DEVELOPMENT COMMITTEE
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Boards of Governors of the Bank and the Fund
On the
Transfer of Real Resources to Developing Countries)

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RECENT TRENDS IN THE TRANSFER OF RESOURCES TO DEVELOPING COUNTRIES

Attached for the September 25, 2000 Development Committee meeting is a background note prepared by World Bank staff on Recent Trends in the Transfer of Resources to Developing Countries. (This note is based on the Global Development Finance 2000, updated to reflect recent events.)

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Recent Trends in the Transfer of Resources to Developing Countries

A Background Note for the Development Committee Meeting of September 25, 2000
Prepared by Staff of the World Bank

Net resource flows to developing countries, after falling $43 billion in 1999 (to $280 billion) may have shown little increase during the first half of this year, despite the acceleration of global trade and production and improved prospects for many developing countries. World GDP growth in 2000 appears on track to exceed last year's 4 percent rise, due largely to rapid growth in the United States, a continuing recovery in East Asia, stronger growth in Europe and perhaps an end to the lengthy recession in Japan. The upswing is fueling an anticipated 11.5 percent rise in world trade this year. At the same time, capital flows to developing countries have been constrained by rising interest rates to contain demand pressures in industrial countries, continued volatility in financial markets, and depressed terms of trade of countries dependent on non-oil commodity exports.

This paper reports on recent developments in international resource flows, with updates on capital market flows, foreign direct investment, and official aid since the note issued for the Spring meetings (which was based on Global Development Finance 2000). Our estimates for net long-term resource flows (see annex tables) in 1999 are largely unchanged, with the exception of official-source flows. This data will be revised during the preparation of the next Global Development Finance report.

Flows from international capital markets

Gross capital market flows (including bond, bank lending, and portfolio equity) to developing countries rose to $106 billion in the first half of 2000, 10 percent above the comparable period in 1999 (but remained 30 percent below the pre-crisis level in the first half of 1997). International equity placements doubled, largely owing to a rise in placements from East Asia, while bond issues increased in almost all regions, but only from public sector borrowers. Bank lending declined, by 5 percent. Improved conditions in several developing countries reduced the spread on their debt compared with U.S. Treasury bills, viewed as the risk premium required for lending to developing countries. The average secondary market spread fell to 775 basis points, compared with over 1100 basis points in 1999.

Figure 1 Capital flows to emerging markets, 1997 to Jun-2000

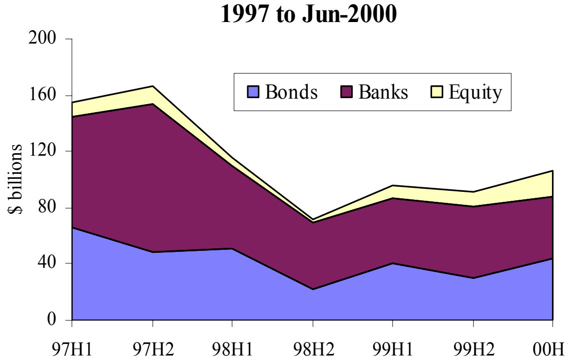
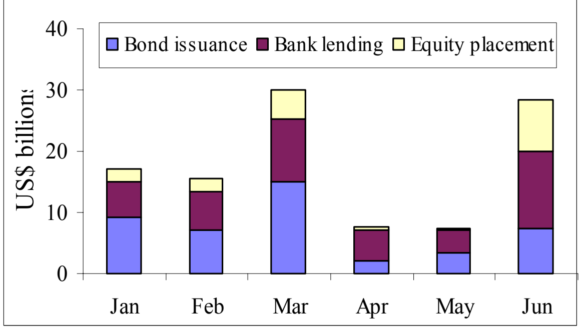
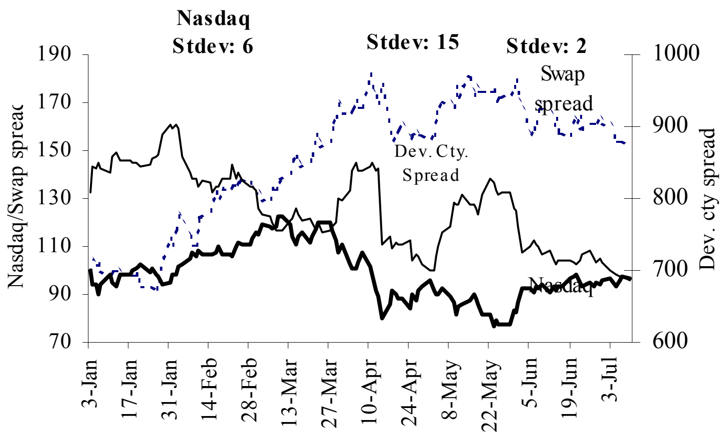


