DEVELOPMENT COMMITTEE
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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 29, 2001 Development Committee meeting is a background note prepared by World Bank staff on Recent Trends in the Transfer of Resources to Developing Countries.

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Recent Trends in the Transfer of Resources to Developing Countries
A Background Note for the Development Committee Meeting of October 1, 2001
Prepared by Staff of the World Bank

The global economic environment during the first half of this year was less conducive for capital flows to developing countries than last year. For the first time in three decades all three industrial regions are simultaneously experiencing economic slowdown. The growth rate of world trade has slowed sharply to around 2.5 percent from 13 percent last year, and non-oil commodity prices have moderated further. This combination of economic slowdown in industrial countries and adverse export outlook for developing countries, combined with the threat of crisis in some major emerging market economies, has heightened risk aversion towards investments in developing countries.

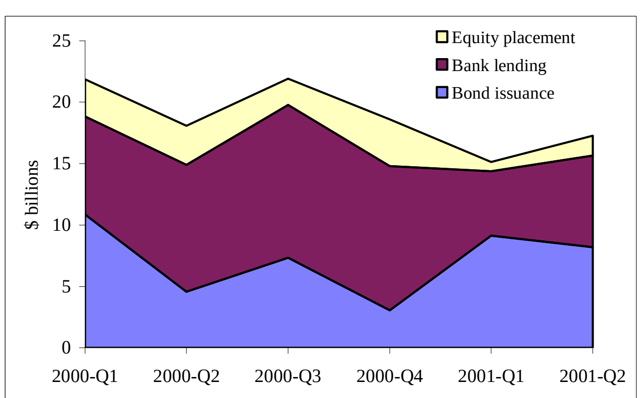
As a result, net resource flows to developing countries may have declined during the first half of 2001, despite the interest rate cuts in the US and Europe. Gross capital market flows to developing countries declined 20 percent during this period compared to the first half of last year. Although bond placements from developing countries increased modestly, syndicated bank lending and equity placements declined significantly. Preliminary data on foreign direct investment flows (FDI) for the first quarter of 2001 indicate little change from the first quarter of last year.

This paper reports on recent developments in international resource flows since the note issued for the Spring meetings (which was based on Global Development Finance 2001). It updates information on capital market commitments until the second quarter and on FDI until the first quarter of this year. It also discusses data revisions on aid flows in 2000. Our estimates for net long-term resource flows (see annex tables) in 2000 are largely unchanged, with the exception of FDI flows and official-source flows. These data will be revised during the preparation of the next Global Development Finance report.

Private flows from international capital markets

Capital market commitments to developing countries in the first half of 2001 declined by 20 percent compared with the comparable period in 2000 (figure 1). The decline was due to economic slowdown and heightened risk aversion in industrial countries, economic difficulties in a few major developing countries, and depressed demand for external funds from East Asia and some oil exporters.

Figure 1: Capital market commitments to developing countries



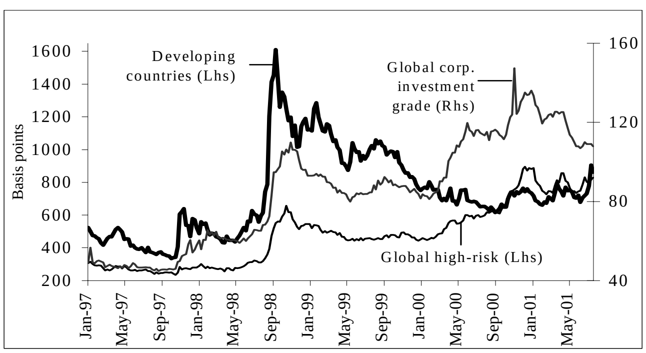
Source: Capital DATA Bondware and Loanware and World Bank staff calculations.

Even as interest rates were cut in the United States and Europe and the spreads on global investment grade corporate bonds declined in the first half of 2001, investors became more cautious about investing in high risk assets (figure 2 and table 1). As two-thirds of developing countries with sovereign bond ratings fall into the high risk category, the average spread on developing countries' bonds rose from 735 basis points at the end of 2000 to 915 basis points in mid-July, 2001, accompanied by a decline in new capital market commitments.

Capital market flows also declined in response to a deterioration in the macroeconomic and political environment of some major emerging market economies. Argentine spreads were on average 250 basis points higher than in 2000 and reached levels over 1600 basis points in mid-July, the highest since the Mexican crisis in 1994. Similarly, the spreads on Turkey, which were on average 350 basis points higher than in 2000, reached close to 1200 basis points in mid-July. Several other countries like Ecuador, Russia and Venezuela also experienced deterioration in their spreads.

