.9	22.1	99.6	100.0
Mauritania	2 096.1	2 588.6	84.1	88.9	34.5	42.7	9.8	19.4	86.3	100.0
Mozambique	4 652.8	8 208.3	78.2	71.2	11.6	25.6	20.0	19.0	48.2	96.9
Myanmar	4 694.8	5 680.4	89.8	79.6	26.3	21.1	12.3	35.8	79.7	84.9
Nepal	1 640.0	2 645.7	91.8	97.5	80.0	85.3	0.6	0.4	100.0	58.4
Niger	1 725.5	1 659.4	69.5	91.9	45.6	62.6	6.4	5.7	49.0	100.0
Rwanda	711.7	1 225.9	92.9	95.8	76.2	82.8	1.4	6.2	100.0	97.9
Samoa	92.0	180.1	98.3	85.7	89.0	80.2	0.0	0.0	..	..
Sao Tome and Principe	150.0	245.8	88.5	95.0	49.1	65.6	19.3	13.5	95.9	100.0
Sierra Leone	1 151.1	1 243.1	53.2	90.8	25.2	57.4	30.7	3.7	71.8	90.2
Solomon Islands	120.5	152.4	74.5	68.6	51.6	60.1	0.2	5.4	100.0	49.4
Somalia	2 370.3	2 635.0	86.4	76.2	38.5	34.1	39.2	67.9	96.4	97.1
Sudan	14 762.0	16 843.0	57.3	50.1	18.1	16.8	63.7	80.2	75.9	77.6
Togo	1 274.7	1 448.4	87.1	96.4	50.7	61.7	0.3	1.9	65.0	100.0
Uganda	2 582.9	3 935.2	81.6	94.7	60.1	71.9	11.5	7.4	42.0	75.3
Utd. Rep. of Tanzania	6438.2	7 602.6	84.5	84.8	33.0	44.8	18.8	23.9	74.9	82.5
Vanuatu	40.2	63.2	72.4	85.8	39.6	70.1	0.0	0.0	..	..
Yemen	6 344.8	4 138.0	55.1	90.6	16.2	44.9	16.2	17.9	49.2	75.5
Zambia	6 916.2	6 865.3	73.1	93.1	34.0	50.0	32.3	12.9	92.3	91.2

Source: UNCTAD secretariat estimates, based on World Bank, *Global Development Finance 2000*, and *World Development Indicators 2000*.

a on long-term debt, including IMF.

b on long-term debt, excluding IMF.

TABLE 18: EXTERNAL DEBT BURDEN INDICATORS FOR THE LDCs, 1990 AND 1998
(Percentage)

