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

DC2002-0002
March 29, 2002

RECENT TRENDS IN THE TRANSFER OF RESOURCES TO DEVELOPING COUNTRIES

Attached for the April 21, 2002 Development Committee meeting is a background note prepared by World Bank staff entitled "Recent Trends in the Transfer of Resources to Developing Countries". (This note is based on the Global Development Finance 2002.)

Recent Trends in the Transfer of Resources to Developing Countries

A Background Note for the Development Committee Meeting of April 2002

Prepared by Staff of the World Bank[1]

Flows from international capital markets

The global economy slowed sharply in 2001, significantly reducing capital market flows (bond issues, bank lending and international equity issues) to developing countries. Global growth fell to 1.2 percent, or 2.7 percentage points lower than in 2000, the sharpest deceleration in output since 1974, during the first oil crisis (table 1). The slowdown in economic activity coincided with an unprecedented 14 percentage points deceleration of world trade, from record growth of 13 percent in 2000 to a 1 percent decline in 2001.

Table 1: Global economic conditions, 2000-2003

percent change	2000	2001a/	2002b/	2003b/
World trade	13.1	-0.8	1.8	8.3
World GDP	3.9	1.2	1.3	3.6
Industrial countries	3.5	0.8	0.8	3.2
Developing countries	5.4	2.8	3.2	5.0

a/ estimate
b/ forecast

The slowdown in industrial countries reduced developing countries' export revenues and hence their capacity to borrow, although this was partially mitigated by the drop in interest rates. Hardest hit were exporters of non-oil commodities, the prices of which fell by 9 percent in 2001 after sharp declines since 1997-98.

The slowdown also reduced the private sector's capital flows to developing countries. Long-term capital market commitments to developing countries fell from $228 billion in 2000 to $171 billion in 2001 (table 2). Since the peak in 1997, capital market commitments have fallen from 5 percent of developing country GDP to under 3 percent. The drop in capital market flows in 2001 also reflected lower demand in a few of the more creditworthy developing countries. This decline is also evident in the data on net capital market flows (disbursements minus amortization), which fell from $59 billion in 2000 to -$8 billion in 2001 (sum of private loans and portfolio equity investment in annex table).[2]

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[1] This report is based on the Global Development Finance 2002.

[2] The fall in capital market flows was to some extent offset by increased net use of IMF credit, which rose from -$10.8 billion in 2000 to $13.5 billion in 2001.

The sharpest fall was registered in bank lending, and, to a lesser extent, in equity issuance. By contrast, bond issues by developing countries remained stable, because many developing country borrowers through the bond market are rated investment grade, and hence were less affected by investors' reduced appetite for risk.

Table 2: Capital market commitments to developing countries 1991 – 2001

(US$ billions)	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
Total	77	80	116	135	173	236	316	189	178	228	171
Bond issuance	11	20	50	46	53	98	114	73	68	68	68
Bank lending	61	54	57	73	113	125	179	108	90	125	93
Equity Placement	5	6	8	17	8	14	22	9	20	35	10

a/ Estimate

Note: The data in this table are gross commitments, and thus differ significantly from the data in the annex table, which are gross disbursements minus amortization. The data on equity placements refers only to initial offerings of equity transactions marketed across borders, and does not include net purchases of securities by foreigners in domestic stock markets (which are included in the line "portfolio equity investment" in the annex).

The decline in capital market commitments deepened during the course of 2001. Capital market commitments fell to about $16 billion per month during the first half of 2001 (compared with $19 billion per month in 2000), and then dropped to only $9 billion per month following the September 11th terrorist attacks (table 3). Spreads on developing countries' bonds shot up to 924 basis points in the aftermath of the attacks, compared with 716 basis points in the first-half of 2001. Excluding Argentina and Turkey (the two major countries most affected by domestic economic crises) the rise in spreads was modest. Commitments recovered during the last quarter, but remained well below the 2000 level.