Figure 2 Monthly capital market flows to developing countries, Jan-Jun 2000



The relative stability in capital flows during the first half of this year masks considerable volatility within the period, however. In the first quarter, total capital market flows increased by 65 percent over the first quarter of 1999, more than a third higher than last year's quarterly average. The rise in flows reflected increased confidence, as the Y2K threat to financial markets evaporated and equity prices rose in the United States (by 24 percent) and developing countries (5 percent).

Figure 3 Nasdaq, swap spread and developing country spread, 2000



The external environment for capital market flows deteriorated towards the end of first quarter and into the second. Volatility in the U.S. Nasdaq market jumped sharply and the market suffered sharp corrections, for instance, dropping 10 percent between March 10th and March 15th and 25 percent between April 7th and April 14th (figure 3). In addition, the sixth increase (50 basis points in May) in U.S. interest rates since June 1999 tightened monetary conditions, and may have been higher than the expectations of many market participants. The risk premium on the U.S. high-yield asset class jumped from 460 basis points at the beginning of the year to 560 basis points towards the end of the quarter. Swap spreads, the difference between the AA (LIBOR) and AAA (U.S. Treasury) interest rates (often used as a measure of the market appetite for risk), jumped from 107 basis points in mid-March to an all time high of 138 basis points towards mid-April.[1] Spreads on developing country debt rose from 760 basis points to about 850 basis points, over the same period.[2]

Volatility in international capital markets had a marked impact on flows to developing countries, which fell by 75 percent in April compared with the previous month. The decline in stock prices in industrial country markets was accompanied by a sharp fall in developing country equities. The correlation of developing country stock markets (as measured by IFC composite index) with the U.S. Nasdaq market shot up to 0.83 between mid-March and mid-April, compared to 0.28 between January and mid-March. As in the United States, volatility was

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1 Changes in swap spreads may also reflect technical factors. The declining supply of outstanding and new U.S. Treasury securities, (the benchmark for pricing new securities) due to buybacks and reduced demand for debt by the U.S. Treasury may have increased swap spreads.

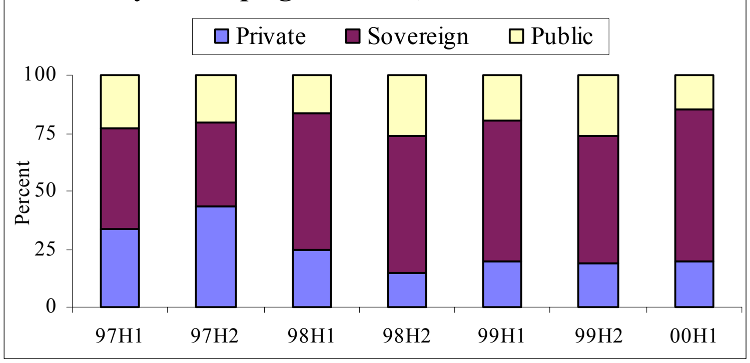
2 The latter figure is the average spread as of April 13th, prior to the decline related to the London Club restructuring of Russia's debt.

greatest in high technology sectors (e.g., the Internet and telecommunications), which accounted for about 65 percent of total equity placement in developing countries during the first half of 2000.

Capital market flows to developing countries jumped again in June, tripling over May. Equity placements rose from less than half a billion in May to over $8 billion in June (including over $5 billion from China). At the same time, volatility in industrial country markets declined, while swap spreads narrowed (although spreads on U.S. high-yield assets edged up a bit). Secondary market spreads on developing country debt compressed to 700 basis points in June, from a high of 830 basis points in May. Thus the relative stability in capital market flows during the first half of the year was made up of a sharp increase in the first quarter, a severe decline from later March to May, and further rise in June.

There is some evidence that concern over risk is increasing the share of flows to developing countries going to the better quality borrowers. Sixty percent of the total developing country bond issuance came from sovereign borrowers (perceived to be less risky than the private sector borrowers) compared with 55 percent in 1999, and the share of private borrowers remains low compared with 1997 (figure 4). Of the total market-based financing, over 70 percent went to only seven countries in the first half of 2000, compared with 75 percent raised by 14 countries in 1999. A substantial portion of bank lending (55 percent) went to finance roll over of upcoming liabilities or took the form of less risky lending, such as trade finance or securitized lending.

