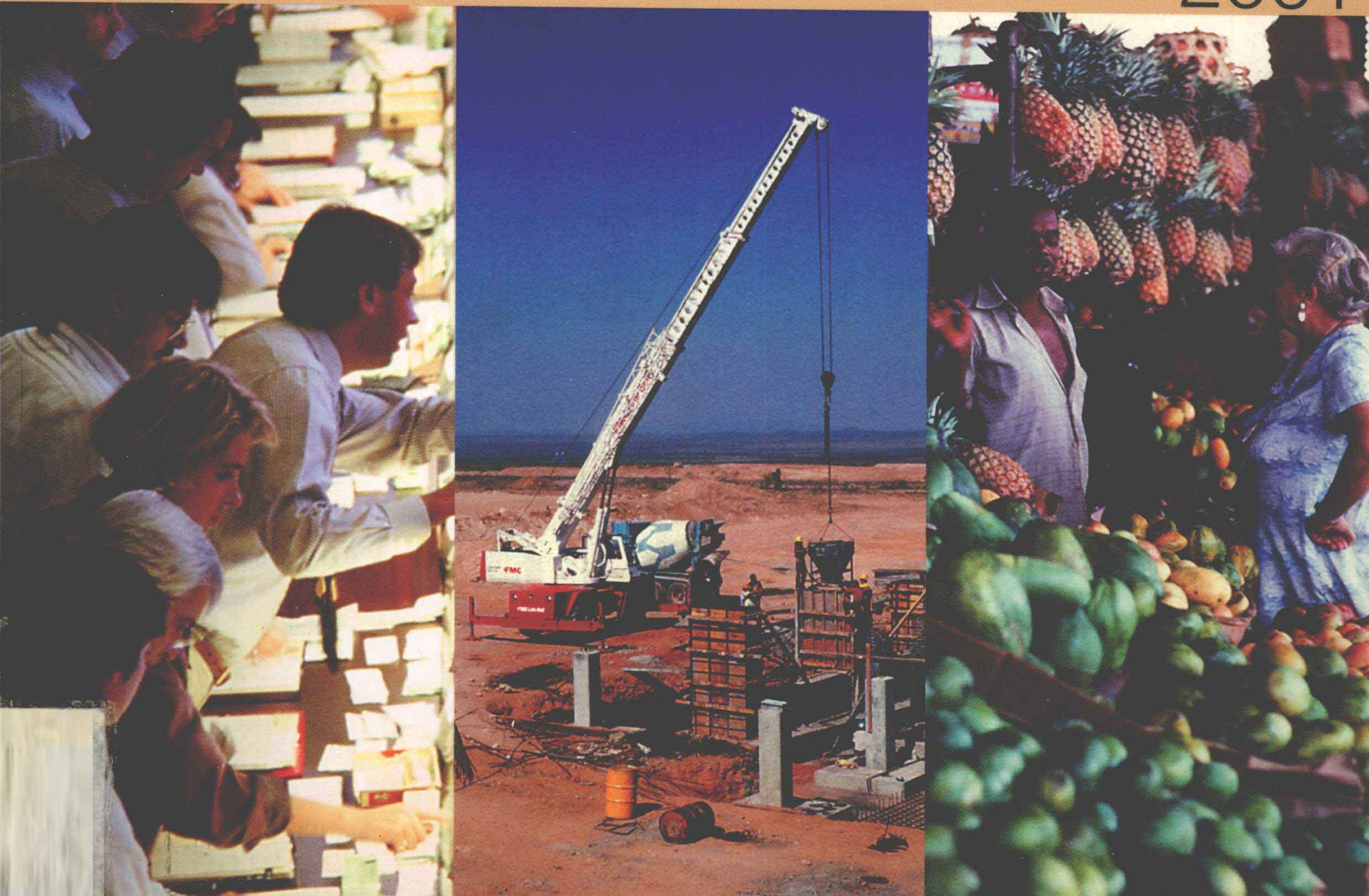
THE WORLD BANK

Global Development Finance

Building Coalitions for Effective Development Finance

ANALYSIS AND SUMMARY TABLES

2001



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THIS REPORT WAS PREPARED BY THE ECOnomic Policy and Prospects Group, and drew on resources throughout the Development Economics Vice Presidency, the Economic Policy Sector Board, and the World Bank operational regions. The task manager and principal author of the report was Ashoka Mody, assisted by William Shaw, with direction by Uri Dadush. The chapter authors were Hans Timmer (chapter 1); Himmat Kalsi and Shoko Negishi (chapter 2); Deepak Mishra, Ashoka Mody, and Antu Panini Murshid (chapter 3); Robert Keyfitz and Malvina Pollock (chapter 4); and Marco Ferroni, Ashoka Mody, and Aristomene Varoudakis (chapter 5). Ibrahim Al-Ghelaiqah, John Baffes, Betty P. Dow, Caroline Farah, Fernando Martel Garcia, Annette I. De Kleine, Robert Lynn, Dominique van der Mensbrugghe, Donald O. Mitchell, Elliot Joseph Riordan, Virendra Singh, Shane S. Streifel, and Bert Wolfe contributed to chapter 1. Additional contributions and background papers were provided by Mark Taylor, Eung Ju Kim, and Jung Yeon Kim (chapter 2); David Wheeler (chapter 3); Eung Ju Kim and Debashri Mukerji (chapter 4); and Scott Barrett, Anne Hassberger, Dilip Ratha, Devesh Roy, and Todd Sandler (chapter 5). The financial flow and debt estimates were developed in a collaborative effort by Punam Chuhan, Nevin Fahmy, and Ibrahim Levent of the Financial Data Team along with Himmat Kalsi, Eung Ju Kim, and Malvina Pollock of the Economic Prospects Group. The report was prepared under the general direction of Jo Ritzen and Nicholas Stern.

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Preface

GLOBAL DEVELOPMENT FINANCE WAS formerly published as *World Debt Tables*. The new name reflects the report's expanded scope and greater coverage of private financial flows.

Global Development Finance consists of two volumes: *Analysis and Summary Tables* and *Country Tables*. *Analysis and Summary Tables* contains analysis and commentary on recent developments in international finance for developing countries, with particular focus on the global financial crisis. Summary statistical tables are included for selected regional and analytical groups comprising 150 countries.

Country Tables contains statistical tables on the external debt of the 137 countries that report public and publicly guaranteed debt under the Debtor Reporting System. Also included are tables of selected debt and resource flow statistics for individual reporting countries, as well as summary tables for regional and income groups.

For the convenience of readers, charts on pages xi to xiii summarize graphically the relation between debt stock and its components; the computation of flows, aggregate net resource flows, and aggregate net transfers; and the relation between net resource flows and the balance of payments. Exact definitions of these and other terms used in *Global Development Finance* are found in the Sources and Definitions section.

