Global Development Finance

Mobilizing Finance and Managing Vulnerability

I: ANALYSIS AND STATISTICAL APPENDIX 2005

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Foreword

THE GLOBAL ECONOMY IS AT A turning point. Growth has peaked, and pressures to address global imbalances are growing, exposing important risks facing both developed and developing countries as the needed adjustments occur. Whether or not the rebalancing occurs in an orderly fashion will have a crucial impact on whether recent improvements in developing-country performance can be sustained—and whether progress towards the Millennium Development Goals (MDGs) can be accelerated. The stakes are large.

Global economic performance over the last year provides continuing evidence of the growing interdependence of developed and developing countries. Global growth was high, in part from record expansion in developing countries, which have been benefiting from favorable global conditions and from years of domestic policy improvements. Financial flows to developing countries during 2004 reached levels not seen since the onset of the financial crises of the late 1990s. And developing countries' increasing integration with the global financial system continues to raise their stake in the health and resilience of that system.

But the strong recovery has also given rise to sizable global financial imbalances that will have to be addressed. If the global growth cycle has indeed peaked, the likely scenario involves continued (though slower) growth and an orderly reduction in imbalances. But there are also risks—of higher-than-expected interest rates, of abrupt and disorderly exchange-rate movements, and of a pronounced global slowdown that could encourage protectionist sentiments and curtail expansion of trade and investment linkages between developed and developing countries.

The resilience of developing-country financial positions will be tested as global conditions tighten, with special concern for the vulnerability posed by increased debt burdens, which have been at the heart of the financial crises over the last decade. There is some good news here—*aggregate* external debt indicators are down, many developing countries have improved their capacity to manage debt, and many countries have acted aggressively to address the weaknesses that contributed to previous crises. But external debt burdens have risen in more than half of emerging market economies, and, in many, *domestic borrowing* has risen dramatically as well. Although the shift from external to domestic borrowing can reduce vulnerability to external shocks, it also carries risks from possible overborrowing or inadequate supervision. The central policy message is that excessive borrowing is risky, regardless of the source, and that efforts to avoid the discipline required by external borrowing by switching to domestic sources will fail.

Emerging market economies are also vulnerable to the possible impact of larger-than-expected increases in interest rates (which would translate into higher borrowing costs) and possible capital losses on dollar-denominated assets from dollar depreciation. The impact could be particularly acute for economies in which reserve accumulation far exceeds normal prudential levels, which entails fiscal costs as monetary authorities issue low-yield securities to absorb the excess liquidity created by reserve accumulation.

For low-income countries, the major vulnerabilities stemming from the current global environment are linked less to the evolution of interest rates and exchange rates and more to the future of flows of aid from bilateral and multilateral sources. While the challenge of generating sufficient aid to help low-income countries reach the Millennium Development Goals (MDGs) remains large, there are some encouraging signs of progress, as some donors have increased their commitment levels and aid flows have turned upwards. But concerns persist about whether these increases are large enough, and whether adequate flows are reaching areas that need them most, such as Sub-Saharan Africa. As the global community reevaluates progress towards the MDGs in the coming year, donors and recipients alike must remain focused on the imperative of generating resources that can be effectively used in developing

countries that have supportive policy and institutional environments.

Equally encouraging is the growing evidence that financial flows other than official aid are growing—from rapid expansion in private investment (including substantial growth in South-South investment flows), to private grants, to other sources of foreign exchange such as workers' remittances. While such flows can not and should not substitute for sustained and targeted official aid, they nonetheless highlight the growing options and opportunities open to low-income countries.

Global Development Finance is the World Bank's annual review of the external financial conditions facing developing countries. The current volume provides analysis and summary tables on selected macroeconomic indicators and financial flows. A separate volume contains detailed, standardized, external-debt statistics for 136 countries. More information on the analysis, including additional material and sources, is available at www.worldbank.org/prospects. A companion online publication, Prospects for the Global Economy, is available in English, French, and Spanish at www.worldbank.org/globaloutlook.

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Selected Abbreviations

AGFUND	Arab Gulf Program for United Nations Development Organizations
AGOA	African Growth and Opportunity Act (United States)
ASEAN	Association of Southeast Asian Nations
BADEA	Arab Bank for Economic Development in Africa
BIS	Bank for International Settlements
CAC	Collective action clause
CPIA	Country Policy and Institutional Assessment (World Bank)
DAC	Development Assistance Committee, OECD
DPR	Diversified payment rights
DRS	Debtor Reporting System (World Bank)
EBA	Everything But Arms (European Union)
EMBI	Emerging Markets Bond Index
EU	European Union
FDI	Foreign direct investment
G-3	Group of Three (European Union, Japan, United States)
G-7	Group of Seven (Canada, France, Germany, Italy, Japan, United Kingdom, United States)
G-8	G-7 plus Russian Federation
GAVI	Global Alliance for Vaccines and Immunization
GDP	Gross domestic product
GNI	Gross national income
GNP	Gross national product
HIPC	Heavily Indebted Poor Countries Initiative
IACD	Inter-American Agency for Cooperation and Development
IBRD	International Bank for Reconstruction and Development
ICRG	International Country Risk Guide
IDA	International Development Association (World Bank)
IFC	International Finance Corporation
IFF	International Finance Facility
IFFIm	IFF for Immunization
IFI	International financial institution
IMF	International Monetary Fund
LICUS	Low-income countries under stress
JICA	Japan International Cooperation Agency
LIBOR	London interbank offered rate
MDG	Millennium Development Goals
MFA	Multi-Fibre Arrangement
MIGA	Multilateral Investment Guarantee Agency
NEPAD	New Partnership for Africa's Development
NERICA	New Rice for Africa
NGO	Nongovernmental organization
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of Petroleum-Exporting Countries
PPP	Purchasing power parity
PRSP	Poverty reduction strategy paper
S&P	Standard and Poor's
SDDS	Special Data Dissemination Standard (IMF)
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
WARDA	West Africa Rice Development Association
WEO	*World Economic Outlook* (IMF)
WTO	World Trade Organization

Overview and Policy Messages: Mobilizing Finance and Managing Vulnerability

2004 WAS A ROBUST YEAR FOR THE global economy, especially for developing countries, which recorded their fastest growth in more than three decades. The global recovery strengthened, with much of the momentum coming from the United States and Asia (notably China), and broadened, with a pickup in Latin America, acceleration in Japan, and modest recovery in the European Union (EU). Driven by favorable global conditions and strong domestic performance at home, developing countries continued to attract capital in 2004, although more slowly than in 2003.

Favorable global economic and financial conditions over the past few years, along with domestic policy initiatives, have improved economic fundamentals in most developing countries, strengthening their external positions and making them less susceptible to external pressures. But significant global financial imbalances suggest the need for adjustment. History has shown time and again that financial crises often take markets and policymakers by surprise. The Asian crisis that erupted in mid-1997 offers a striking example—large exchange-rate exposures on balance sheets in the corporate, financial, and public sectors were not widely recognized until after the fact.

Valuable lessons can be learned from these past episodes. One is that there is a tendency for financial markets and policymakers to miss the warning signs and overshoot, making the necessary adjustment larger when it does occur. Overshooting has contributed to "boom-bust" cycles in global financial markets, which have impeded economic development in many regions. In the current context, the memory of past mistakes raises the question of whether the strong pickup in capital flows to developing countries over the last two years can be sustained over the medium term.

Emerging market economies with access to global finance are particularly vulnerable to changes in interest and exchange rates that may occur as markets anticipate and adjust to policy measures intended to relieve the yawning imbalances. Countries that have accumulated large dollar-denominated reserve holdings face acute pressures and large potential investment losses from the weakening dollar, though their dollar-denominated debt burdens may ease. Those that have failed to take advantage of recent favorable conditions to lighten their debt burden may face debt-servicing difficulties as conditions worsen. All countries, whatever their circumstances, stand to benefit from a better understanding of the complex challenges that are changing the borrowing environment (both external and domestic) and the options open to policymakers.

The risks are somewhat different for low-income countries that are more reliant on official and concessional sources of external finance. Official aid flows are vulnerable to growing fiscal pressures in donor countries, while private flows will come to reflect tightening global conditions. Keeping growth on a sustainable path as the global recovery evolves will therefore be a major factor in attaining the Millennium Development Goals embraced by the world's leaders at the UN Millennium Summit in 2000.

The theme of this year's edition of *Global Development Finance*—mobilizing finance and managing vulnerability—embraces three key challenges:

- Managing the vulnerability inherent in global economic and financial imbalances,

- Confronting the risks posed by the new complexities in developing country debt, and
- Mobilizing and diversifying sources of finance for low-income countries with more limited access to international capital markets.

Capital flows to developing countries continued to recover, but at a slower pace

The strong recovery of capital flows to developing countries that began in 2003 carried over to 2004, albeit at a reduced pace. Total private and official net debt flows totaled a record high of almost $325 billion, up significantly from $200 billion during 2000–2. The pickup is more modest after taking into account factors such as inflation, economic growth, and the sizable depreciation of the dollar against most major currencies. Net capital flows to developing countries equaled 4.5 percent of their gross domestic product (GDP) in 2004, up slightly from 4.3 percent in 2003, but significantly below highs exceeding 6 percent reached in the mid-1990s (chapter 1).

Developing countries continued to export capital and accumulate reserves

Drawing on healthy trade balances, developing countries have continued to generate large current account surpluses, a dramatic turnaround from past decades. Combined with expanding capital flows, the growing surpluses contributed to accelerating accumulation of foreign reserves by developing countries—from $292 billion during 2003 to $378 billion during 2004. Although the largest reserve accumulation was concentrated in Asia, the phenomenon was widespread. More than three-quarters of developing countries reporting reserve changes (101 of 132) accumulated reserves during the year. A sizable portion of this new accumulation is invested in U.S. Treasuries, indicative of the growing stake of developing countries in the global financial system.

FDI inflows increased modestly, but outflows surged

FDI inflows to developing countries increased during 2004, partly offsetting the decline during the previous two years. While the concentration of FDI flows remains high (five emerging market economies account for 60 percent of FDI and 88 percent of the increase), the share flowing to low-income countries reached 11 percent, the highest in 15 years. Reported FDI *outflows* from developing countries surged dramatically, reaching an estimated $40 billion in 2004 (from only $3 billion in 1991). The bulk of the FDI outflows originated in countries that have been major recipients of inflows in recent years. In response to greater foreign competition, domestic firms in those countries have launched an aggressive search for markets abroad—often elsewhere in the developing world.

Private debt flows showed strong gains from record levels of bond issuance

Net international bank lending continued to decline as net bond flows rebounded sharply, reaching a record high in 2004. Gross bond issuance surpassed gross bank lending for the first time, although bank lending remains available to a larger group of countries. The strong gains in bond issuance over the past two years reflect both supply and demand factors—ample global liquidity, low advanced-country interest rates promoting a "search for yield," and a broad-based improvement in credit fundamentals in many emerging markets. Apart from some short-lived volatility in April–May (as the tightening of U.S. monetary policy began), emerging-market bond spreads fell steadily during 2004, reaching a near-record low by the end of the year.

Official aid continued to shift from loans to grants

Recent figures confirm the continuing structural shift in official development assistance (ODA) from loans to grants over the last several years. While bilateral aid grants have risen annually since 2001, net official *lending*, largely multilateral, has declined dramatically, falling from $27 billion in net inflows to developing countries, to $25 in net outflows in 2004. The largest factor underlying this shift has been a $30 billion net decline in lending by the International Monetary Fund (IMF), reflecting repayment of sizable crisis-related disbursements made in 2001. But net lending by the World Bank also fell by $9 billion over the period, as several countries

repaid large structural adjustment loans, and other Bank loans were repaid ahead of schedule.

While ODA figures for 2004 are not yet available, promising signs of expansion since the March 2002 Monterrey Conference on Financing for Development are evident, with an increase in 2003 of around $10 billion to $69 billion (although after accounting for inflation and exchange rate changes, the real increase was only 5 percent). Sub-Saharan Africa has received 60 percent of the increases in ODA disbursements over the five-year period from 1998 to 2003. However, with most of these funds allocated to postconflict situations, the increase in development aid has been small.

Five bilateral donors have increased disbursements to levels exceeding the United Nations (UN) target of 0.7 percent of GNI; four additional donors have specified explicit time tables for meeting the UN target over the next few years. ODA as a share of gross national income (GNI) in donor countries is projected to rise from 0.25 percent in 2003 to 0.30 percent in 2006—implying a 9 percent annual increase in ODA in real terms, well above that achieved over the past two years (6 percent).

The world economy is slowing

The growth cycle is peaking

The year 2004 was a record year for developing countries, with aggregate growth of 6.6 percent. While very strong growth in China (and to a lesser extent in Russia and India) contributed importantly to this result, growth was strong throughout the developing world. However, high-frequency data suggest that global growth began slowing in the second half of the year, and this trend is projected to continue into 2005 and 2006. Persistently high oil prices, rising interest rates as a result of monetary tightening, and a waning fiscal stimulus from efforts to address the 2000/01 recession are projected to dampen domestic demand and slow growth among high-income countries. These same forces, plus softening import demand in the developed world, are expected to slow the pace of expansion in low- and middle-income countries. Nevertheless, their growth should continue to outpace industrial economies by a wide margin—partly because of continued strong growth in China and India. Indeed, notwithstanding the slowdown, economic growth in low- and middle-income countries will remain above the rising trend for much of the past two decades. As a result, commodity prices are expected to ease only slowly, and inflation pressures will continue to build in a number of developing countries.

Global imbalances and major currencies are stabilizing

A combination of a somewhat tighter fiscal policy and higher interest rates in the United States is projected to halt and even reverse the widening current account deficit. Higher U.S. interest rates will increase the willingness of private-sector investors to hold dollars, and the two effects should slow the currency's tendency to depreciate. Co-movements among the currencies of developing countries and the compensating effect of an appreciation of the euro have left the real effective exchange rate of most developing countries broadly stable. However, the large swings in the bilateral exchange rates of the major industrialized economies impose adjustment costs on firms that are expected to augment trade growth.

Significant downside risks persist

A reduction in the pace at which central banks are accumulating dollars, a weakening in investors' appetite for risk, or a greater than anticipated pickup in inflationary pressures could cause interest rates to rise farther than projected, provoking a deeper-than-expected slowdown or even a global recession. If the dollar were to depreciate by more than projected, it would likely undershoot its long-run equilibrium level. Should it remain low for an extended period, this could induce a costly restructuring of world industry that would have to be undone in following years as the dollar returned to its equilibrium level. Finally, the slowdown in global growth could sap policymakers' desire to pursue further trade liberalization, which has been a major motor of the improved performance of developing countries over the past half decade.

Sensible policy can reduce the probability and severity of such adverse scenarios. Tighter U.S. monetary and fiscal policy, a relaxation of European monetary policy (relative to the United States), and a managed appreciation of some Asian currencies would reduce the likelihood of a sharp depreciation in the dollar or an abrupt hike in interest rates by reducing global imbalances,

increasing demand for dollars, and lowering inflationary pressure in developing countries. To minimize the impact of a weaker-than-projected outcome, developing countries should ensure that debt and spending obligations will remain affordable, even if output and tax revenues slow substantially and interest rates rise. While a coordinated response would be ideal, the policies described above would be beneficial for each economic grouping—even if adopted unilaterally.

Growing global imbalances pose risks for emerging market economies

Despite recent strong performance, developing countries face substantial risks from trends in the global economy. The channels through which events in global financial markets affect developing countries reflect the changing character and growing significance of developing countries' international financial relationships. Not only is there concern about the traditional sensitivity of emerging-market finance to cyclical developments in international capital markets, but, for some countries, the carrying costs of large accumulations of foreign exchange reserves raise new challenges. Looking ahead, the possibility of "disorderly" adjustments of external payments imbalances in the global economy could pose acute risks to emerging markets.

Exchange-rate volatility and higher interest rates could affect the cost and availability of capital

While the baseline outlook for the global economy (chapter 2) is for an orderly adjustment in global imbalances in external payments, less salutary outcomes are possible. One key implication of a more disorderly adjustment scenario for emerging market economies is that it would likely bring an end to the favorable economic and financial environment that has supported a strong rebound in capital flows over the last two years. The most likely consequence would be a widening of credit spreads on emerging-market bonds, which in turn could adversely affect the flow of debt.

On the positive side, a weaker dollar reduces the net external debt burden (measured in local currency) of countries with dollar-denominated debt. For example, in the 100 or so developing countries whose exchange rate is not pegged to the U.S. dollar, the dollar's slide since 2002 has reduced average ratios of debt to gross national product (GNP) and debt service to exports by about 1 percentage point.

Global tightening of monetary policy as major industrial economies move to a neutral stance will have an impact on market interest rates. Rising interest rates, in turn, will likely slow global economic growth, as increases in short-term policy rates lead to higher borrowing costs (although this effect has been modest to date, as long-term yields in the United States have not increased as in previous monetary tightenings).

How market interest rates respond to future changes in monetary policy—particularly in the United States—and how such reactions spill over to emerging bond markets is taking on considerable significance. With emerging-market bond spreads at record lows (which suggests that markets may be underestimating credit risks), an unexpected deterioration in global conditions could lead to a precipitous widening of those spreads as investors adapt their expectations and reduce their risk appetite. With gross bond financing surpassing bank financing in 2004 for the first time, the impact of sharply higher spreads on emerging markets would be substantial.

Borrowing costs would rise if such pressures lead credit-rating agencies to downgrade their rating of emerging-market borrowers. It is estimated, for example, that for the "typical" low-investment-grade borrower, a one-notch downgrade raises borrowing costs an average of 80 basis points. This effect could be accentuated for more vulnerable countries. For example, for countries with high external debt levels, a 200-basis-point increase in U.S. rates (the approximate increase currently anticipated) would bring an additional increase of 65 basis points (on top of the 200). For countries with low debt, the incremental impact is only around 6 basis points.

Excessive reserve accumulation has costs

Not all of the increase in capital inflows has been directed to productive domestic investment or consumption. Some has been channeled into foreign exchange reserves. Recent record levels of reserve accumulation across a broad range of developing countries reflect several motives: insuring against abrupt reversals of capital flows, liquidity considerations related to exchange-rate management and

creditworthiness concerns, and, for some, relieving upward pressure on a fixed exchange rate to help maintain trade competitiveness.

Although these motives are justifiable under some conditions, one outcome is that current reserve levels in several countries exceed by a large margin the conventional measures of reserve adequacy. That excess leads to concerns over the cost and the sustainability of current policies, particularly (i) the quasi-fiscal cost associated with central banks' sterilized intervention operations to offset the expansionary monetary impact of higher reserves, and (ii) potential capital losses on dollar-dominated reserve assets (chapter 3).

The quasi-fiscal burden reflects the difference between what the foreign-currency reserve assets earn and what the central bank must pay on domestic securities issued to offset their expansionary monetary impact. This burden can be substantial—the gap between the two rates, under prevailing market conditions, can be as high as 6–8 percent, with each percentage point costing the central bank an additional $100 million annually for each $10 billion in reserves. Moreover, where domestic financial markets are still underdeveloped, there are institutional limits on central bank capacity to pursue such sterilized market operations. India has a shortage of available instruments to use in sterilization operations, Korea has run up against limits on the amount of securities it can issue, and state-owned banks in China have reached the limits of their capacity to purchase additional securities at below-market rates.

The capital loss costs relate to the valuation and management of the central bank's portfolio of reserve assets. While most central banks are engaging professional asset managers, an estimated 70 percent of reserves are held in dollar-denominated assets (individual country estimates are generally not available), implying that a sharp drop in the dollar could translate into a corresponding drop in the domestic value of the reserve holdings.

Looking ahead, countries accumulating substantial excess reserves will have to reconcile the benefits of higher reserves with the potential for capital losses and growing quasi-fiscal carrying costs. Even when costs are hidden (for example, by requiring banks to hold domestic assets at below-market yields), the domestic macroeconomic consequences are very real, as countries reach the limit of their ability to sterilize the impact of large reserve accumulations.

Clear policy challenges are emerging

For developing countries, the greatest challenge is to continue taking advantage of current favorable financing conditions, while pursuing the necessary domestic macroeconomic and structural reforms necessary to promote long-term stability in their external financing sources. This would involve:

- Renewed commitment to macro stabilization and structural reforms that have laid the foundation for the recovery and vigorous expansion of capital flows since 2002.
- In high-reserve countries, reevaluation of the sustainability and costs of rapid reserve accumulation, both in terms of domestic macroeconomic management and increased vulnerability to changing external conditions. These countries need to consider how to manage appreciation of their currencies against the major currencies, to share the global adjustment burden.
- Continuing efforts to improve asset and liability management, especially by lengthening borrowing maturity, retiring high-cost debt, diversifying the currency composition of debt, and hedging currency exposure as much as possible.
- Pushing forward with efforts to strengthen the health and soundness of the domestic financial system through measures to improve prudential regulations, enhance banks' capitalization, develop local bond markets, and remove incentives for excessive foreign currency intermediation.

The complexity of developing-country debt poses new challenges

Much has changed since the wave of financial crises rocked emerging market economies and disrupted global financial markets from the mid-1990s up until 2002. Many countries that were at the center of earlier crises have made significant progress in improving prudential and regulatory policies and structures whose weaknesses contributed to the crisis. Fiscal policies have generally

been more prudent, although concerns persist about the sustainability of public debt in several countries. Inflation has fallen. Greater exchange rate flexibility has reduced the likelihood that an exchange-rate crisis will become a debt crisis and raised awareness of the risks inherent in currency mismatches. Since 1996, 19 developing countries have shifted to floating exchange-rate regimes. Overall, the improved disposition of investors toward developing countries has been reflected in the trends in average credit quality, which has risen steadily since early 2002. The number of countries carrying formal credit risk ratings (around 60) is now almost four times higher than in the mid-1990s.

The dynamics of external debt have been transformed

The debt-related crises of the 1990s, which were concentrated in a small group of emerging market economies, have induced changes in debt dynamics in many developing countries. A rapid expansion in bond finance, pursued most aggressively in countries that experienced severe debt pressures or crises in the 1990s, has increased vulnerability to changing market conditions in global markets (over which individual countries can exercise little control) and domestic circumstances, which can quickly translate into higher borrowing costs through their impact on spreads (chapter 3) or reduced capital availability. Furthermore, the enormous increase in the number of stakeholders that has accompanied the shift into bonds has complicated the resolution and management of crises.

International capital markets today are more attuned to, and more discriminating about, development finance than in the past. This in turn imposes a degree of discipline on borrowing through greater transparency, a more substantial flow of information, increased market research, and finer distinctions in credit risk. Overall, these developments have reduced the systemic risk in market-based emerging market finance.

Similarly, the international financial architecture, which aims to prevent defaults and facilitate orderly debt restructuring, has been strengthened. Collective action clauses have been introduced in some bond financing transactions, and discussions over a code of conduct continue. The Capital Adequacy Accord (Basel II) offers the potential to strengthen the banking sector and enhance the ability of banks to take on and sustain riskier lending, through measures to mitigate and manage risk. Joint international efforts on statistics and monitoring are improving the quality and quantity of information available for use in managing approaching crises.

But while efforts to strengthen the international framework for dealing with financial distress have started to yield results, much remains to be done. For example, the adoption of collective action clauses can help facilitate debt restructuring, but their impact is still quite limited, as they apply only to bond debt, are not adopted in all new issues, and do not apply to pre-2002 debt.

External debt burdens have eased for some, but not for most

Developing countries' burden of external debt (public and private) declined from a peak of 45 percent of GNI in 1999 to an estimated 39 percent in 2003. This improvement occurred despite an increase of almost $207 billion in the nominal value of external debt. It therefore reflects the impact of stronger developing country performance: since the late-1990s, GNI has grown three times faster than external debt. Other indicators of developing countries' vulnerability to interest and exchange rates have improved as well: ratios of debt to exports dropped from 135 percent in 1997 to 125 percent in 2003.

Amid the overall improvement, the debt circumstances of individual countries differ considerably. The reduction in aggregate debt burden has been driven by large improvements in a few countries (representing about 30 percent of outstanding debt). But in two-thirds of middle-income countries, the debt burden *increased* between 1997 and 2002. For nine emerging market economies in this group (Argentina, Brazil, Indonesia, Philippines, Poland, Russian Federation, South Africa, and Turkey), the average deterioration in the debt/GNI ratio was 21 percentage points. Currency revaluation effects also loom large for countries with large dollar-denominated debts (chapter 3), more than offsetting the underlying reduction in debt stocks through repayment for some countries.

The share of foreign direct investment (FDI) and portfolio equity in the finance mix of many developing countries has grown in recent years—a

trend that enhances stability. Equity flows accounted for 80 percent of total external financing during 1999–2003, compared with just 60 percent during 1993–98.

The composition of external debt has changed, with an increase in private borrowing

Developments in international capital markets and developing countries, as well as expansion in the investor base, have helped facilitate the private sector's access to international capital markets. As a result of greater private borrowing, the share of public sector debt in total external debt declined from 82 percent during 1990–95 to 69 percent during 1996–2003. At the same time, the public sector's emphasis on domestic sources of financing has increased.

The reduction in the public debt share might appear to lower sovereign vulnerability, but as the Asian crisis demonstrated, excessively risky private sector behavior can precipitate a crisis—and the subsequent cleanup often blurs the lines between public and private.

The rise in domestic debt partly offsets the reduced burden of external debt

Debt from domestic sources has grown rapidly in emerging market economies, largely through the development of domestic bond markets. In many countries where external debt burdens have stabilized or fallen, domestic public debt burdens have *increased* (chapter 4). As a result, in many developing countries, the burden of public sector debt remains high, calling into question the apparent improvement associated with falling external indebtedness.

The extent of the shift from external to domestic debt has varied across regions. In Asia, following the market-forced retrenchment of credit that occurred during the crisis, the switch was rapid and intentional—the ratio of domestic to external debt rose from close to parity in 1997 to 3 to 1 in 2002. Initial domestic debt buildup was driven by crisis responses (often bailouts or recapitalizations of failing banks), while more recent increases have been driven by conscious policies to reduce reliance on external debt (and, for many, a buildup in foreign exchange reserves). Elsewhere, the picture is more mixed—in Latin America, for example, the decline in external financing since 1999 has not been matched by as large an increase in domestic financing.

Greater domestic borrowing by the private sector also poses dangers. High levels of domestic credit to the private sector have been the precursor to many financial crises. The risk is particularly great when *perceptions* of risk motivate swift changes in global asset allocations, beyond what is warranted by underlying fundamentals. The burden imposed by private sector bailouts, especially in the financial sector, can lead to a buildup of debt for the public sector as well. In addition, the corporate sector's engagement in derivative-type transactions can pose contingent liabilities that are at times unanticipated, often for lack of information.

But the deepening of local bond markets brings many benefits. Local bond markets help finance government deficits, compensate for the effects of holding large, low-yield reserves, and facilitate domestic monetary policy by providing a liquid debt market to facilitate operational aspects of monetary policy. They also strengthen the domestic financial system—bond markets complement structured financing and stimulate competition, while the infrastructure required to support them (clearing and settlement systems, regulatory and legal frameworks) makes the entire financial system more efficient. Domestic debt markets also offer an increasingly attractive destination for foreign investors and have encouraged an important catalytic role for international financial institutions, which have often taken the lead in initiating borrowing in developing-country currencies.

The need to balance external and domestically financed debt has created new challenges

With the shift in the balance of external and domestic debt, new challenges have emerged. On the positive side, lower external debt reduces vulnerability to external shocks (related to exchange rates or interest rates), which in turn builds confidence among international investors. It also can relieve pressure on exchange rates and raise credit ratings, leading to lower external borrowing costs and even increased asset demand as the economy moves into a risk class more open to institutional investors.