Figure 4 Sectoral breakdown of bond financing by developing countires, 1997 - Jun/2000

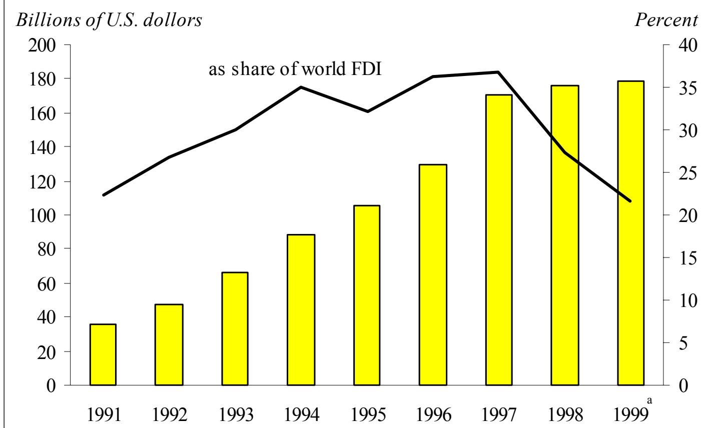


Foreign direct investment

FDI flows, the single largest source of external financing in developing countries in the 1990s, reached an estimated $180 billion in 1999 (equivalent to 2.6 percent of developing country GDP), slightly up from $176 billion in 1998. The rise in 1999 reflected a payment for large-scale privatization projects in Argentina (e.g., the sale of YPF SA brought in $16 billion). FDI also increased in Eastern Europe due to the progress in the privatization programs in the Czech Republic and Poland. On the other hand, FDI flows to East Asia and the Middle East and North Africa declined, largely due to declines in China and Saudi Arabia respectively.[3] At the same

[3] The value of new FDI commitments declined in China in the late 1990s, from $111 billion in 1993 to $52 billion in 1998, which has been reflected in the downward trend of actual FDI since 1998.

time, FDI in developing countries fell as share of world FDI flows, from the peak of 37 percent in 1997 to an estimated 22 percent in 1999 (figure 5).



a. Preliminary
Source: World Bank Debt Reporting System

Figure 5 FDI flows to developing countries rose steadily over 1990s

The recent wave of mega-scale cross-border mergers and acquisitions (M&A) among industrialized countries is driving world FDI flows. Global cross-border acquisitions of a more than 10 percent stake reached $720 billion in 1999, up by 35 percent from 1998. At $130 billion, developing countries' share of M&A reached 11 percent in 1999, which was, however, less than the 18 percent share in 1998. While the post-crisis upsurge in East Asia appears to be stabilizing, cross-border M&A has become increasingly important as an entry form of FDI, in both industrialized and, to a lesser extent, developing countries.[4]

Preliminary data indicate some contraction in FDI flows during the first quarter of 2000. FDI in the major recipient countries fell by 7 percent compared with the same period of 1999 (table 1). This downturn reflects declining commitments in the major recipient countries, slowing down in mergers and acquisitions (M&A) activity in East Asia, and the completion of large-scale privatization projects. China's downward trend in new FDI commitments continued in 1999, by a further 21 percent. The values of approved projects have also fallen in Thailand and Malaysia in 1999, by 30 percent and 6 percent respectively. Large-scale privatization projects in Latin America, the driving force of FDI in the region in the past few years, appear to have subsided.[5] Having completed the privatization of YPF in 1999, Argentina received 2.8 million pesos through privatization in the first quarter of 2000, compared with 1.8 billion pesos for the same period of 1999.

[4] M&A transaction values cannot be directly compared to balance of payments FDI values. The M&A reported values include components not included in reported FDI data.

[5] The advance payment of the 2000 installment for Brazil's Telebras privatization was completed in 1999, which is likely to reduce FDI inflows in 2000.