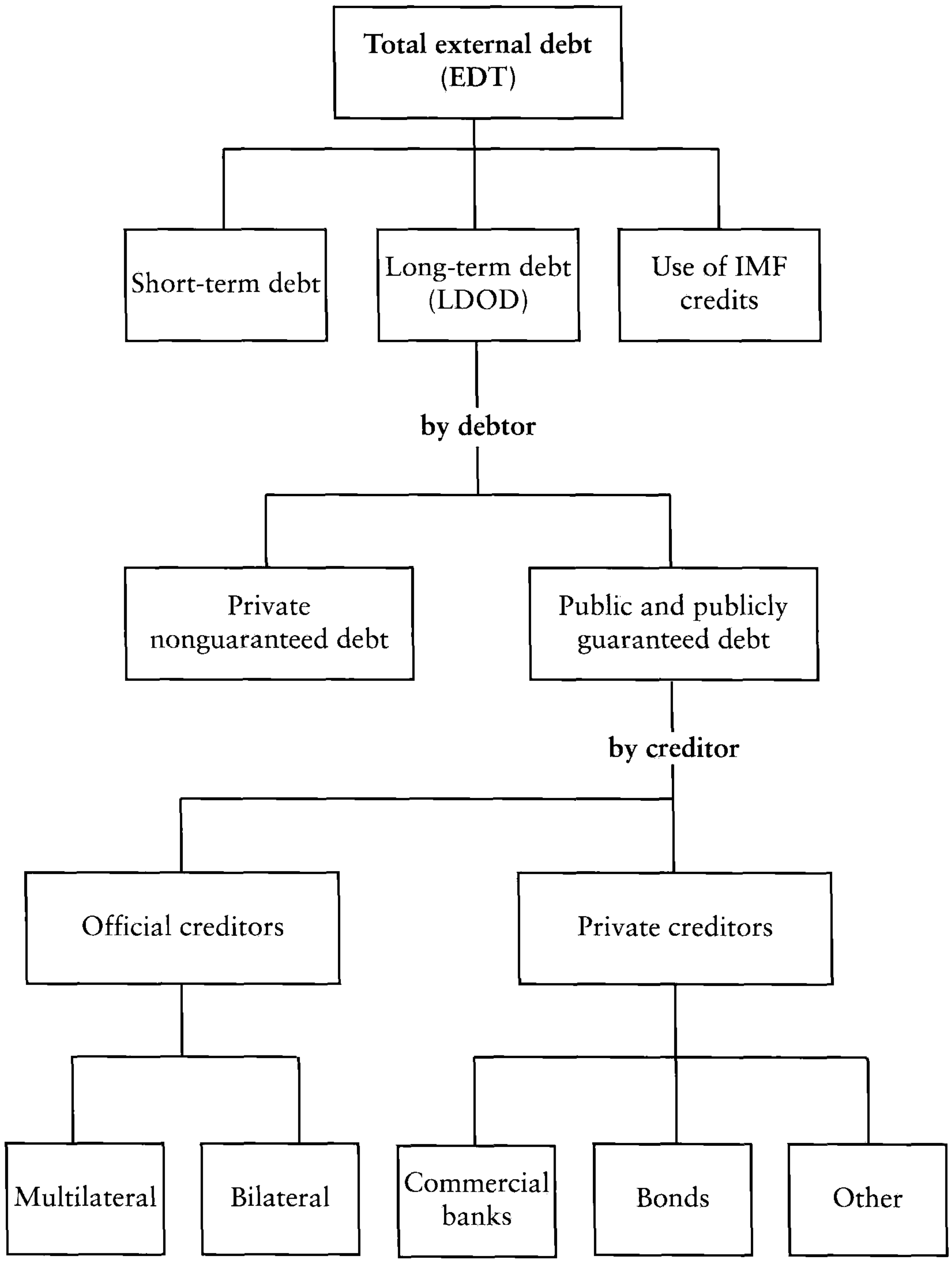
The economic aggregates presented in the tables are prepared for the convenience of users; their inclusion is not an endorsement of their value for economic analysis. Although debt indicators can give useful information about developments in debt-servicing capacity, conclusions drawn from them will not be valid unless accompanied by careful economic evaluation. The macroeconomic information provided is from standard sources, but many of them are subject to considerable margins of error, and the usual care must be taken in interpreting the indicators. This is particularly true for the most recent year or two, when figures are preliminary or subject to revision.