But the switch to domestic debt heightens other risks—notably the uncertainties of rolling over short-term debt (because maturities of domestic

debt are generally shorter than those of external debt), and associated interest-rate risks. To minimize risk, domestic borrowing, like external borrowing, must be based on sound measures for managing public debt, a capable tax system, and effective regulatory and legal environment for domestic financial activity. Exchange-rate management remains particularly crucial, because international demand for domestic assets will be critically affected by perceptions of the soundness of exchange-rate policy and concerns over volatility and convertibility. Finally, any temptation to borrow excessively from domestic sources needs to be resisted. A debt crisis sparked by excessive domestic borrowing can be just as devastating as one created through external borrowing, and a domestic debt problem can quickly grow to affect external debt.

Despite the growing sophistication of international capital markets and a steady growth in the capacity of central banks and monetary authorities in developing countries, significant weaknesses remain both in the international architecture that has evolved to regulate those markets and in the quality of data available on the fast-growing domestic debt markets in many emerging market economies. Improving the monitoring and dissemination of information on public and private domestic debt flows should remain a priority for international institutions and national authorities.

Meeting poor countries' financing needs requires recognition of the countries' special challenges

Poor countries are operating in an external financing environment of growing complexity. Although ODA is still the major resource flow for many countries, many others now receive growing private capital flows (FDI and private debt flows, sometimes originating in other developing countries) or other nontraditional private resource flows (workers' remittances and grants from nongovernmental organizations [NGOs]). Understanding the differential availability of the new mix of financing resources to individual poor countries will be essential to efforts to maximize aid effectiveness and achieve development objectives—notably the MDGs (chapter 5).

Sources of external finance have changed

Since the early 1990s, the relative importance of ODA as a source of external financing for poor countries has declined, in part due to the end of the Cold War and waning support for client states, but also because of growing global integration through the liberalization of financial flows, trade, and migration. Aggregate figures mask enormous variation among the 28 countries considered in this study: ODA dependence ranges from a high of 36 percent of GDP in Mozambique to 2.2 percent in Bangladesh.

But other forces were at work as well. While ODA was declining, other sources were rising: FDI rose from only 0.4 percent of GDP to 2.7 percent of GDP in 2003, reflecting improving performance and a sounder investment climate. FDI has been of considerable importance for many poor countries—including Lesotho, Mauritania, Moldova, and Mozambique. Nonetheless, much FDI to poor countries still flows to enclave mining and natural resources projects, which may limit benefits and add to volatility.

While not technically a capital flow, private transfers (including NGO grants and workers' remittances) have become relatively more important in poor countries than in other developing countries. Both are large, stable sources of foreign exchange for poor countries and may be more likely than other capital flows to reach poor households. In addition, the size and stability of such current account flows (especially workers' remittances) over time may facilitate poor countries' access to capital markets through securitization.

Flows from other developing countries have grown

The traditional view of developing countries as reliant solely on financing from industrial economies is increasingly outdated. While the final report from Monterrey mentioned the importance of cooperation between developing countries only briefly, the available data suggest a different perspective: with respect to poor countries, other developing countries (especially larger ones such as Brazil, China, India, Saudi Arabia, and South Africa) are increasingly important financial players.

With wealth increasing and administrative capital controls being eased in the 1990s, developing

countries have also emerged as significant sources of FDI outflows, in the form of investments by developing country firms—usually in other developing countries. Because of proximity, cultural similarities, and similar cost structures, developing country firms may have advantages in certain FDI projects. Companies from other developing countries bought assets in a broad range of privatization deals during the 1990s, in sectors ranging from mining to agro-business to telecommunications.

Similarly, although aggregate numbers are still small (and available data limited), ODA providers are becoming more diverse. With the emergence of new donors such as China, Brazil, South Africa, and India, the scope of South-South development assistance is growing, with innovative approaches such as triangular cooperation (developed-country financing of South-South technical cooperation) receiving greater emphasis.

Finally, the South is the primary destination for poor-country migrants—a large portion of poor-country migrants in Africa and South Asia migrate to another developing country. As a result, other developing countries (not industrial economies) are the major source of workers' remittances to the poor countries. The countries with the highest remittance shares are all adjacent to larger, wealthier developing countries, an interdependence that creates both opportunities and risks.

An agenda for financing the Millennium Development Goals

As other sources of finance grow, the development community must continue to play the leading role in mobilizing the external resources on which developing countries are depending to achieve the MDGs. Action is needed on four fronts.

First, donors must fulfill commitments already made (at Monterrey and afterwards) to substantially increase ODA and other resources needed to achieve internationally agreed development goals. Meeting those commitments will require overcoming mounting fiscal pressures in many donor countries and avoiding distractions surrounding shifting strategic considerations—so that aid can be channeled to the places that need it most. Much of the enhanced aid effort must be directed toward Africa, where the MDGs will only be met by 2015 if rates of progress increase considerably. The Commission for Africa recently urged a doubling of aid to Sub-Saharan Africa. And in February 2005, the G-7 finance ministers reaffirmed their countries' commitments to helping the developing world, particularly Africa, achieve the MDGs by 2015. That goal is one of two main themes for discussion at the G-8 leaders' summit scheduled for July 2005.

Second, donors should pursue efforts to make aid flows more reliable. Recognizing that aid is more effective when it is allocated preferentially to countries that demonstrate a capacity to absorb additional aid and to use it well, and that aid cannot be expected to stabilize economic fluctuations in recipient countries, volatility *per se* is inimical to aid effectiveness. Aid has been observed to be more volatile than GDP in recipient countries, and more volatile than some other sources of foreign exchange. Efforts to make it less volatile (through vehicles such as the International Financing Facility, for example) could enhance its effectiveness.

Third, donors (both developed and developing) and recipients should press for better donor coordination, selectivity, and country ownership to improve the effectiveness of aid, and increase the focus on results. Significant progress has been made on this agenda over the last decade, but there is still enormous duplication among donors and a wide variation among them in terms of selectivity. As efforts are made to scale up interventions to achieve the MDGs, the relevance of initiatives targeting coordination and effectiveness will grow even further.

Fourth, the development community should support policies that could facilitate better market access for poor countries and encourage investment through expanding risk-mitigation instruments to stimulate and build on private-sector participation. Most important, poor countries themselves need to pursue effective economic and pro-poor policies. There is clear and growing evidence of a link between reforms in governance, an improved investment climate, and growth in resource inflows of all types—FDI, official flows, and even remittances. Poor countries should continue their efforts to improve the investment climate not only to attract more resources, but also to ensure their effective use.

As a final point, the question of whether robust growth in developed and developing countries can be sustained over the medium term has potentially important implications for attaining the MDGs. A central concern underlying the global economic outlook over the medium term is whether the current large external payments imbalances will unwind in an orderly manner. Collective policy actions by developed and developing countries alike will continue to play a prominent role. A multifaceted, cooperative approach involving all countries is essential to rebalance the world economy on a path of sustainable growth.

1

Financial Flows to Developing Countries: Recent Trends and Near-Term Prospects

THE GLOBAL RECOVERY BROADENED in 2004, boosting world gross domestic product (GDP) by an estimated 3.8 percent—the highest rate in four years and up sharply from 2.5 percent in 2003 and 1.7 percent in 2002.[1] Gradual realignment of stimulative monetary policies in many advanced countries led to modest increases in short-term interest rates during the year (particularly in the United States), but long-term rates remained low in most advanced and developing countries, particularly when adjusted for inflation. Macroeconomic objectives were attained in most developing countries, and progress was made on key structural reform initiatives. These favorable external and domestic factors contributed to strongly improving economic fundamentals, as reflected in a record expansion in developing-world GDP growth (6.6 percent in 2004, much higher than the global average), upgrades in credit ratings, and a reduction in emerging-market bond spreads to near record lows by the end of the year.

Against this favorable backdrop, capital flows to developing countries continued to expand in 2004, following a strong rebound in 2003. This chapter examines key developments and emerging trends in the various components of capital flows and considers the outlook for continued short-term gains. Among our main findings:

- The pickup in capital flows to developing countries over the past two years has coincided with a dramatic improvement in their current account balances. Developing countries continue to export capital to developed countries (mostly the United States) in the form of rapidly growing accumulations of foreign reserves.
- Flows of foreign direct investment (FDI) into developing countries have become increasingly concentrated, while FDI *outflows* from developing countries have increased dramatically.
- Most emerging market economies have taken advantage of favorable financing conditions over the past few years to restructure their debt.
- Strong gains in private capital flows over the past few years have been partly offset by declining official flows arising from large repayments to bilateral and multilateral creditors.
- Within official flows, the shift from loans to grants has accelerated, with the decline in net official lending more than offset by the increase in bilateral aid grants, but not to the extent of official aid commitments. More resources are needed to support efforts to reach the MDGs.

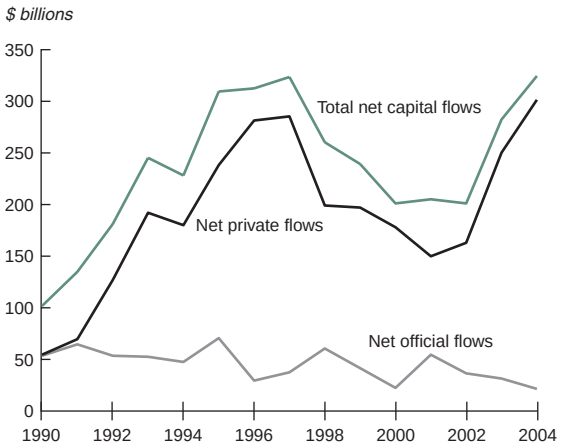
Capital flows to developing countries

Capital flows continue recovery, but pace slows

Net capital flows increased by $42 billion in 2004, continuing the recovery that began in 2003, although at a slower pace than the $81 billion rebound of 2003 (figure 1.1 and table 1.1). Private and official net debt flows reached a record high of $324 billion in 2004, up significantly from $200 billion during 2000–2 and just above the $323 billion level reached in 1997.

The pickup in net capital flows over the past two years appears more modest after taking into account inflation, economic growth, and the sizeable depreciation of the dollar against most major

Figure 1.1 Financial flows to developing countries, 1990–2004



Sources: World Bank Debtor Reporting System and staff estimates.

currencies. The offsetting impact of these factors can be captured by measuring capital flows as a percentage of GDP in the recipient countries (figure 1.2). From this perspective, recent performance has been less robust: net capital flows to developing countries equaled 4.5 percent of their GDP in 2004, up slightly from 4.3 percent in 2003, but significantly below highs of more than 6 percent reached in the mid-1990s.

Developing countries continue to export capital

Current account balances in developing countries continue to strengthen, swelling from a slight deficit in 1999 to a surplus of $153 billion in 2004. That surplus was equal to 2.0 percent of their GDP (table 1.1), up from 1.8 percent

Table 1.1 Net capital flows to developing countries, 1996–2004

$ billions

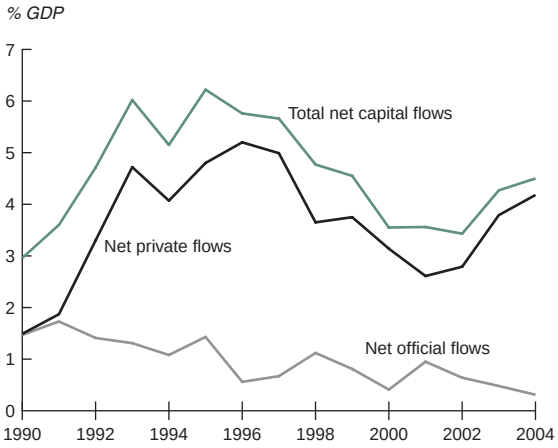
	1996	1997	1998	1999	2000	2001	2002	2003	2004e
Current account balance	−83.6	−87.2	−93.7	−8.0	43.6	16.9	72.0	112.8	152.7
as % of GDP	−1.7	−1.7	−1.6	−0.1	0.8	0.4	1.3	1.8	2.0
Financed by:									
Net equity flows	161.4	190.6	178.1	195.1	178.6	180.9	159.8	176.6	192.3
Net FDI inflows	128.6	168.1	171.5	182.4	166.2	174.8	154.0	151.8	165.5
Net portfolio equity inflows	32.9	22.6	6.6	12.7	12.4	6.0	5.8	24.8	26.8
Net debt flows	123.7	106.9	54.9	15.4	−6.2	−3.5	8.9	62.2	84.1
Official creditors	3.8	12.9	34.4	13.9	−5.8	27.0	5.2	−11.6	−24.9
World Bank	7.3	9.2	8.7	8.8	7.9	7.5	−0.2	−1.2	−1.4
IMF	1.0	3.4	14.1	−2.2	−10.7	19.5	14.0	2.4	−10.9
Others	−4.5	0.4	11.6	7.3	−3.0	0.0	−8.6	−12.8	−12.7
Private creditors	119.9	94.0	20.5	1.5	−0.4	−30.5	3.7	73.8	109.0
Net medium- and long-term debt flows	82.5	84.8	85.0	21.6	7.4	−6.6	0.9	24.9	55.4
Bonds	49.5	38.2	39.7	29.8	17.5	11.0	11.2	28.1	63.0
Banks	30.7	43.8	50.4	−6.8	−5.8	−11.0	−3.8	3.1	−1.8
Others	2.3	2.9	−5.2	−1.5	−4.3	−6.5	−6.5	−6.3	−5.7
Net short-term debt flows	37.4	9.2	−64.5	−20.1	−7.9	−23.9	2.8	48.9	53.6
Balancing item[a]	−111.2	−157.5	−122.9	−169.1	−169.1	−112.5	−69.0	−59.9	−50.9
Change in reserves (− = increase)	−90.4	−52.9	−16.3	−33.4	−46.8	−81.7	−171.7	−291.9	−378.2
Memo items:									
Total foreign aid (grants) (ex technical cooperation grants)	26.7	25.3	26.7	28.5	28.7	27.9	32.2	43.4	47.4
Net private flows (debt + equity)	281.3	284.6	198.6	196.6	178.1	150.3	163.5	250.4	301.3
Net official flows (aid + debt)	30.5	38.2	61.1	42.4	23.0	54.9	37.4	31.7	22.5
Total net capital flows (private and offical)	311.8	322.8	259.6	239.1	201.1	205.2	200.9	282.1	323.8

Note: e = estimate

a. Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries.

Sources: World Bank Debtor Reporting System and staff estimates; IMF, *Balance of Payments Yearbook*, various years; and Dealogic Bondware and Loanware.

Figure 1.2 Financial flows to developing countries as a percentage of GDP, 1990–2004



Sources: World Bank Debtor Reporting System and staff estimates.

Figure 1.3 Current account balance of developing countries, 1976–2004

Sources: IMF; World Bank staff estimates.

in 2003. Current account surpluses in the developing world are a dramatic change from previous decades, when the developing countries as a group consistently ran modest current account deficits (figure 1.3) that averaged 1.4 percent of their GDP from 1976 to 1999. The swing in the current account is even more dramatic in low-income countries, where current account deficits averaged 2.3 percent of GDP in 1976–99 (figure 1.3).

The pace of reserve accumulation accelerates

The dramatic current account surpluses chalked up in the past few years have been used primarily to accumulate foreign exchange reserves, rather than to finance productive domestic investments. That trend accelerated last year, as foreign reserve accumulation in developing countries continued to finance a large share of the U.S. current account deficit in 2004. Foreign reserves held by developing countries grew by $378 billion in 2004 (4.9 percent of GDP), following a $291 billion (4.1 percent of GDP) increase in 2003. Meanwhile, the U.S. current account deficit ballooned from $531 billion in 2003 (4.8 percent of GDP) to $666 billion in 2004 (5.6 percent of GDP).

The acceleration in reserve accumulation was highly concentrated in just a few countries.[2] China accounted for more than half of the increase in 2004, with foreign reserves increasing by $207 billion. China's share of developing-country reserve holdings rose from 33 percent in 2003 to 38 percent in 2004.

Strong gains in private flows were partly offset by declining official flows

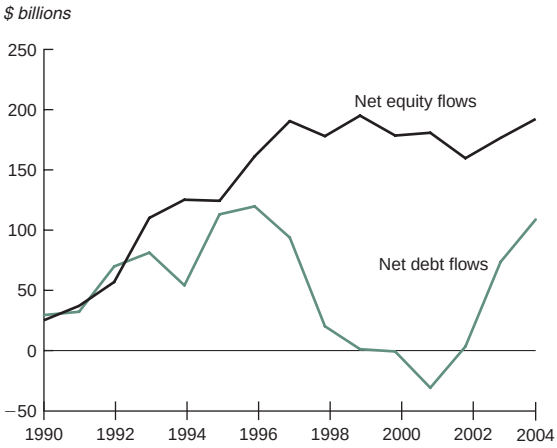
The pickup in net capital flows over the past few years (measured in dollars) reflects strong gains in net private flows as well as declines in net official flows (figure 1.1). Net private flows (debt and equity) have grown by a cumulative total of $140 billion since 2001, rising from 3.8 to 4.2 percent of GDP—still below the high of 5.2 percent reached in 1996 (figure 1.2). In contrast, net official flows (concessional aid and long-term debt) have declined by a cumulative total of $32 billion since 2001 (from 1.0 to 0.3 percent of GDP). The $20 billion increase in bilateral aid that has occurred has been eclipsed by a $52 billion decline in net official lending, which reflects large repayments made to multilateral and bilateral creditors. From a historical perspective, the recent decline in net official flows continues a downward trend that began in the early 1990s (figures 1.1 and 1.2).

Capital flows from the private sector

Debt and equity flows showed modest gains

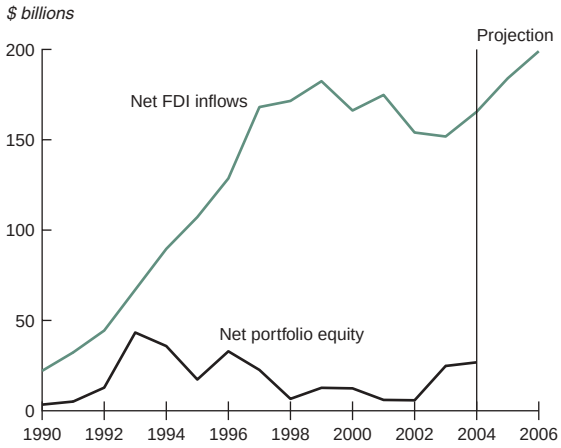
Net private flows (debt and equity) increased by $51 billion in 2004, following a $87 billion surge in 2003. The modest gains in 2004 were split between net debt and equity flows (figure 1.4).

Figure 1.4 Financial flows to developing countries from the private sector, 1990–2004



Sources: World Bank Debtor Reporting System and staff estimates.

Figure 1.5 Net equity flows to developing countries, 1990–2006



Sources: World Bank Debtor Reporting System and staff estimates.

Net equity flows increased by $16 billion in 2004, reaching $192 billion in 2004, marginally below the $195 billion peak attained in 1999. Net equity flows have been stable at 2.7 percent of GDP since 2002, below the high of 3.7 percent attained in 1999.

Net private debt flows increased by $35 billion in 2004, reaching $109 billion, up significantly from a low of –$30 billion recorded in 2001, but still below the high of $120 billion recorded in 1995. As a percentage of GDP, net debt flows increased from –0.5 percent in 2001 to 1.4 percent in 2004 (compared to the high of 2.3 percent reached in 1995).

Equity flows have been much more stable than debt flows since the late 1990s (figure 1.4). Why? First, FDI inflows—the largest component of equity flows—have been much more stable than flows of debt and portfolio equity (figures 1.4 and 1.5).[3] Second, net FDI and portfolio equity flows have been negatively correlated over the past few years,[4] so that the sum (net equity flows) becomes even more stable. This negative correlation reflects the substitutability of the two categories of equity. For example, mergers and acquisitions often involve reclassifying portfolio equity claims as FDI claims, which entails offsetting changes in net FDI and portfolio equity flows.[5]

FDI is increasingly concentrated

Economic conditions over the past few years have favored FDI inflows to developing countries. The investment climate in many developing countries has improved markedly, with higher corporate earnings, liberalization of foreign ownership rules, and a stronger global recovery. In response to these improvements, net FDI inflows to developing countries increased by $14 billion (9 percent) in 2004, partly reversing a $23 billion cumulative decline in the previous two years (figure 1.5).

The increase was spread across most regions, with the exception of the Middle East and North Africa (table 1.2). In Latin America, a $6 billion rebound reversed substantial declines in the previous four years and raised Latin America's share of net FDI inflows to developing countries slightly from 25 percent in 2003 to 26 percent in 2004, still well below the share of 48 percent the region reached in 1999–2000. The East Asia and Pacific region

Table 1.2 Regional composition of net FDI inflows to developing countries, 2002–4

$ billions

	2002	2003	2004e
All developing countries	154.0	151.8	165.5
Regional composition			
East Asia and Pacific	55.6	59.6	63.6
of which China	49.3	53.5	56.0
Latin America and Caribbean	45.7	36.5	42.4
East Europe and Central Asia	35.0	35.6	37.6
Sub-Saharan Africa	9.0	10.1	11.3
South Asia	4.8	5.2	6.5
Middle East and North Africa	3.8	4.8	4.1

Note: e = estimate
Sources: World Bank Debtor Reporting System and staff estimates.

received a $4 billion increase in FDI inflows in 2004, bringing its share of FDI flows to the developing world to 38 percent, down slightly from 2003 but still substantially above the 27 percent average share for the period 1999–2001. FDI to Europe and Central Asia has stabilized over the past three years at 23 percent of the developing-world total, significantly above its 9 percent share in 1994.

The widely distributed regional gains in FDI inflows mask concentration at the country level. Fully 88 percent of the estimated *increase* in net FDI flows to developing countries in 2004 went to five countries—Brazil, China, India, Mexico, and the Russian Federation. To understand this pattern, remember that several of these countries—China, India, and the Russian Federation—grew significantly faster than other developing countries. The same five account for just over 60 percent of net FDI inflows in 2004, up from 57 percent during the previous three years. China accounted for one-third of net FDI inflows to all developing countries[6] (down from 35 percent in 2003) and for almost 90 percent of net FDI inflows to the East Asia and Pacific region, a share unchanged from its average of the previous three years.

The share of net FDI inflows going to low-income countries increased substantially over the past four years, rising from a low of less than 7 percent in 2000 to almost 11 percent in 2003/04, the highest level in the past 15 years (figure 1.6). The increase reflects strong gains in FDI in India's service sector and in the oil and gas sectors of a few African countries (Angola, Chad, Equatorial Guinea, and Sudan). The share of FDI going to the least developed countries has shown steady gains over the past 10 years, rising from a low of 1 percent in 1994 to just under 5 percent in 2003/04.[7]

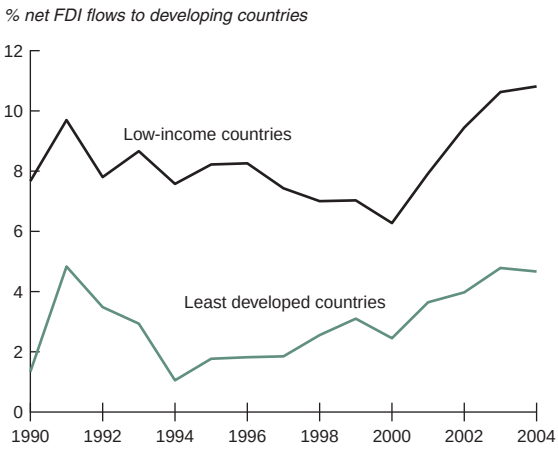
FDI outflows from developing countries increased dramatically

Faced with growing competition and limited markets at home, many companies in developing countries have sought to expand their operations abroad. Relaxed controls on capital outflows have allowed them to pursue global investment opportunities more aggressively in recent years. As a consequence, FDI outflows from developing countries have swelled over the past few years, rising from $3 billion (0.1 percent of GNI) in 1991 to $16 billion (0.3 percent of GNI) in 2002, and then surging to an estimated $40 billion (almost 0.6 percent of GNI) in 2004 (figure 1.7).

The increase in FDI outflows is concentrated in many of the same countries that receive the bulk of FDI *inflows* to developing countries—Brazil, China, India, Mexico, and the Russian Federation).[8] However, the correspondence between developing-country shares of FDI inflows and outflows is not very tight. For example, China accounted for one-third of FDI inflows to developing countries in 2004, but less than 10 percent of the estimated outflows.

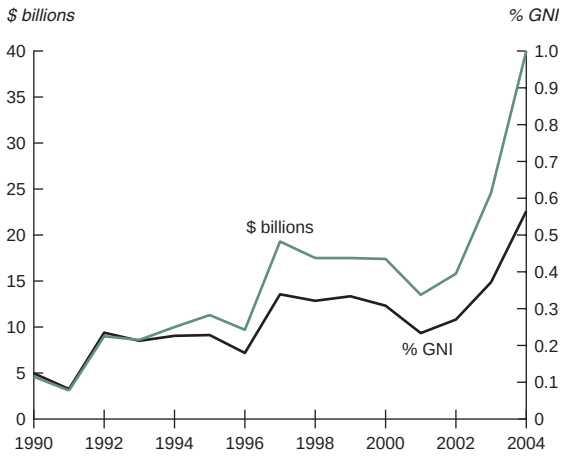
Much of the surge in FDI outflows in recent years can be traced to developing countries

Figure 1.6 Share of net FDI inflows to low-income and least developed countries, 1990–2004



Sources: World Bank Debtor Reporting System and staff estimates.

Figure 1.7 FDI outflows from developing countries, 1990–2004



Sources: World Bank Debtor Reporting System and staff estimates.

investing abroad in developed countries, as well as other developing countries.[9] This has enabled companies to expand and diversify their operations across a wider spectrum of countries and provide greater scope for diffusion of technical innovation and managerial expertise.

Because of the poor quality and coverage of data on FDI outflows from developing countries (many developing countries do not even record statistics on FDI outflows), the reported figures are substantial underestimates.[10] The quality and country coverage of the data are improving, however, and measurement improvements almost certainly account for some of the increase in reported FDI outflows over the past few years, as shown in figure 1.7.

Prospects for net FDI flows

The short-term prospects are good for further modest gains in FDI inflows to developing countries. As

Box 1.1 Measuring capital flows in dollars versus as a percentage of GDP

Capital flows to developing countries are in one of three major currencies—the dollar (the most common), the euro, or the Japanese yen. Transactions in currencies other than the dollar are typically converted into dollars to facilitate comparison. The exchange rate used in the conversion can have a major influence on comparisons across countries and over time.

To illustrate, consider a case in which transactions are made in euros. A €1 billion transaction would have been valued at $0.88 billion in February 2002, but $1.34 billion in December 2004—a 52 percent increase caused by the depreciation of the dollar against the euro.

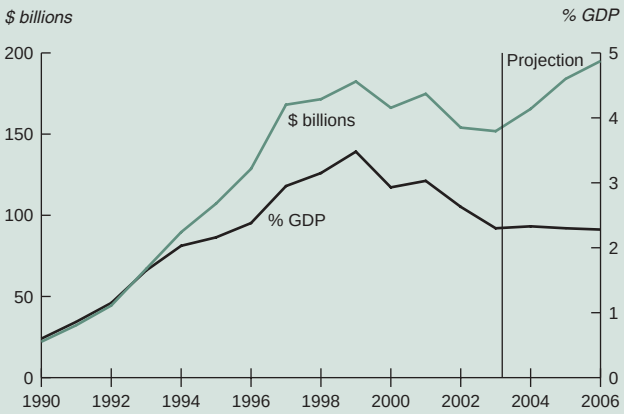
In the simple case where the recipient country's exchange rate is fixed to the euro and it trades exclusively with euro zone countries, the purchasing power of capital flows is best measured in euros. Converting the euro value to dollars in such cases greatly overstates the purchasing power of capital flows.