	Debt stocks to GDP		Debt stocks to exports		Debt service paid to exports		Present value of debt to exports
	1990	*1998*	*1990*	*1998*	*1990*	*1998*	*1998*
Angola	83.7	162.9	214.7	309.8	8.1	34.4	291.9
Bangladesh	42.8	38.3	365.6	182.4	22.6	7.6	134.6
Benin	70.0	71.4	233.3	288.6	6.9	10.6	183.0
Bhutan	29.3	30.0	88.0	76.4	5.5	5.9	50.0
Burkina Faso	30.2	54.2	129.1	343.2	5.3	13.0	166.9
Burundi	80.2	126.4	928.8	1819.0	43.4	49.1	828.7
Cambodia	166.4	77.0	..	259.0	..	1.5	207.6
Cape Verde	39.9	49.2	77.2	91.8	3.3	7.2	79.1
Central African Republic	47.0	87.2	316.9	633.2	13.2	20.9	393.8
Chad	30.1	64.4	191.1	326.9	4.4	10.6	188.8
Comoros	74.0	103.5	318.8	590.4	1.9	18.0	289.4
Dem. Rep. of the Congo	109.9	185.6	397.5	777.2	13.5	1.2	731.5
Djibouti	48.3	..	..	..	..	..	..
Equatorial Guinea	182.5	67.1	570.0	73.3	12.1	1.4	59.9
Eritrea	..	23.0	..	39.2	..	1.0	34.1
Ethiopia	126.2	158.2	1276.3	983.5	34.9	11.3	829.7
Gambia	116.5	114.7	217.5	177.7	22.2	9.7	100.4
Guinea	87.9	98.5	294.4	431.6	20.0	19.4	307.4
Guinea-Bissau	283.7	468.9	2463.0	3131.2	29.9	25.6	2253.2
Haiti	29.8	27.1	273.6	218.5	10.1	8.2	125.0
Lao PDR	204.5	193.3	1690.2	493.3	8.7	6.3	227.0
Lesotho	63.6	87.3	71.3	114.0	4.2	8.4	81.6
Liberia	..	..	..	..	.	..	..
Madagascar	120.1	117.2	748.6	514.7	45.0	14.7	383.3
Malawi	86.4	144.8	344.4	430.1	29.3	14.7	241.2
Maldives	53.5	48.9	42.4	41.4	4.8	3.1	27.3
Mali	101.9	118.8	375.9	492.2	10.2	12.6	335.5
Mauritania	184.7	261.6	417.6	648.0	29.1	27.6	358.2
Mozambique	185.2	210.8	1552.0	1413.5	26.2	18.0	470.3
Myanmar	..	..	703.2	325.5	9.0	5.3	278.9
Nepal	45.2	55.3	312.9	192.8	13.6	6.4	119.0
Niger	69.6	81.0	297.8	492.3	17.0	18.4	330.5
Rwanda	27.5	60.6	472.6	981.5	13.9	16.6	555.6
Samoa	63.1	102.6	67.3	106.7	4.0	3.0	83.1
Sao Tome and Principe	299.8	602.1	1807.2	2119.0	33.7	31.9	1245.0
Sierra Leone	128.4	192.2	547.4	1108.9	10.1	18.2	735.4
Solomon Islands	57.1	50.7	123.2	76.6	11.9	3.3	32.7
Somalia	258.5	..	3362.1	..	15.2	..	..
Sudan	112.1	162.5	1848.7	2694.4	6.2	9.8	2537.7
Togo	78.3	95.9	170.1	205.1	11.4	5.7	142.3
Uganda	60.0	58.1	1051.2	581.9	60.0	23.6	350.6
United Rep. of Tanzania	152.6	94.8	1182.8	644.6	32.9	20.8	481.7
Vanuatu	26.3	26.2	33.6	32.7	2.0	0.9	20.1
Yemen	134.3	95.8	138.6	217.1	3.7	6.5	105.4
Zambia	210.3	204.8	507.8	600.8	14.9	17.7	482.8

Source: UNCTAD Secretariat estimates, based on World Bank, *Global Development Finance 2000*, and *World Development Indicators 2000*.
Note: Exports are defined as exports of goods and services and workers remittances' receipts

data is available, external debt stocks in nominal terms were less than $2 billion. Yet using the criteria which the international community has recently adopted under the enhanced HIPC Initiative to judge debt sustainability, it is apparent that in 1998 the external debt was unsustainable in two thirds (28) of the 45 LDCs for which data are available.

There were certainly some improvements in external indebtedness indicators in the period 1994–1997. However, the debt-servicing capacity of the LDCs deteriorated critically in 1998, as their earnings from exports of goods and services declined by about 8 per cent (or $2.6 billion), according to World Bank figures, from $34 billion in 1997 to $31.4 billion in 1998. Twenty-seven out of the 45 LDCs for which data are available were unable to acquit themselves of their debt service obligations in 1998.

The debt-servicing capacity of the LDCs deteriorated critically in 1998, as their earnings from exports of goods and services declined by about 8 per cent.

Total debt service paid by LDCs as a whole amounted to $4.4 billion in 1998, compared with $3.9 billion in 1990. The ratio of debt service to exports declined from 14 per cent in the latter year to 12 per cent in 1998. But the relatively low average debt service ratio reflects payments actually made, not payments due. In 1990, arrears constituted 19 per cent of the total debt stock, whilst by 1998 this was as high as 30.4 per cent.