Table 3: Capital market commitments and spreads for developing countries, 2000–2001

	2000	2001			
		Jan-Jun	Jul-Aug	Sep-Oct	Nov-Dec
(Monthly average, $ billion)					
Capital market commitments	19.3	15.8	12.7	9.3	16.6
Bonds	5.7	6.9	4.1	2.5	6.8
Banks	10.6	7.7	7.9	6.7	9.1
Equity	3.0	1.2	0.6	0.2	0.7
(Basis points)					
Developing country spreads	707	716	844	924	865
Without Argentina and Turkey	507	440	416	447	404

Source: Dealogic, JP Morgan Chase and World Bank staff calculations.
Note: Developing country spreads refer to J.P. Morgan Chase's Emerging Market Bond Index Global, which uses country weights based on the market capitalization of outstanding debt.

After rallying in the last quarter of 2001, capital market commitments (in particular, bank lending) to emerging markets weakened again January-February 2002. Average monthly commitments of bank lending to developing countries in the first two months of 2002 dropped to one of the lowest levels seen in the 1980s. This sharp fall may to some extent reflect idiosyncratic factors, such as the timing of major transactions, rather than a further deterioration in market access. We anticipate a recovery of capital market flows during the year, as global economic activity picks up in the context of relatively low interest rates.

In contrast to the crises of the late 1990s, the contagion effects of the Argentine crisis were limited. Increases in spreads in other emerging markets were uneven during major crisis episodes, and spreads tended to return to former levels relatively quickly (table 4). The reasons behind the absence of contagion from Argentina are: (a) the Argentine crisis was anticipated by many market participants, and hence had less immediate impact; (b) developing countries have adopted more prudent financial policies by achieving lower inflation, moving towards more flexible exchange rates, increasing foreign exchange reserves and reducing short term debt (the average ratio of short-term debt to reserves of major emerging markets fell from 92 percent in mid-1997 to 40 percent by the third quarter of last year); and (c) the recession in industrial countries, with low interest rates and falling stock market prices, reduced the attractiveness of alternatives to investments in developing countries.

Table 4: change in spreads during crisis periods, 2000 – 2001

(basis points)

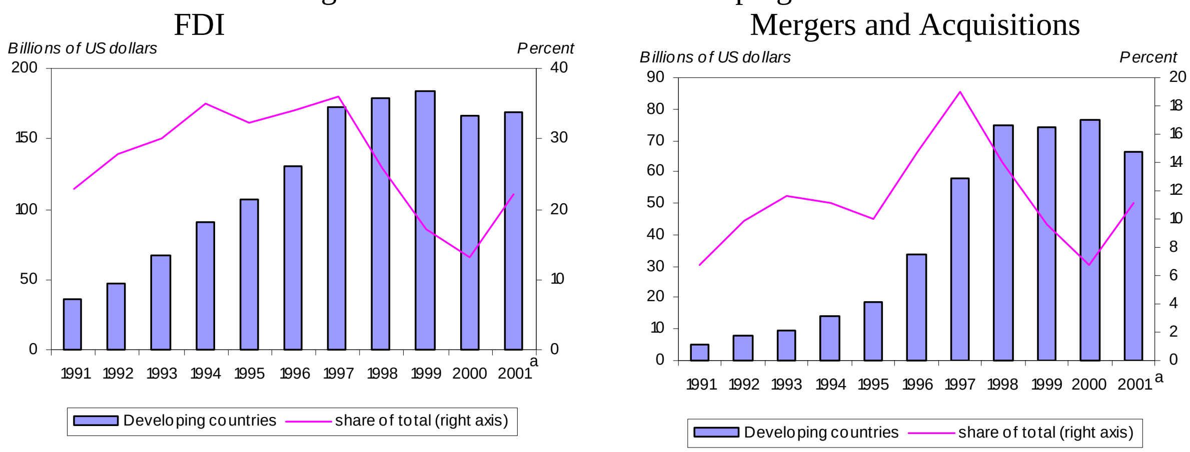
	October 2000	April 2001	July 2001	December 2001
Argentina	317	363	874	3806
Developing countries exc. Argentina, Turkey	64	-1	68	-46

Note: Each crisis period is defined as the previous low point of spreads to the peak. The weights used for developing countries excluding Argentina and Turkey in December 2001 differ slightly from the previous periods.