In general, the purchasing power of capital flows will depend on the recipient country's exchange-rate regime, as well as the response of domestic prices to changes in the exchange rate. This can be captured by comparing the value of capital flows received with the value of goods and services that the recipient country produces, as measured by its GDP. Returning to the simple example outlined above, the 52 percent appreciation of the euro against the dollar would have no effect on capital flows measured as a percentage of GDP.

Measuring capital flows as a percentage of GDP also takes into account inflation and economic growth. The value of GDP in developing countries, measured in dollars, has grown at an average annual rate of 7.6 percent over the past 40 years, which reflects an average real growth rate of 4.2 percent and an implicit average inflation rate of 3.4 percent (measured in dollars). Meanwhile, the value of capital flows to developing countries (again measured in dollars) has increased at an average annual rate of 9 percent, thereby exceeding the rate of real economic growth and inflation by 1.4 percentage points on average. This indicates that the value of capital flows has not only maintained its purchasing power relative to the general price level (inflation), but also has increased faster than the expansion in real economic activity.

The distinction between measuring capital flows in dollars and as a percent of GDP is well illustrated with reference to net FDI flows to developing countries, as shown in the figure. Net FDI inflows are projected to increase from $152 billion in 2003 to a record high of $195 billion in 2006. The projected average growth rate of 9 percent is similar to that projected for GDP; hence, net FDI inflows are projected to be constant as a share of GDP. They are not expected to meet or exceed the level of 3 percent of GDP observed in the late 1990s.

Net FDI flows to developing countries, 1990–2006



Sources: World Bank Debtor Reporting System and staff estimates.

economic fundamentals strengthen further and countries continue to implement policies designed to attract investment, the climate should continue to improve, especially with regard to liberalization of restrictions on foreign ownership (notably in India).

Econometric projections based on economic fundamentals indicate that over the next two years, FDI inflows will grow at the 9 percent rate recorded in 2004, keeping net FDI inflows at about 2.3 percent of developing-country GDP (see box 1.1).[11]

Small gains in portfolio equity flows in the face of volatile equity prices

Net portfolio equity flows registered a small increase of $2 billion in 2004, following a surge of $19 billion in 2003. The $21 billion increase over the past two years was spread across most regions, with the exception of Latin America and the Caribbean, where flows dropped by $5 billion in 2004, after increasing by $2 billion in 2003 (table 1.3). Almost half of the global gains of the past two years came in the East Asia and Pacific region ($9.5 billion). China dominated, with a $8.3 billion increase, accounting for almost 40 percent of net portfolio equity flows to all developing countries in 2004. There were also strong gains in South Asia, where India recorded a $6.4 billion increase over the past two years, bringing its share to one-third of the total for the developing world.

Portfolio equity flows continue to be highly concentrated in just a few countries—China, India, and South Africa together accounted for 82 percent of all portfolio equity flows to developing countries in 2004, close to their average share for the past five years (85 percent). Eleven percent of portfolio equity flows to developing countries went to low-income countries, up from 7 percent five years ago, while 5 percent went to the least-developed countries, up from 3 percent five years ago.

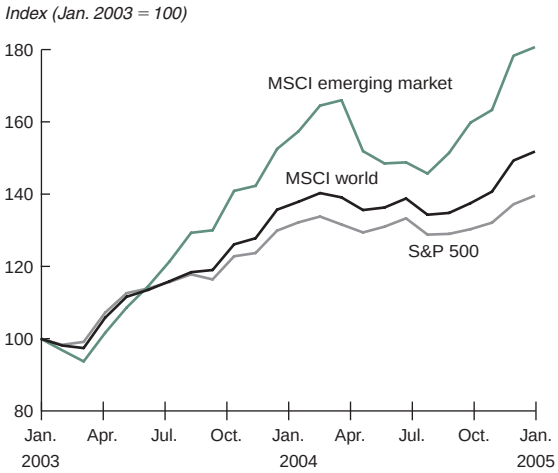
Table 1.3 Regional composition of net portfolio flows to developing countries, 2002–4

$ billions

	2002	2003	2004e
All developing countries	5.8	24.8	26.8
Regional composition			
East Asia and Pacific	4.0	11.8	13.6
of which China	2.2	7.7	10.5
Latin America and Caribbean	1.4	3.4	−1.5
East Europe and Central Asia	−0.1	0.6	3.6
Sub-Saharan Africa	−0.4	0.7	3.5
South Asia	1.1	8.2	7.5
Middle East and North Africa	−0.2	0.1	0.2

Note: e = estimate
Sources: World Bank Debtor Reporting System and staff estimates.

Figure 1.8 Equity price indexes, 2003–4



Sources: J.P. Morgan Chase and Standard and Poor's.

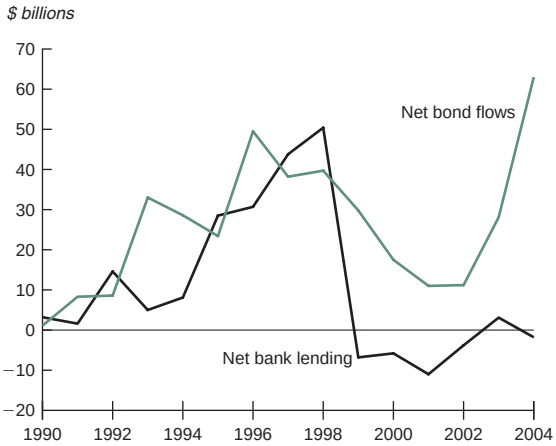
The strong rebound in portfolio equity flows in 2003, followed by small gains in 2004, rode the back of large swings in emerging-market equity prices. Equity prices rallied strongly throughout much of 2003, followed by a sizeable correction in the first half of 2004 and then a rebound in the second half of the year (figure 1.8).

The large swings in equity prices over the year were mirrored in investments in emerging-market equity funds. Inflows reached $3.1 billion in the first quarter, reversed quickly to net outflows of $1.4 billion between May and August, and then recovered partially to finish the year with net inflows of $0.4 billion. Average returns on equity in emerging markets have been higher than in mature markets over the past two years (figure 1.8), but prices have been much more volatile. Major divergences in equity prices have occurred across regions, with emerging Europe and Latin America outperforming emerging Asia by a wide margin.

The ongoing shift from bank to bond finance

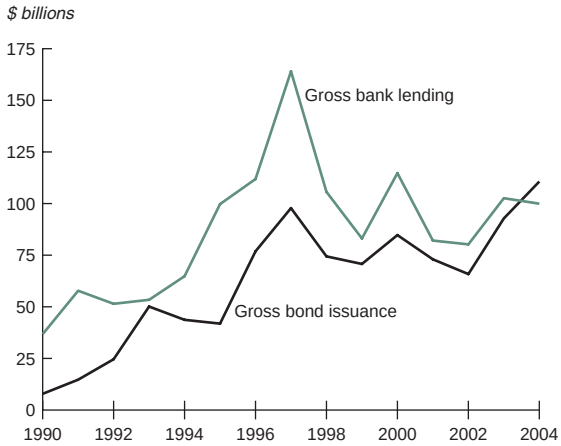
Net medium- and long-term lending by banks to developing countries has been on the decline since the late 1990s, as bond issuance has risen. Net medium- and long-term bank lending declined by $2 billion in 2004, following a $3 billion increase in 2003 and declines averaging $7 billion during the previous four years (figure 1.9). In contrast, medium- and

Figure 1.9 Net private debt flows to developing countries, 1990–2004



Sources: World Bank Debtor Reporting System and staff estimates.

Figure 1.10 Gross private flows to developing countries, 1990–2004



Sources: Dealogic Bondware and Loanware.

long-term net bond flows rebounded sharply over the past two years, increasing by a total of $52 billion, reaching a record high of $63 billion in 2004. *Gross* bond financing also increased dramatically over the past two years, exceeding *gross* bank lending for the first time (figure 1.10).

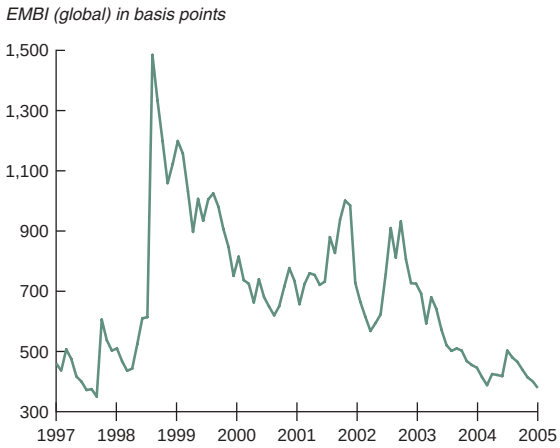
Bank lending continues to cater to a wide array of developing countries' financing needs, despite the declines in net lending over the past six years. Twice as many countries tapped this segment of the debt markets in 2004 than the bond financing segment. The private corporate sector accounts for a growing share of bank credit to developing countries. That share increased to 67 percent in 2004, compared with 57 percent in 2003. In comparison, the private sector accounted for only a third of total developing-country bond financing.

The strong gains in bond issuance over the past two years reflect both "push" and "pull" factors that sparked investors' interest in the emerging-market asset class. Low interest rates in advanced countries propelled a search for yield in higher-risk assets, while improved fundamentals in most emerging-market economies lowered investors' assessment of default risk significantly.

Emerging market bond markets exhibited volatility in the first half of 2004, matching that in portfolio equity. In April/May, bond spreads widened by about 125 basis points as various indicators suggested that the global recovery was stronger than anticipated (particularly in the United States and Japan), which raised concerns that central banks would be forced to raise interest rates abruptly. These concerns dissipated over the course of the year, however, as it became evident that the global recovery was decelerating and interest rate increases would be implemented gradually. Emerging-market bond spreads narrowed over the second half of 2004—despite increases in short-term interest rates in many advanced countries (the United States in particular). The Emerging Markets Bond Index (EMBI) spread narrowed from a peak of 550 basis points in May to below 350 basis points in December, the lowest level since 1997 (figure 1.11). The last time that the EMBI spread was below 500 basis points was in April 1998, just before the sharp increase to almost 1,500 basis points in August 1998, in the wake of the financial crisis in the Russian Federation.

Some emerging market economies, particularly in Latin America, had difficulties accessing external capital markets when bond spreads widened suddenly in the spring. Since then, bond issuance by developing countries has been resilient, even in the face of heightened economic and geopolitical uncertainty. The narrowing of bond spreads to near record lows indicates that the transition to higher interest rates in most advanced countries over the course of the year and the significant increase in world oil prices have had little impact to date on investors' assessment of risk in the emerging-market asset class. Investors' sanguine assessment is also reflected in improved credit ratings for many emerging market economies.

Figure 1.11 Emerging-market bond spreads, 1997–2004



Source: J.P. Morgan Chase.

Prospects for private debt flows

The outlook for private debt financing is expected to remain quite positive in the short run, but could become less benign over the medium term. However, the probability of a generalized credit compression or major retrenchment remains low.

The dynamics of both the supply of capital by investors and the demand for funds by developing countries are likely to dampen flows in 2005. Creeping tensions in pricing may put pressure on benchmark spreads to widen, while rising benchmark rates used in pricing bank loans (the Libor, in particular) may also curtail loan financing. In addition, uncertainty surrounding the future path of interest rates may raise market volatility and further discourage bond issuance. Given the competitive pricing of developing-country risk, opportunistic profit-taking by investors may also exert occasional pressures on spreads to widen.

The supply of capital for developing countries may be affected by new, high-yield investment opportunities in the developed world. Improved corporate profitability in industrial countries, particularly for firms in high-yield sectors, would sharpen competition for investment funds. At the same time, the lingering weakness in global equity markets, especially in the technology sector, could erode investor sentiment, reducing appetite for risk.

The prospect of higher interest rates in advanced countries continues to pose a major downside risk. Although short- and long-term interest rates in the United States and the euro zone remain relatively low, particularly when adjusted for inflation, the monetary tightening that began in the United States in June 2004 has brought higher short-term rates. To date, long-term rates have shown little movement. In fact, the yield on the benchmark 10-year U.S. Treasury note decreased by 50 basis points between June and December, while the yield on one-month U.S. Treasury bills increased by 100 basis points. Monetary conditions in the United States are expected to continue to tighten gradually over the balance of the year as the slack in the U.S. economy is reduced. The risk of an abrupt increase in U.S. interest rates remains a serious concern. Large, sudden movements in long-term rates, in particular, could provoke a sharp widening of emerging-market bond spreads.

The potential impact of global imbalances on exchange rates also clouds the prospects for private capital flows to developing countries. Abrupt movements in exchange rates—as in interest rates—could cause emerging-market bond spreads to widen dramatically, which could have significant implications for those emerging market economies that have high debt burdens and heavy financing needs (see chapter 3).

On the upside, most developing countries are now less vulnerable to a sudden shift in investor sentiment than they were a few years ago. The external and domestic credit quality of many countries has improved significantly over the past few years. Moreover, there has been a marked decline in speculative positions in emerging-market assets over the past 10 years.

Favorable financial conditions have enabled many emerging market economies to prefinance a significant portion of their external funding requirements for 2005. Some countries have also taken the opportunity to strengthen their debt management by issuing a higher proportion of bonds that have longer maturities, are denominated in domestic currency, or are not indexed to the exchange rate, inflation, or short-term interest rates. In addition, many emerging market economies have accumulated additional foreign reserves over the past year (see chapter 3). Taken together, these initiatives should make many emerging market economies less vulnerable to the risk of a sharp deterioration in financing conditions.

Contagion is always a possibility, but it is less likely than in earlier periods, as investors appear to

be more discerning in assessing risks across countries. Thus, while pressures on pricing remain, the probability of a sharp sell-off of emerging-market debt remains limited.

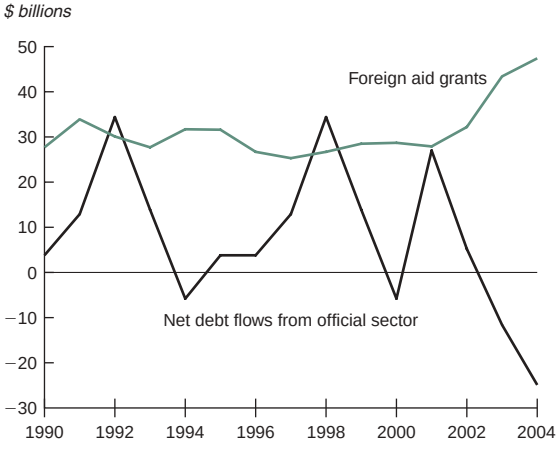
Capital flows from the official sector

Shift from loans to grants accelerates

Official flows of development finance have shown a dramatic shift from loans to grants over the past three years (figure 1.12). Foreign aid grants have increased by a cumulative total of $20 billion during the period, while net official lending has declined by $52 billion—implying a $32 billion decline in net official flows (aid and lending combined).

Most of the decline in net official lending over the past three years can be attributed to a cumulative $30 billion decline in net lending by the IMF, which reflects net repayments to the IMF of large disbursements of emergency assistance in 2001—mainly to Argentina, Brazil, and Turkey. Net lending by bilateral donors declined by a cumulative total of $14 billion over the past three years, largely from the shift in funding from loans to grants and because of prepayments by some developing countries of earlier debt obligations to the Paris Club. In addition, net lending by the World Bank fell by a cumulative total of $9 billion over the three years as some developing countries (notably China, India, and Thailand) repaid a portion on their loans ahead of schedule, while other developing countries (notably Argentina, Indonesia, and the Russian Federation) repaid structural adjustment loans made in the midst of financial crises in the late 1990s.

Figure 1.12 Official debt flows and foreign aid grants, 1990–2004



Source: World Bank Debtor Reporting System.

Net official debt flows, then, have been dominated by cycles in medium-term (three- to five-year) financing to developing countries in crisis and by unscheduled repayments (prepayments) on bilateral and multilateral loans. A better measure of the resources available to finance countries' long-term development needs is provided by official development assistance (ODA), because ODA is defined by the Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development (OECD) as aid grants and concessional loans made by donor governments and multilateral agencies *for the purpose of promoting economic development and welfare*.

Progress on official aid commitments

ODA data for 2004 will not be available until April 2005. In 2003, ODA increased by $10 billion to reach $69 billion, following a $6 billion increase in 2002 (table 1.4). This represents a nominal increase of 18 percent in 2003, following a 2002 increase of 11 percent. But in real terms (adjusting for inflation and exchange-rate changes), ODA increased by just 5 percent in 2003 and 7 percent in 2002.

Strategic factors continue to play a major role in the allocation of ODA across recipient countries. In particular, the share of bilateral ODA disbursements to five countries—Afghanistan, Colombia, Iraq, Jordan, and Pakistan—has increased from 3 percent on average during 1980–2000 to more than 6 percent in 2001–2, and more than 11 percent in 2003. Reconstruction aid to Iraq alone totaled $2.2 billion in 2004. Although the scope for improved aid effectiveness has improved in some of those countries, such changes alone cannot account for the size of the increase in their shares of ODA.

From the perspective of the recipient countries, net ODA flows have grown gradually over the past few years. ODA has been quite stable as a share of GDP in recipient countries, averaging just over 1 percent since 1996, below the high of 2 percent reached in 1991 (figure 1.13). For the poorest recipient countries (excluding those in conflict or postconflict), ODA has averaged just over 2 percent since 1996, well below the high of 3.7 percent in 1992.

Half of net ODA flows in 2003 were comprised of special-purpose grants, which include

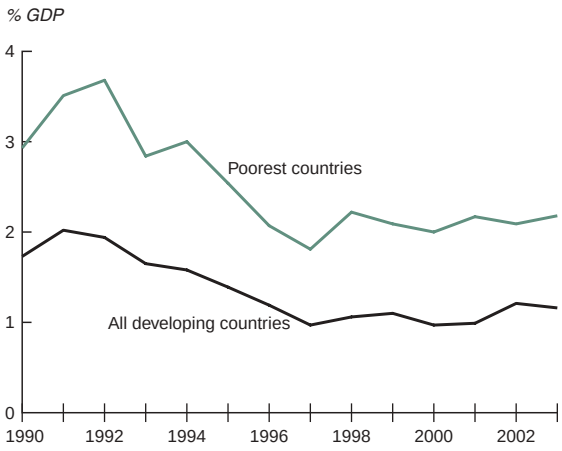
Table 1.4 Net official development assistance (ODA) from principal donor countries, 1990–2003

$ billions

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	Percent change in real terms in 2003[a]
Total ODA	54.3	58.3	62.4	56.1	58.8	58.8	55.6	48.5	52.1	53.2	53.7	52.4	58.3	69.0	4.8
G-7 countries	42.4	45.6	48.6	44.6	46.6	44.7	41.3	35.1	38.6	39.4	40.2	38.2	42.6	49.9	6.3
United States	11.4	11.3	11.7	10.1	9.9	7.4	9.4	6.9	8.8	9.1	10.0	11.4	13.3	16.3	20.4
Japan	9.1	11.0	11.2	11.3	13.2	14.5	9.4	9.4	10.6	12.2	13.5	9.8	9.3	8.9	−9.2
France	7.2	7.4	8.3	7.9	8.5	8.4	7.5	6.3	5.7	5.6	4.1	4.2	5.5	7.3	8.7
Germany	6.3	6.9	7.6	7.0	6.8	7.5	7.6	5.9	5.6	5.5	5.0	5.0	5.3	6.8	5.3
Non-G-7 countries	11.8	12.7	13.8	11.5	12.2	14.1	14.3	13.3	13.5	13.8	13.5	14.2	15.6	19.1	0.5
memo item:															
EU countries	28.3	30.3	33.5	29.5	30.1	31.2	31.4	26.8	27.6	26.7	25.3	26.4	30.0	37.1	3.0

a. Takes into account inflation and exchange-rate movements.
Source: OECD Development Assistance Committee.

Figure 1.13 ODA as a percentage of GDP in recipient countries, 1990–2003



Source: OECD Development Assistance Committee.

technical cooperation, debt forgiveness, emergency and disaster relief, and administrative costs. Although special-purpose grants are an essential element of the development process and have budgetary consequences for donor countries, they do not provide additional financial resources to recipient countries to support programs that are needed to achieve the Millennium Development Goals (MDGs).[12]

Once special-purpose grants are subtracted from the bilateral portion of ODA, development aid declined slightly in 2003 (in nominal terms), after increasing by about $1 billion in 2002 (table 1.5).

Total ODA increased from 0.22 percent of GNI in the DAC donor countries in 2001 to 0.25 percent in 2003, but it remains significantly below the 0.34 percent level reached in the early 1990s (table 1.5) and well below the UN target level of 0.7 percent of GNI. The bilateral portion of ODA (less special-purpose grants) declined from 0.06 percent of GNI in 2000 to just under 0.05 percent in 2003, well below the 0.12 percent level reached in 1990.[13]

Prospects for development aid

The World Bank's International Development Association (IDA) helps the poorest countries alleviate poverty by providing interest-free loans and some grants for programs aimed at boosting economic growth and improving living conditions. The fourteenth replenishment of IDA (IDA14), finalized in late February 2005, set a positive tone for future development financing.

During the replenishment negotiations, donor countries stressed the importance of several key initiatives:

- A new system for allocating IDA grants based on countries' risk of debt distress
- A strong focus on growth, private sector development, and infrastructure
- A results-measurement system for IDA14
- Increased transparency and accountability, including the disclosure of IDA's country performance assessments
- Measures to strengthen coordination and harmonization among development partners.

Financial resources provided by IDA over the coming three years are set to increase by 25 percent at a minimum—the largest expansion in IDA resources in more than two decades. The proportion of IDA resources provided through grants is set to increase from about 19 percent over the thirteenth

Table 1.5 Net bilateral ODA and special purpose grants, 1990–2003
$ billions

	1990	1995	2000	2001	2002	2003
Total ODA	54.3	58.8	53.7	52.4	58.3	69.0
Bilateral ODA	38.5	40.5	36.1	35.1	40.8	49.8
Special purpose grants:	18.7	24.0	21.5	22.4	26.9	36.1
Technical cooperation	11.4	14.3	12.8	13.6	15.5	18.4
Debt forgiveness	4.3	3.7	2.0	2.5	4.5	8.3
Emergency and diaster relief	1.1	3.1	3.6	3.3	3.9	5.9
Administrative costs	2.0	2.9	3.1	3.0	3.0	3.5
Bilateral ODA less special-purpose grants	*19.8*	*16.5*	*14.6*	*12.8*	*13.9*	*13.7*
As percentage of GNI in DAC donor countries						
Total ODA	0.34	0.26	0.22	0.22	0.23	0.25
Bilateral ODA	0.24	0.18	0.15	0.15	0.16	0.18
Bilateral ODA less special-purpose grants	*0.12*	*0.07*	*0.06*	*0.05*	*0.06*	*0.05*

Source: OECD Development Assistance Committee.

replenishment to an estimated 30 percent over the IDA14 period. The allocation of grants in IDA14 will be determined primarily through assessments of debt sustainability. Half of IDA14 resources will be directed to those African countries that can meet performance standards required to make aid effective.

This will be supplemented by an agreement on the tenth replenishment of the African Development Fund (ADF-X) that was reached in late December 2005. The African Development Fund was established in 1972 to provide concessional development finance to the poorest member countries. The new agreement will provide $5.4 billion in funding, a 43 percent increase over the ninth replenishment (ADF-IX). The grant component of funding will rise as well, from 21 percent under ADF-IX to about 44 percent. ADF assistance to two-thirds of the eligible countries (26 countries) will be in the form of grants only.

The Commission for Africa issued a report in March 2005 that urges a doubling of aid to Africa, including an investment of $150 billion in infrastructure over the next decade. The report calls for an additional $25 billion per year in aid, to be achieved by 2010. Subject to a review of progress, a further $25 billion per year is to be provided by 2015.

Participants at the United Nations Conference on Financing for Development in Monterrey in March 2002 recognized that a substantial increase in ODA and other resources would be required if developing countries were to achieve internationally agreed development goals and objectives. Developed countries were urged to "make concrete efforts" to increase ODA to the UN target of 0.7 percent of GNI.[14] New development assistance commitments announced at Monterrey implied that by 2006, ODA would increase by a total of $12 billion per year. Moreover, there was agreement at Monterrey that although additional debt relief was an essential element of the development agenda (box 1.2), it should not detract from augmenting the other financial resources required to enable developing countries to attain the MDGs.

In 2003, ODA in 5 of the 21 DAC donor countries exceeded the United Nations target of 0.7 percent of their GNI: Denmark, Luxembourg, the Netherlands, Norway, and Sweden (table 1.6). Three of these countries (Luxembourg, Norway, and Sweden) have agreed to increase ODA further to 1 percent of GNI. Four additional donor countries (Belgium, Finland, France, and Ireland) have specified a firm date for raising ODA to 0.7 percent of GNI. Spain and the United Kingdom have projected dates. Other donor countries have specified interim targets for raising ODA as a percent of GNI over time. As a group, the members of the European Union aim to increase ODA from 0.35 percent of GNI in 2003 to 0.39 percent by 2006.

Reflecting those commitments, ODA is projected to increase from 0.25 percent of GNI in donor countries in 2003 to 0.30 percent by 2006,

Box 1.2 Implementation of the Heavily Indebted Poor Countries (HIPC) Initiative

In 1996, concerned that excessive debt was stifling economic growth and crippling efforts to reduce poverty in some of the world's poorest countries, the World Bank and International Monetary Fund (IMF) launched the Heavily Indebted Poor Countries (HIPC) Initiative. The Initiative was based on an agreement by all major international lenders to offer a fresh start to countries that were making efforts to reduce poverty. The Initiative was enhanced in 1999 to provide deeper and faster debt relief to a larger group of eligible countries and to increase the program's links with ongoing poverty reduction efforts in those countries.

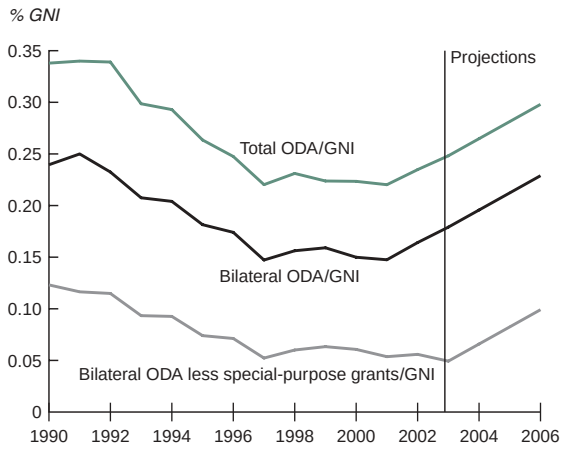
Currently eligible for debt relief under the HIPC Initiative are 38 countries, 32 of them in Sub-Saharan Africa. Twenty-seven have reached the HIPC "decision point" at which donors make a commitment to provide the debt relief necessary to meet a specified debt ratio. (Most of the 11 countries that have not reached the decision point have been beset by internal strife, cross-border conflict, governance challenges, or substantial arrears.) Fifteen countries have reached their "completion points," seven since September 2003—Ethiopia, Ghana, Guyana, Madagascar, Nicaragua, Niger, and Senegal. All 15 have received irrevocable debt relief. The debt relief accorded the other 12 "decision point" countries will not become irrevocable until they pass the completion point.