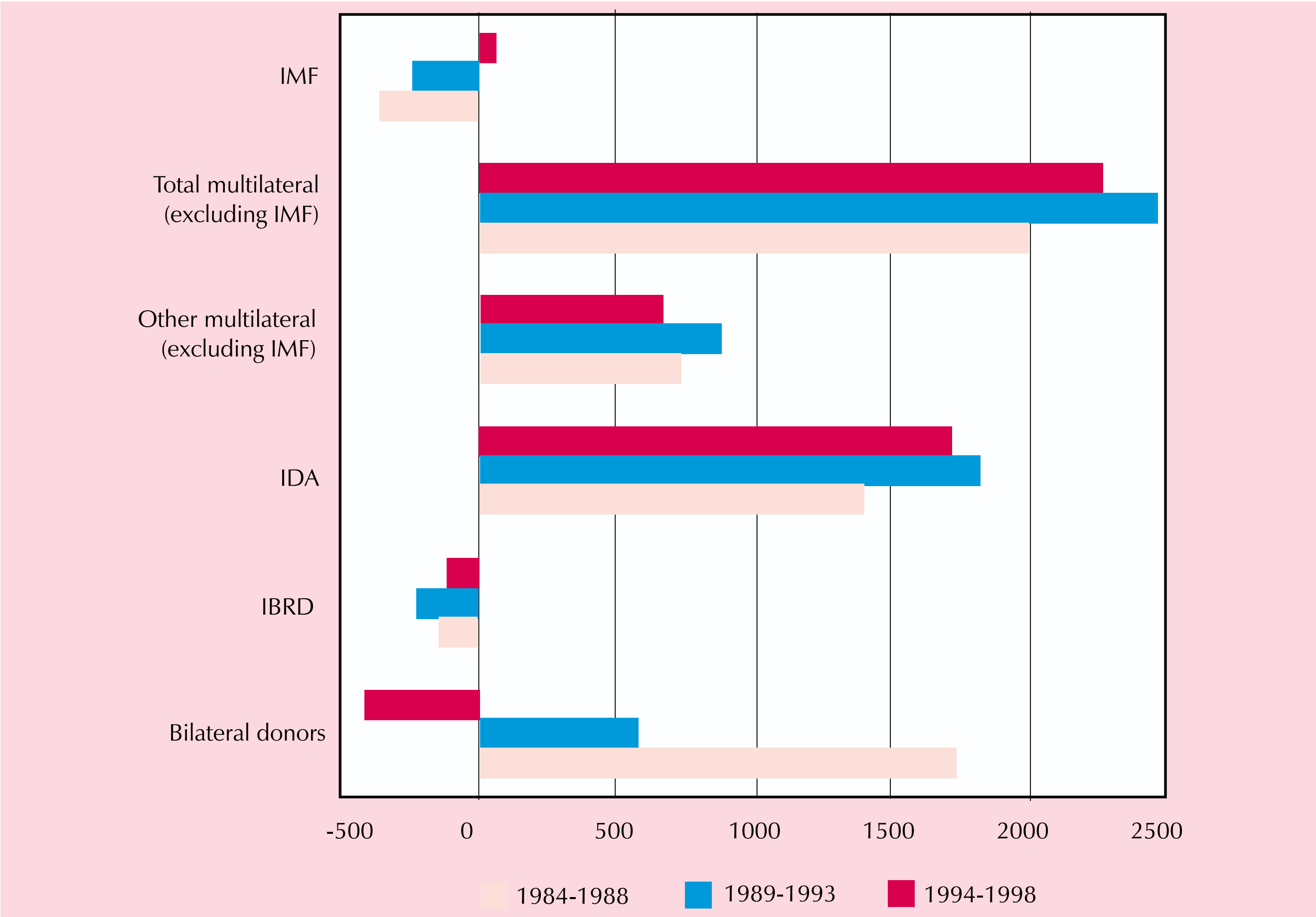
Analysis of the pattern of arrears shows that they are particularly high in LDCs which have experienced protracted armed conflict and/or which have been cut off from international assistance, notably Angola, Cambodia, the Democratic Republic of the Congo, Ethiopia, Liberia, Myanmar, Somalia and Sudan.[7] However, the inability to pay debt service is a widespread problem. As well as in these eight countries, arrears constituted over 15 per cent of the debt stock in 1998 in the Central African Republic, Comoros, Guinea, Guinea-Bissau, Madagascar, Mali, Mauritania, Mozambique, the United Republic of Tanzania, and Yemen.