Acronyms and Abbreviations

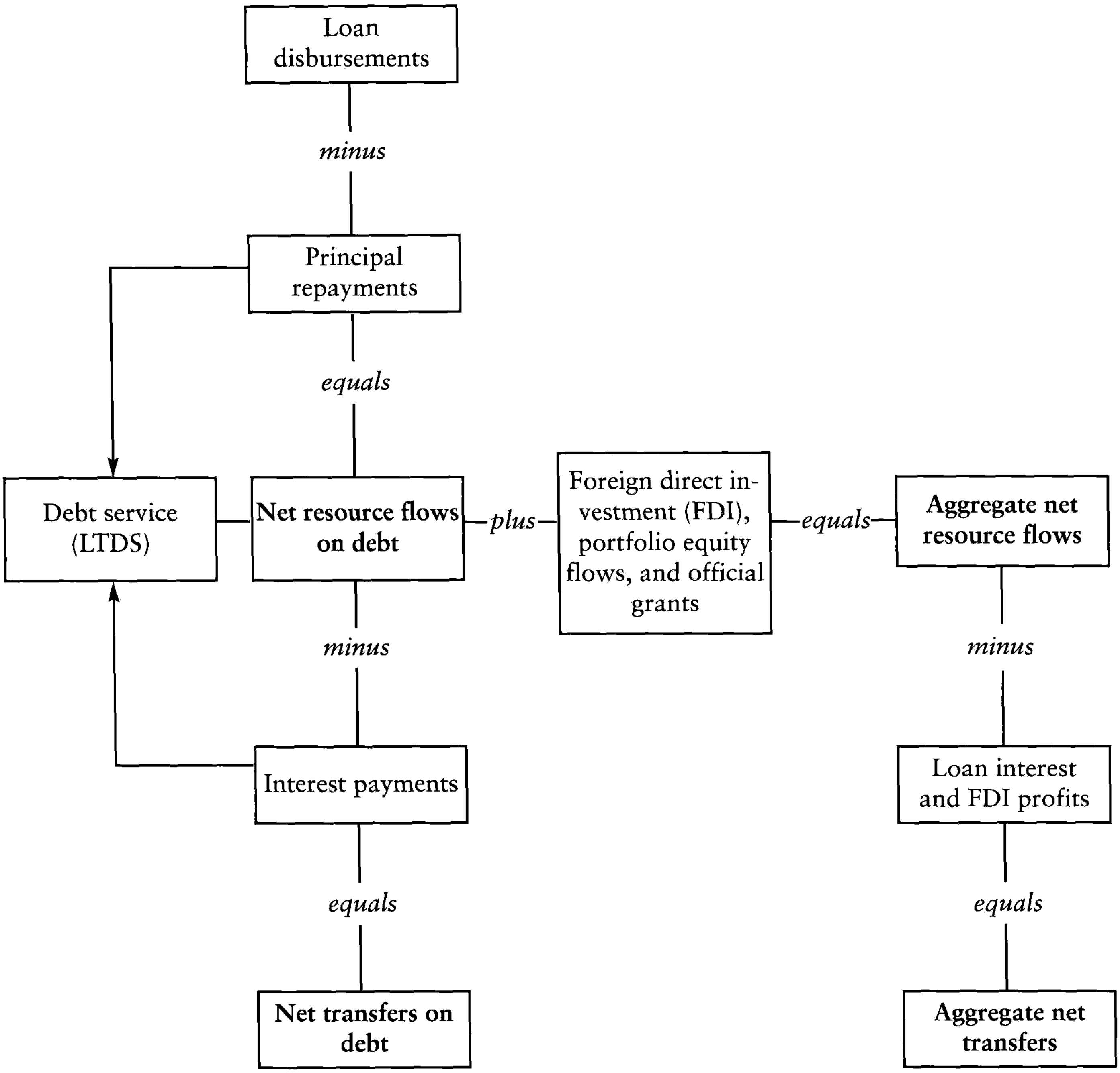
AIDS	acquired immune deficiency syndrome
CDF	Comprehensive Development Framework
CFC	chlorofluorocarbon
CGIAR	Consultative Group for International Agricultural Research
CIS	Commonwealth of Independent States
CPIA	Country Policy and Institutional Assessment index
CRS	Creditor Reporting System (of the OECD)
DAC	Development Assistance Committee (of the OECD)
DDSR	debt and debt service reduction
DGF	Development Grant Facility
DRF	Debt Reduction Facility (of the International Development Association)
DRS	Debtor Reporting System (of the World Bank)
DSA	debt sustainability analysis
ECB	European Central Bank
EMBI	Emerging Market Bond Index
EU	European Union
FDI	foreign direct investment
G-7	Group of Seven (Canada, France, Germany, Italy, Japan, United Kingdom, United States)
GDP	gross domestic product
GEF	Global Environment Facility
GNP	gross national product
HIPC	heavily indebted poor countries
HIV	human immunodeficiency virus
IAN	interest arrears notes
IBRD	International Bank for Reconstruction and Development (of the World Bank Group)
ICT	information and communications technology
IDA	International Development Association (of the World Bank Group)
IDB	Inter-American Development Bank
IMF	International Monetary Fund
LIBOR	London interbank offered rate
LILIC	less indebted low-income country
LIMIC	less indebted middle-income country
M&A	mergers and acquisitions
Mercosur	Southern Cone Common Market (Argentina, Brazil, Paraguay, and Uruguay)
MILIC	moderately indebted low-income country
MIMIC	moderately indebted middle-income country
MMV	Medicines for Malaria Venture
MYRA	multiyear rescheduling agreement
NAFTA	North American Free Trade Agreement
NATO	North Atlantic Treaty Organization
NGO	nongovernmental organization
NPV	net present value
ODA	official development assistance
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
PRIN	principal notes
PRSP	Poverty Reduction Strategy Paper
PV	present value
R&D	research and development
Saar	seasonally adjusted annual rate
SDR	special drawing right (of the International Monetary Fund)
SILIC	severely indebted low-income country
UNCTAD	United Nations Conference on Trade and Development
XGS	exports of goods and services