The decline in capital market commitments in the case of some East Asian countries was in part due to their lack of demand as these economies continued to have excess capacity, depressed investment rates and current account surpluses. Also, capital market commitments to oil exporting countries fell as their oil revenues increased.

Figure 2: Trends in risk premium



Source : JP Morgan Chase and Merrill Lynch.

Table 1: Interest rate spreads

(Basis points)	1998	1999	2000	2001[a]
Developing countries	1123	751	735	862
Latin America	941	598	702	949
Other countries	1442	1013	791	696
Global				
Investment grade	93	82	136	108
High risk	546	452	881	829
Tech/Media related [b] sectors	514	372	969	1091

Note: Premiums are as of end period.
[a] Data for 2001 are until July 20.
[b] For United States only.
Source: JP Morgan Chase, Merrill Lynch and World Bank staff calculations.

In the first half of 2001, bond issuance by developing country borrowers increased 10 percent over the first half of 2000. Rating upgrades helped reopen the bond market to Russia, and also provided market access to a few smaller borrowers, such as Croatia, Kazakhstan, Lithuania and Ukraine. However, other borrowers, particularly in Argentina and Turkey, suffered reduced access to bond financing by 77 percent and 85 percent respectively compared with their half-year average of 2000. Some countries, such as Brazil, Colombia, Croatia, South Africa and Uruguay, were able to issue bonds in European and Japanese markets, especially at times of high risk aversion (January, March and May) in the U.S. market.

Syndicated bank lending commitments—which has traditionally catered to lower rated and un-rated corporate sector borrowers from developing countries—declined by 45 percent over the first half of 2000. According to the U.S. Federal Reserve, commercial banks tightened lending standards, reaching levels not seen since the 1990-91 recession, after suffering losses on lending to the telecommunication and information technology related sector. Bank lending commitments to East Asia fell further in the first half of 2001 compared to already depressed levels in 2000, and commitments to the oil exporting countries fell by 35 percent over the first half of 2000.

International equity placement from developing countries in the first half of 2001 dropped by 62 percent over the first half of 2000. Emerging equity markets, especially those with a high exposure to information and communications technology (ICT) sectors, continued to reflect the decline of and the volatility in industrial country financial markets. For example, the Standard & Poors/International Finance Corporation Investable (S&P/IFCI) index in which ICT sectors have a one-third weight, was down by 22 percent in the first half of 2001, mirroring a 42 percent drop in NASDAQ. Although the Chinese and the South Korean equity markets performed rather well[1], and accounted for nearly 60 percent of equity placements from developing countries, placements from other countries remained weak.

There was a marked increase in contagion effects from Argentina and Turkey on major emerging market borrowers in July 2001. Compared to the first and the second quarter of the year, the correlation between interest spreads in selected countries (that are part of the EMBI global index) and those of Argentina increased sharply in July 2001 (table 2). Moreover, the strikingly high and narrow range of these correlation coefficients indicate that investors differentiated little between countries with good credit rating and those with high risks.[2]

[1] Equity placement by South Korea largely reflected the $2.2 jumbo deal of Korea Telecom Corporation.

[2] There was a similar pattern of correlation between these country spreads and those of Turkey during January-July 2001.

Table 2: Correlation between selected country spreads with those of Argentina

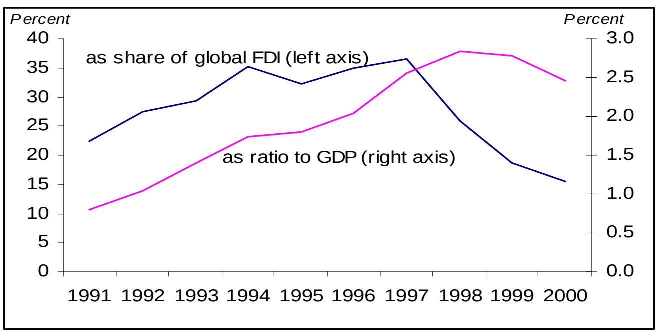
	2001-Q1	2001-Q2	2001-Jul
Brazil	0.93	0.69	0.94
Chile	-0.28	-0.01	0.85
Colombia	-0.35	0.24	0.90
Mexico	0.72	0.28	0.92
Philippines	-0.16	0.25	0.92
Poland	0.19	-0.19	0.88
Russia	0.54	0.28	0.92
Turkey	0.77	0.03	0.91
Venezuela	0.35	0.36	0.93