F. Aggregate net transfers and exceptional financing

After the outbreak of the debt crisis in the early 1980s, aggregate net transfers to middle-income countries actually became negative as capital inflows fell and interest payments rose. For the least developed countries, the increased concessional inflows during the 1980s helped to ensure that this did not occur. Net transfers by the international creditor/donor community has been positive mainly because of the scale of bilateral grants, and loans through IDA and multilateral organizations other than the IBRD and IMF. During the period 1988–1993, annual aggregate net transfers on loans to the IBRD and IMF for LDCs as a whole were in each case negative (i.e more money was being taken out than put in), and during 1994–1998, although net transfers on debt to the IMF became positive, they remained negative for the IBRD and became negative for bilateral loans (chart 33).

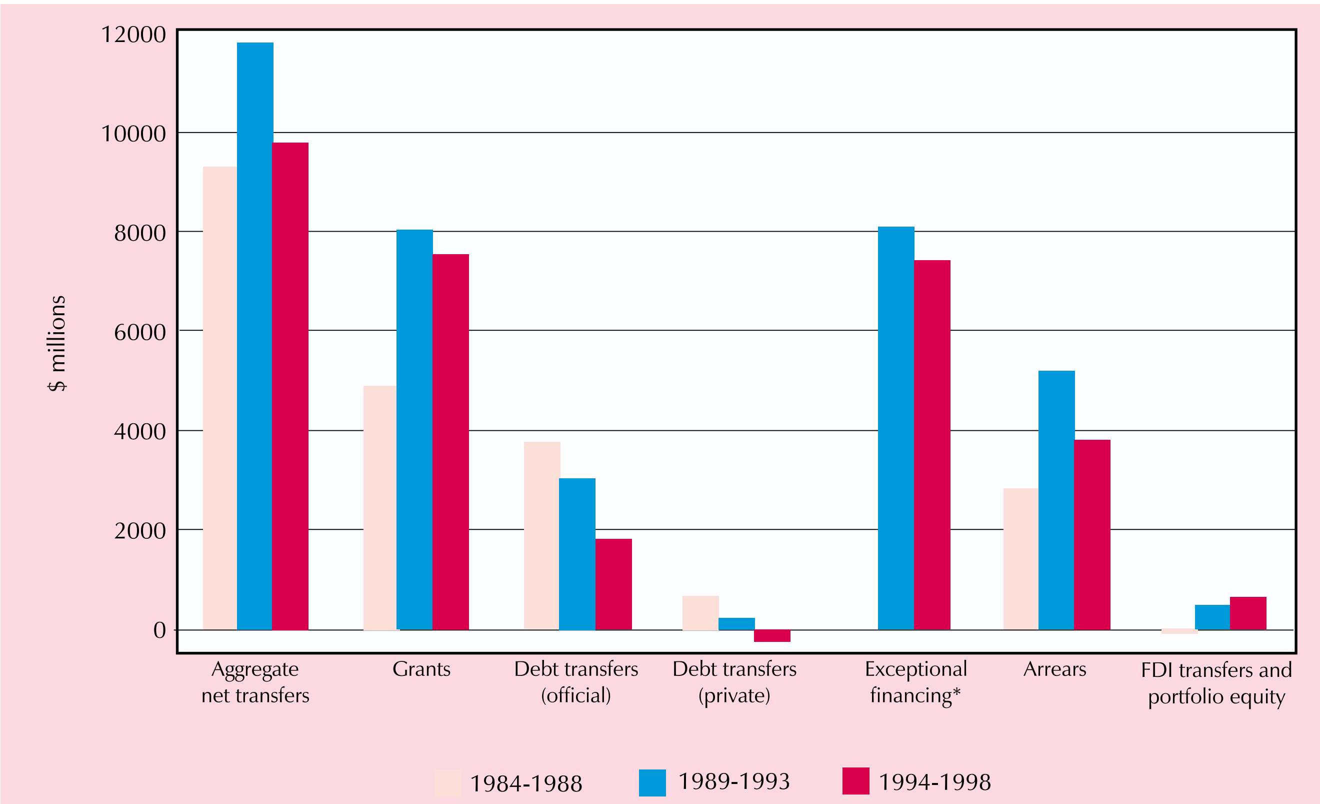
Sustaining positive aggregate net transfers to the least developed countries has also become dependent on debt rescheduling, debt forgiveness and the accumulation of arrears to external creditors, which together reduce the actual levels of debt service outflows. Chart 34 provides some estimates of levels of such exceptional financing for the least developed countries during the period 1984–1998. Exceptional financing is defined here as the difference between debt service which were contractually due and debt service which were actually

CHART 33: NET OFFICIAL TRANSFERS ON DEBT TO THE LDCS BY CATEGORY OF CREDITORS, 1984–1998
(Average annual net transfers, $ millions)



Source: As in table 12.
Note: Net official transfers on debt are loan disbursements minus debt service (principal repayments and interest payments).