The debt stock of the 27 countries that have reached the decision point under the HIPC Initiative has been reduced by two-thirds. The World Bank alone has committed about $13 billion in nominal debt-service relief to this group of countries over the next two decades. As a result of the relief, ratios of debt service to exports have been substantially reduced. Funds freed up by debt relief are directed, under the terms of the HIPC Initiative, to programs designed to improve the lives of the poor. Poverty-reducing expenditures, on average, have risen from 6.4 percent of GDP in 1999 to 7.9 percent of GDP in 2003, nearly three times higher than debt service expenditures.

Eligibility for the Initiative is based on several criteria related to income and indebtedness. In September 2004, the IMF and Bank extended the enhanced HIPC Initiative by two years to end-2006. The extended timeframe may allow other countries to enter the program. They will have to establish a track record of macroeconomic performance in order to reach their decision point and qualify for debt relief. In addition, several proposals are currently being considered to provide additional debt relief to make debt more sustainable in low-income countries.

Sources: IMF/World Bank (2004) and World Bank staff.

Figure 1.14 ODA as a percentage of GNI in DAC donor countries, 1990–2006



Source: OECD Development Assistance Committee.

still significantly less than the 0.34 percent level reached in the early 1990s (table 1.4 and figure 1.14).[15] The near-term increases imply an average 9 percent annual increase in ODA in real terms over the period 2004–6, well above the average rate of real increases for the past two years (6 percent).[16] The EU members as a group are projected to raise their net ODA contributions to 0.44 percent of their GNI, exceeding their stated goal of 0.39 percent by a significant margin. The projected increase in EU contributions (equal to $11.7 billion) accounts for 60 percent of the total projected increase in ODA ($19.4 billion). If donor countries are to raise the amount of aid that can be used for development purposes by the same proportion, bilateral ODA, less special-purpose grants, would have to increase from 0.05 percent

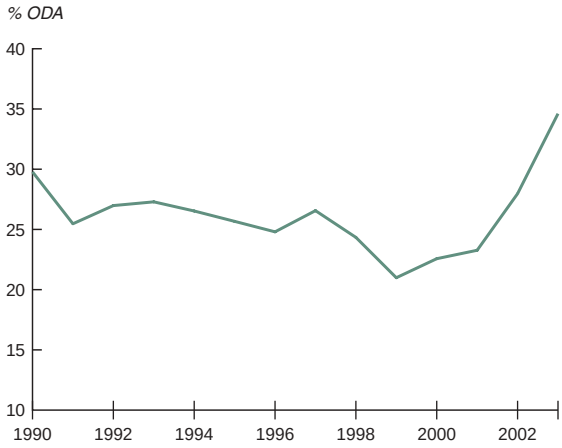
Table 1.6 Projected increases in ODA from DAC donors, 2003–6

ODA as a percentage of GNI

	2003	2006	Change
Norway	0.92	1.00	0.08
Denmark	0.84	0.83	−0.01
Luxembourg	0.81	0.87	0.06
Netherlands	0.80	0.80	0.00
Sweden	0.79	1.00	0.21
Belguim	0.60	0.64	0.04
France	0.41	0.47	0.06
Ireland	0.39	0.61	0.22
Switzerland	0.39	0.38	−0.01
Finland	0.35	0.41	0.06
EU members	0.35	0.44	0.09
UK	0.34	0.35	0.01
Germany	0.28	0.33	0.05
Australia	0.25	0.26	0.01
Canada	0.24	0.27	0.03
Spain	0.23	0.33	0.10
New Zealand	0.23	0.26	0.03
Greece	0.21	0.33	0.12
Austria	0.20	0.33	0.13
Japan	0.20	0.22	0.02
Italy	0.17	0.33	0.16
United States	0.15	0.19	0.04
Total	**0.25**	**0.30**	**0.05**

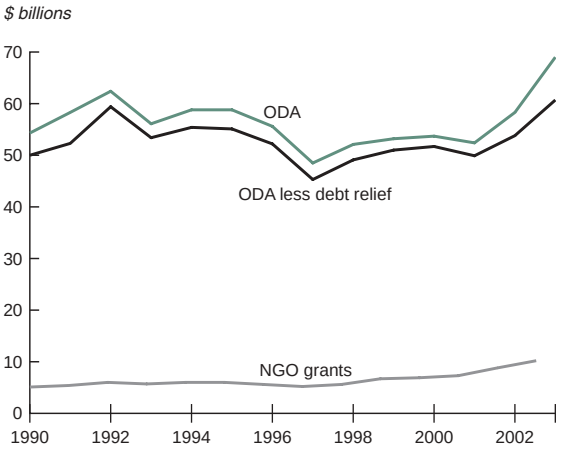
Source: OECD Development Assistance Committee.

Figure 1.15 Percentage of ODA disbursed to Sub-Saharan Africa, 1990–2003



Source: OECD Development Assistance Committee.

Figure 1.16 ODA and grants from nongovernmental organizations, 1990–2003



Source: OECD Development Assistance Committee.

of GNI in donor countries in 2003 to 0.10 percent by 2006.

African countries deemed to be strategically important are likely to be the largest recipients of increases in ODA. The Africa Action Plan announced at the G-8 Leaders Summit in Kananaskis (Canada) in June 2002 suggested that "in aggregate half or more of our new development assistance could be directed to African nations that govern justly, invest in their own people, and promote economic freedom." Sub-Saharan Africa received 60 percent of increases in ODA disbursements over the five years from 1998 to 2003, raising its share of total ODA disbursements by DAC donors from 24 percent to 34 percent (figure 1.15). However, most of these funds were allocated to postconflict situations, limiting the amount provided for development aid.

The major challenge facing most donor countries will be to augment aid to levels required to support the MDGs and the Monterrey consensus in the face of growing fiscal pressures. Vigilance is needed to ensure that unanticipated events (such as the devastation caused by the tsunami in late December 2004), as well as funding for crisis response and postconflict recovery,[17] do not divert resources from efforts to attain the MDGs. In addition to providing emergency relief to the countries affected by the tsunami, substantial aid will be needed to provide medical care and rebuild infrastructure over the medium term (box 1.3).

Growing fiscal imbalances in many key donor countries, along with the prospect of further financing gaps as populations age, are exerting intense pressures on donor countries to pursue fiscal consolidation. Financing for development will need to be a top priority on the political agenda of

Box 1.3 Aid in the wake of the Asian tsunami

The tsunami that hit the Indian Ocean basin on December 26, 2004, is one of the worst human disasters of modern times. Triggered by an earthquake measuring 9.0 on the Richter scale, the tsunami affected eight countries in East Asia, South Asia, and Africa. Fatalities are expected to exceed 200,000, and some 1.5 million people lost their homes and livelihoods. The world's response has been generous: some $7.8 billion in official emergency and reconstruction aid has been pledged, supplemented by private donations of between $1 billion and $2 billion.

This global response continues an upward trend in emergency relief. Since 1970, the proportion of ODA accounted for by emergency relief has increased from 0.1 percent to 7.8 percent—a rise from $6.9 million to $5.4 billion. The trend is believed to reflect two factors:

- *Heightened awareness and concern about events in the developing world among people everywhere.* Emergency aid can be seen as an altruistic response to more thorough and timely news from abroad, as well as a reflection of the growing importance of developing countries in the global economy.
- *An increase in the number of people living in vulnerable areas.* As the global population has grown from 3.7 billion in 1970 to 6.2 billion in 2003, more people now live in areas vulnerable to natural disasters—on fault lines, in floodplains and regions susceptible to hurricanes, and in areas affected by environmental degradation or climate change. Population growth has been concentrated in developing countries, where fewer public and private resources are devoted to prevention and early warning, building codes are inadequate, and infrastructure is old. Between 1985 and 1999, 96 percent of recorded disaster fatalities were in developing countries (Center for Research on the Epidemiology of Disasters 2005).

Ensuring that disbursements follow the substantial resources pledged will require careful monitoring. According to the United Nations, resources actually delivered have fallen far short of pledges in recent natural disasters. Just half of the $400 million pledged after the 2000 floods in Mozambique was received. And only one-third of the $8.7 billion promised to Honduras and Nicaragua after Hurricane Mitch in 1998 was sent. Obstacles—damaged or destroyed transport and logistical infrastructure, a multiplicity of donor organizations, and shortages of local staff and officials to coordinate aid distribution—need to be overcome before pledged aid can reach the affected areas.

In addition to the emergency and reconstruction aid outlined above, Paris Club creditors announced a debt moratorium for countries affected by the disaster. The countries have the option to request a deferral of principal and interest payments due to Paris Club creditors so that more resources can be allocated to the reconstruction effort.

Tsunami aid should come on top of, rather than in lieu of, other programmed development assistance. With many of the bilateral donors making tsunami pledges approaching or exceeding their 2005 annual disaster relief budgets, there is reason to be concerned that the assistance may be reallocated from existing commitments or diverted from other recipient countries' aid budgets. Emergency aid clearly plays a vital role in the broader development agenda, but it cannot displace other financial resources that are required to support the MDGs.

these countries if ODA is to increase as a percentage of GNI—as foreseen in Monterrey.

Grants from nongovernmental organizations (NGOs) play a more prominent role

NGOs are providing a growing source of financial resources for developing countries.[18] Grants by private voluntary agencies (the private-sector component of NGO grants) have increased by $5 billion (in nominal terms) between 1990 and 2003. ODA has increased by $15 billion over this period, while ODA less debt relief has increased by $10 billion (figure 1.16). Between 1990 and 2003, NGO grants increased from a value equal to 10 percent of ODA less debt relief to 17 percent.

Annex: Recent trends in workers' remittances to developing countries

Strong gains in workers' remittances to developing countries

Workers' remittances provide valuable financial resources to developing countries, particularly the poorest.[19] Remittances to developing countries from overseas resident and nonresident workers are estimated to have increased by $10 billion (8 percent) in 2004, reaching $126 billion. That increase followed a $17 billion (17 percent) increase in 2003 (table 1A.1). Much of the $10 billion increase in 2004 occurred in low-income countries, where remittances rose by $6.7 billion (18 percent).[20] Since 2001, remittances to developing countries have increased by $41 billion (almost 50 percent). Low-income countries account for almost half of the increase: the share of remittances going to low-income countries rose from 28 percent in 2001 to 35 percent in 2004.

Most of the $41 billion increase in remittances to developing countries from 2001 to 2004 was concentrated in South Asia ($17 billion), Latin America and the Caribbean ($13 billion), and, to a lesser extent, East Asia and the Pacific ($7 billion). Remittances are more evenly distributed than capital flows to developing countries.

Increases in remittance flows have been particularly strong in China, India, Mexico, Pakistan, and the Philippines (table 1A.2). Those five countries together account for $31 billion of the $41 billion increase in remittances to all developing countries between 2001 and 2003. The data available for 2004 suggest that remittance flows will continue to show strong gains in India, Mexico, and the Philippines.

Even though most top recipient countries are large, remittances to many small developing countries are significant as a share of GDP or in per capita terms. Examples include Lesotho, Tajikistan, and Tonga. Lebanon also is among the top recipients of remittances, when measured on a per capita basis.

The surge in remittance flows over the past few years reflects several factors. There have been significant reductions in remittance sending costs in some countries—for example, 60 percent in the U.S.-Mexico corridor since 1999. Growing migration and measurement issues also play prominent roles. The sizeable depreciation of the dollar against most other major currencies (the euro in particular) over the past three years has increased the dollar value of nondollar remittances over time. Some of the increase in remittance flows can

Table 1A.1 Workers' remittances to developing countries, 1990–2004

$ billions Change

	1990	1995	2000	2001	2002	2003	2004e	2001–4
Developing countries	31.3	56.7	76.8	84.6	99.0	116.0	125.8	41.2
Lower middle-income	17.5	34.8	41.9	44.1	49.1	54.8	55.6	11.5
Upper middle-income	5.7	8.6	13.1	16.8	18.7	24.4	26.8	10.0
Low income	8.1	13.3	21.7	23.8	31.2	36.7	43.4	19.6
Latin America and the Caribbean	5.8	13.4	20.2	24.2	28.1	34.1	36.9	12.7
South Asia	5.6	10.0	16.0	16.0	22.3	26.7	32.7	16.7
East Asia and the Pacific	3.2	9.0	11.2	12.9	16.6	19.5	20.3	7.4
Middle-East and North Africa	11.7	13.0	13.5	15.2	15.5	16.8	17.0	1.8
Europe and Central Asia	3.2	8.1	11.0	11.4	11.5	12.8	12.9	1.5
Sub-Saharan Africa	1.9	3.2	4.9	4.9	5.1	6.0	6.1	1.2

Note: e = estimate
Remittances are defined as the sum of workers' remittances, compensation of employees, and migrant transfers.
Sources: IMF *Balance of Payments Statistics Yearbook 2004* and World Bank estimates.

Table 1A.2 Developing countries with highest remittance flows, 2001 and 2003
$ billions

	2001	2003	Change
India	11.1	17.4	6.3
Mexico	9.9	14.6	4.7
China	1.2	4.6	3.4
Pakistan	1.5	4.0	2.5
Philippines	6.2	7.9	1.7
Poland	1.1	2.3	1.2
Bangladesh	2.1	3.2	1.1
Brazil	1.8	2.8	1.0
Colombia	2.1	3.1	1.0
Vietnam	2.0	2.7	0.7
All developing countries	84.6	116.0	31.4

Sources: IMF *Balance of Payments Statistics Yearbook 2004* and World Bank estimates.

be attributed to improvements in data recording by central banks. In addition, security concerns and heightened scrutiny by immigration authorities in many rich countries are believed to have encouraged outward remittance of savings by undocumented migrants. This is reportedly the case in Pakistan, which recorded a tripling of remittance receipts between 2001 and 2003.

As a final point, it should be recognized that the above data represent *officially recorded* remittances, which are sometimes estimated. Flows through informal channels, such as *hawala,* are not captured in the official statistics but are believed to be quite large. Also, a significant portion of remittances flows through formal channels that are not included in the official statistics, because most countries do not insist on regular reporting of flows below certain predefined thresholds.[21]

Notes

1. Projections of world GDP growth are measured using market exchange rates; projections measured using purchasing power parity (PPP) weights are reported in table 2.1.

2. For a more detailed discussion of foreign reserve accumulation in developing countries and global imbalances, see chapter 3.

3. More specifically, the equity capital component of FDI tends to be stable; the other two components—intercompany loans and reinvested earnings—tend to be as volatile as portfolio equity and debt flows. This is discussed in greater detail in World Bank (2004: 86–90) and in box 4.2 in World Bank (2003: 89).

4. Net FDI and portfolio equity flows have a correlation coefficient of –0.6 over the period 1996–2004.

5. For a more complete discussion of the main factors explaining substitution between FDI and portfolio equity flows, see box 4.8 in World Bank (2004: 101).

6. A recent study by Xiao (2004) estimates that FDI inflows to China are overstated by between 26 and 54 percent, implying that China's share of FDI inflows to all developing countries is in the 15–25 percent range.

7. See chapter 5 for a more detailed discussion of FDI flows to low-income developing countries.

8. FDI outflows from Brazil totaled $9.5 billion in 2004. This includes a $5 billion merger between *Ambev* (a Brazilian beverage group) and *Interbrew* (a Belgium-based brewer), which was financed by an equity swap (*Ambev* shareholders received shares of *Interbrew* and vice versa). This $5 billion transaction was reported in the inward and outward FDI flows in Brazil's balance of payments.

9. Developing countries are estimated to have accounted for about one-third of FDI inflows to other developing countries ("South-South flows") over the period 1997–2001 (World Bank 2004: 81).

10. For a more complete discussion of the extent to which FDI outflows from developing countries are underestimated see box 4.3 in World Bank (2004: 90).

11. Econometric projections for net FDI inflows to developing countries over the period 2005–6 are generated using the model discussed in World Bank (2004: 100).

12. For one set of estimates of the financial resources required to meet the MDGs, see chapter 4 of the Overview Report in United Nations (2005).

13. See chapter 5 for a more complete discussion of the evolution of aid flows since the early 1990s.

14. The 0.7 percent target was originally specified in a 1970 resolution of the UN General Assembly.

15. Reported in OECD (2005: 12).

16. This calculation is based on a projected growth rate for GNI in donor countries of 2.5 percent in 2004 and 2.7 percent in 2005–6 and abstracts from exchange-rate changes over the projection period.

17. Donor conferences have already committed substantial funding to postconflict countries, notably Iraq ($32 to $36 billion over the period 2004–7), Afghanistan ($8 billion over the period 2004–6), and Haiti ($1 billion over the period 2004–6).

18. See box 5.2 in chapter 5 for a discussion of the growing importance of NGOs in financing poor countries.

19. For more detailed analysis of workers' remittances see chapter 7 in World Bank (2003), and "Monetary Lifeline" in *The Economist*, July 31, 2004, 66.

20. See chapter 5 for a discussion of the growing importance of remittances sent to the poorest countries.

21. For example, remittances under $10,000 are not required to be reported in the United States; nor are remittances under €12,500 in the European Union.

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2

Global Outlook and the Developing Countries

FOLLOWING VERY STRONG GROWTH of 3.8 percent last year, the world economy is slowing. Output increased particularly quickly in the first half of 2004, driven by solid U.S. performance and a torrid export-led expansion in China. But higher oil prices and the effects of exchange rate appreciation caused quarterly output in many high-income countries to decline in the second half, notably in Germany, Italy, and Japan. Developing economies outgrew high-income countries, with aggregate GDP rising by some 6.6 percent for the year as a whole—a record expansion. In addition to China, India and Russia also grew very quickly. But all developing regions grew faster in 2004 than they did during the past decade.

Very strong world demand was reflected in emerging capacity constraints, rising prices in commodity markets, and increased inflation in some developing regions, notably South Asia, Latin America, and some parts of developing Europe. Oil prices rose 31 percent, while other commodity prices increased 18 percent, with mixed consequences for developing countries. Oil and other commodity exporters were able to build up current account surpluses, while importers (the majority of developing countries) saw a significant rise in their import bills. In contrast to earlier episodes of rising commodity prices, developing countries, notably China, were the principal source of increased demand over the past few years.

Increases in U.S. interest rates, the waning effect of earlier fiscal loosening, and, in Europe, the effects of the 25 percent real effective appreciation of the euro since February 2002 contributed to a slowing of GDP growth in the second half of 2004 and into 2005. These same factors are projected to cause GDP growth among high-income countries to slow to about 2.5 percent in 2005. Moreover, coupled with reduced demand for imports, those factors are expected to reduce growth in low- and middle-income economies—although continued gains in market share should temper the slowdown. Thus, while growth should decline, these economies are nevertheless expected to expand by a robust and above-trend 5.7 percent in 2005. Partly as a result, oil and metal prices are expected to rise further in 2005, before softening in 2006 and 2007 as new capacity comes onstream.

Over the period through 2007, a gradual pickup in activity outside of the United States, coupled with higher U.S. interest rates and a limited tightening of fiscal policy should reverse the rising trend in the U.S. current account deficit, which is projected to fall from 5.6 percent of GDP in 2004 to about 5.3 percent in 2007. At the same time surpluses in the developing world are projected to decline from 2.7 to 1.4 percent of GDP. Although these changes will not significantly reduce the supply of dollars on world financial markets, higher U.S. interest rates should increase the appetite of private sector investors for dollar-denominated assets, so that the currency is likely to depreciate only modestly over the projection period.

The depreciation of the dollar to date against most currencies has increased the importance of domestic demand outside the United States as a driver of global growth. A further rotation of trade patterns is projected, with the volume of exports from the United States expected to grow by about 8 percent in 2007. Up to now, most developing countries have experienced only moderate fluctuations in their real effective exchange rates, either because of co-movements of their

exchange rate with that of their dominant trading partner or because the effect of the dollar's depreciation has been offset by the appreciation of the euro and the yen. While changes in bilateral exchange rates are likely to impose some adjustment costs, the export growth of low- and middle-income countries is expected to remain strong because their overall real-effective exchange rates have moved relatively little. As a result, these countries are projected to continue increasing their share of world markets.

This is a relatively benign scenario. However, an abrupt increase in interest rates, a further large and precipitous depreciation of the dollar, a larger-than-anticipated hike in oil prices, or a resurgence of protectionist sentiment could provoke a significant slowdown or even recession in the global economy.

Policy can help reduce the likelihood and potential severity of a weaker outturn. A significantly tighter U.S. fiscal policy would reduce the extent to which higher interest rates in the United States (or lower rates in Europe) will be required to support the dollar. For their part, developing economies need to ensure that they do not accumulate excessive liabilities, the future repayment of which, under conditions of higher interest rates and slower world growth, could pose serious problems. In addition, in some countries a managed appreciation might help alleviate domestic inflationary pressures and facilitate the sharing of the benefits of economic growth by lowering the costs of imported consumer goods and services. While a move away from a strict dollar peg by some developing currencies would tend to cause the dollar to depreciate more, it would likely dissipate some of the tensions in international financial markets caused by thus-far-unrealized expectations of such a depreciation. Meanwhile, the multilateral trade liberalization process is in need of a kick start. Without it, the Doha Round runs the risk of yielding few gains for developing economies.

While a coordinated international policy response would likely be optimal, the policy steps outlined above should be taken even in the absence of coordination because they would benefit each identified group even if the others failed to act.

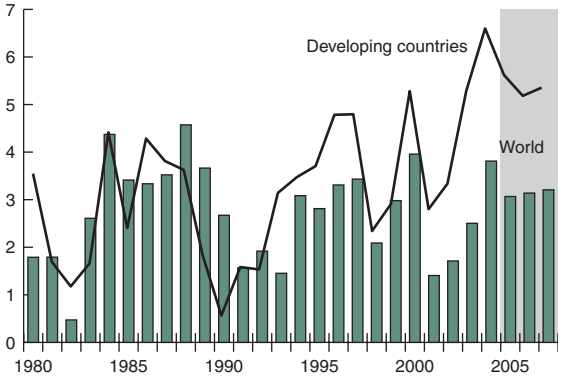
Global growth

World GDP is estimated to have increased 3.8 percent in 2004, supported by an impressive 10.3 percent increase in trade volumes (table 2.1). Growth among high-income countries came in at a robust 3.1 percent, led by the United States (up 4.4 percent), but moderated by weaker performance in Japan (2.6 percent growth) and Europe (1.8 percent). While growth in Japan and Europe was stronger than in 2003, the appreciation of their currencies contributed to the weakening of their exports in the second half of the year. Overall, output in Germany and Italy actually declined in the third and fourth quarters, although several other major European economies, including France and Spain, recorded growth in excess of 2.5 percent. Meanwhile, the depreciation of the dollar supported U.S. export growth despite a slowing in world trade volumes. This, plus strong consumer and investment spending in an environment of very low interest rates, kept U.S. growth robust in the second half. Japan also recorded negative growth in the second and third quarters, but a pickup in inventory accumulation in the fourth quarter returned the economy to a positive growth track.

At 6.6 percent, growth among developing economies was the fastest it has been at any time in the past 30 years (figure 2.1). China led the way with growth of 9.5 percent, driven by strong domestic demand and very large increases in both exports and imports. As a result, China's performance has become an increasingly important factor in global growth prospects, particularly for East Asia. Both India and Russia grew around 7 percent, led by exports in the case of India and strong oil-revenues in the case of Russia. Growth in the remainder of the developing world

Figure 2.1 Developing-country and world growth, 1980–2007

% GDP growth (1995 constant dollars)



Source: World Bank.

Table 2.1 The global outlook in summary

(percentage change from previous year, except interest rates and oil price)

	2003	2004e	2005f	2006f	2007f
Global conditions					
World trade volume	5.6	10.3	7.7	7.7	8.0
Consumer prices					
G-7 countries[a,b]	1.6	1.8	1.7	1.6	1.6
United States	2.3	2.7	3.0	3.5	3.2
Commodity prices (U.S. dollar terms)					
Non-oil commodities	10.2	17.5	4.7	−5.2	−5.4
Oil price (US$ per barrel)[c]	28.9	37.7	42.0	36.0	33.0
Oil price (percent change)	15.9	30.6	11.3	−14.3	−8.3
Manufactures unit export value[d]	7.5	7.0	3.0	2.8	1.9
Interest rates					
$, 6-month (percent)	1.2	1.6	3.5	4.6	5.0
€, 6-month (percent)	2.3	2.1	2.1	2.8	3.2
Real GDP growth[e]					
World	2.5	3.8	3.1	3.1	3.2
Memo item: World (PPP weights)[f]	3.9	5.0	4.3	4.2	4.3
High income	1.9	3.1	2.4	2.6	2.6
OECD countries	1.8	3.1	2.3	2.5	2.6
Euro Area	0.5	1.8	1.2	2.2	2.6
Japan	1.4	2.6	0.8	1.9	1.9
United States	3.0	4.4	3.9	3.0	2.6
Non-OECD countries	3.2	6.2	4.4	4.4	4.3
Developing countries	5.3	6.6	5.7	5.2	5.4
East Asia and Pacific	8.0	8.3	7.4	6.9	7.2
Europe and Central Asia	5.9	6.8	5.5	4.9	5.0
Latin America and the Caribbean	1.7	5.7	4.3	3.7	3.7
Middle East and North Africa	5.8	5.1	4.9	4.3	4.3
South Asia	7.8	6.6	6.2	6.4	6.7
Sub-Saharan Africa	3.4	3.8	4.1	4.0	4.1
Memorandum items					
Developing countries					
excluding transition countries	5.2	6.7	5.7	5.3	5.5
excluding China and India	3.9	5.8	4.8	4.4	4.4

Note: PPP = purchasing power parity; e = estimate; f = forecast.
a. Canada, France, Germany, Italy, Japan, United Kingdom, United States.
b. In local currency, aggregated using 1995 GDP weights.
c. Simple average of Dubai, Brent, and West Texas Intermediate crude oils.
d. Unit value index of manufactured exports from major economies, expressed in U.S. dollars.
e. GDP in 1995 constant dollars; 1995 prices and market exchange rates.
f. GDP measured at 1995 PPP weights.
Source: World Bank.

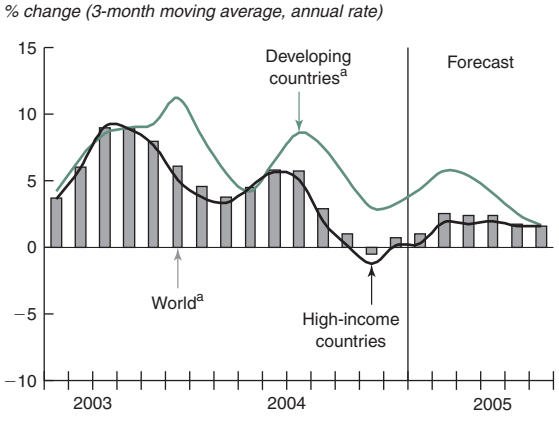
was also robust, with GDP expanding by more than 5.5 percent.

Strong investment growth has played a major role in these results. Low interest rates helped increase ratios of investment to GDP to 28 percent for low- and middle-income economies as a group. Double-digit increases in trade were also central to this strong performance, as developing countries exploited low domestic costs, market openings, and other structural reforms to increase their share in world exports (from 20 to 25 percent since 1999).

High-frequency data suggest that the rate of expansion among developing countries slowed during 2004, with industrial-production growth easing from 12 percent in the first half to 8 percent in the second half (figure 2.2). Merchandise trade volume also moderated, slowing from an annualized rate of 18 percent in the first quarter to some 14 percent in the second half. Slowing trends have continued into 2005, although leading business indicators suggest that a turnaround can be expected during the course of the year.