Source: JPMorgan Chase EMBI database

Foreign direct investment

There has been a downward revision in the data on FDI flows to developing countries since the last Global Development Finance 2001. With a decline of 6 percent to an estimated $172 billion, the share of FDI in developing countries in global FDI fell to 15 percent in 2000, less than half its peak of 37 percent in 1997 (figure 3). FDI flows saw significant declines in East Asia (as the volume of cross-border acquisitions of assets by foreign investors fell), and Latin America (due to the completion of several large-scale privatization projects in 1999). These declines offset some significant increases in FDI flows to Eastern European economies in 2000.[3]

Figure 3: FDI flows to developing countries



Source: World Bank Debt Reporting System and staff estimates

Preliminary data indicate that FDI flows to the major recipient countries were nearly unchanged in the first quarter of 2001 compared to the same period of 2000 (table 3). While large-scale privatization in Latin America is unlikely to be revived this year, sizeable acquisitions in the private sector may bring back FDI flows to some countries.[4]

[3] For example, the privatization of Slovenske telekomunikacie in the Slovak Republic and Telekomunikacja Polska (TPSA) in Poland raised $1 billion and $3.2 billion respectively.

[4] One example is the acquisition of Mexico's Banamex-Accival financial group by Citigroup for $12.5 billion.

Table 3: FDI flows to major recipient countries (billions of US dollars)

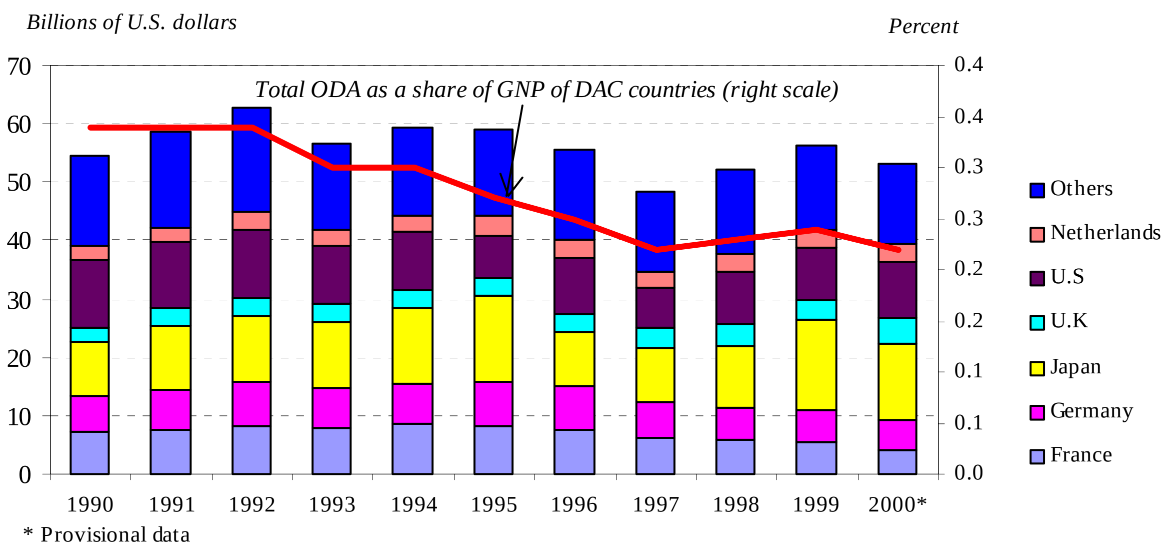
	2000 Q1	Q2	Q3	Q4	2001 Q1
China	7.1	10.1	8.9	14.7	8.0
Brazil	7.0	6.4	9.2	10.1	4.7
México	3.3	3.9	2.5	3.5	3.6
Argentina	2.3	1.8	6.1	1.0	1.4
Poland	1.6	1.2	0.9	5.7	1.4
Korea	1.4	3.2	1.8	2.3	0.8
Chile	0.5	1.1	0.9	1.1	2.5
Czech Republic	1.1	1.2	1.0	1.3	0.9
Venezuela	0.8	1.9	0.5	0.9	0.6
Thailand	0.7	0.7	0.8	0.8	0.4
India	0.7	0.7	0.5	0.7	0.7
Russia	0.5	0.5	0.7	1.1	0.4
Hungary	0.3	0.7	0.5	0.4	0.9
Peru	0.1	0.3	0.05	0.1	0.03
Total	27.4	33.7	34.4	43.7	26.3

Source: IMF International Financial Statistics and central banks

Official development assistance

Preliminary data of the OECD show that official development assistance (ODA) flows from donors fell to \$53.1 billion in 2000 compared to \$56.4 billion in 1999. This reversal of an upward trend seen since 1998 was due to two reasons: ten countries with relatively high per capita income levels were removed from the list of ODA recipients on January 1, 2000;[5] and Japan's aid was \$2.3 billion lower in 2000 than in 1999 when Japan made exceptional contributions to the Asian Development Bank in the wake of the Asian financial crisis.