Table 1: FDI flows to major recipient countries (billions of US dollars)

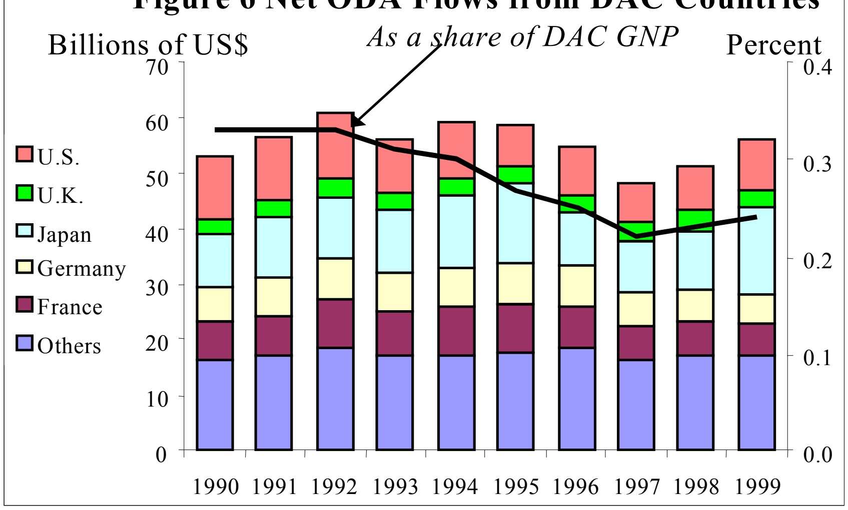
	1999				2000
	Q1	Q2	Q3	Q4	Q1
China	7.3	11.3	10.6	9.5	7.1
Brazil	7.2	5.1	8.5	6.2	6.4
Mexico	2.9	2.8	2.4	3.4	3.1
Argentina	4.4	14.5	3.0	1.3	2.0
Poland	1.1	1.2	2.5	1.9	2.0
Korea	1.4	1.8	2.7	2.8	1.6
Czech Republic	0.6	0.7	2.2	1.6	1.0
Venezuela	0.6	0.7	0.6	0.7	0.8
Thailand	1.0	2.2	1.2	1.3	0.7
India	0.7	0.5	0.6	0.4	0.7
Chile	0.6	5.5	2.1	1.0	0.6
Russia	0.6	0.8	0.7	0.8	0.6
Peru	0.5	0.6	0.5	0.2	0.4
Hungary	0.3	0.4	0.4	0.8	0.3
TOTAL	29.3	48.1	38.0	31.9	27.2

Source: IMF International Financial Statistics and central banks
Note: Estimates of FDI in have been updated since publication of Global Development Finance 2000.

Official development assistance

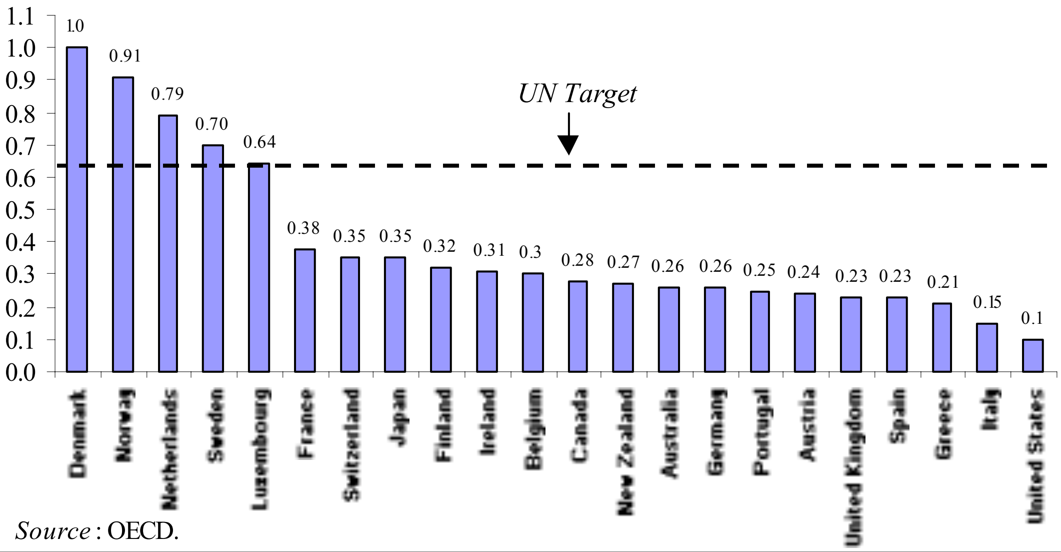
Official development assistance (ODA) flows from donors rose from $52 billion in 1998 to $56 billion in 1999 (an increase of 5 percent in real terms), and equaled 0.24 percent of DAC members combined GNP (figure 6). This increase continues the upward movement that commenced in 1998 when aid flows rose by $3.2 billion, reversing the decline in aid flows that lasted from 1992 to 1997 (during which period total ODA from DAC member countries to developing countries and multilateral institutions fell steadily from 0.33 percent of their combined GNP to a record low of 0.22 percent).

