

# Financing for Low-Income Countries: Collateral Damage of Global Imbalances

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Low-income countries<sup>1</sup> (LICs) play a limited role in global macroeconomic imbalances, as measured by current accounts, that is, the savings/investment equilibria, external positions, and their financing. However, they are disproportionately affected by their consequences. These imbalances have contributed to the increasingly important role of East Asia, especially China, in global value chains. This rise of East Asia's influence has further reinforced raw materials-based economic setups in most LICs, particularly in Africa, preventing manufacturing-led development, increasing their vulnerability and restricting their long-term growth potential. Moreover, global current account surpluses primarily finance U.S. deficits at the expense of countries that are "natural" capital importers, primarily LICs. This report analyzes recent trends in LICs' current account deficits and their financing, with a focus on African LICs.

The first finding is that LICs have sustained a structural current account deficit, persistent but modest, since the early 2000s. This deficit widened until the mid-2010s, experienced a significant shock during the pandemic, and then returned to its pre-crisis level. The presence of a deficit is not uncommon for young, capital-poor economies with considerable investment requirements. However, current account deficits in LICs are more indicative of limited capacity to mobilize the external financing needed to support growth and structural transformation than of prudent external balance management. This problem is particularly acute in Africa, where deficits have been more pronounced than in other LICs in recent years. These current account deficits stem primarily from the negative trade balance of goods and, to a lesser extent, of services. Despite growth in exports and improved terms of trade

for several groups of countries, export momentum remains weak relative to the needs of economies in the early stages of development. We estimate that annual financing needs of LICs will amount to approximately \$160 billion per year by 2030 to reach investment rates of 30%, which are conducive to economic takeoff.

The second finding is that LICs are highly dependent on a limited number of sources of external financing. Deficits in the balance of goods and services are partly financed through remittances and Official Development Assistance (ODA) grants and loans. In African LICs, ODA plays a central role, while remittances dominate in non-African LICs. Foreign direct investment (FDI) flows play a more limited role and tend to be concentrated in a few countries and in the extractive sector. The critical issue is that these financing sources are fragile in light of future needs. The anticipated decline in ODA and the sectoral concentration of FDI undermine the long-term sustainability of external financing at a time when financing needs related to demographics, climate, and the energy transition are growing rapidly. Finally, debt financing is not viable, given the weak growth of current account receipts, particularly export earnings from goods and services.

The third finding is the forced specialization of LICs in natural resources. LICs, and African LICs in particular, face persistent trade deficits, rely heavily on a small number of trading partners, primarily China, and mainly export primary products, especially extractive resources, while importing manufactured goods. As of 2024, China has emerged as the primary trading partner of African LICs, both in terms of exports and imports, and accounts for the majority of their trade deficits. Additionally, their bilateral trade is highly

1. According to the IMF's list of low-income countries eligible for the PRGT, which includes 57 countries, 38 of which are in Africa.

asymmetrical, with 88% of exports from African LICs to China consisting of unrefined extractive resources (minerals and hydrocarbons) and 93% of imports consisting of manufactured products. This pattern has further entrenched a development trajectory where the economy is undiversified, vulnerable to shocks, and unsuited to fostering productive capacity.

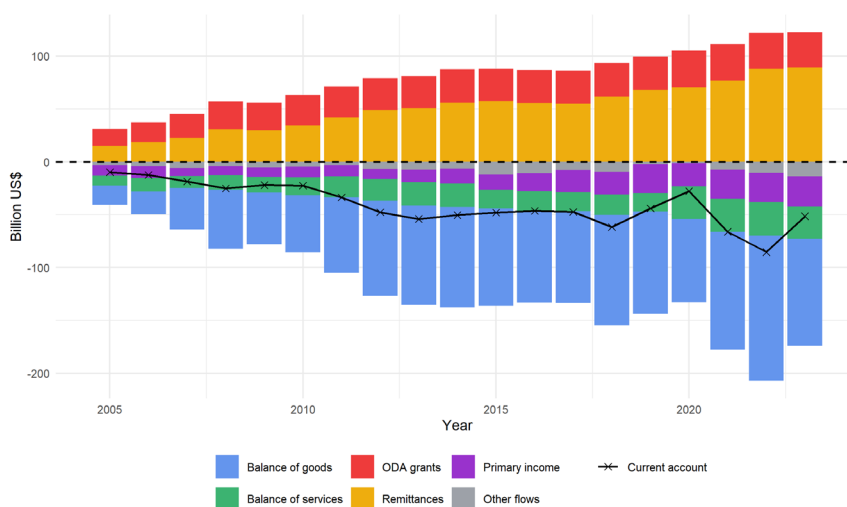
The report also indicates that the emergence of China and, to a wider extent, of Asian value chains has reduced the scope and potential for growth in manufacturing in African LICs. It was believed that rising Chinese wages would create a window of opportunity for African LICs to capture a part of the market share. However, this increase in wages has been accompanied by productivity gains and a shift toward higher-value-added products that have helped China to maintain its competitiveness. Meanwhile, other Asian economies have entered lower-cost market segments. This has resulted in a deepening of Africa's reliance on extractive industries. Additionally, services-led development does not appear to be a viable option at this stage. Service exports from low-income countries are driven by tourism and transportation, with a lack of highly productive services or those with significant positive externalities. While poli-

cies that provide preferential access to Western domestic markets (such as AGOA and Everything But Arms) and Aid for Trade policies are essential for LICs, they are inadequate to ensure the much-needed diversification necessary for LICs to thrive.

The report calls for better inclusion of LICs in international efforts to reduce global macroeconomic imbalances, in order to prevent policies designed by high-income economies to remedy their own imbalances from inadvertently exacerbating the financial constraints of the most vulnerable countries. Even the most cooperative scenarios, based on reduced savings in surplus countries and increased investment in deficit countries, may fail to benefit low-income countries, if they leave underlying patterns of global capital allocation and the resulting status quo unchanged. Conversely, uncoordinated reductions in bilateral imbalances could have adverse consequences for low-income countries.

Several courses of action are thus proposed: (1) maintaining policies that provide LICs with preferential market access to Western countries, particularly in the context of resurgent protectionism; (2) redirecting ODA flows toward the poorest countries so that the overall decline in ODA is not borne by these countries, even if this means sacrificing the leverage effect as the main instrument of allocation;

(3) promoting intra-African trade through policies that support the African Continental Free Trade Area; (4) encouraging greater FDI flows to LICs, particularly in non-extractive tradable sectors; and (5) paying special attention to LICs in the implementation of the G7 Principles for Mutually Beneficial International Partnerships.



**Fig. 1** Decomposition of the current account of low-income countries

**Note:** This graph excludes countries for which we do not have complete data: Afghanistan, Chad, the Central African Republic, Eritrea, Mauritania, and Somalia.

**Sources:** IMF, World Bank, and UNCTAD.

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