Dollars are current U.S. dollars, unless otherwise specified.

Debt stock and its components



Aggregate net resource flows and net transfers (long-term) to developing countries



Note: Includes only loans with an original maturity of more than one year (long-term loans). Excludes IMF transactions.

Aggregate net resource flows (long-term) and the balance of payments

	Credits	Debits
Current account	• Exports of goods and services • Income received • Current transfers Including workers' remittances and private grants	• Imports of goods and services • Income paid • Current transfers
	• Official unrequited transfers (by foreign governments)	• Official unrequited transfers (by national government)
Capital and financial account	• Official unrequited transfers (by foreign governments) • Foreign direct investment (by nonresidents) (disinvestment shown as negative)	• Official unrequited transfers (by national government) • Foreign direct investment (by residents) (disinvestment shown as negative)
	• Portfolio investment (by nonresidents) (amortizations shown as negative) • Other long-term capital inflows (by nonresidents) (amortizations shown as negative)	• Portfolio investment (abroad by residents) (amortizations shown as negative) • Other long-term capital outflow (by residents) (amortizations shown as negative)
	• Short-term capital inflow	• Short-term capital outflow
Reserve account	Net changes in reserves	

Aggregate net resource flows

Net resource flows on debt (long-term)

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Overview: Building Coalitions for Effective Development Finance

Policy highlights

THE STRING OF FINANCIAL CRISES IN DEVELOPing countries in the second half of the 1990s shook the confidence of many in global financial markets. At the same time, aid, on the decline through much of the decade, was increasingly criticized as ineffective. Together these experiences called into question the long-held view that international resource transfers—both private and official—play a significant and positive role in economic development.

This report concludes that, to the contrary, international financial flows to developing countries are perhaps even more valuable than traditionally thought—and that the prospects for using them effectively continue to improve. These flows work to transfer resources across national borders, from rich countries to poor ones, and to create and realize investment opportunities. But they can have an even greater influence on development by stimulating improvements in developing countries' policies and institutions and keeping them sound. They can thus reinforce those countries' initiatives to step up productivity and efficiency in the economy.