Figure 6 Net ODA Flows from DAC Countries



Sixteen of the 22 DAC member countries reported a rise in ODA in 1999. But by far the most significant increase came from Japan, where ODA rose by $4.7 billion (more than the $3.9 billion total increase) due to the special assistance program to countries affected by the Asian financial crisis. The international effort to assist refugees from Kosovo also contributed to aid flows in 1999. These increases were sufficient to offset the decline in net ODA flows from four of the G7 countries – France, Germany, Italy and the United Kingdom. Falls in aid from Italy and the United Kingdom largely reflected the timing of their contributions to multilateral institutions. Denmark, the Netherlands, Norway and Sweden remain the only countries to surpass the United Nations ODA target of 0.7 percent of GNP.

Figure 7 Net ODA in 1999-as a percentage of GNP



Source: OECD.

Aid flows received by developing countries, as measured by their receipts of concessional finance (but excluding technical assistance), are estimated to have risen in 1999 (see annex table). Net concessional finance totaled $41 billion (in current values) in 1999, [6] a marked increase above the $37 billion in 1998, but still some $5 billion below the 1994 level (which represents a total decline of 10 percent in real terms, deflated by the world import price index). One positive development was continued attention to raising resource flows to those very poor countries in Sub-Saharan Africa and elsewhere that are implementing better poverty reduction programs through the HIPC Initiative.

[6] This estimate of aid receipts (based on reports from aid recipients) differs significantly from the estimate of ODA flows given above (which is based on reports from donors), largely because the receipts do not include technical assistance grants, which totaled about $15.9 billion in 1999 to developing countries as a group. The difference also reflects the timing of donor contributions to multilateral organizations versus the receipt of disbursements from those institutions.

Annex

Long-Term Aggregate Net Resource Flows to Developing Countries
(US$ billions, at constant 1999 prices)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Official Development Finance [1]	45.9	50.3	46.3	42.8	43.6	54.8	62.0	51.8	52.8	45.0	48.5	27.9	37.1	50.1	53.6
Concessional Flows	32.8	35.7	37.4	36.3	35.8	42.9	50.5	42.3	41.1	45.3	40.7	35.5	31.2	37.1	41.0
Official Grants [1]	17.3	19.5	18.9	19.5	20.1	27.7	34.9	29.3	28.1	32.1	29.4	25.2	24.2	26.9	27.0
Official Concessional Loans	15.4	16.2	18.5	16.8	15.7	15.2	15.6	13.0	13.1	13.2	11.2	10.3	7.0	10.1	14.0
Official Non-concessional Loans	13.1	14.6	8.9	6.5	7.7	12.0	11.5	9.6	11.7	-0.3	7.8	-7.6	5.9	13.0	12.6
Private Flows	40.3	28.8	28.0	41.8	40.2	42.7	61.4	95.6	164.0	171.0	182.9	253.8	284.0	271.3	226.8
Private Loans	26.3	16.6	12.1	20.0	12.5	15.4	18.7	36.5	48.3	49.4	55.9	91.8	96.4	80.7	19.2
Foreign Direct Investment [2]	13.9	11.5	15.1	20.6	24.2	23.6	35.1	45.6	65.3	87.1	94.4	117.7	159.5	175.0	180.0
Portfolio Equity Investment	0.1	0.7	0.8	1.2	3.6	3.6	7.6	13.5	50.4	34.5	32.5	44.3	28.2	15.5	27.6
AGGREGATE NET FLOWS	86.2	79.2	74.3	84.6	83.8	97.6	123.4	147.4	216.8	216.1	231.4	281.6	321.2	321.4	280.4
Memorandum Items:															
Interest payments	92.3	82.7	75.1	80.7	75.8	69.2	71.9	65.7	67.9	76.7	90.8	95.8	105.2	119.4	135.3
Profits on Foreign Direct Investment	15.2	14.0	14.0	14.2	17.9	17.3	18.2	20.0	22.6	24.4	23.8	26.9	29.7	35.0	41.6
Private Grants	3.7	4.1	4.5	4.6	4.2	5.0	5.4	5.7	6.2	6.9	5.9	5.7	6.4	2.0	0.0
Related Data:															
Net Use of IMF Credit [3]	-0.3	-3.6	-6.2	-5.3	-2.4	0.1	3.2	1.2	1.7	1.6	15.1	0.9	13.7	19.1	-12.8
Technical Coop. Grants	9.7	11.0	12.2	13.1	12.7	13.9	15.4	16.9	18.0	16.5	18.1	16.6	14.5	16.0	15.9
World Bank Net Flows	6.6	6.9	5.4	3.1	3.2	5.0	2.6	0.1	2.8	-0.3	1.0	1.3	6.2	6.6	4.5
IDA-Net Flows	3.6	3.8	4.3	4.0	3.6	4.0	4.3	4.6	4.5	5.5	4.4	5.1	4.9	4.8	4.7