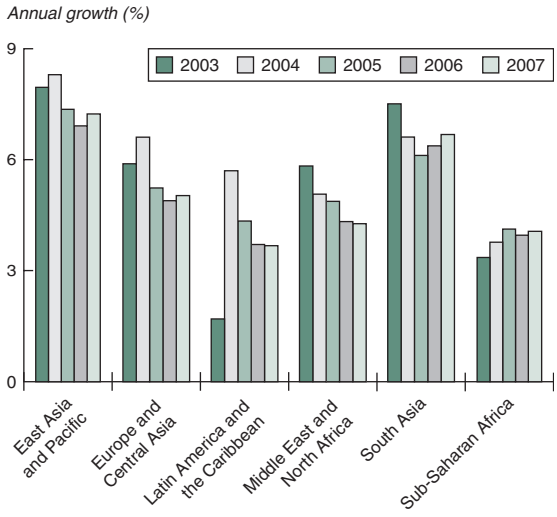
Looking forward, rising interest rates and high oil prices, combined with the waning of the fiscal stimulus that has supported growth in the recent past should continue to dampen world

Figure 2.2 Slowing industrial production, September 2003–May 2005



[a]Excluding China.
Source: World Bank.

Figure 2.3 Regional growth projections, 2003–7



Source: World Bank.

growth. As a result, global economic activity is projected to slow fairly sharply in 2005 before stabilizing in 2006 and picking up somewhat in 2007.

As the Federal Reserve moves to a more neutral stance of monetary policy in the United States, higher interest rates are expected to slow the pace of both consumption and investment activity. At the same time, however, the depreciation of the dollar should stimulate export growth, helping to sustain activity at a relatively high level. In Japan, sharply falling world demand for high-tech products, slowing global trade, the appreciation of the yen, and the domestic investment cycle contributed to a weak second half in 2004. The economy is projected to expand by just 0.8 percent in 2005.

Moderate wage growth in Europe and high oil prices have cut into consumer demand, while the appreciation of the euro has hurt exports. These negative factors are counterbalanced by significant pent-up demand for capital goods, following years of subdued investment—already evident in the steady (if unspectacular) acceleration in investment activity over the past year. Further strengthening of investment and the waning negative influence of the euro's appreciation are projected to result in a gradual firming of euro zone growth rates to about 2.6 percent in 2007.

While the human costs of the December 2004 tsunami were horrific, its economic impacts are expected to remain localized. Disaster-related declines in output are projected to slow growth during the first half of 2005 in Indonesia, the Maldives, Sri Lanka, and Thailand, with the brunt of the impact borne by the coastal regions immediately affected. As reconstruction efforts get underway, growth should firm toward the end of the year. However, the overall impact of these changes will be difficult to discern in regional growth rates.[1]

The projected slowdown among high-income economies will be reflected in slower trade and output growth among developing economies, while higher world interest rates will also slow the expansion of domestic demand (figure 2.3). As a group, however, low- and middle-income countries should again outperform the high-income economies by a large margin through to 2007. And growth rates are expected to exceed the levels observed in the 1990s.[2]

Growth in the economies of the *East Asia and Pacific* region will continue to reflect developments in China. There, administrative controls have succeeded in slowing the pace of investment in some sectors, and there are increasing signs that personal incomes and expenditures are rising less quickly than in the immediate past. As a result, GDP growth is expected to moderate, and inflation should stay in check. Elsewhere in East Asia, exports are being affected by falling world demand for high-tech products and somewhat less robust Chinese investment demand. Overall, regional GDP growth is projected to ease to 7.4 and 6.9 per-

cent in 2005 and 2006 before picking up somewhat in 2007. For the region excluding China, a similar pattern is expected, with growth at about 5.4 percent in 2005 and picking up to 6.2 percent by 2007.[3]

GDP increased in the *Europe and Central Asia* region by 6.8 percent in 2004, spurred on by very strong growth in the Russian Federation, where high oil prices have boosted incomes. Regional GDP and trade growth were also enhanced by investment flows related to the accession of several countries to the European Union—a factor reflected in very high rates of increase in both imports and exports. A sharper-than-expected decline in Turkish inflation boosted real incomes, triggering strong domestic demand and a steep increase in its current account deficit. Elsewhere in the region, inflationary pressures are building. This is expected to provoke a tightening of domestic monetary policy that, in combination with expected increases in world interest rates, should see regional interest rates rise even further, slowing investment and consumption. A leveling-off of oil incomes and the negative influence of a strong real effective appreciation by a number of the region's economies[4] are expected to dampen regional growth to about 5 percent by 2007.

Economic activity in *Latin America and the Caribbean* increased by some 5.7 percent during 2004, substantially faster than the region's 0.4 percent average growth rate over the preceding three years. Strong world demand for commodities contributed to large output gains in Brazil, Chile, and Mexico. Argentina's substantial rebound following its 45 percent real effective depreciation between late 2001 and early 2005 contributed to the strong performance of the region. The expected leveling-off of commodity prices in 2005 and 2006 means that the contribution to growth from increases in resource-based incomes will decline. Nevertheless, still-high prices imply that incomes will remain elevated, continuing to support demand at high levels. Rising interest rates, prompted by higher world rates and growing domestic inflationary pressures, will be a further drag on growth, which is projected to slow to about 3.7 percent by 2007.

The economies of the *Middle East and North Africa* continued to profit from high oil prices in 2004. GDP growth among developing oil exporters was strong at 5.5 percent, but down from 6.7 percent in 2003 as capacity constraints made themselves felt. Labor-abundant and resource-poor countries benefited from strong world demand, notably from regional oil exporters, causing their exports to grow by 6.2 percent. Economic activity among regional oil exporters is projected to slow to about 4 percent in 2006, partly because the full impact of stronger domestic demand will be partly offset by leakages in the form of accelerating imports. This strong import demand, coupled with the easing of oil prices beginning in the second half of 2005 (see the commodities discussion below) and the entry into force of preferential trade agreements with the European Union will nudge up growth among oil importers to about 5.2 percent in 2006.

GDP increased some 6.6 percent in *South Asia* in 2004, down from 7.8 percent the year before. Most of the slowdown occurred in India and reflected poor crops. Nevertheless the Indian economy led the region, expanding by 6.8 percent. Growth among other South Asian countries actually picked up a bit, coming in at 5.9 percent. Overall regional GDP is projected to slow in 2005 to 6.2 percent, reflecting more moderate Chinese and OECD import demand, before regaining strength in 2006 and 2007, when it should increase by about 6.7 percent. Rising inflation in Pakistan and Sri Lanka will require a strong response from domestic authorities, weakening near-term growth prospects in those countries.

Economic activity in *Sub-Saharan Africa* increased by an estimated 3.8 percent in 2004, with virtually all countries reporting positive growth (Côte d'Ivoire, the Seychelles, and Zimbabwe being notable exceptions). A large number of countries saw output increase by 5 percent or more. Growth in the region is projected to pick up in 2005 to 4.1 percent as the benefits from past reforms and a globally more peaceful environment are reflected in improved growth rates. Still-high metals and minerals prices will contribute to good performance in many countries, notably South Africa, while continued tightness in the oil market will benefit regional oil exporters such as Nigeria. Ethiopia and Sierra Leone are expected to perform particularly well as they continue to benefit from more peaceful conditions. The projected upturn in Europe, the region's main trading partner, should also stimulate growth, while rising exports to China will play an increasing role. Despite substantially improved performance, per capita GDP growth in the region will lag the rest of the world by a significant margin, implying a further widening of income gaps.

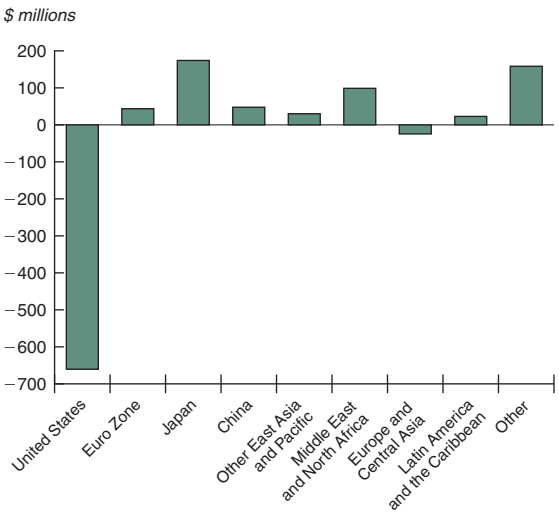
Global imbalances, currencies, and inflation

The current account of the United States has been in deficit throughout the past two decades, with the sole exception of 1990. Following several years of deterioration, it reached a new high of $666 billion, or 5.6 percent of GDP in 2004. As a consequence of these repeated deficits, the United States has been transformed from a significant net international investor in the 1970s to the world's largest debtor. Its net external liability at the end of 2003 was estimated at $2.7 trillion (23 percent of U.S. GDP, or 7.5 percent of world GDP).

Reflecting these developments, but also a wide range of structural policies that have improved economic performance, the current account position of most developing countries has improved, and now virtually all major regions are running modest current account surpluses (figure 2.4).

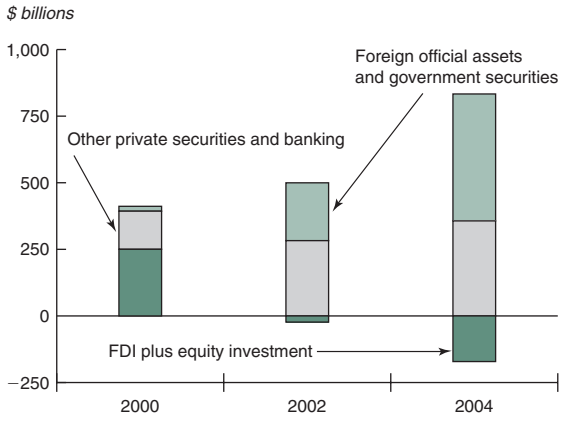
Until recently, the U.S. deficit was financed largely through private capital inflows in the form of foreign direct investment (FDI) and purchases of U.S. corporate securities. Beginning in 2001, however, this changed. Net foreign purchases of private sector assets dried up and actually turned negative in the first half of 2004. For the year as a whole, most of the current account deficit was financed by sales of public sector assets and securities (figure 2.5). Moreover, a substantial share of these purchases is finding its way into the rapidly rising official reserves of foreign central banks, notably those of developing countries (chapter 3).

Figure 2.4 Estimated global imbalances in current accounts, 2004



Source: World Bank.

Figure 2.5 Financing the U.S. current account: net flows by asset type, 2000, 2002, and 2004



Sources: U.S. Department of Commerce; World Bank estimates.

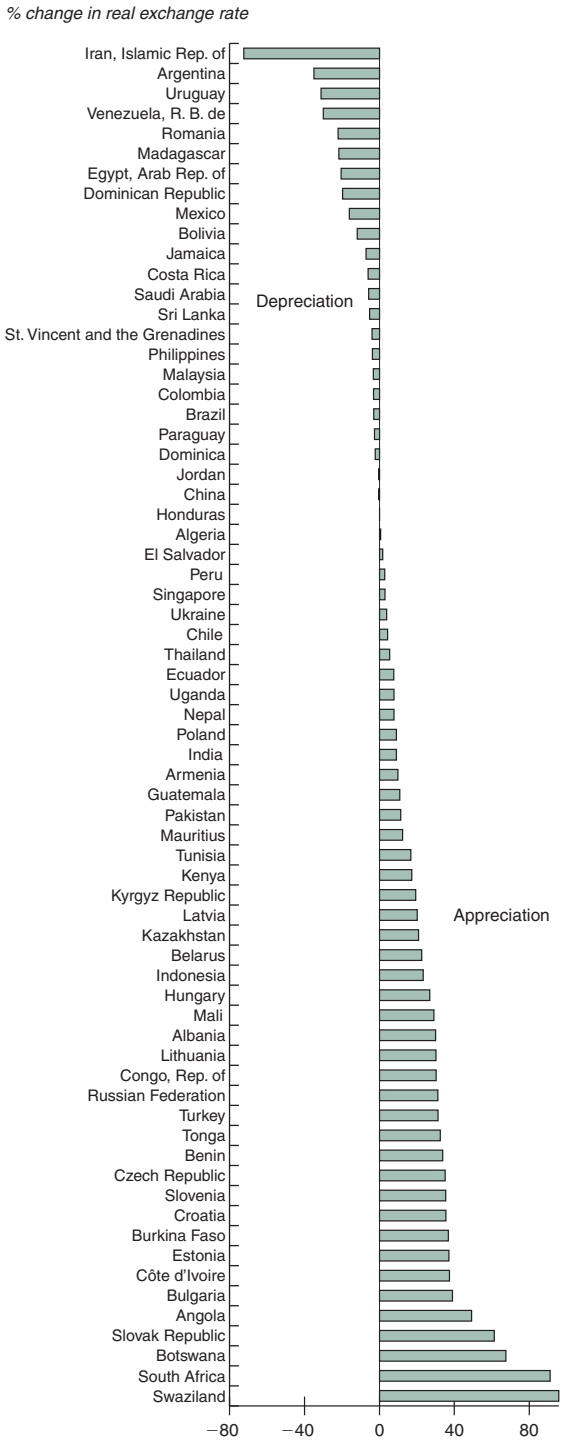
Partly as a consequence of the net outflow of private sector investment, the dollar began to slide, not just against the euro but also against most developing-country currencies, both nominally and in real terms (figure 2.6).

These imbalances are expected to stop increasing and may even diminish somewhat. In particular, the U.S. current account deficit is expected to stop rising and gradually decline—reaching 5.3 percent of GDP in 2007.

Several factors are expected to contribute to this development.

- Both U.S. short- and long-term interest rates are projected to continue rising, reaching about 5 percent by 2007 as the Federal Reserve Bank moves towards a more neutral monetary policy stance. As a result, real interest rates, which have been negative in recent years, will turn positive. This should induce an increase in net private savings,[5] which currently represent less than 1 percent of household income, and reduce imports—thereby contributing to a lower current account deficit.
- A modest tightening of U.S. fiscal policy is projected, with the general government deficit expected to decline from an estimated 4.4 percent of GDP in 2004 to some 3.5 percent in

Figure 2.6 Appreciation of developing-country currencies against the dollar between January 2002 and February 2005



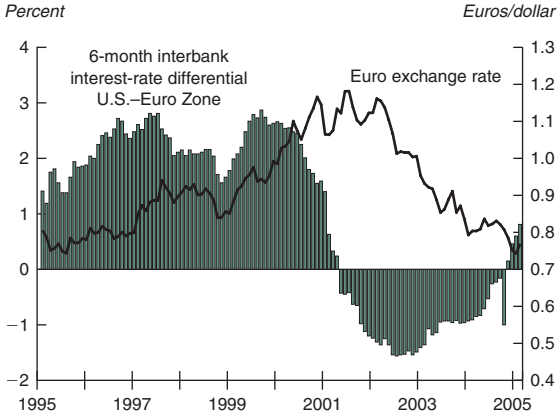
Source: World Bank.

2007. This, along with the cumulative effect of the dollar depreciation, will also help constrain overall demand and contribute to a decline in the current account deficit.

- Continued strong growth in developing economies and robust demand for imports will increase U.S. exports. In particular, domestic demand is projected to be very strong among oil-exporting countries, leading to a reduction in the current account surplus of oil-exporting Middle East countries equal to 8 percent of their GDP.

In addition to the stabilization and even modest shrinking in the U.S. current account deficit, rising interest rates in the United States relative to rates elsewhere should alleviate downward pressure on the dollar by increasing investors' willingness to finance the deficit. Specifically, short-term U.S. interest rates are projected to increase more than European rates until 2006, opening up a gap of almost 200 basis points between them. These higher returns on dollar-denominated assets should be sufficient to induce additional private sector purchases of dollar-denominated bonds. As a result, the dollar is expected to depreciate only modestly, by about 10 percent over the forecast period. Estimates suggest that the increases in U.S. interest rates already observed (figure 2.7) have been sufficient to almost eliminate financial incentives to continue the "carry trade" against the dollar (Moore 2004).[6]

Figure 2.7 Interest rates and the weakening dollar, 1995–2005

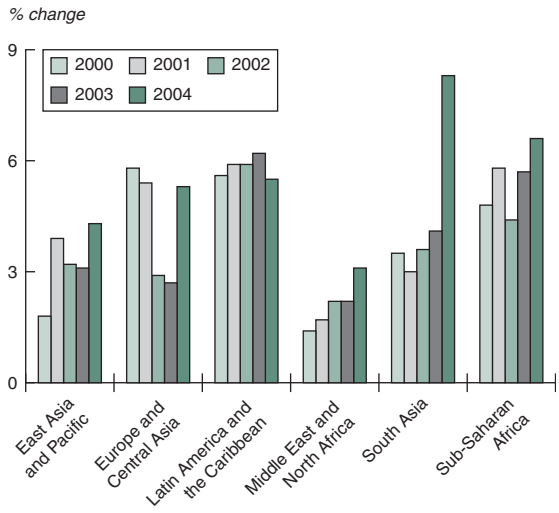


Source: World Bank.

Figure 2.8 Very low real interest rates in the United States, 1997–2005

Note: Long-term rates are 10-year yields on U.S. government bonds. Short-term rates are the federal fund rate. Both are deflated by consumer inflation.
Source: World Bank.

Figure 2.9 Rising consumer inflation, 2000–4



Source: World Bank.

The recent period of very low real interest rates (figure 2.8) has been particularly beneficial to developing economies. Together with narrower risk premia, low rates have allowed developing countries to reduce their financing costs (chapters 1 and 3) and pursue strong investment growth.

However, this strong economic performance has brought on a pickup in inflation in many developing countries (figure 2.9). Inflation increased from 3.8 percent in the fourth quarter of 2003 to 6.2 percent by the third quarter of 2004. Since then, it has eased somewhat and was 4.8 percent in February 2005. The largest hikes have been in commodity prices. Regionally, inflation has picked up markedly in South Asia (India, Pakistan) and to a lesser extent in Latin America (Argentina and Mexico) as emerging capacity constraints have made themselves felt. Most recently, falling food prices (see the discussion of commodity prices below) have contributed to some easing of inflationary pressures.

In contrast, there are few signs of rising inflation among high-income countries, except perhaps in the United States, partly reflecting higher import prices following the slide in the dollar. Rather, widespread asset inflation, notably in housing prices, and a strong increase in investors' tolerance for risk (as evidenced by reduced risk premia on junk bonds and developing-country debt[7]) are the most visible signs of abundant liquidity and underlying inflationary pressures in high-income countries.

As global interest rates rise, these pressures should dampen. However, inflation in developing countries is projected to continue rising in 2005 as growth remains at or above trend rates. In Europe, the disinflationary effects of the euro's appreciation and still-large output gaps should limit price increases. In contrast, the lower dollar can be expected to generate additional upward price pressure in the United States. In particular, import prices are expected to begin contributing to rising inflation in the United States, as rising inflation in developing countries is passed through as higher U.S. import prices.[8]

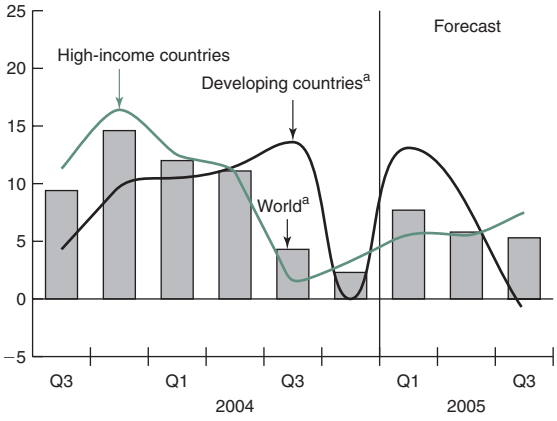
World trade

World trade expanded dramatically in 2004, increasing by some 10.3 percent. China's integration into the global marketplace continued, with exports and imports increasing by some 30 percent. The pace of trade expansion elsewhere in the developing world was more moderate (12.3 percent), but nevertheless much higher than the 8.5 percent expansion registered by high-income countries. High-frequency data indicate that trade growth slowed toward the end of the year (figure 2.10).

In line with the projected moderation of global economic activity, international trade is forecast to slow as compared with 2004 as a

Figure 2.10 Slower trade growth, 2003–5

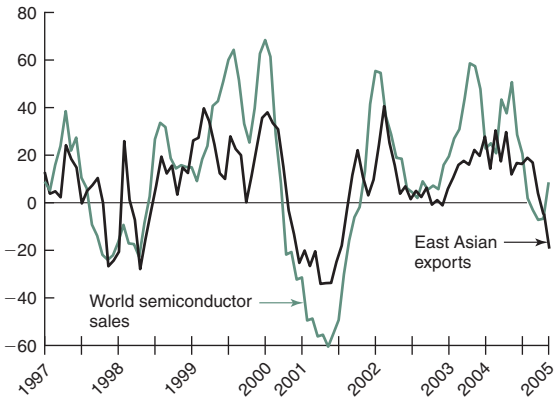
Export volumes (quarterly, annualized growth rates, %)



[a]Excluding China.
Source: World Bank.

Figure 2.11 World semiconductor sales and East Asian technology exports, 1997–2005

% change (3-month moving averages, seasonally adjusted annualized rates)



Sources: Semiconductor Industry Association; World Bank.

whole. Trade volumes are expected to increase by around 7.7 percent in 2005 and 2006, which is nevertheless quicker than during the 1990s.

In addition to slower trade growth due to reduced import demand, developments in specific markets will influence the overall pattern of trade. In particular, a sharp slowdown in the high-tech cycle has hit exports from East Asia and the Pacific, where such products represent as much as two-thirds of some countries' exports.[9] The high-tech market is characterized by sharp swings in demand but over a relatively short cycle (figure 2.11). Thus, while exporters in the region are expected to go through a difficult patch over the next several months, demand should pick up toward the end of 2005 and remain strong in 2006. As discussed in the following section, demand for commodities is also expected to remain strong.

Impact of dollar depreciation on developing economies

Notwithstanding the broad depreciation of the dollar and appreciation of the euro, most developing-country currencies have been relatively stable in real effective terms (figure 2.12). Of the 69 low- and middle-income countries for which data permit the calculation of real effective exchange rates, only 15 have experienced an appreciation of more than 10 percent since February 2002, when the dollar began to slide, and more than half have depreciated. The revaluation of many developing-country currencies was relatively moderate because in many cases the depreciation of the dollar and the appreciation of the euro were offsetting, leaving countries' real effective position broadly unchanged.

For those countries for which the United States or the euro zone represent a disproportionate share of trade, co-movements in their own currencies have largely mitigated the impacts that these fluctuations might otherwise have had. Most developing countries that did experience a significant real effective revaluation did so because of domestic factors or a strong terms-of-trade impact following the recent run-up in commodity prices (South Africa).

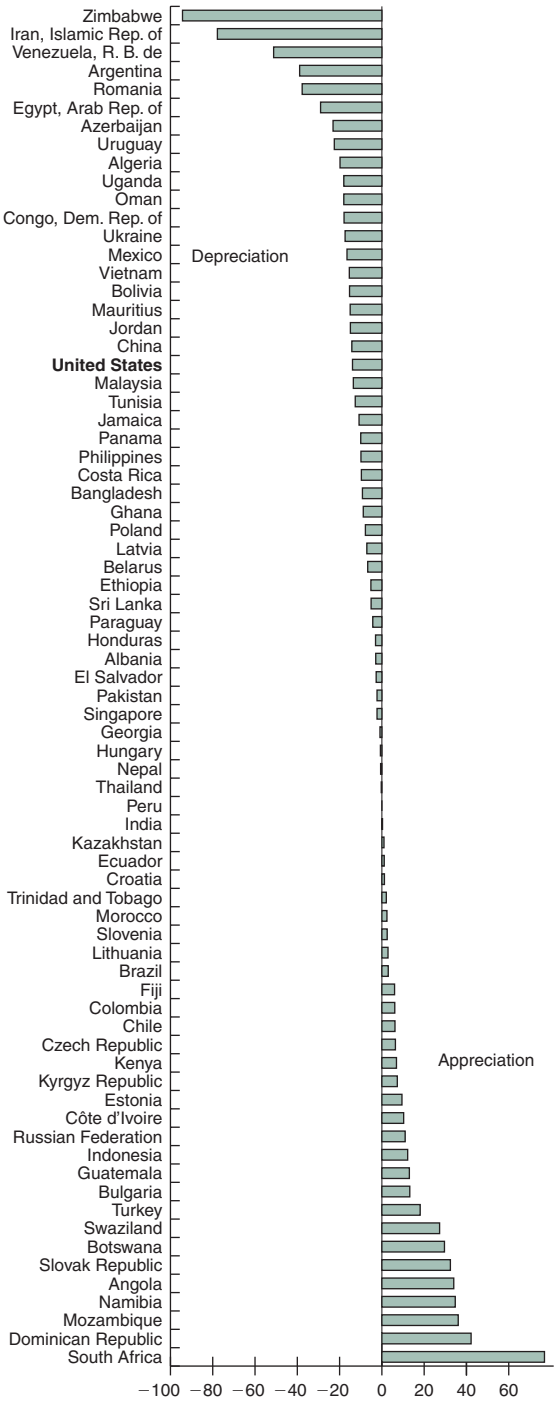
While small compared with the shift in the euro/dollar bilateral exchange rate, the currency fluctuations experienced by developing countries are likely to have consequences for the real economy over the projection period.

Unless compensating policy measures are taken, growth will be stimulated in depreciating countries, possibly overheating their economies. By the same token, economic activity is likely be weaker among countries that appreciate. Or, if exporters lower margins to retain market share, incomes will decline.

The realignment of currencies will influence the pattern of exports and imports and could impose adjustment costs.[10] For individual developing economies the impact will depend importantly

Figure 2.12 Real effective revaluations of developing-country exchange rates, 2002–5

% change in real effective exchange rate between February 2002 and January 2005



Source: World Bank.

on preexisting trade patterns. Countries that trade more or less equally in Europe and the United States (Namibia, Paraguay, Poland) will find it easier to exploit changes in competitiveness because firms already have knowledge of the foreign market and networks with which to deal. In contrast, firms (and nations) whose trade is particularly focused on the United States may encounter significant delays before lost sales in the U.S. market can be recuperated through increased sales in Europe or elsewhere. Even countries that followed the dollar in its depreciation (many South American and East Asian countries) will face adjustment costs in the form of higher inflation and lost competitiveness among firms that rely on non-U.S. imports.

Finally, although evidence is not conclusive, some research (for example, Esquival and Larráin 2002) suggests that volatility in the exchange rates of major economies tends to introduce uncertainty into international trade and may therefore contribute to a slowdown in global trade volumes.

Longer-term prospects for trade expansion

Notwithstanding these costs, low- and middle-income countries are projected to continue increasing their world market shares. Over the past five years developing countries as a whole have increased their share of world exports from 20 to 25 percent. China actually doubled its market share during this period from 2.5 to more than 5.4 percent.

This trade expansion has been a critical motor for economic betterment. Those countries that have been most successful in expanding their market shares have registered the sharpest reduction in poverty over the past 15 years.[11]

Overall, 40 percent of the total increase in the exports of developing countries was due to increased market share. This reflects several factors, including a gradual exposure of underlying comparative advantages following the numerous trade liberalizations of the past two decades. These saw developing-world tariffs fall from some 30 to less than 10 percent. In addition, improved macroeconomic policies, lower inflation, reduced government deficits, and improved current account positions contributed to better trade performance by reducing uncertainty for investors and traders alike.

In the baseline forecast, these conditions are assumed to persist. As a result, developing-country market shares should increase a further 1 percentage point between 2004 and 2007.