CHART 34: ANNUAL AVERAGE NET TRANSFERS AND EXCEPTIONAL FINANCING TO THE LDCS, 1984–1998
($ millions)



Source: As in table 12. *Note:* FDI transfers are net FDI minus profit remittances.
* Data on exceptional financing are not available for 1984–1988.

paid.[8] It should be stressed that the numbers are best estimates, since there are difficulties in calculating with precision what debt service was due. However, it is clear that LDCs as a whole are highly dependent on these "virtual financial flows", which come either through formally negotiated debt relief on debt service payments or through disorderly accumulation of arrears. If these "virtual financial flows" were not supplementing the actual flows, aggregate net transfers would have been just 31 per cent of their actual level during 1989–1993 and only 25 per cent of their actual level in 1994–1998.

As noted above, arrears accumulation has been particularly important in countries that are experiencing conflict or have been excluded from official inflows. However, as table 19 shows, exceptional financing has been critically important for a wide range of countries. Indeed, during 1989–1993, it constituted more than 2 per cent of GNP in more than two thirds (25) out of the 38 countries for which data are available, and during 1994–1998, it constituted over 2 per cent in more than half of the countries for which data are available (23 out of 41). For many severely indebted LDCs, "virtual financial flows" have become the main source of external finance after ODA.[9]

For many severely indebted LDCs, "virtual financial flows" have become the main source of external finance after ODA.

As will be argued in later chapters, it is not helpful to treat exceptional financing as a form of development finance. But in practice, debt relief is functioning as such, which is making it natural for debt relief and ODA to be treated as analogous forms of assistance, and for ODA to be diverted into debt relief.

G. Conclusions

The evidence of this chapter highlights seven important features of trends in the volume and sources of external finance available to the least developed countries.

First, long-term capital flows have declined by about 25 per cent in nominal terms during the 1990s, and in real per capita terms capital inflows have fallen by about 40 per cent.

Second, the main source of long-term capital inflows into LDCs is ODA. The degree of reliance on official rather than private sources of external finance is a major difference between LDC and non-LDC economies. This contrast was apparent in the 1970s, but it became clearer after 1982 and has become particularly marked in the 1990s. ODA grants are particularly important for many LDCs, and especially important to African LDCs.

Third, the declining trend in long-term net capital inflows into LDCs as a whole is the result of declining aid flows coupled with the failure of most LDCs to attract sufficient private capital inflows to offset that decline. Other developing countries are increasingly relying on international flows of private capital as a key component of their development strategy. But only a few LDCs have been able to attract significant private capital inflows.

Fourth, the declining aid flows to the LDCs reflect the failure of the international community to implement commitments made as an outcome of the Second United Nations Conference on the Least Developed Countries held at Paris in 1990. In the Paris Declaration and Programme of Action for the Least Developed Countries for the 1990s, the international community, particularly the developed countries, committed itself to a "significant and substantial

TABLE 19: EXCEPTIONAL FINANCING[a] AS A PERCENTAGE OF GNP, 1989–1993 AND 1994–1998
(Annual averages)

	1989–1993	1994–1998
Angola	19.2	48.1
Bangladesh	0.2	0.0
Benin	5.6	1.8
Bhutan	0.3	0.0
Burkina Faso	2.5	1.6
Burundi	2.5	1.5
Cambodia	..	5.3
Cape Verde	1.3	0.5
Central African Republic	4.0	4.0
Chad	2.1	1.8
Comoros	5.8	3.9
Democratic Republic of the Congo	11.8	14.2
Djibouti	..	1.2
Equatorial Guinea	14.4	7.3
Eritrea	..	..
Ethiopia	9.6	12.7
Gambia	0.3	0.1
Guinea	7.7	2.9
GuineaBissau	24.7	26.9
Haiti	2.0	1.5
Lao People's Democratic Republic	0.6	0.0
Lesotho	0.4	0.1
Liberia	..	..
Madagascar	13.6	10.1
Malawi	1.0	0.6
Maldives	0.0	0.0
Mali	3.4	9.2
Mauritania	13.6	9.3
Mozambique	16.8	16.4
Myanmar	..	..
Nepal	0.1	0.0
Niger	5.5	5.4
Rwanda	0.8	1.5
Samoa	0.1	0.0
Sao Tome and Principe	17.4	22.5
Sierra Leone	13.4	10.4
Solomon Islands	0.1	2.0
Somalia	..	..
Sudan	11.1	7.0
Togo	7.2	7.8
Uganda	3.0	2.4
United Republic of Tanzania	10.3	7.5
Vanuatu	0.6	0.0
Yemen	9.0	17.4
Zambia	18.8	5.0