Figure 4: Official Development Assistance from donor countries



* Provisional data

Source: OECD April, 2001

[5] Aruba, French Polynesia, Gibraltar, Korea, Libya, Macao, the Netherlands Antilles, New Caledonia, Northern Marianas and the Virgin Islands. Adjusting for this change, ODA fell by 0.2 percent in real terms in 2000.

The disparity in the ratio of ODA to GNP between the G7 and the non-G7 countries continued in 2000. Total ODA from G7 countries fell by 4.8 percent in real terms while aid from non-G7 countries increased by 8.3 percent in real terms. The fall in Japan's aid combined with a fall in aid from France as a result of the removal of French Polynesia and New Caledonia from the aid list, and a fall in aid from Italy due to the timing of contributions to multilateral institutions offset the increase in aid from the United Kingdom, Germany and the United States.

Fifteen of the 22 DAC member countries reported a rise in ODA in 2000. Denmark set a record ODA/GNP level of 1.06 percent and Luxembourg reached the 0.7 percent United Nations ODA/GNP target for the first time. Aid from the United Kingdom rose by 35.6 percent in real terms. Other countries to significantly increase their aid were Belgium, 21.7 percent, Greece, 28.7 percent, the Netherlands, 10 percent and Sweden, 22.3 percent

Prospects for a rise in ODA in 2001 are not strong given the economic slowdown in the largest donor countries, where the desire to stimulate domestic economic activity may increase pressure to reduce aid budgets.

Aid receipts (excluding technical cooperation grants) reported by developing countries declined to $39.5 billion in 2000 from $40.3 billion in 1999. When deflated by the world import price index, net concessional finance[6] registered a decline of 5.7 percent in real terms in 2000 (see annex table) over the 1999 level and, in fact, a decline of over 22 percent compared to the 1991 level. Although there was an increase in aid flows to Europe and Central Asia, other regions, most notably East Asia, experienced a decline in aid flows from Japan. This was particularly true of Indonesia where political turmoil slowed the reform process. In Sub Saharan Africa, civil conflict and delays in implementation of reforms resulted in a fall in net aid flows to Cote d'Ivoire, Guinea, Kenya, Niger and Togo, even as other countries (e.g., Tanzania, Uganda, and Zambia) pursuing good policies saw the net inflow of aid rise. In Middle East and North Africa continued aid flows to support the peace-keeping effort were more than offset by the fall in aid to middle income countries in the region, notably Algeria and Egypt. The decline in aid to South Asia reflected cuts in aid to Pakistan. In contrast, there was a sharp increase in aid received by Europe and Central Asia due to emergency assistance and peace-keeping operations in the Balkans, and support to the Czech Republic, Hungary, Poland and Slovak Republic in their efforts to join the European Union.