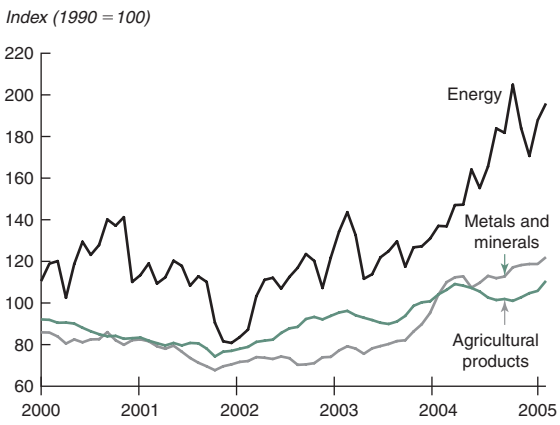
Commodity markets

The run up in commodity prices since 2002 (figure 2.13) reflected very strong demand for commodities and emerging capacity constraints in producing countries. Overall, energy prices rose some 30 percent in 2004. Metals and minerals prices were up 37 percent, and, as yet, show no sign of easing. In contrast, the prices of most agricultural commodities peaked in the second quarter of 2004 before beginning to decline, but still registered a 10.5 percent annual gain.

Unlike previous episodes of overheating, the main sources of excess demand were developing countries, notably China.

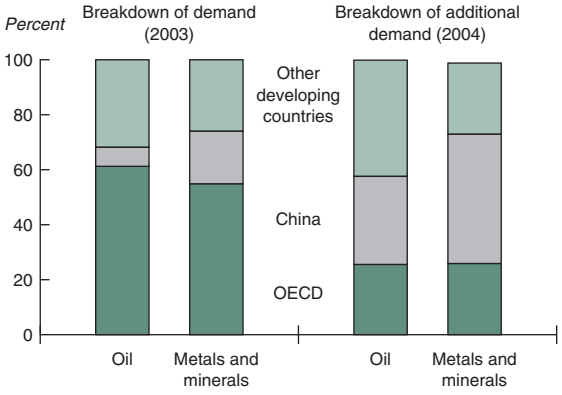
Indeed, 74 percent of the total increase in crude-oil demand during 2004 came from developing economies (figure 2.14)—almost twice their share in total demand. Almost half of the increment came from China, whose thirst for raw materials also underpinned the increase in demand for metals and minerals. Overall, low- and middle-income countries were responsible for 74 percent of the additional demand for metals in 2004, but only 45 percent of total demand. Developing-country demand was particularly pronounced in the zinc and aluminum markets, where their share in the increase in demand exceeded 80 percent in 2004.

Figure 2.13 Commodity prices, 2000–4



Source: World Bank.

Figure 2.14 Developing-country demand and commodity prices, 2003 and 2004



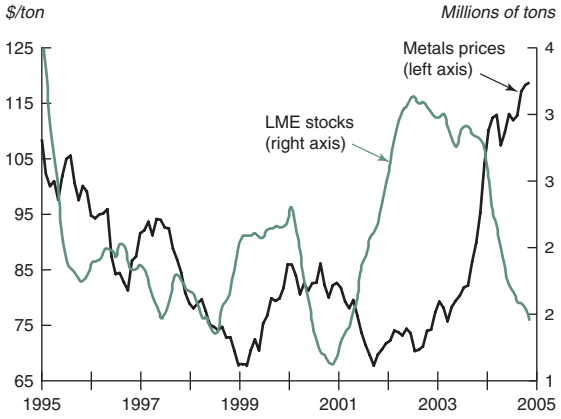
Source: World Bank.

This is unlikely to be an isolated development. The share of developing economies in world demand for commodities is projected to continue rising. Partly this reflects the progressive transfer of an increasing proportion of the world's labor-intensive manufacturing activity to these countries. It also reflects faster population growth and rising incomes, which are projected to increase demand for resource-intensive products such as automobiles—placing further pressure on commodity markets. Such factors underpin the prediction of the International Energy Agency (IEA 2004) that by 2030 the demand for oil from economies currently classified as low- and middle-income will more than double to some 50 percent of world demand.

Notwithstanding the run up in commodity prices and the increasing importance of developing economies in these markets, commodity prices are projected to ease over the next three years. In agriculture, increased supply—following endogenous reactions to high prices and recovery from poor crop years—is already pushing down the prices of a number of agricultural commodities, notably soybeans and cotton. Further supply increases and the projected global slowdown are expected to reduce agricultural prices by about 6 percent in 2006.

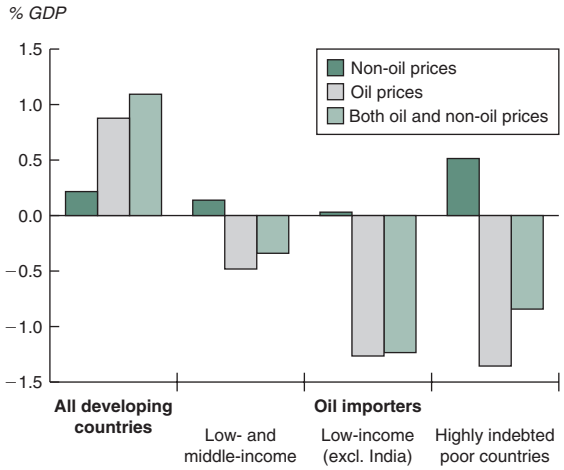
Simple models of the derived demand for oil suggest that the developing world's demand for petroleum products will continue to grow quickly. Although daily world production is expected to

Figure 2.15 Metals—lower stocks mean higher prices



Sources: London Metals Exchange; World Bank.

Figure 2.16 Terms-of-trade gains to developing countries from commodity price changes, 2001–4



Source: World Bank.

increase by about 1.5 million barrels, low stocks and robust demand are projected to keep oil prices high during the first half of 2005 before they begin to ease. For the year as a whole, they are projected to average some $42 in 2005.[12] As the growth of demand moderates further and new supplies come onstream, prices are expected to decline slowly, reaching $33 by 2007.

Conditions in the mineral and metal market remain very tight (figure 2.15). Excess demand, emanating particularly from China, drove prices up some 37 percent in 2004 and caused inventories to fall by 50 percent (60 and 90 percent in the case of lead and copper). Firms have reacted to high prices by substituting less-expensive materials (using lower quality nickel in the production of steel, for example), which should help ease demand pressure. However, these conditions are projected to keep pushing metals prices up during the first half of 2005, before increasing supplies trigger a cyclical decline later in the year. A big uncertainty in this projection is Chinese demand. If it fails to moderate as expected but remains at the levels seen in the first half of 2004, metals prices (notably steel and iron ore), coal prices, and freight rates could remain high for an extended period or even rise further.

Regional consequences of higher commodity prices

Higher commodity prices have contributed substantially to the solid economic performance of commodity-exporting countries over the past several years (figure 2.16). This is particularly true for oil exporters, for whom higher oil prices have meant a terms-of-trade gain of an estimated 5.6 percent of GDP. But net exporters of other commodities also gained. Exporters of metals and minerals benefited strongly, while the positive effect for agricultural exporters was less marked.

However, as discussed in more detail in last fall's *Global Economic Prospects 2005* (World Bank 2004), although high commodity prices are good for developing countries in aggregate, most developing countries are oil importers. For them the net effect of the commodity price increases observed to date has been negative. For South Asia as a whole, the effect was equivalent to terms-of-trade −2.2 percent of GDP.

Risks and policy priorities for the global economy

In the baseline outlook, increased private and public savings in the United States and strong growth among developing countries begin to redress global imbalances and generate a modest decline in the U.S. current account deficit. Combined with the opening of a positive gap between U.S. and European short-term interest rates, this is expected to reduce, but not eliminate, downward pressure on the dollar. The currency will continue to depreciate, but in a gradual and orderly manner.

This scenario is exposed to a number of risks:

- Higher interest rates
- The possibility that oil prices rise further or fail to moderate as projected
- An overshooting or a disorderly depreciation of the dollar, and
- Endogenous reactions to high prices and the emergence of protectionist sentiment.

The first and arguably most important risk is that both short-term and long-term interest rates rise by more than projected. Several distinct but related factors contribute to this risk.

Rates could rise even further either because the current bearish sentiment of investors vis-à-vis the dollar intensifies or because Asian central banks, which have financed much of the U.S. current account deficit (chapter 3), decide to slow the pace at which they accumulate reserves. In either case, investors would demand higher rates before taking on more debt or additional risk. Indeed, recent suggestions by some Asian authorities that they might be diversifying their reserve portfolios sparked brisk sell-offs that ceased only when firm denials of such diversification were subsequently issued. Higher U.S. interest rates would likely put upward pressure on interest rates in other countries as well.

Another factor that might lead to globally higher rates is investors' appetite for risk. Risk premia for sub-investment-grade corporate and emerging-market bonds are at very low levels. Should investors' appetite for or perceptions of underlying risk change, interest rates in these markets could rise sharply, rapidly drawing liquidity out of international capital markets.

Many developing countries have made significant strides in reducing their overall financial vulnerability and are, therefore, in relatively strong positions to withstand such a deterioration in international financial conditions. However, countries with weak domestic banking and capital markets remain fragile. Those with high debt burdens are especially vulnerable to sudden reassessments of country risk (chapters 3 and 4).

Finally, if the excess liquidity engendered by low interest rates manifests itself as rising inflation, real interest rates would rise even further as the monetary authorities react.

To the extent that increases in asset prices are a reflection of unusually low interest rates, interest-rate hikes could generate substantial losses in wealth, with significant negative impact on consumer demand. For example, if housing prices were to stabilize at current levels, the elimination of the positive wealth effect that higher housing prices have contributed to consumer demand would be sufficient to reduce consumer spending in the United Kingdom and the United States by more than 1 percent.[13] Were asset deflation to occur, the impact could be much more serious.

Figure 2.17 reports the results of three simulations that attempt to quantify the real-side impacts of these risks.[14]

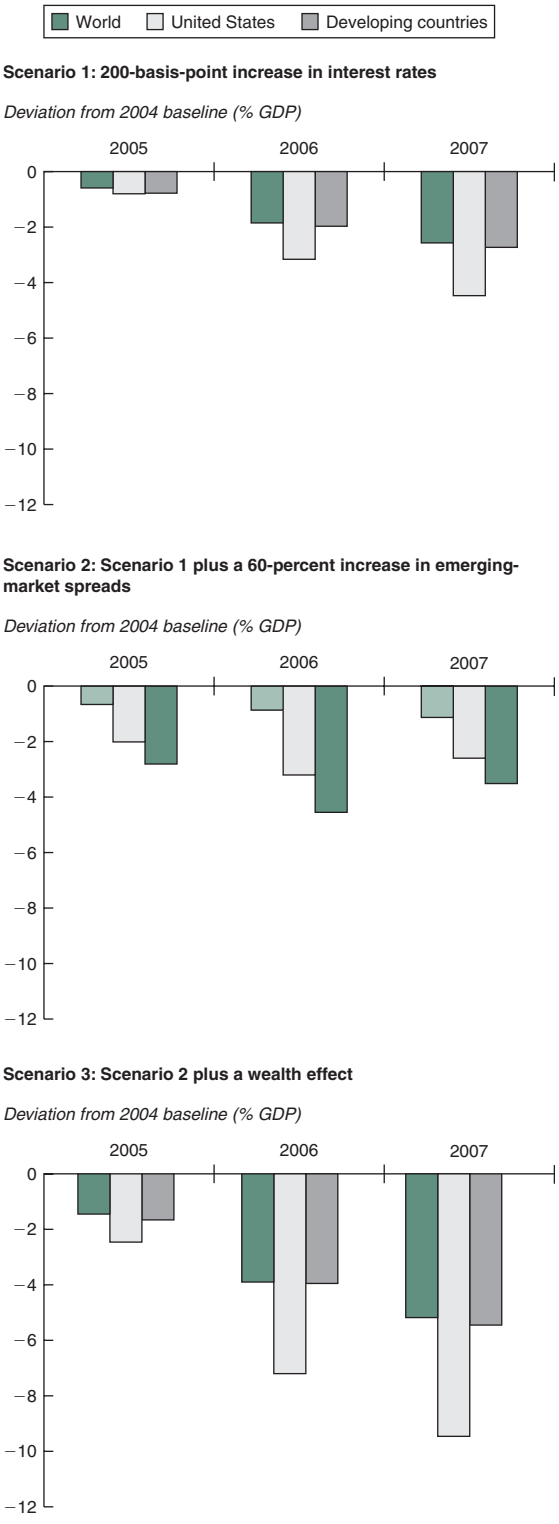
The first scenario assumes that U.S. short- and long-term interest rates rise by 200 basis points more than in the baseline scenario due to increases in investors' required rate of return on dollar-denominated assets. Real interest rates abroad react endogenously, rising by somewhat less than in the United States. Growth in the United States slows by about 1 percentage point in 2005 compared with the baseline and by 2 percentage points in 2006, but a recession is avoided. Slower growth in the United States dampens the expansion of global trade. As a result, growth in developing economies slows by about 1 percentage point in each of 2005 and 2006.

The second scenario builds on the first and assumes that reduced global liquidity from the above tightening causes both bond and emerging-market spreads to return to normal levels. This compounds the effects of the first scenario in developing economies by provoking additional reductions in consumption and investment demand due to higher interest rates. Growth in the United States is broadly unchanged.

Prospects for developing economies are much weaker, with a cumulated loss in output of close to 4.6 percent of GDP. Highly indebted countries are hit particularly hard.

The final scenario combines these effects, adding a substantial wealth effect in France, Spain, the United States, and the United Kingdom, as higher interest rates are assumed to trigger a 10 percent decline in housing prices and therefore in consumer wealth in each of these countries. This contributes to further slowing in demand. In this case, the United States enters a relatively deep recession in 2006, leading a significant global slowdown in which world growth declines to about 1 percent.

Figure 2.17 Effects of higher interest rates on GDP growth, 2005–7



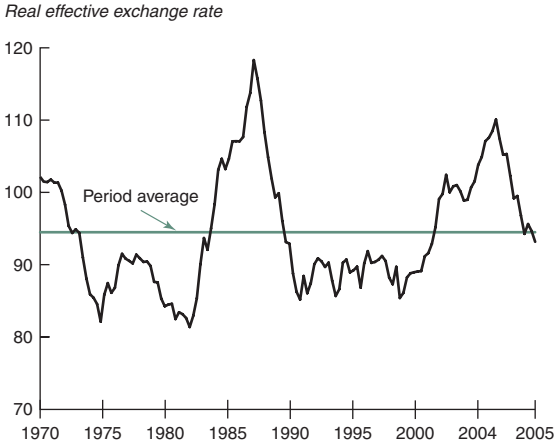
Source: World Bank.

The risk that oil prices would rise further or fail to decline by as much as projected was discussed in detail in the World Bank's *Global Economic Prospects 2005* (2004, 12–14). That report concluded that a further $10 hike in oil prices would slow global growth by about 0.5 percent the next year. For oil-importing developing countries, the terms-of-trade shock of the hike would be about −2.4 percent of GDP. Moreover, because such countries have limited access to international financial markets, the impact on domestic demand of such a shock would be much higher than in high-income countries.

The possibility that the dollar will overshoot its equilibrium value and become undervalued for a prolonged period is a risk in the medium term. The depreciation to date has brought the dollar close to its long-run average level in real effective terms (figure 2.18). If it were to depreciate by much more, as it might if public and private savings behavior does not change, it could well overshoot its long-run equilibrium value. Such an event would increase adjustment costs as exporters lost sales in some markets and had to increase market penetration elsewhere. As the dollar eventually returned to its long-run equilibrium value, these costs would be incurred a second time.

In addition, large swings in the dollar could have significant financial impacts for developing countries (chapter 3). For countries with substantial dollar reserves, a depreciation would imply

Figure 2.18 The dollar in historical perspective, 1970–2004



Source: J.P. Morgan.

large paper losses that could have implications for fiscal policy. In contrast, countries with significant dollar-denominated debt would benefit from a depreciation because it would erode the local-currency value of their debt.

Finally, the global slowdown could result in a slowing of trade liberalization or the emergence of protectionism. The recent pursuit of initiatives to deepen trade has coincided with a period of strong growth for both developing and developed countries. Weaker economic conditions could prompt a break in that trend, by derailing the Doha process or limiting the extent to which any eventual agreement would benefit low-income countries. At the extreme it could provoke a protectionist backlash among high-income countries. In either case, the access of developing countries to rich-country markets could be curtailed to the detriment of growth and poverty reduction. Similarly, should lower growth in developing countries reduce the pace of structural reform, which underpins much of recent economic gains, the impact on future growth prospects could be severe.

Policy challenges

Policy can help avoid and limit the severity of the scenarios dicussed above. A significantly tighter U.S. fiscal policy would increase aggregate saving in the U.S. economy, narrow the current account deficit, and reduce the extent to which higher interest rates will be required to support the dollar. In Europe, policy should seek to maintain interest rates at relatively low levels. Not only would this bolster domestic demand, thereby compensating for weaker exports following the appreciation of the euro, it would also decrease the relative attractiveness of euro-denominated financial assets—thereby reducing the likelihood of a further appreciation and discouraging a disorderly shift away from dollars. In this regard, should inflationary pressures arise it may be desirable to pick up the pace of fiscal consolidation to reduce the likelihood of overheating.

Faced with the prospect of a slowing world economy and the possibility of a pronounced slowdown, policymakers in developing countries need to redouble efforts to consolidate their fiscal positions and take advantage of today's low interest rates to restructure debt—as indeed many have done. Moreover, they must be particularly prudent to ensure that they do not accumulate excessive liabilities or spending obligations, the future financing of which under conditions of higher interest rates and slower world growth could pose serious problems. In addition, a careful reassessment of exchange-rate policy in some countries might reveal that a managed appreciation of their currencies would help alleviate emerging inflationary pressures, while facilitating the sharing of the gains from recent growth among the entire population by lowering the cost of imported consumer goods.

While a coordinated international policy response would likely be optimal and would minimize the costs for developing countries, the domestic benefits of each of the policy steps outlined above will accrue whether or not the other economies take action.

Notes

1. The East Asia and Pacific region suffered the greatest damage from the tsunami, followed by South Asia and, to a much lesser extent, Sub-Saharan Africa.

2. All told, three quarters of developing countries saw their growth rates increase during the first four years of this decade, compared with the 1990s. This contrasts with high-income countries, about half of which saw improvement and half declines.

3. This chapter's companion Web site, Prospects for the Global Economy, http://globaloutlook.worldbank.org, presents more detail on regional economic developments and forecasts.

4. Bulgaria, the Russian Federation, and the Slovak Republic all recorded appreciations in excess of 10 percent.

5. Household savings net of capital accumulation (OECD 2004).

6. The term "carry trade" describes the practice of borrowing money at low interest rates in one currency and investing it in a second currency at higher rates of return. Such interest rate arbitrage likely explains some of the strong swings in the bilateral exchange rate of the dollar and euro.

7. While significant improvements in fundamentals underpin some of the improvement in emerging-market risk premia, the concurrent compression of corporate spreads suggests that abundant global liquidity is also playing a key role.

8. Until the third quarter of 2002, U.S. import inflation was negative, reflecting a rising share in both imports and GDP of low-cost developing-country imports and falling import prices due to strong growth in developing-world productivity.

9. In 2003, high-tech products represented 13 percent of Thailand's exports, but more than 50 percent of Taiwanese, Malaysian, and Philippine exports.

10. These adjustment costs and the mechanisms by which they effect output are qualitatively similar to those described by Lilien (1982) in the context of oil price hikes, another international price shock.

11. The correlation coefficient between per capita increases in incomes and increases in trade shares is 0.5.

12. A simple model of oil demand suggests that an increase in demand of some 1.8 million barrels per day would be consistent with World Bank output projections. Coupled with expected increases in output of 1.5 million barrels (IEA 2004), there is little prospect for a substantial easing of oil prices in 2005.

13. The stock of housing in the United States is estimated by the Federal Reserve Bank to be equal to $15.2 trillion or about 138 percent of GDP. A 10 percent change in the value of that stock would represent 13.8 percent of GDP or 19 percent of consumption. Econometric estimates suggest that the long-term marginal propensity to consume from housing wealth is .05 (see, for example, Catte and others 2004 and Benjamin and others 2004), implying a reduction in consumption of 1.35 percent.

14. Chapter 3 discusses in more detail some of the potential financial-sector impacts of higher interest rates.

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3

Global Imbalances and Emerging Market Economies

THE GROWING IMBALANCES IN external payments among the world's economies and the financing needs associated with those imbalances have provoked concern in international policy circles and anxiety in capital markets. The previous chapter discussed their nature and scale and identified the risks they posed for financial markets and the global economy. This chapter assesses the implications of such risks for developing countries—particularly emerging market economies, which depend on international capital markets to finance their investment and growth and, increasingly, to allocate their national savings.[1] Our concern here is not only the traditional sensitivity of emerging-market finance to cyclical developments in international capital markets, but also the implications for external balance sheets of accumulations of foreign exchange reserves.

The channels through which events in global financial markets affect developing countries reflect the changing character and growing significance of developing countries' international financial relationships. An improved external environment, years of structural reforms in developing countries, and improved macroeconomic stability have combined to produce the current favorable cycle of healthy trade surpluses, surging foreign exchange reserves, low inflation, and strong growth prospects. Such developments have contributed to the marked strengthening of private capital flows in the past two years (2003–4) from their long slide after 1997 (see chapter 1). Reinforced by higher oil prices and fixed exchange rates in Asia, they also have resulted in a large buildup of foreign currency assets with monetary authorities and central banks of several developing countries. But the increasing size and complexity of external balance sheets pose new challenges that will require not only appropriate strategies to manage external assets and liabilities, but also attention to the domestic macroeconomic implications of higher reserve levels.

Serious concerns remain about how the unwinding of global financial imbalances might affect the external financing conditions in which emerging market economies operate. From their perspective, the gravest risk is an abrupt and disorderly adjustment of major exchange rates, combined with a higher-than-expected rise in international interest rates. Persistent structural weaknesses in banking and financial systems, especially when coupled with high indebtedness or a record of macroeconomic mismanagement and default, render some now-thriving economies particularly vulnerable to sudden reassessments of country risk by capital markets.[2]

- A sharp depreciation of the dollar could result in large capital losses in local-currency terms for developing countries with substantial dollar reserves. On the other hand, countries with dollar-denominated debt would benefit from the erosion in the dollar value of their debt.
- Higher global interest rates could contribute to wider emerging-market bond spreads, particularly for borrowers with high ratios of debt to GDP, which would compound the adverse impact of higher U.S. Treasury benchmark rates.
- The growing carrying costs associated with central bank purchases of foreign exchange reserves could increase pressure on some

countries to moderate their reserve accumulations and allow exchange rates to share some of the adjustment burden. Expansion in aggregate domestic demand (including consumption) to reduce upward pressure on local currencies, coupled with greater openness on both trade and capital accounts, will also be required in many countries with large reserve holdings.[3]

The mixed effect of exchange-rate fluctuations

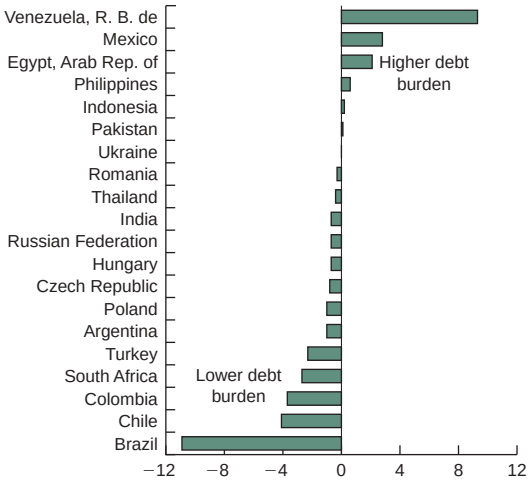
Fluctuations in the exchange rates of the major global currencies—dollar, euro, and yen—have important implications for emerging markets through their impact on flows of trade and finance. Because of the dollar's unique role in both trade and finance, fluctuations in its value tend to have a relatively larger impact on emerging market economies than do changes in other currencies. On the trade side, high volatility among G-3 exchange rates hurts developing countries' exports (Esquivel and Larrain 2002). But to the extent that international investment positions in emerging market economies diverge from their trade patterns, fluctuations among major currencies may have various added effects. Such effects vary by country, depending on their net trade and foreign asset holding patterns.

A further weakening of the dollar does have positive benefits for certain emerging market economies with large dollar-denominated external debt. To the extent that they are net debtors in dollars (as is the case for many that are active borrowers in global financial markets), pronounced dollar weakening reduces their real net external debt burden (measured in domestic currency). Since the end of 2002, the depreciation of the dollar against most developing-country currencies has reduced ratios of debt to GNP and of debt service to exports by 0.7 percentage point. If one excludes countries (such as China) whose currencies have been fixed against the dollar over this period, the decline in these ratios is even greater—nearly one percentage point.

The magnitude of this effect varies substantially, depending on the amount of dollar-denominated debt and the magnitude of the dollar depreciation that has occurred. Focusing on the effect of dollar depreciation for Brazil, for example, the ratio of debt service to exports has declined by 10 percentage points over the period, while for countries (including Mexico) whose currencies fell against the dollar, the debt-service burden rose (figure 3.1). The overall impact of dollar depreciation will of course depend on net asset positions. As discussed in the next section, beneficial effects on debt service could be partially offset in countries that have accumulated large dollar-denominated foreign exchange reserves. There may also be an important distributional distinction between gains accruing to the private sector in emerging markets (likely to be a net debtor) and losses accruing to the public sector (which may hold substantial dollar reserves).[4] Consideration should also be given to the extent to which policymakers or market participants may have hedged their net exposure to currency movements through forward or currency derivative markets.[5]

Figure 3.1 Impact of dollar depreciation on debt service ratios, 2002–4

Change in ratio of debt service to exports (in local currency)



Sources: World Bank data and staff estimates.

Global monetary tightening: higher interest rates

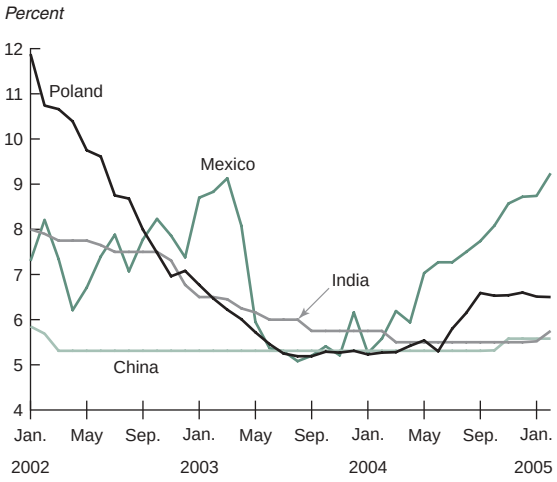
The evolution of interest rates in world capital markets—strongly influenced by U.S. rates—has the most direct (and perhaps most potent) impact on emerging-market risks. This occurs not

only through the traditional, direct channel—monetary tightening to control inflation in industrial countries, which produces higher rates—but also because higher rates can lead to large capital losses on official dollar-denominated bond portfolios.

Historically, virtually every cyclical monetary policy turn in the United States over the past two decades has been accompanied by heightened volatility in emerging financial markets, with direct implications for the level and price of capital flows. The 1994 tightening cycle, which raised the Fed funds rate from 3 to 6 percent in just over a year, had particularly severe consequences, causing turmoil in financial markets and reducing global liquidity. On the other hand, the global monetary easing that began in the fall of 1998 helped end the 1997/98 round of crises (Frankel and Roubini 2003).