Source: UNCTAD secretariat estimates, based on World Bank, *Global Development Finance 2000*.
a For definition of exceptional financing, see text.

increase in the aggregate level of external support" to the LDCs. In order to reach a flow of concessional resources commensurate with the increase called for, donor countries agreed to seek to implement the following targets:

- Donor countries already providing more than 0.20 per cent of their GNP as ODA to LDCs: continue to do so and increase their efforts;
- Other donor countries which have met the 0.15 per cent target [set by the Substantial New Programme of Action for the Least Developed Countries for the 1980s]: undertake to reach 0.20 per cent by the year 2000;
- All other donor countries which have committed themselves to the 0.15 per cent target: reaffirm their commitment and undertake either to achieve the target within the next five years or to make their best efforts to accelerate their endeavours to reach the target;
- During the period of the Programme of Action, the other donor countries: exercise their best efforts individually to increase their ODA to LDCs so that collectively their assistance to LDCs will significantly increase (UNCTAD, 1992: 26).

National and international policy efforts to promote economic growth, poverty reduction and sustainable development in the LDCs must start from the reality that not only are the central accumulation and budgetary processes of the LDCs dominated by external rather than domestically generated resources, but also long-term net capital inflows are dominated by aid.

In practice, the share of aid to LDCs in DAC donors' GNP fell from 0.09 per cent in 1990 to 0.05 per cent in 1998, and in that year only five DAC members met the 0.15 per cent target of the Programme of Action, namely Denmark, Luxembourg, the Netherlands, Norway and Sweden.

Fifth, ODA commitments to LDCs are increasingly being devoted to social infrastructure and services, as well as to debt forgiveness and emergency aid.

Sixth, many LDCs, particularly in Africa, have serious external debt problems. Some progress towards lessening the debt burden was made in the mid-1990s, but levels of external indebtedness are now higher than in 1990. According to international criteria of debt sustainability, which many regard as conservative, the external debt is unsustainable in two thirds of the least developed countries.

Seventh, in spite of growing debt stocks and interest payments, the LDCs have continued to receive positive net resource transfers. This was achieved during the 1980s and up to 1992 through increased commitment of resources on concessional terms by official creditor-donors. But exceptional financing in the form of debt forgiveness, debt rescheduling and the accumulation of arrears, all of which reduce actual debt service to below levels that were contractually due, has also become important, particularly since 1988. Such "virtual financial flows" are particularly significant for highly indebted LDCs.

It is apparent that national and international policy efforts to promote economic growth, poverty reduction and sustainable development in the LDCs must start from the reality that not only are the central accumulation and budgetary processes of the LDCs dominated by external rather than domestically generated resources, but also long-term net capital inflows are dominated by aid. The next chapter focuses on the reasons why most LDCs have not been able to attract as much private capital as other developing countries, and on the potential for changing this situation. The last three chapters deal with the conditions that govern access to concessional finance and debt relief, the question of who controls the uses to which aid is put, and the consequences for the LDCs of the domination of their central accumulation and resource allocation processes by multiple aid donors.