Foreign direct investment

Net FDI flows to developing countries equaled $168 billion in 2001, virtually unchanged from the 2000 level (figure 2, also see annex). This stability was in contrast to a fall in global FDI flows from $1.3 trillion in 2000 to $0.8 trillion in 2001 (figure 2). Declines in global FDI and stability in FDI to developing countries means that share of developing countries rose in 2001, partially reversing the substantial fall in their share during second half of 1990s. This reflects improved conditions in many emerging markets after the crises of late 1990s, as well as recession in industrial countries coupled with the collapse of industrial country stock markets which had fed the boom in mergers and acquisitions.

Figure 2: FDI and M&A in developing countries



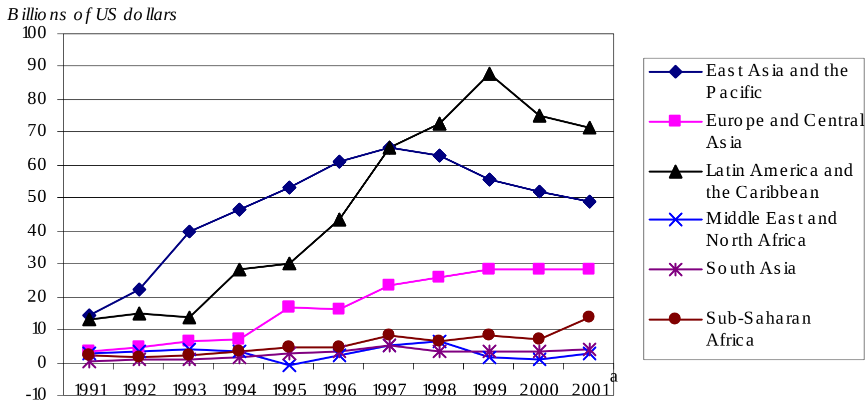
Source: World Bank, *Global Development Finance: Country Tables* and sources cited therein, various years; UNCTAD, *World Investment Report 2001*; and World Bank staff estimates for 2001.

Although overall FDI flows were stable in 2001, there were significant shifts among countries. Eight out of the top ten recipients saw changes (either increases or decreases) in FDI flows of 20 percent or more from the previous year. These changes were driven in part by a few large transactions, including the sale of the Mexican Banamex-Accival financial group for $12.5 billion and the take over of the South African De Beer's mining company by foreign acquisition of shares worth $20 billion. In other countries changes in FDI flows reflected changes in the overall economic environment rather than the impact of a few transactions. Examples include Brazil, where economic uncertainty restrained greenfield FDI; Argentina, where lower FDI flows reflected a slowdown in private sector M&A transactions with the increasing economic difficulties; Korea, where the process of corporate and financial restructuring has slowed; and China, where FDI boomed with the anticipation of accession to the World Trade Organization.[3]

These major changes largely determined the regional trends (figure 3). FDI continued to fall in Latin America (the largest recipient region) and in East Asia. Net FDI flows to Middle East and North Africa stagnated, largely due to the transfer of funds from foreign affiliates in the oil-exporting countries to their parent companies. The De Beers sale boosted flows to Sub-Saharan Africa.

[3] The extent to which FDI inflows in China represent additional resources to the country remains open to question, because a significant portion of registered FDI to China may have originated in the country.

Figure 3: Regional trends of FDI flows



a. World Bank staff estimates.

Source: World Bank, *Global Development Finance: Country Tables* and sources cited therein, various years; and World Bank staff estimates for 2001.