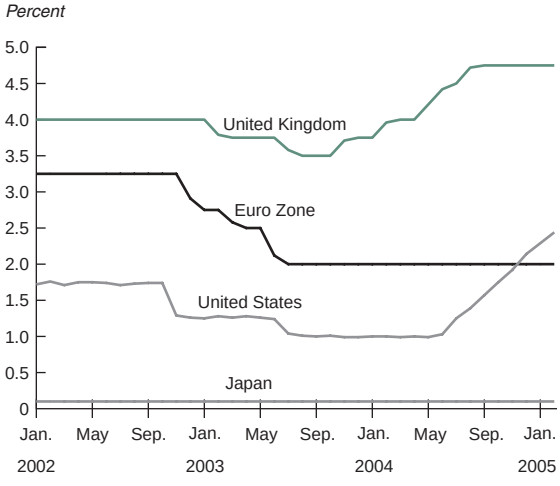
Market interest rates are influenced fundamentally by G-3 monetary policy, as shaped by central banks' reaction to domestic inflation and output gaps. The most visible turning point in the current global interest rate cycle came in June 2004, when the U.S. Federal Reserve began a widely anticipated series of interest-rate hikes after a long period of monetary expansion. Short-term policy rates have been increased in several other countries, as well (figures 3.2 and 3.3). With real interest rates still negative in the United States, there is scope for further monetary tightening (figure 3.4), and forward interest rates signal expectations of higher future rates (figure 3.5). Estimates of "neutral" Fed fund rates for the United States—on the order of 2 percent in real terms—imply a target rate of at least 4 percent in nominal terms, or 150 basis points higher than the current level of 2.5 percent.

Figure 3.3 Short-term policy rates in major emerging markets, 2002–4



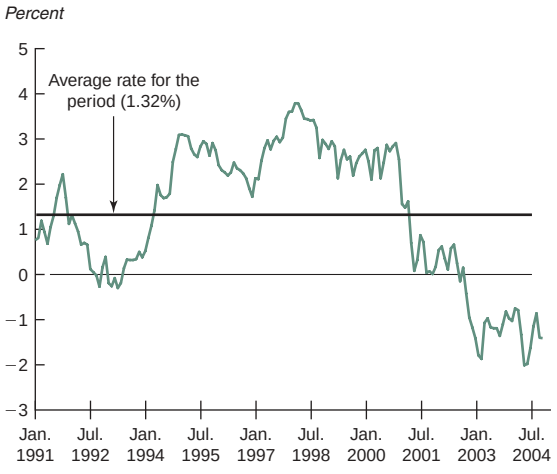
Source: World Bank data.

Figure 3.2 Short-term policy rates in developed countries, 2002–4



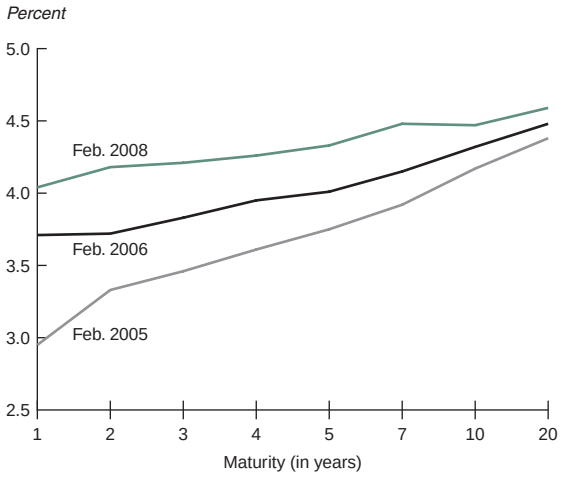
Source: World Bank data.

Figure 3.4 Movement of real federal fund rates, 1991–2004



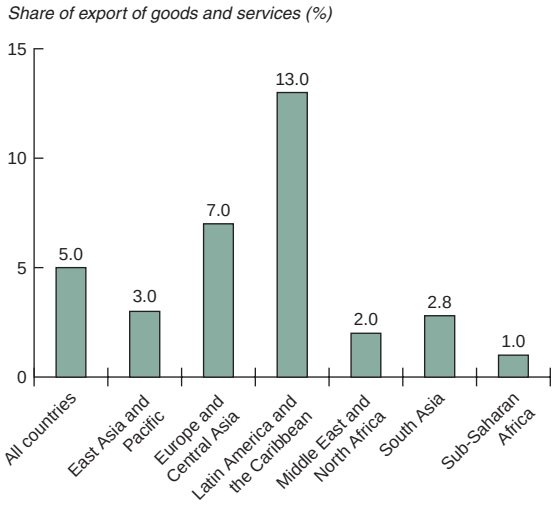
Sources: U.S. Federal Reserve; World Bank staff estimates.

Figure 3.5 U.S. Treasury implied forward rates



Source: Bloomberg.

Figure 3.6 Estimated additional debt service burden due to increase of one percentage point in U.S. interest rates



Source: World Bank staff estimate.

The pressure from rising interest rates is likely to have a negative impact on global economic growth, particularly in developing countries. About one-fifth of developing countries' outstanding external debt is estimated to be based on variable interest rates. Thus, increases in U.S. rates and subsequent effects on related dollar benchmarks, such as the dollar London-interbank-offered (LIBOR) rate, exact a direct cost. Estimates suggest that an increase of 1 percentage point in U.S. medium-term interest rates can imply an additional debt-service burden equivalent to about 5 percent of developing countries' exports of goods and services—with considerable regional variation, ranging from 1 percent in Sub-Saharan Africa to 13 percent in Latin America and the Caribbean (figure 3.6).

A key question from the perspective of emerging market economies is how market interest rates are likely to react to changes in monetary policy—particularly in the United States—and how such reactions spill over to emerging bond markets. With G-3 central banks relying on short-term policy rates to conduct monetary policy, this question can be pursued at two levels: first, how market participants react to current and expected future changes in short-term policy rates in G-3 countries, particularly the United States (box 3.1); and second, how such reactions are factored into the determination of dollar-denominated emerging-market bond prices and spreads, which are typically benchmarked against 10-year U.S. Treasuries.

Potential volatility in emerging-market spreads

The cost of borrowing in emerging markets will be affected not only by movements in interest rates in global markets, but also by the evolution of country-specific spreads over these rates. The persistence of emerging-market bond spreads at near-record-low levels for much of 2004 (see chapter 1) raises concerns that markets are not adequately assessing—and pricing—emerging-market risks. This in turn raises the possibility that, should global conditions deteriorate, these spreads could widen suddenly and dramatically, as investors adapt their expectations to a more pessimistic outlook and shift out of emerging-market assets.

Deteriorating global conditions can affect emerging markets through their impact on sovereign credit ratings. Countries that rely primarily on market-based financing could face further pressures if credit ratings deteriorated, because deterioration would increase borrowing costs in primary capital markets. In general, the marginal cost of a downgrade increases as one moves down the credit spectrum. Since credit ratings for most emerging markets are concentrated around low investment grade or high noninvestment grade, a slip of one grade implies, on average, additional

Box 3.1 Asset prices and unanticipated news

Understanding the transition from short-term policy rates to bond-market prices and yields requires paying greater attention to the dynamics of market expectations in shaping views on interest rates and monetary policy changes. In forming views on the economic outlook, including expected paths of inflation and short-term interest rates, bond-market investors and traders pay close attention to actions, views, and perceived intentions of monetary authorities. Based on such expectations, market participants form their views about long-term interest rates through the term structure of interest rates, which provides information on the whole maturity spectrum, from the short end (three months) to the long end (30 years).

Recent research on finance has emphasized the finding that asset prices are driven primarily by unanticipated information or news contained in macroeconomic announcements. This analysis argues that the anticipated part of economic "news" is already incorporated into asset prices. In most industrial countries, announcements are released regularly at specific times during any given business day, providing market participants with a steady flow of new information and insights into economic fundamentals, and shaping expectations about the economic outlook and likely official policy reactions. Using intra-day high-frequency data, recent empirical work has documented the adjustment response of different financial markets to economic news announcements. For example, it has been shown that news regarding labor-market conditions, output changes, and consumer confidence are incorporated in U.S. bond prices within one minute, and also that German government bond yields are more responsive to U.S. economic news than to Euro-area or German news. Also, favorable "growth news" causes the dollar to appreciate relative to other major currencies (Balduzzi and others 2001; Brandt and Kavajecz 2004; Goldberg and Leonard 2003).

borrowing costs of about 80 basis points over and above the regular costs.

Empirically, the link between global monetary conditions and emerging bond markets is also reflected in the way U.S. interest rates affect emerging-market spreads. Examining time series of correlations of Emerging Markets Bond Index (EMBI) spreads with U.S. interest rates (measured over 36-month rolling periods between December 1992 and June 2004) yields several conclusions:

- First, the estimated correlations vary over time and fluctuate a great deal, with a clear break between crisis and noncrisis periods—suggesting that during crisis periods, spreads are driven by factors other than movements in U.S. rates.
- Second, the effect of U.S. rates on emerging-market spreads is nonlinear; as higher U.S. interest rates affect the creditworthiness of emerging economies (through the channels identified earlier), emerging-market spreads rise more quickly.[6]
- Third, emerging-market spreads appear to track movements in short-term U.S. rates (both the Fed target rate and the three-month Treasury rate) more closely than the longer-term (10-year) rates, implying that the orientation of investors in the asset class may be driven more by changes in short-term U.S. rates than by longer-term yield considerations.

Such aggregate analysis helps delineate the dynamics between U.S. interest rates and emerging-market bond conditions, but fails to incorporate the influence on spreads of specific country variables and credit quality. It is reasonable to expect that higher U.S. interest rates, for instance, have a more serious adverse effect on spreads in countries with high levels of external debt than in countries with moderate external debt. For countries with strong economic fundamentals, the impact of higher U.S. interest rates is likely to be modest. Box 3.2 summarizes research results that consider the role of individual country factors in determining emerging-market spreads.

A 200-basis-point increase in U.S. interest rates (approximately equal to current expectations of future U.S. Fed rate increases during the current round of tightening) would translate into additional increments in emerging-market spreads ranging from 6 basis points (for countries with

Box 3.2 Determinants of emerging-market spreads

To examine how individual country conditions affect the relationship between U.S. interest rates and emerging-market bond conditions, we draw on the recent literature on asset-pricing models for sovereign yield spreads (Duffie, Pedersen, and Singleton 2003; Menkveld, Cheung, and de Jong 2004; and Dailami, Masson, and Padou 2004). To analyze determinants of the emerging-market spread over U.S. Treasuries, we performed panel regressions on domestic determinants of a country's creditworthiness, as well as global variables that explain the supply and cost of credit to emerging markets. The results point to several important conclusions.

Country-specific variables seem to dominate U.S. interest rates in terms of the influence on emerging-market spreads. In particular, trade openness has a strong negative effect on spreads—plausible because more open countries are better able to adjust their balance of payments to generate earnings to service external debt. This variable may also reflect the finding in the growth literature that more open countries tend to grow faster. Higher indebtedness (measured by the ratio of debt to GDP) has a positive impact on spreads, whereas a higher ratio of reserves to debt and a lower share of short-term debt each have a significant negative influence. The latter effect may simply reflect an upward-sloping term structure.

The risk that U.S. monetary tightening might lead to dramatic increases in emerging-market spreads and in global risk appetite appears lower than in past periods. Levels of indebtedness in emerging markets are generally lower than in earlier periods, as countries have recognized the dangers of external borrowing (especially short-term), and the level of foreign exchange reserves is considerably higher. Countries are differentially affected by the current high level of commodity prices, with some benefiting from higher prices for key commodity exports, and others adversely affected by the higher price of their oil imports.

The fact that monetary tightening is largely anticipated (which was not the case, for instance, in March 1994) is likely to mean a less abrupt adjustment of spreads that will permit emerging market economies to take palliative measures, such as lengthening maturities to lock in lower rates. The latter tactic is evident in actions by several countries to "prefinance" future financing needs while current conditions are favorable. For countries that still limit the fluctuations of their currencies against the U.S. dollar through a peg or "dirty float," the weakening of the dollar against the euro and yen offers more room for maneuver.

There is evidence that today's investors are much better able to discriminate among borrowers and less likely to infer that problems in one country signal problems in others. The default by Argentina in 2002—the largest in history—did not cause much disruption in world capital markets, nor did neighboring countries suffer major increases in their spreads. While the Argentina episode was in some ways a special case—the "crisis" unfolded over a period of months, plenty of time for market participants to anticipate events—it may also signal that when higher interest rates push a country to the edge of default, the likelihood of generalized contagion is now low.

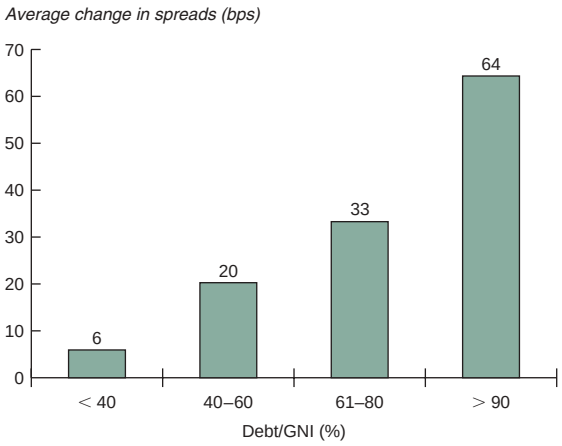
debt-to-GNI ratios below 40 percent) to 65 basis points (for highly indebted countries with debt-to-GNI ratios above 90 percent). This increase would come on top of the underlying increase in the 10-year U.S. Treasury yields, which would likely increase by less than the 200 basis points (figure 3.7).

Capital flows and reserve accumulation

Developing countries are now capital *exporters* to the rest of the world. Highlighted in *Global Development Finance 2004,* this trend has continued to increase in scale and strategic importance. It warrants careful attention.

The aggregate current account surplus of developing countries has widened steadily since 2000, rising in 2004 to $153 billion (2.0 percent of developing-country GDP). Within developing countries, the current account surpluses have been concentrated largely in emerging markets—notably Brazil, China, Malaysia, the Russian Federation, and República Bolivariana de Venezuela, several of which maintain managed exchange-rate regimes and limited capital account convertibility (table 3.1). The large surpluses mirror a decline in domestic investment relative to savings, a trend that is particularly noteworthy in East Asia. The long-running stagnation of Japan and the steep fall in growth and investment in developing economies since the crisis of 1997/98 have generated surpluses equivalent to 9 percent of the U.S. deficit

Figure 3.7 Change in sovereign bond spreads following increase of 200 basis points in U.S. interest rates, by degree of indebtedness of country



Sources: World Bank Debtor Reporting System and staff estimates; J.P. Morgan Chase; Dailami, Mason, and Padou 2004.

Table 3.1 Current account balances in developing countries, 2000–4

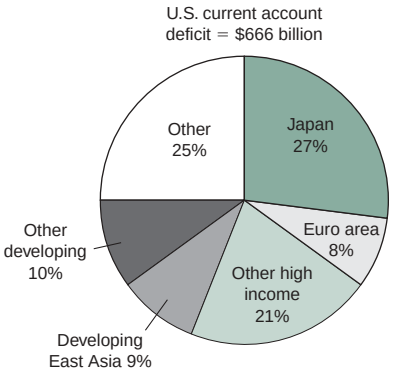
$ billions

	2000	2001	2002	2003	2004e
Developing countries	**43.6**	**16.9**	**72.0**	**117.7**	**152.7**
Argentina	−9.0	−3.9	9.1	7.8	3.2
Brazil	−24.2	−23.2	−7.6	4.0	11.1
China	20.5	17.4	35.4	45.9	47.3
Czech Republic	−2.7	−3.3	−4.3	−5.7	−6.0
Egypt, Arab Rep. of	−1.0	−0.4	0.6	3.7	3.3
India	−4.3	0.2	5.8	8.0	−1.1
Indonesia	8.0	6.9	8.1	7.5	3.7
Malaysia	8.5	7.3	7.2	13.4	13.8
Mexico	−18.2	−18.2	−14.1	−9.2	−8.3
Pakistan	−0.1	1.9	3.9	3.6	2.5
Philippines	6.3	1.3	4.4	3.3	4.1
Poland	−10.0	−5.4	−5.0	−4.6	−4.4
Russian Federation	46.8	33.8	29.1	35.8	55.4
South Africa	−0.3	0.1	0.6	−1.5	−5.6
Thailand	9.3	6.2	7.0	8.0	5.4
Turkey	−9.8	3.4	−1.5	−6.8	−14.9
Venezuela, Rep. Bol. de	11.9	2.0	7.6	11.5	12.5
Memo items:					
Low-income countries	8.2	3.2	15.3	12.1	7.6
Middle-income countries	35.4	13.7	56.7	100.7	145.0

Note: e = estimate
Sources: World Bank, *Global Development Finance*, various years; World Bank staff estimates for 2004.

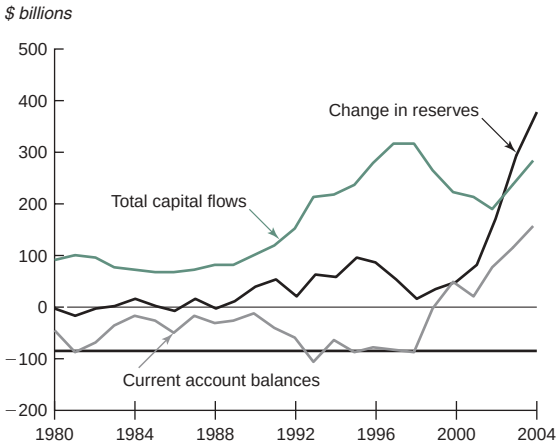
(figure 3.8). At the same time, the ratio of investment to GDP in major developing East Asian economies (other than China) fell by an average of 9 percentage points of GDP between 1996 and 2003 (World Bank 2004).

Figure 3.8 World current account surpluses as shares of U.S. current account deficit, 2004



Source: World Bank staff estimates.

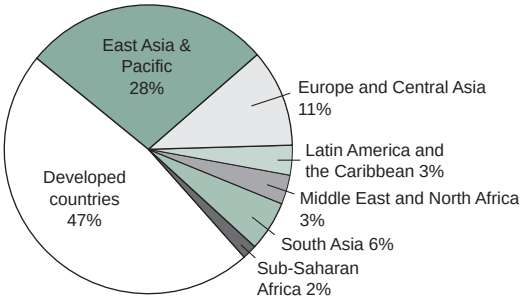
Figure 3.9 Capital flows, current account balances, and reserve accumulations in developing countries, 1980–2004



Sources: World Bank staff estimates; IMF International Financial Statistics.

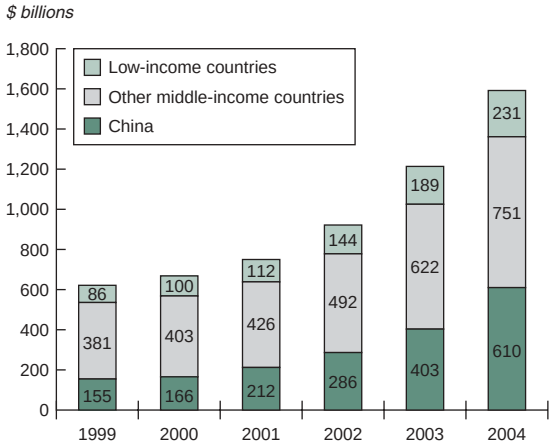
The disparity between growing current account surpluses and steady or declining domestic investment and consumption is explained by the fact that a portion of the surplus has been funneled into reserve accumulation (figure 3.9). Over the last five years, developing countries have accounted for more than half of the global increase in foreign exchange reserves (figure 3.10). The developing countries as a group have raised their foreign exchange reserves to unprecedented levels in recent years. At the end of 2004, they held an estimated $1.6 trillion in foreign exchange, compared to

Figure 3.10 Global foreign exchange reserve accumulation, 1999–2004



Sources: World Bank staff estimates; IMF *International Financial Statistics Yearbook*.

Figure 3.11 Foreign-exchange reserves in developing countries, 1999–2004



Sources: World Bank staff estimates; IMF *International Financial Statistics Yearbook*.

$1.2 trillion in 2003 and $921 billion in 2002. Approximately 86 percent of the total is held by middle-income countries, with China alone accounting for 38 percent, or $610 billion, an increase of $207 billion over 2003 (figure 3.11). Other emerging market economies saw large increases as well—the reserves of the Russian Federation increased by $41 billion to $114 billion; India's by about $28 billion to $125 billion; and Malaysia's by $18 billion to about $62 billion. In 2004, 101 of 132 developing countries that reported data for 2004 increased their foreign exchange reserves, approximately the same number as in 2003. And while East Asia dominates, reserves have increased in all developing regions over this period.

The benefits of higher reserves

Accumulation of higher reserve levels across a broad range of developing countries is tangible evidence of prudent policies and strong trade performance since the crises of the late 1990s. In general, it lowers vulnerability to external shocks. With financial markets focusing on borrowing countries' level of reserves as an important indicator of financial health, the recent increases provide a margin of comfort and confidence.

Three factors have driven the rapid growth in reserves:

- *The quest for self-insurance against external shocks.* The financial crises of the late 1990s gave developing-country policymakers a renewed appreciation for the value of reserves as protection against currency crises and abrupt reversals of capital flows. Such protection is especially important for countries with heavy external financing needs (Brazil, Turkey) and for those with a high degree of trade concentration (Pakistan) that are vulnerable to sudden interruptions in gross flows as a result of changing domestic conditions or broader contagion in global markets.
- *The search for credit on favorable terms.* Reserve levels are also an important factor in assessments of creditworthiness and broader policy credibility. Increases in reserves contribute to credit upgrades, which in turn translate into lower borrowing costs and reduced volatility.
- *The need for liquidity to achieve and manage exchange-rate stability.* In countries pursuing a fixed exchange-rate policy, reserves help monetary authorities defend a target peg in the face of external pressures to raise the value of their currency.

The costs and risks of "excessive" reserves

There is ample evidence of and broad consensus about the benefits to developing countries from maintaining an adequate level of foreign exchange reserves that provide liquidity for exchange-rate management and can be readily accessed when needed.

There is less agreement, however, on what constitutes an "adequate level of reserves," especially when countries are operating under a flexible exchange-rate regime and are relatively open to

Box 3.3 Developing countries as exporters of capital—a new twist on the Bretton Woods system

The buildup of foreign exchange reserves in the hands of developing countries' central banks and monetary authorities—and its use in financing global payment imbalances—marks a new phase in the postwar system for financing international payments. In the years following the establishment of the Bretton Woods system in 1948, when most exchange rates were fixed, capital mobility restricted, and access to private sources of capital limited to a few high-income countries, the balance of payments was maintained primarily through official finance. Anchored by the International Monetary Fund (IMF), but also encompassing supplementary financing facilities through the Bank for International Settlements and central banks, this regime assured a sufficient supply of balance-of-payments financing as long as imbalances were not too large and countries adhered to the norms of good policy behavior—for example, by avoiding competitive currency devaluation. But as the European countries recovered from the devastation of the war, they made their currencies convertible and secured access to private capital markets. Only developing countries continued to draw on official financing to maintain their balance of payments.

The rise in world oil prices in the 1970s and the associated accumulation of balance-of-payments surpluses in the member states of the Organization of Petroleum Exporting Countries strengthened the role of private financing, as surpluses were intermediated to deficit countries through private capital markets, particularly banks. This "privatization" of balance-of-payments financing had the effect of easing previous balance-of-payments constraints on national economies and, to a degree, substituted market discipline for the discipline of official financing. In the process it also contributed to the financial crises of the 1980s and 1990s.

foreign capital flows (IMF 2003; Wijnholds and Kapteyn 2001; Feldstein 1999). In the 1970s and 1980s, when most exchange rates were fixed and capital accounts closed, the rationale for holding reserves was to provide a safeguard against external volatility in exports and imports (box 3.3). Three to six months of imports was often used as a rule of thumb to define an adequate level of reserves. When the underlying source of volatility and crisis shifted from trade to the capital account in the 1990s, the measure of reserve adequacy moved from an import-based indicator to one that would express the country's ability to weather volatility and the possibility of a reversal of capital flows—whence the new convention, likewise just a rule of thumb, that reserves should be equal to short-term debt (debt maturing in one year or less).

In several countries reserve levels have come to exceed, by a large margin, conventional measures of adequacy: six-months of imports or the entire stock of outstanding external short-term debt. In these countries, the question of the potential cost of reserve holdings can reasonably be posed. China, the Czech Republic, India, Malaysia, Pakistan, Thailand, and República Bolivariana de Venezuela all have reserves that are more than four times their external short-term debt (table 3.2). Many of these economies have accumulated these reserves as a result of policies that have kept exchange rates fixed or pegged.

Table 3.2 Ratios of foreign-exchange reserves to imports and external short-term debt in emerging market economies, 2004

	Reserves as months of imports	Ratio of reserves to short-term debt
Argentina	11	1.1
Brazil	12	1.8
China	12	14.1
Czech Republic	6	4.6
Egypt, Arab Rep. of	14	3.7
India	16	6.3
Indonesia	13	2.6
Malaysia	6	5.3
Mexico	4	2.1
Pakistan	10	10.7
Philippines	4	1.6
Poland	6	2.6
Russian Federation	11	3.1
Thailand	6	5.0
Turkey	6	1.8
Venezuela, Rep. Bol. de	20	5.0

Sources: World Bank staff estimates; IMF International Financial Statistics.

But holding reserves has costs, too. And when reserve levels become high enough, the costs can become quite large. The high level of reserves,

particularly in emerging market economies, has prompted much debate about whether the protection is worth the cost. The key economic costs of excessive reserve accumulation fall into two categories: (i) "quasi-fiscal" costs associated with central banks' sterilization efforts; and (ii) potential capital losses on reserve assets held, typically, in highly rated foreign government securities.

The quasi-fiscal cost of reserve accumulation stems from central banks' efforts to offset (or sterilize) the expansionary monetary impact of their purchase of reserves. Without open-market sterilization operations (or other administrative measures), ballooning reserves would cause the monetary base to expand beyond the productive capacity of the economy, leading to inflation. As central banks sterilize by selling government securities in local markets to mop up liquidity, they incur an income loss, because the yields on their reserve holdings generally fall short of the yields they must pay on the securities they issue.