Notes

1. For another review of trends in capital flows to poor countries, as well as discussion of related development issues, see Griffith-Jones and Ocampo (1999).
2. It should be noted that these data are estimates, since not all ODA commitments are classified.
3. These numbers are sometimes referred to as "aid dependency ratios", but following O'Connell and Soludo (forthcoming), they are referred to here as "aid intensity ratios".
4. This point is persuasively discussed in Bhinda et al. (1999: chapter 1).
5. This category can also include inward movement of capital by foreign investors, the return of money which previously exited the country as flight capital, and private gifts for humanitarian emergencies, or simply misrecording of items. In East Africa in particular, it is suggested that private capital inflows are misclassified as current transfers (see Kasakende, Kitabire and Martin, 1999).
6. These threshold levels are those beyond which it has been found that there is over a 60:40 chance of needing to reschedule (Cohen, 2000).
7. For a discussion of the interaction between external indebtedness, growth and investment in conflict and post-conflict African economies, see Elbadawi and Ndung'u (2000).
8. The term "exceptional financing" is widely used in the context of evaluations of the IMF's Enhanced Structural Adjustment Facility (ESAF), where it often refers to accumulation of arrears to external creditors, rescheduling of interest and/or principal repayments, and debt cancellation, as well as to balance-of-payments support from multilateral organizations. In the present context, it is used to refer to the difference between debt service contractually due and debt service actually paid. This has been calculated by adding up principal and interest rescheduled, principal and interest forgiven and an estimate of unpaid arrears during the year. This last figure, it must be stressed, is a best estimate. When the change in the year-end stock of arrears is positive, the change has been included since it is reasonable to assume that these arrears resulted from amounts due and not paid in the current year. However, when the change in the stock of arrears is negative, it has been ignored in the calculations since it is impossible to identify how the arrears were cleared. If the reduction is due to rescheduling of arrears, it relates to payments due in prior years. If it is a result of clearance by payment, it measures actual payments made and, ideally, if this is the case, we should deduct this payment from the calculation (since, again, it does not relate to amounts due in the current year). It is likely that when this occurs in LDCs, the chances are that the arrears were rescheduled. Thus, it is likely that this assumption is reasonable.
9. For estimates of the importance of debt re-scheduling, debt cancellation and arrears accumulation in ESAF countries, see IMF (1997: table 5).

References

Bhinda, N. et al. (1999). *Private Capital Flows to Africa: Perception and Reality*. Forum on Debt and Development (FONDAD), The Hague.

Brooks, R. et al. (1998). External debt histories of ten low-income developing countries: lessons from their experience, IMF Working Paper WP/98/72, Washington DC.

Cohen, D. (2000). The HIPC initiative: true and false promises, paper presented at the Joint DAC/Development Centre Seminar "Development Finance – The Way Forward", 29-30 March, Paris.

Daseking, C. and Powell, R. (1999). From Toronto terms to the HIPC initiative: a brief history of debt relief to low-income countries, IMF Working Paper WP/99/142, Washington DC.

Elbadawi, I. and Ndung'u, N. (2000). External indebtedness, growth and investment in conflict and post-conflict African countries, paper presented at the conference on "The Economics of Political Violence, March 18–19, Princeton University, Princeton, New Jersey.

Griffith-Jones, S. and Ocampo, J.A. (1999). *The Poorest Countries and the Emerging International Financial Architecture*, Expert Group on Development Issues 1999, Vol.4, Almqvist and Wicksell International, Stockholm.

Kasakende, L., Kitabire, D. and Martin, M. (1999). Capital inflows and macroeconomic policy in sub-Saharan Africa. In: Helleiner, G. *Capital Account Regimes and the Developing World*, Macmillan Press, in association with UNCTAD, London.

Krumm, K.L. (1985). The external debt of sub-Saharan Africa: origins, magnitude, and implications for action, World Bank Staff Working Paper No. 741, Washington DC.

O'Connell, S.A. and Soludo, C.C. (forthcoming). Aid intensity in Africa. *World Development* (an early draft was presented at the African Economic Research Consortium/Overseas Development Council (AERC/ODC) conference on "Managing the Transition from Aid Dependency in Sub-Saharan Africa", Nairobi, 21–22 May, 1998).

OECD (2000). *Development Cooperation 1999 Report*, OECD, Paris.

UNCTAD (1992). Paris Declaration and Programme of Action for the Least Developed Countries for the 1990s, UNCTAD/RDP/LDC/58, United Nations, New York.

UNCTAD (1999). *Trade and Development Report, 1999*. United Nations publication, sales No. E.99.II.D.1, United Nations, Geneva.

World Bank (1999). *Global Development Finance: Analysis and Summary Tables*. Washington DC.