Official development assistance

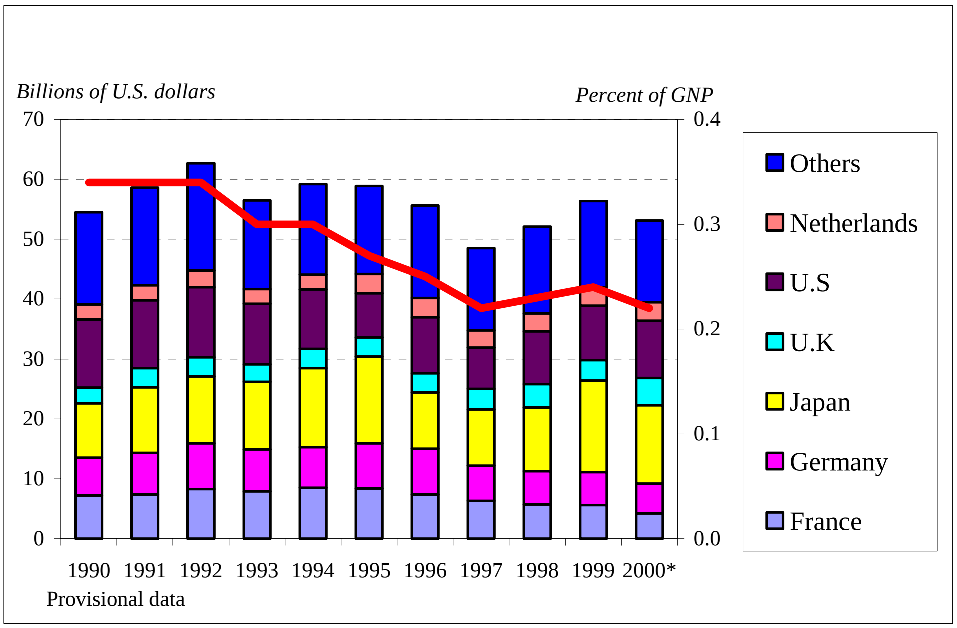
The past two years have seen a further decline in aid. Aid flows *received by developing countries* (excluding technical cooperation grants) are estimated to have declined by a further 3.4 percent in 2001, to $39.3 billion, after a 3.8 percent fall in 2000.[4] Much of this decline was due to a drop in Japanese aid to East Asia, as disbursements fell relative to the period of the Asian crisis. Preliminary estimates suggest a continued increase in aid to Eastern Europe and Central Asia, both due to stepped-up assistance to the Balkans and support for the efforts of the advanced Eastern European countries to join the European Union. Aid flows have declined to Sub-Saharan Africa—due to delays in implementation of reform in some countries—and to South Asia, despite a rise in humanitarian assistance to India following the devastating earthquake in 2001.

The amount of official development assistance (ODA) *provided by donors* fell by 1.6 percent in real terms in 2000 to $53.1 billion, or 0.22 percent of Development Assistance Committee (DAC) members' GNP (see figure 4; data on aid flows from donors for 2001 are not yet available). This decline, which reversed the upward trend that commenced in 1998, was due to two special factors: the above-noted fall in aid from Japan, and the removal of countries from the list of those eligible to receive ODA because their per capita incomes now exceed the cut-off

[4] Concessional aid flows are measured in two ways: aid recorded as received by developing countries and aid recorded as provided by donor countries. The two measures are different because in any given year the concessional funding provided by donors to multilateral institutions is not the same as those institutions' disbursements to developing countries.

for flows to be counted as aid.[5] Adjusting for the change in the DAC list, ODA fell by 0.2 percent in real terms in 2000. The decline was due to the fact that in the G7 countries aid fell by 4.8 percent in real terms; aid from non—G7 countries increased by 8.3 percent in real terms. At the same time, further progress was made in providing debt relief through the Enhanced Heavily Indebted Poor Countries Initiative, which is described in a separate paper to the Development Committee.

Figure 4: ODA from donor countries
(US$ billions and in relation to their GNP)



Source: OECD April, 2001
Note: Line refers to ODA from donor countries relative to GNP (right axis)
Bars refer to ODA in billions of dollars (left axis)

The decline in aid over the past few years comes on top of falling aid through much of the 1990s. Expressed as a share of donors' GNP, aid fell from 0.33 percent in 1990 to 0.22 percent in 2000. Only five donor countries reached (or surpassed) the United Nation's target of 0.7 percent of GNP which was endorsed by Group of Seven (G7) countries at the Earth Summit in Rio in 1992. At the same time, the need for aid continues to grow. Developing countries' population rose by 17 percent during the 1990s, and the number of people (outside of China) living on less than $1 a day has remained roughly the same. Some 60 million people in developing countries are infected with HIV. The Millennium Development Goals cannot be met without increased aid. Preliminary calculations indicate that a doubling of aid, coupled with improved developing country policies and increased allocation of aid to countries with good