The report also highlights ongoing international initiatives to leverage the far-reaching potential of international financial flows. Among these initiatives are, at the global level, the reform of the international financial architecture and, at the country level, the World Bank's Comprehensive Development Framework, which emphasizes the critical importance of a holistic approach to development. The success of both will depend on effective coordination among various parties, attention to diverse local conditions, and a track record of strong and effective implementation. These, in turn, will require international and national coalitions to internalize the evolving lessons—and to give them legitimacy. Even then, these and other initiatives will require a period of strong commitment to produce the desired results.

In this context the report attempts to identify the conditions under which international financial transfers support the development process. And it considers what public policy—national and international—can do to foster productive transfers. Among the key findings:

- The cyclical slowdown of the global economy that began toward the end of 2000 has been significant because U.S. equity markets, consumer confidence, and short-term economic prospects have all dropped sharply and in tandem. A rebound in the course of this year seems possible due to the available policy instruments for stabilization.
- After precipitous declines in 1998 and 1999, capital flows to developing countries grew smartly in 2000, but their recovery has still lagged behind growth of output and trade since the late-1990s crises.
- For all countries with strong investment climates, private capital flows reinforce the payoffs to good policies and good institutions through even faster growth. But the volatility of those flows needs to be managed through stronger domestic financial systems and, possibly, larger foreign exchange reserves and sources of contingent credit.
- Aid flows increased in 2000, and the pace of debt relief was stepped up—but it will take vigilance to sustain these gains. The increases in aid effectiveness in the 1990s support the case for greater aid to achieve the Interna-

tional Development Goals set by the international community.

- International resource transfers provide about $5 billion a year to finance such international public goods as health, a clean environment, knowledge, and peace. To achieve the maximum dividends from these activities, the international financial institutions need to take a flexible and pragmatic approach to coalition building.

Challenges for developing countries during the cyclical slowdown

The cyclical slowdown of the global economy that began in the second half of 2000, brought on by higher interest rates and oil prices, suddenly intensified toward the end of the year. Shifts in market sentiment have become more important in determining short-term output and trade trends.

Chapter 1 of this report argues that a recovery in the course of this year from the current slowdown is more likely than prolonged slow growth, because economic cycles have become shorter and because the scope for policy adjustments (fiscal and monetary stimulus) is greater. However, the possibility of a continued feedback from financial markets to the real economy may delay the recovery. The slowdown is expected to differ in magnitude across developing countries, creating both risks and opportunities. A harder-than-expected landing in the industrial world would have serious consequences in many developing countries but could bring some partially offsetting benefits, such as lower interest rates. Even in the more likely soft-landing scenario, some sectors and countries will be hit hard.

Trends in private capital flows

As chapter 2 documents, resource transfers to developing countries increased in 2000 but remain well below their 1997 levels, before the series of crises. In 2000, private capital flows increased smartly after the precipitous decline in 1998 and 1999, but the recovery of capital flows since the crises has not caught up with postcrisis growth of output and trade. This relative decline reflects some improvement in the "quality" of flows: volatile short-term debt flows have fallen sharply.

Trends in capital flows to and from developing countries reflect three forces. The first is the greater, although still imperfect, financial integration of the global economy. The second is recent technological change, which requires increasingly sophisticated investment environments for efficient business operations. And the third is psychological factors. Some of the chapter's findings:

- Although the rise in capital inflows to developing countries in the first half of the 1990s received most of the attention, capital outflows also increased. And at least a part of the decade's increase in capital inflows may reflect transactions tied to capital outflows, perhaps to avoid taxes. Those outflows also reflect greater economic integration with the rest of the world.
- The worldwide boom in cross-border capital flows has been directed to industrial economies, especially the United States, reflecting, in part, optimism about technological trends. Developing-country shares in capital flows have declined sharply since the crises. The greater concentration of capital in a few countries reemphasizes the importance of a hospitable business climate in attracting and sustaining foreign direct investment (FDI) flows, which, although resilient during the crises, appear to have plateaued.
- Capital market flows were bolstered last year by modest improvements in perceived creditworthiness. But a lack of liquidity and indications of investor nervousness suggest that the memory of the crises remains. For countries with marginal access but significant dependence on international capital markets, the risk of being unable to roll over their borrowings could be significant. Despite the strong rise in 2000, international capital flows are likely to account for smaller shares of developing countries' gross domestic product (GDP) in the next few years.