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[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 $17.1 billion in 2000 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$ billion)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
At constant 2000 prices																
Official Development Finance	48.3	51.9	47.7	44.2	44.7	56.3	62.5	55.9	54.7	48.6	51.1	29.6	41.2	56.0	47.1	36.5
Concessional Flows	34.1	36.8	38.5	37.5	37.0	44.2	50.8	45.9	42.5	48.6	42.9	36.8	34.2	39.4	41.9	39.5
Official Grants [1]	17.9	20.1	19.5	20.1	20.8	28.5	36.0	30.2	28.9	33.1	30.3	26.1	25.1	28.0	30.0	28.7
Official Concessional Loans	16.3	16.7	19.0	17.4	16.3	15.7	14.8	15.7	13.7	15.6	12.5	10.8	9.1	11.4	11.8	10.8
Official Non-concessional Loans	14.1	15.0	9.2	6.8	7.7	12.1	11.7	10.0	12.1	-0.1	8.3	-7.2	6.9	16.6	5.2	-3.0
Private Flows	41.5	29.7	28.8	43.1	41.6	44.1	63.7	98.2	170.1	177.6	191.4	259.3	289.0	288.1	224.6	250.9
Private Loans	27.0	17.0	12.4	20.6	12.9	15.8	19.3	37.7	50.2	51.0	58.5	91.5	93.3	90.2	-0.7	31.3
Foreign Direct Investment [2]	14.3	11.9	15.6	21.3	25.0	24.5	36.7	46.6	67.9	91.0	99.4	122.2	166.7	181.9	189.5	171.7
Portfolio Equity Investment	0.1	0.8	0.8	1.2	3.7	3.7	7.8	13.9	51.9	35.6	33.5	45.6	29.0	16.0	35.8	47.9
AGGREGATE NET FLOWS	89.7	81.6	76.5	87.4	86.3	100.4	126.0	154.1	224.1	224.9	241.0	287.4	329.4	343.5	274.7	295.8
Memorandum Items:																
Interest payments	95.3	85.3	77.4	83.2	78.2	71.2	74.2	67.7	70.0	79.1	93.7	98.6	108.6	122.2	127.4	133.6
Profits on Foreign Direct Investment	15.6	14.4	14.4	14.7	18.5	17.8	16.4	17.9	20.5	25.2	24.6	27.9	30.6	36.1	41.6	50.2
Private Grants	3.8	4.2	4.7	4.7	4.3	5.2	5.5	5.9	6.0	6.1	5.6	5.2	5.0	5.7	5.9	5.5
Related Data:																
IMF Net Resource Flows	0.1	-3.4	-6.8	-5.5	-2.6	-1.8	4.7	1.5	1.9	1.6	16.0	0.6	14.0	19.7	-13.1	-10.7
Technical Coop. Grants	10.2	11.5	12.6	13.5	13.2	14.3	16.0	17.5	18.6	17.1	18.6	17.3	15.1	16.6	17.2	17.1
World Bank Net Flows	6.8	7.1	5.6	3.2	3.4	5.2	2.7	0.5	3.3	0.2	1.6	1.8	7.0	7.5	5.8	3.3
IDA-Net Flows	3.6	3.8	4.4	4.1	3.7	4.1	4.4	4.8	4.6	5.7	4.6	5.3	5.1	4.9	4.7	4.1
At current prices																
Official Development Finance	36.7	41.0	41.0	40.1	41.4	55.7	60.9	56.5	53.6	48.0	55.1	31.9	42.8	54.6	45.3	36.5
Concessional Flows	26.0	29.1	33.1	34.0	34.2	43.7	49.5	46.4	41.7	48.1	46.2	39.7	35.6	38.4	40.3	39.5
Official Grants [1]	13.6	15.9	16.8	18.2	19.2	28.2	35.1	30.5	28.3	32.7	32.7	28.1	26.1	27.3	28.9	28.7
Official Concessional Loans	12.4	13.2	16.3	15.8	15.0	15.5	14.4	15.9	13.4	15.4	13.5	11.6	9.5	11.1	11.4	10.8
Official Non-concessional Loans	10.8	11.9	7.9	6.1	7.1	12.0	11.4	10.1	11.9	-0.1	8.9	-7.8	7.2	16.2	5.0	-3.0
Private Flows	31.5	23.5	24.8	39.1	38.5	43.6	62.1	99.3	166.8	175.7	206.3	279.5	300.5	280.9	216.2	250.9
Private Loans	20.6	13.5	10.7	18.7	11.9	15.7	18.8	38.1	49.2	50.5	63.0	98.7	97.0	87.9	-0.6	31.3
Foreign Direct Investment [2]	10.9	9.4	13.4	19.3	23.2	24.2	35.7	47.1	66.6	90.0	107.2	131.7	173.3	177.4	182.4	171.7
Portfolio Equity Investment	0.1	0.6	0.7	1.1	3.4	3.7	7.6	14.1	50.9	35.2	36.1	49.2	30.2	15.6	34.5	47.9
AGGREGATE NET FLOWS	68.3	64.5	65.8	79.2	79.9	99.2	122.8	155.8	219.7	222.4	259.8	309.8	342.5	334.9	264.5	295.8
Memorandum Items:																
Interest payments	72.5	67.4	66.6	75.4	72.4	70.4	72.3	68.5	68.7	78.2	101.0	106.3	112.9	119.2	122.7	133.6
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	40.0	50.2
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
Related Data:																
IMF Net Resource Flows	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	-10.7
Technical Coop. Grants	7.7	9.1	10.8	12.3	12.2	14.1	15.6	17.7	18.2	16.9	20.0	18.7	15.7	16.2	16.6	17.1
World Bank Net Flows	5.2	5.6	4.8	2.9	3.1	5.1	2.6	0.5	3.3	0.2	1.7	2.0	7.3	7.3	5.6	3.3
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	4.1

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: 2000 numbers are estimates.

1/ Excludes Technical Cooperation.

2/ Source: IMF.