[5] Ten countries or territories were removed from the list of ODA recipients on January 1, 2000: Aruba, French Polynesia, Gibraltar, Korea, Libya, Macao, the Netherlands Antilles, New Caledonia, Northern Marianas and the Virgin Islands.

policies, will be required to halve poverty by 2015.[6] Vigorous steps to increase the availability of aid resources, in conjunction with improved donor policies to support increased aid effectiveness and the removal of barriers to trade in industrial countries that restrain developing countries' exports, should be the top priorities for the international community.

[6] See Goals for Development: History, Prospects and Costs, a background paper for the September 2001 Development Committee Meeting.

Annex

Long-Term Aggregate Net Resource Flows to Developing Countries (US$ billion)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
*At constant 2001 prices**																	
Official Development Finance	46.5	51.2	48.5	46.2	46.2	58.5	63.7	56.0	52.5	46.4	51.4	28.6	40.1	53.5	45.8	36.4	36.0
Concessional Flows	32.9	36.3	39.2	39.2	38.3	45.9	51.8	46.0	41.0	46.6	43.0	36.4	33.7	38.3	42.1	39.0	39.3
Official Grants [1]	17.2	19.8	19.8	21.0	21.5	29.7	36.7	30.3	27.8	31.7	30.5	25.7	24.8	27.4	30.0	28.7	29.6
Official Concessional Loans	15.7	16.5	19.3	18.2	16.9	16.2	15.1	15.8	13.2	14.9	12.5	10.6	8.9	10.9	12.0	10.4	9.7
Official Non-concessional Loans	13.6	14.8	9.3	7.0	7.9	12.6	11.9	9.9	11.6	-0.1	8.4	-7.7	6.5	15.2	3.8	-2.7	-3.3
Private Flows	39.9	29.3	29.3	44.9	42.7	44.4	64.9	98.6	164.6	170.8	191.5	253.3	280.5	278.1	223.3	216.6	160.0
Private Loans	26.0	16.8	12.7	21.4	13.1	15.0	19.7	37.9	49.1	49.6	58.8	88.4	91.5	87.8	5.6	7.9	-26.8
Foreign Direct Investment [2]	13.7	11.7	15.8	22.2	25.8	25.4	37.3	46.8	65.4	87.2	99.2	119.8	160.9	175.0	183.4	159.9	168.2
Portfolio Equity Investment	0.1	0.7	0.8	1.3	3.8	3.9	7.9	13.9	50.1	34.0	33.5	45.0	28.2	15.3	34.3	48.8	18.5
AGGREGATE NET FLOWS	86.3	80.4	77.8	91.1	88.9	102.9	128.7	154.6	217.1	217.2	242.9	281.9	320.6	331.6	269.1	253.0	196.0
Memorandum Items:																	
Interest payments	91.7	83.9	78.5	86.7	80.8	74.0	75.5	67.8	67.0	75.1	93.7	97.7	105.3	116.5	121.3	121.5	122.2
Profits on Foreign Direct Investment	15.0	14.2	14.6	15.3	19.1	18.5	16.7	17.9	19.7	24.1	24.6	27.5	29.6	34.6	40.1	43.5	55.3
Private Grants	3.7	4.1	4.7	5.0	4.5	5.4	5.7	6.0	5.8	5.8	5.6	5.1	4.8	5.5	5.7	5.3	5.4
Related Data:																	
Net Use of IMF Credit [3]	0.1	-3.4	-6.8	-5.8	-2.7	-1.9	4.8	1.6	1.9	1.5	16.1	0.5	13.5	18.9	-12.5	-10.3	13.5
Technical Coop. Grants	9.8	11.3	12.8	14.1	13.7	14.8	16.3	17.6	17.9	16.3	18.7	17.1	14.7	16.0	16.5	14.9	15.2
World Bank Net Flows	6.6	6.9	5.6	3.4	3.5	5.4	2.7	0.1	2.7	-0.3	1.0	1.2	6.3	6.7	5.1	3.3	2.2