International capital flows and economic growth

Private capital was implicated in the severe crises of the late 1990s, and some have questioned its efficacy in stimulating long-term growth. Chapter 3 examines how private capital inflows are related to, and perhaps contribute to, domestic investment and productivity, but also to volatility. The chapter concludes that private capital flows bear a significant relationship to long-term growth, although in general they tend to reinforce an existing positive growth dynamic generated by domestic efforts and initiatives. Among the chapter's findings:

- On average, private capital inflows raise domestic investment almost one for one. But the effect is strongest for those countries least integrated with international financial markets, where FDI augments domestic saving, identifying and financing new investment opportunities. The association between greater foreign inflows and domestic investment is thus strong in Africa. For developing countries in general, however, the relationship has declined since the 1980s, because growing financial integration means that countries' domestic investment decisions depend less on the availability of external financing.
- The potential for productivity growth through private capital flows has probably increased because of the growing importance of knowledge as a production input. But the benefits are available mainly to countries that have a strong capacity to absorb these flows.
- Capital inflows, through their volatility, can also impose significant costs. Although the management of this volatility has improved, prudential safeguards (through greater liquidity and measures to limit domestic financial instability) remain high on the policy agenda.
- There has been no environmental "race to the bottom": FDI to developing countries is not attracted primarily by lower environmental standards. Countries experiencing rapid growth of FDI have also steadily improved their environments, because communities in those countries place a growing value on protecting their environment, and because foreign investors have reputations to maintain.

Making aid and debt relief more effective

The achievement of the International Development Goals will require a significant rise in aid flows—and in their effective use. As chapter 4 reports, aid flows did increase in 2000, and the pace of debt relief was stepped up, but continued commitment is required to ensure that these increases are not temporary.

The effectiveness with which aid was allocated across countries also increased in the 1990s. This happened in part because policies in recipient countries improved, increasing their capacity to absorb aid, and in part because countries with weak policies got less aid. But there exists significant potential to reduce poverty by directing flows from middle-income to low-income countries and by increasing flows to countries with good performance that thus far have received little or no increase in aid. More resources can also be effectively deployed for international public goods, as discussed in chapter 5.

Recent moves toward donor specialization can also make aid more effective. So can increasing the commitment to provide assistance through predictable and medium-term budgetary support to each country's chosen development programs, based on agreed-on policy frameworks and conditioned on results. The shift to programmatic approaches reflects the importance of country "ownership" of the policy agenda and the long-standing difficulties in coordinating a host of separate projects, each with different donor reporting requirements.

The Heavily Indebted Poor Countries (HIPC) Initiative, which embodies some leading-edge approaches to aid effectiveness, marks an opportunity for a new start. The recent enhancements to the initiative have quickened the pace and increased the resources for debt relief, although the extent to which the initiative will increase total donor assistance is unclear. Since weak policies and institutions are the key constraint on growth in most heavily indebted countries, the tie to policy reform is the key factor for success. At the same time, greater access to industrial-country markets will help these countries integrate with global markets and grow.

Financing international public goods

Chapter 5 attempts a first-ever comprehensive inventory of the use of international resource transfers to fund the creation of international public goods in developing countries. It finds that, for all developing countries worldwide, transfers of about \$5 billion a year go to finance international public goods, and an additional \$11 billion finances the complementary domestic infrastructure that allows the absorption of these goods. These resources mainly support activities in health, environmental protection, knowledge creation and diffusion, and safeguarding peace. With active support from private charitable foundations, donors have been channeling more resources to international public goods, even as aid budgets have de-