Sources: DRS and OECD.
Note: 1997 numbers are estimates.
1/ Excludes technical cooperation. Data based on receipts of official finance (concessional and nonconcessional) reported by countries, rather than donor reports (DAC data).
2/ Source: IMF.
3/ Includes IMF Trust Fund and PRGF.

Long-Term Aggregate Net Resource Flows to Developing Countries
(US$ billions, current)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Official Development Finance [1]	36.0	41.0	41.1	40.0	41.6	55.9	62.3	54.0	53.4	45.9	53.9	31.0	39.8	50.4	53.6
Concessional Flows	25.7	29.1	33.2	33.9	34.2	43.7	50.8	44.1	41.6	46.2	45.2	39.5	33.5	37.3	41.0
Official Grants [1]	13.6	15.9	16.8	18.2	19.2	28.2	35.1	30.5	28.4	32.7	32.7	28.0	26.0	27.1	27.0
Official Concessional Loans	12.1	13.2	16.4	15.7	15.0	15.5	15.7	13.6	13.2	13.5	12.5	11.5	7.5	10.2	14.0
Official Non-concessional Loans	10.3	11.9	7.9	6.1	7.3	12.2	11.6	10.0	11.8	-0.3	8.7	-8.5	6.3	13.1	12.6
Private Flows	31.6	23.5	24.8	39.1	38.4	43.5	61.7	99.7	165.8	174.4	203.3	282.1	304.6	272.8	226.8
Private Loans	20.6	13.5	10.7	18.7	11.9	15.7	18.8	38.1	48.8	50.4	62.2	102.1	103.4	81.2	19.2
Foreign Direct Investment [2]	10.9	9.4	13.4	19.3	23.1	24.1	35.3	47.5	66.0	88.8	105.0	130.8	171.0	176.0	180.0
Portfolio Equity Investment	0.1	0.6	0.7	1.1	3.4	3.7	7.6	14.1	51.0	35.2	36.1	49.2	30.2	15.6	27.6
AGGREGATE NET FLOWS	67.6	64.5	65.9	79.1	80.0	99.5	124.0	153.7	219.2	220.4	257.2	313.1	344.4	323.2	280.4
Memorandum Items:															
Interest payments	72.4	67.4	66.6	75.4	72.3	70.5	72.3	68.5	68.7	78.2	100.9	106.5	112.8	120.1	135.3
Profits on Foreign Direct Investment	11.9	11.4	12.4	13.3	17.1	17.6	18.3	20.9	22.9	24.9	26.5	29.9	31.8	35.2	41.6
Private Grants	2.9	3.3	4.0	4.3	4.0	5.1	5.4	5.9	6.3	7.0	6.6	6.3	6.9	2.0	0.0
Related Data:															
Net Use of IMF Credit [3]	-0.2	-2.9	-5.5	-5.0	-2.3	0.1	3.2	1.2	1.7	1.6	16.8	1.0	14.7	19.2	-12.8
Technical Coop. Grants	7.6	9.0	10.8	12.2	12.1	14.2	15.5	17.6	18.2	16.8	20.1	18.5	15.5	16.1	15.9
World Bank Net Flows	5.2	5.6	4.8	2.9	3.1	5.1	2.6	0.1	2.8	-0.3	1.1	1.4	6.7	6.6	4.5
IDA-Net Flows	2.8	3.1	3.8	3.7	3.4	4.1	4.3	4.8	4.5	5.6	4.9	5.7	5.3	4.8	4.7

Sources: DRS and OECD.
Note: 1999 numbers are estimates.
1/ Excludes technical cooperation. Data based on receipts of official finance (concessional and nonconcessional) reported by countries, rather than donor reports (DAC data).
2/ Source: IMF.
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