IDA-Net Flows	3.5	3.8	4.4	4.2	3.8	4.3	4.5	4.8	4.4	5.4	4.6	5.2	4.9	4.7	4.5	4.0	4.7
At current prices																	
Official Development Finance	36.7	41.0	41.0	40.1	41.3	55.6	60.9	56.4	53.5	48.0	55.3	31.2	43.0	54.5	46.1	37.9	36.0
Concessional Flows	26.0	29.1	33.2	34.0	34.3	43.6	49.5	46.4	41.7	48.1	46.3	39.7	36.1	39.0	42.3	40.7	39.3
Official Grants [1]	13.6	15.9	16.8	18.2	19.2	28.2	35.1	30.5	28.3	32.7	32.8	28.1	26.6	27.9	30.2	29.9	29.6
Official Concessional Loans	12.4	13.2	16.4	15.8	15.1	15.4	14.4	15.9	13.4	15.4	13.5	11.6	9.5	11.1	12.1	10.8	9.7
Official Non-concessional Loans	10.8	11.9	7.9	6.1	7.1	12.0	11.4	10.0	11.8	-0.1	9.0	-8.5	6.9	15.5	3.8	-2.8	-3.3
Private Flows	31.5	23.4	24.8	39.0	38.2	42.2	62.0	99.4	167.6	176.4	206.1	276.5	300.8	283.2	224.4	225.8	160.0
Private Loans	20.5	13.4	10.7	18.6	11.7	14.3	18.8	38.2	50.0	51.2	63.3	96.5	98.1	89.4	5.6	8.2	-26.8
Foreign Direct Investment [2]	10.9	9.4	13.4	19.3	23.1	24.1	35.7	47.1	66.6	90.0	106.8	130.8	172.5	178.3	184.4	166.7	168.2
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	34.5	50.9	18.5
AGGREGATE NET FLOWS	68.2	64.5	65.9	79.1	79.6	97.8	122.9	155.8	221.1	224.3	261.5	307.7	343.8	337.7	270.5	263.7	196.0
Memorandum Items:																	
Interest payments	72.4	67.3	66.5	75.3	72.3	70.3	72.2	68.3	68.2	77.6	100.8	106.6	112.9	118.7	121.9	126.7	122.2
Profits on Foreign Direct Investment	11.9	11.4	12.4	13.3	17.1	17.6	16.0	18.0	20.1	24.9	26.5	30.0	31.8	35.2	40.3	45.4	55.3
Private Grants	2.9	3.3	4.0	4.3	4.0	5.1	5.4	6.0	5.9	6.0	6.0	5.6	5.2	5.6	5.7	5.5	5.4
Related Data:																	
Net Use of IMF Credit [3]	0.1	-2.7	-5.8	-5.0	-2.4	-1.8	4.6	1.6	1.9	1.6	17.3	0.6	14.5	19.2	-12.6	-10.8	13.5
Technical Coop. Grants	7.7	9.1	10.8	12.3	12.2	14.1	15.6	17.7	18.2	16.9	20.1	18.7	15.7	16.3	16.6	15.5	15.2
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	6.8	5.1	3.4	2.2
IDA-Net Flows	2.8	3.0	3.8	3.7	3.4	4.1	4.3	4.8	4.5	5.6	4.9	5.7	5.3	4.8	4.5	4.2	4.7

Sources: *Global Development Finance Country Tables* and sources cited therein, World Bank Global Economic Model, OECD Development Assistance Committee's *Geographic Distribution of Flows*.
Note: 2001 numbers are estimates.
* A new series of deflators has been used to calculate official flows in constant terms. As in the past the deflator measures merchandise imports for all developing countries, including the transition countries in Eastern Europe and the Former Soviet Union. But, the new series more accurately reflects the global pattern of commodity, oil and manufactures trade and the pricing of the energy and non energy related components.
1/ Excludes Technical Cooperation.
2/ Source: IMF.
3/ Includes IMF Trust Fund and EASF.