The magnitude of this fiscal burden varies across countries, depending on the gap between the interest rate paid on domestic issues and the rate earned on reserve holdings, adjusted by expected changes in exchange rates. For emerging markets with high reserves, that gap (based on the difference between domestic interest rates and the yield on two-year U.S. government bonds) is estimated at around 7.6 percent for China, 8 percent for the Russian Federation, and 1.8 percent for India (table 3.3). Assuming an average spread of 250 basis points between an emerging-market bond with a two-year maturity and a U.S. Treasury bill of corresponding maturity, each $10 billion of reserve holdings costs the central bank about $250 million in annual carrying charges—a sizable cost. Moreover, these costs are likely to increase as sterilizing operations add to public sector debt and put upward pressure on domestic interest rates, in turn increasing the size of the rate gap and associated carrying charges.[7]

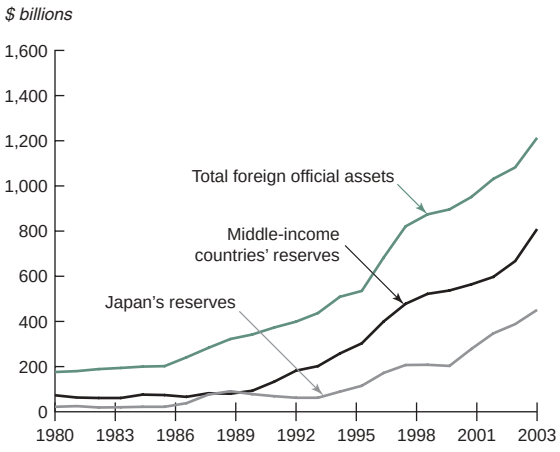
The risk of capital losses on reserves depends on the level of reserves, but also on the portfolio investment decisions of reserve managers—and particularly on their choices of currency composition and acceptable risk parameters. Virtually all reserves are held in five major currencies (dollar, euro, Japanese yen, British pound, and Swiss franc), with about 70 percent invested in dollar-denominated assets, both inside the United States and in global euro-dollar markets. Although detailed data on allocations in the reserve portfolios of individual countries are not available (because central banks have little reason to disclose such information),[8] there is a strong correlation between emerging markets' total reserve holdings and total foreign official assets in the United States (figure 3.12), suggesting that a substantial share of reserves is in fact invested in dollar assets in the United States. If this is indeed the case, a drop in the value of the dollar vis-à-vis the local currency

Table 3.3. Reserve carrying costs in emerging markets

	Spreads	Expected annual change in exchange rate	Expectation-adjusted spreads[a]
Brazil	−0.6	14.3	−14.9
China	2.4	−5.2	7.6
Czech Republic	−0.7	−0.5	−0.2
Egypt, Arab Rep. of	6.8		
India	2.3	0.5	1.8
Indonesia	6.0	2.6	3.4
Malaysia	−0.5		
Mexico	5.6	4.3	1.3
Pakistan	−0.1		
Philippines	3.2	4.1	−0.9
Poland	3.3	3.1	0.2
Russian Federation	9.8	1.8	8
Thailand	−1.2	−0.2	1
Turkey	16.8	17.4	−0.6

a. Spreads over U.S. two-year government bond yields as of Jan. 7, 2005.
Sources: Bloomberg; J.P. Morgan Chase; World Bank staff estimates.

Figure 3.12 Foreign official assets in the United States, 1980–2003



Source: U.S. Department of Commerce.

implies an equivalent drop in the real asset value of the reserves held. Similarly, increases in global interest rates can generate capital losses on reserve assets held in fixed-income securities, particularly those with longer maturity. For example, an increase of 200 basis points in U.S. interest rates would translate into a $26.8 billion loss on the dollar-denominated bond portfolio of the six emerging market economies, with the largest asset holdings in U.S. Treasuries as of October 2004 (Brazil, China, India, Mexico, Thailand, and Turkey).

In practice, these losses are typically absorbed by reducing income transfers from the central bank to the treasury or reflected in the central bank's capital position. But other outcomes are possible—in countries where the banking system is under government control and interest rates are not market-determined, such as China, the quasi-fiscal expenditure has been largely off-loaded onto state-owned commercial banks that have been required to purchase securities sold by the People's Bank of China at below market-clearing interest rates. While this approach keeps the cost of reserve holdings off the government's (and the central bank's) books, it tends to further reduce the already tenuous profitability of the state-owned banks and so contribute to financial system fragility. The broader point is that these losses impose real economic costs, whose incidence (on the treasury or on banks) will depend on the policies and institutional arrangements pursued.

For the majority of developing countries, whose currencies are not fully convertible on the capital account, institutional constraints often limit the sustainability of sterilized foreign exchange interventions. Underdeveloped government securities markets and an insufficient volume of securities with which to conduct sterilization operations limits the scope for effective open-market action in many countries. The Reserve Bank of India, for example, now faces a dilemma because its inventory of government securities is falling rapidly, yet it is not allowed to issue its own securities or sell rupee assets on international markets. Similarly, in connection with its open-market operations, the Bank of Korea came up against the annual limit set by the legislature on sales of government securities. By October 2004, it had sold 17 trillion won ($15.9 billion) of a permitted 18.8 trillion won ($16.9 billion) total. The People's Bank of China, which accumulated nearly $100 billion of foreign exchange reserves in the fourth quarter of 2004 alone, had (as of November 2004) sold the equivalent of nearly $80 billion of central bank bonds domestically, more than tripling the total stock of bonds outstanding.

Looking ahead, policymakers in developing countries are likely to find it increasingly difficult to ignore certain important policy questions:

- As official financing from developing countries plays an increasingly important role in meeting global financing needs, questions regarding the sustainability of these flows become more important. Changes in the pattern of reserve accumulation could have important implications for international stability and repercussions for private capital flows to developing countries.
- Developing countries that are accumulating reserves in excess of (i) prudential demand for liquidity and (ii) amounts needed to protect against volatility in capital flows will have to address the growing quasi-fiscal carrying costs, potential capital losses from further weakening of the dollar, and opportunity costs associated with directing capital inflows away from productive domestic investment (including infrastructure) and into foreign asset accumulation.

Promoting stability in global capital flows

Since the beginning of 2004, the external financing environment in which developing countries must operate has been extraordinarily stable. Driven by improved domestic economic fundamentals and high global liquidity, private capital flows expanded vigorously throughout the year, uninterrupted by any sign of crisis or abrupt changes in market sentiment (with the exception of the short-lived rise in emerging-market bond spreads in April and May). Today, however, that stability is threatened by risks arising through three channels discussed above:

- Growing imbalances in external payments
- Exchange-rate fluctuations among the major currencies (dollar, yen, and euro)
- Market reactions to the ongoing tightening stance in global monetary policy.

Enhancing the resilience of developing countries to these risks requires actions on several fronts, with important roles for both developed and developing countries.

For developing countries, the greatest challenge is to continue taking advantage of current favorable external financing conditions while pursuing the domestic macroeconomic and structural reforms necessary for long-term stability in external financing. This strategy involves building on recent macroeconomic gains—low inflation, healthy trade surpluses, greater exchange-rate flexibility, and lower debt burden—to address structural weaknesses in their financial systems, local capital markets, and systems for managing external assets and liabilities. Such policies remain critical to forging closer links with global capital markets and to channeling capital flows to long-term and productive investment and growth opportunities.

Progress in macroeconomic stabilization and structural reforms during the last two decades helped provide the foundation for the recovery and vigorous expansion of capital flows over the last two years. Commitment to such policies needs to be renewed through credible and concrete fiscal actions (reduction in public debt burdens and improved public debt management), monetary actions (long-term price stability and low inflation), and exchange-rate policies (avoiding misaligned exchange rates and expanding flexibility). Such policies have underpinned recent gains in creditworthiness in many emerging markets and could help minimize the adverse impact on credit spreads or availability of finance, should global economic conditions worsen unexpectedly.

The cost-benefit calculus of continued reserve accumulation by central banks in developing countries (especially in Asia) needs to be reexamined in light of increasing associated fiscal costs and potential investment losses. While recognizing that such policies have to date had a largely positive macroeconomic effect on countries that pursued them, continuing accumulation of reserves on such a large scale carries its own clear risks, particularly if central banks (or others) with large dollar holdings shift to other major currencies. In both the short- and long-term, high-reserve countries need to consider how best to manage an appreciation of their currencies against the major currencies, to share the burden of exchange-rate adjustment with others (especially Japan and the European Union).

As developing countries' external balance sheets have grown in recent years, the challenge of asset and liability management has taken on considerable significance. In that context, debt and asset management policies need to strike a meaningful balance between risk and return, through efforts to lengthen the maturity of portfolios, diversify currency composition, and seek higher-yielding assets, while not losing sight of broader macroeconomic and growth objectives. Many emerging market economies have taken advantage of recent favorable external financing conditions to adjust maturity or currency structures of their external debt through refinancing and, in certain cases, retirement of expensive Brady bonds. On the asset side, more central banks are relying on professional asset managers to manage part of their foreign exchange reserve holdings.

The Asian financial crises of 1997/98 provided a stark demonstration that weak domestic financial systems can easily transform a currency crisis into a full-blown economic free fall. Weak prudential regulation, undercapitalized banks, underdeveloped local capital markets, and governments' implicit guarantee of foreign currency borrowings through the prevailing fixed exchange-rate regimes of the time were among the factors that undermined investor confidence and reversed capital flows. While considerable progress has been achieved in many developing countries in strengthening the banking sector and developing local capital markets, the agenda is largely unfinished. In several countries, strengthening domestic financial institutions remains critical if monetary authorities are to pursue a broad range of policies (particularly related to exchange rates) without jeopardizing the soundness of the domestic financial system.

But ultimately it is the macroeconomic policy stance of G-3 countries that must shoulder the burden of required adjustments. As emphasized in the previous chapter, an orderly and market-determined depreciation of the dollar, a key element of such a strategy, would help reduce U.S. external imbalances through its positive impact on the current account deficit and on net external

debt. But orderly depreciation alone will not secure a sufficient reduction in current global payments imbalances. Equally important are efforts to promote a shift in relative aggregate demand through fiscal consolidation in the United States and policies in the European Union and Japan to stimulate domestic demand. It is only through a combination of exchange-rate and demand instruments that the necessary rebalancing of world demand can be engineered in a sustainable manner.

Notes

1. The following countries are usually included in the category of emerging market economies: in Asia—China, India, Indonesia, Malaysia, the Philippines, and Thailand; in Latin America—Argentina, Brazil, Chile, Mexico, Peru, and República Bolivariana de Venezuela; in Eastern Europe—Bulgaria, Czech Republic, Estonia, Hungary, Poland, Russian Federation, and Slovakia. "Emerging market economies" are not a category in the World Bank's country-classification system, which classes countries according to gross national income, indebtedness, and other criteria. See http://www.worldbank.org/data/countryclass/countryclass.html.

2. The notion that a country's history of macroeconomic management and default matters in the assessment of country risk by the capital markets is known as "debt intolerance." See Reinhart, Rogoff, and Savastano (2003).

3. This is not the first time the world economy has faced external payments imbalances and related adjustment difficulties. Postwar history is replete with such episodes. Just as at present, those episodes featured domestic and external policy conflicts, international adjustment bargains, disagreements on burden sharing, and several cases of macroeconomic diplomacy leading to cooperative solutions, such as the Plaza Accord of September 1985 (Henning 1987; Bergsten 1991).

4. Given their relatively higher risk aversion and natural proclivity for safe assets, official investors have a strong demand for government securities, with equities given a low (or even zero) weight in their investment portfolio. This preference for government paper favors government bond markets at the expense of equity markets. Higher bond prices mean lower costs of funds for the public sector, and lower equity prices mean lower return on private capital. The macroeconomic consequence of this rotation is a reallocation of resources from the private to the public sector. With the U.S. economy relying increasingly on official sources in financing its current account deficit, the distributional impact is again to the public sector.

5. While the potential for hedging against cross-currency risk among major currencies is substantial, given the size and depth of global currency and interest-rate derivative markets, the scope for hedging against currency risk vis-à-vis local currencies in developing countries is limited to six-month to one-year forward markets.

6. The relationship between U.S. interest rates and emerging-market bond spreads may be nonlinear because spreads incorporate default probability in a nonlinear way. For instance, at low interest rates and in periods of favorable economic activity in developing countries, a rise in U.S. interest rates may have little effect on investors' estimates of the probability of default. By contrast, when the emerging-market borrower is, or appears to be, at the limit of its ability to repay, a given increase in U.S. rates may (appear to) push the borrower over the edge, sharply increasing the perceived probability of default. Such a scenario may have occurred, for instance, in 1982 and 1994 (Dailami, Masson, and Padou 2004).

7. The fiscal costs occur regardless of whether reserves are held on the central banks' balance sheet or are held by other authorities that purchase foreign exchange reserves in the local interbank market and pay for them with local-currency liabilities or cash. To the extent that the return on reserve holdings in foreign securities falls short of domestic financing costs, there exists a fiscal cost of reserve accumulation. The magnitude of this fiscal cost depends on the spread between foreign and domestic interest rates, the size of reserve increases, and the future changes in the exchange rate of the local currency vis-à-vis reserve currencies. But in practice and in a majority of countries, it is the central bank that is the primary agency in charge of reserve management. Its responsibility extends to adopting more stringent accounting standards for reporting the volume of and changes in reserve levels. Estimating the fiscal costs of reserve accumulation also involves paying attention to the implications of holding reserves on the central bank's balance sheet for the determination of domestic interest rates, the exchange rate, monetary expansion, and government debt dynamics. See Dailami 2005; Kletzer and Spiegel 2004; and Becker and Sinclair 2004 for further discussion of such issues.

8. Reflecting the progress achieved in recent years in the implementation of the IMF's safeguards assessments and the Special Data Dissemination Standard (SDDS, adopted in 1996), the accounting standards, transparency, and quality of reserve information reported by central banks have significantly improved. As of the end of 2004, 53 central banks had committed to the SDDS, and participation is expected to rise further.

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4

Complex Challenges in Developing-Country Debt

MUCH HAS CHANGED SINCE THE wave of financial crises that rocked emerging-market economies and disrupted global financial markets after 1994. Several favorable economic and policy developments over the past few years have renewed foreign investors' interest in developing countries.[1] Private capital flows to developing countries have shown a strong rebound in the past two years (chapter 1) on the strength of marked improvements in economic fundamentals and investors' search for higher yields than those available in developed-country markets. Emerging-market bond spreads have declined to near record lows, reflecting investors' assessments that the risk of a looming financial crisis is close to an all-time low.

But recent history provides a sobering reminder of how poor financial markets are at spotting brewing crises—and how costly such crises can be for the poor in developing countries. The prospects are good for the current favorable economic and financial conditions to continue in most developing countries (chapter 2). But rosy economic projections conceal vulnerabilities created by the stark external imbalances in the global economy and by the evolution of financing patterns, notably the rise of domestic debt in key middle-income countries. Many countries are better prepared for financial difficulties than they were in the 1990s, but others remain exposed. There is no room for complacency on the part of financial market participants and policymakers.

Looking ahead, there is a risk that global imbalances could unwind in a disorderly manner, resulting in abrupt movements in interest rates and exchange rates, possibly accompanied by a global slowdown and perhaps even protectionist trade measures (chapters 2 and 3). Such developments would almost surely affect investors' assessment of the risk of holding debt issued by developing countries. Emerging-market bond spreads could widen rapidly with a sudden swing in investor sentiment, debt-servicing burdens could rise, and disruptions in capital flows could accentuate stresses on vulnerable emerging markets.

But such pressures would not automatically lead to a replay of past crises. The drivers of debt accumulation since the mid-1990s are different from those of earlier decades, and this changed environment poses new and different risks. Several changes stand out.

First, many countries that were at the center of earlier crises have made significant progress in improving prudential and regulatory policies and structures, the weaknesses of which contributed to the crisis. Fiscal positions have been strengthened; corporate practices are more prudent; and the financial sector has moved to adopt international standards.

Second, the composition of financial flows has changed in a way that affects stability. Equity investments (foreign direct investment and portfolio equity flows), which are less volatile than bank lending, account for a growing share of capital inflows to emerging market economies. Bond and

short-term debt has grown in importance relative to bank lending, with important implications for the cost and availability of finance and the management of crises.

Third, the external debt burden of developing countries *as a group* has eased since the wave of financial and economic crises that began in the mid-1990s. But that easing has not been universal. Beyond the aggregates, one finds considerable country diversity. Severe difficulties persist in a few countries, and debt burdens have risen in more than half.

Fourth, the aggregate decline in external indebtedness has been partially offset by *a rise in domestic debt*. That shift brings some benefits, but excessive domestic borrowing can be just as harmful as excessive external debt.

Countries that have lowered their external debt have reduced their vulnerability to changes in the external financing environment and relieved pressure on their exchange rate. But the switch to domestic debt heightens other risks—notably the uncertainties of rolling over short-term debt (because maturities of domestic debt are generally shorter than those of external debt) and associated interest-rate risks.

Despite the growing sophistication of international capital markets and a steady growth in the capacity of central banks and monetary authorities in developing countries, significant weaknesses remain both in the international architecture that has evolved to regulate those markets (*Global Development Finance* 2004, chapter 2) and in the quality of data available on the fast-growing domestic debt markets in many emerging-market economies. Improving the monitoring and dissemination of information on public and private domestic debt flows should remain a priority for international institutions and national authorities.

The chapter proceeds as follows. After surveying significant changes in developing-country finance since the mid-1990s, we focus on current trends in external debt in the emerging-market economies. We then take a closer look at a particularly significant recent development in emerging economies—the rise of domestic debt markets. The interplay between external and domestic debt, and the special challenges of managing a mixed portfolio are the subjects of the last major part of the chapter.

The change since the 1990s

Since the mid-1990s, various developments have occurred that reflect the changing vulnerability of emerging-market economies to future crises:

- Overall external indebtedness has improved.
- The composition and character of external debt has changed.
- Domestic debt markets have grown rapidly in emerging-market economies, leading to new uncertainties about the scale of the overall debt burden in many countries.
- The policy environment has improved in many countries, notably the East Asian countries that were the focal point of the recent crises.
- A more accommodating and discerning international financial environment has evolved.
- Progress has been made on the international framework governing debt.

Reduced external indebtedness for many, and a larger role for non-debt-creating flows

Benchmarked against gross national income (GNI), developing countries' burden of external debt (public and private) declined from a peak of 45 percent of GNI in 1999 to an estimated 39 percent in 2003. The improvement was achieved despite an increase of almost $207 billion in the nominal value of total external debt, which rose over the last few years (after declining in 2000 and 2001), although at a much slower pace than during the 1980s and early 1990s.

Other indicators of the aggregate external debt burden of the developing world have improved significantly as well, although regions and country groups have been affected differently (table 4.1), as detailed in the next part of the chapter. Short-term debt as a percentage of total external debt is lower for both low- and middle-income countries in all regions except in Europe and Central Asia. This decline reflects reduced pressures on countries to maintain foreign exchange liquidity. The aggregate ratio of external debt to exports dropped sharply, from 135 percent in 1997 to 105 percent in 2003, while the debt servicing burden eased from 19 percent of exports to 17 percent.

Table 4.1 Selected indicators of the burden of external debt, 1997–2002/3

Percent

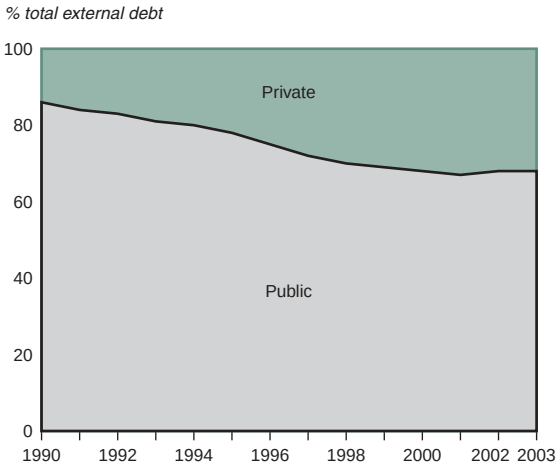
	All countries		Low-income		Middle-income		East Asia & Pacific		Latin America & Caribbean		Europe & Central Asia	
	1997	2003	1997	2003	1997	2003	1997	2003	1997	2003	1997	2003
Short-term debt/total debt	18.4	15.7	10.8	7.9	20.0	17.3	25.1	23.9	19.1	10.7	15.2	19.9
Total debt stock/exports	135.1	104.7	236.3	147.9	123.3	98.6	100.5	60.0	179.6	159.9	106.3	111.1
Total debt service/exports	18.8	17.2	17.7	12.0	18.9	17.8	12.1	10.5	35.1	30.7	12.2	19.8
Reserves/total debt stock	29.2	50.0	14.6	37.9	32.4	52.4	42.7	107.7	26.2	25.8	25.8	36.9
Reserves/imports (months)	4.4	6.5	3.5	6.8	4.5	6.4	5.3	8.3	4.8	5.0	3.0	4.8

Source: World Bank Debtor Reporting System.

Most notably, foreign exchange reserves of developing countries more than doubled, from $631 billion in 1997 (about 30 percent of their external debt stock) to $1.6 trillion in 2004 (60 percent of their debt stock), providing a valuable cushion against unanticipated external shocks (chapter 3). In line with these marked improvements in indicators of external debt, foreign capital flows from private sources recovered as well.

The share of foreign direct investment (FDI) and portfolio equity in the finance mix of many developing countries has grown in recent years. That trend enhances stability, because FDI investors generally emphasize long-term commitment and exhibit greater tolerance for near-term shocks. Equity flows accounted for 80 percent of total external financing during 1999–2003, compared with just 60 percent during 1993–98.

Figure 4.1 Composition of developing countries' external debt, 1990–2003



Sources: World Bank Debtor Reporting System and staff calculations.

The changing composition of external debt—more private borrowers

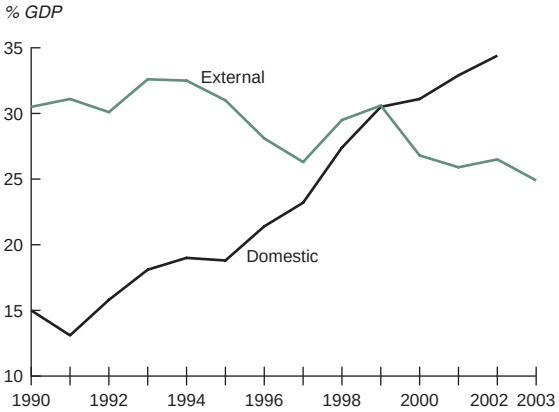
The ownership pattern of external debt has shifted. The share of public sector debt in total external debt declined from 82 percent during 1990–95 to 69 percent during 1996–2003 (figure 4.1).[2] Consequently, the ratio of external public debt to GDP declined from 31 percent to 27 percent over the same period. Deregulation in international capital markets and developing countries, expansion in the base of developing-country investors, and improved information and research—all facilitated access by corporate borrowers in developing countries to international capital markets.

But the declining public share is not universal—public sector indebtedness has *increased* in some countries, creating vulnerability related to their growing exposure to tradable external debt. Establishing access to private sources of cross-border finance often requires public participation to mitigate credit risks, especially in countries with low credit-risk ratings. In many countries bond financing is either a direct public sector liability or carries public sector guarantees. And governments often postpone direct dealings between the corporate sector and private international investors so as to maintain stability in the capital account. Both measures have had the effect of raising public sector indebtedness in some middle-income countries since the mid-1990s—among them Ecuador, Gabon, Lebanon, Romania, and Republica Bolivariana de Venezuela.

Growing reliance on domestic debt markets

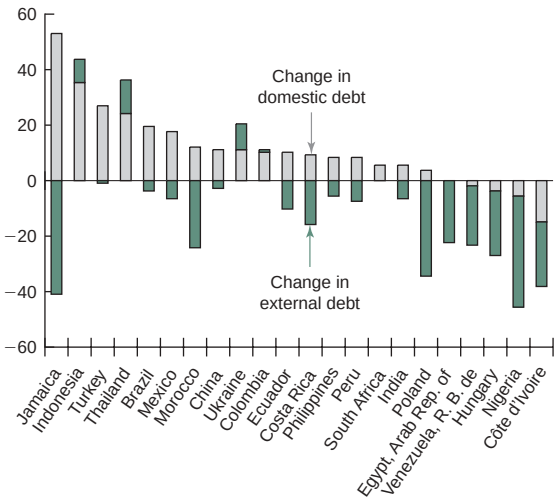
External debt reductions in emerging-market economies have been partly offset by growth in domestic public sector debt (figure 4.2). As a result,

Figure 4.2 Developing countries' total public sector debt, 1990–2003



Sources: World Bank 2004 for external debt data for countries reporting under World Bank Debtor Reporting System; IMF 2003 for domestic debt data.

Figure 4.3 Burden of public debt: external vs. domestic, 1990–2002



Sources: IMF; World Bank Debtor Reporting System.

in many countries, the overall burden of public sector debt remains high. In Costa Rica, Peru, the Philippines, and other countries, the decline in external indebtedness has been completely offset by the rise in domestic debt. In others, such as Indonesia, Thailand, and Ukraine, external and domestic debt have both risen since the mid-1990s (figure 4.3).[3]

The growing importance of domestic debt has been driven by several factors. Many developing countries have made a concerted effort to avoid exposure to currency risks and to assert greater control over public debt management. Both goals are supported by the recognition that the *perception of risk* in international capital markets has an important influence on capital flows and can affect financing prospects regardless of domestic conditions. (This was explored in chapter 3 of *Global Development Finance 2003*.) Liberalization of capital accounts in many countries has contributed to the growth of domestic debt by facilitating the deepening of domestic financial markets, a trend reinforced by the adoption of sound institutional and regulatory policies. But not all of the new money in domestic debt markets has come from within the country. With successful macroeconomic policies to manage inflation in some developing countries, liberalization has brought greater foreign investment in domestic debt markets in developing countries.

In 1993/94, on the eve of the Mexican peso crisis, the *external* public debt of developing countries averaged 33 percent of their GDP, while their *domestic* public debt averaged about 19 percent. By 2002/03, external public sector debt had declined to 26 percent of developing countries' GDP, but the domestic public debt burden had risen to 34 percent. Thus the total public sector debt burden of developing countries rose from 52 percent to 60 percent during this period. The implications of increased domestic debt are explored in greater detail later in the chapter.

An improved policy environment

Policies and performance in developing countries have helped bring about the observed improvement in indebtedness. Since the late 1990s, GNI in developing countries has grown three times faster than external debt. Many countries, especially those touched by recent crises, have adopted more market-oriented financial policies and increased their openness to international trade and investment. Fiscal policies have been more prudent, although concerns persist about the sustainability of public debt in several countries. Inflation has fallen, and many developing countries are showing strong growth in productivity. The spread of flexible exchange-rate systems has reduced the likelihood that an exchange-rate crisis will become a debt crisis and raised awareness of the risks inherent in currency mismatches. Since 1996, 19 developing countries have shifted to floating exchange-rate regimes.

In the Asian countries at the epicenter of the crisis in the late 1990s, initiatives to strengthen corporate and financial sectors have produced impressive gains. Considerable corporate restructuring has taken place, albeit at varying degrees (Kawai, Lieberman, and Mako 2000; Binamira and Haworth 2000). In four key countries (Indonesia, Malaysia, Philippines, Thailand), measures of profitability (income/sales ratios and return on assets) were up in almost all cases between 1998–2003, and measures of vulnerability to external pressures (interest/sales ratios, capital adequacy ratios) have strongly improved (table 4.2).

More broadly, stronger domestic environments and lowered susceptibility to shocks have impressed investors and raised credit ratings throughout the developing world (figure 4.4).

A more accommodating and discerning financing environment

Changes in the international financing environment have benefited emerging-market economies that have made improvements in their domestic macro policy. International capital markets today are more attuned to and more discriminating about development finance than in the past. This in turn imposes a degree of discipline on borrowing through greater transparency, a more substantial flow of information, increased market research, and finer distinctions in credit risk (World Bank 2004).

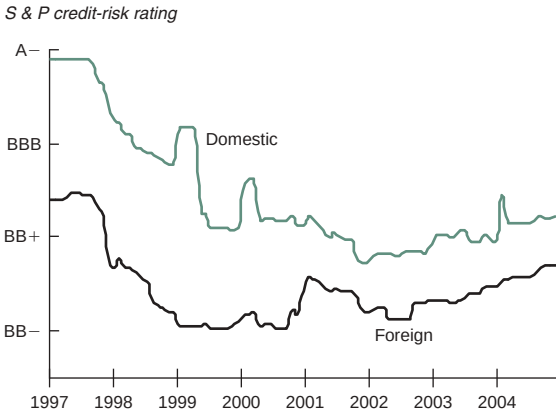
Table 4.2 Corporate and financial sector comparison for Asian crisis countries, 1998 and 2003

Percent

	Indonesia		Malaysia		Philippines		Thailand	
	1998	2003	1998	2003	1998	2003	1998	2003
Corporate sector								
Ordinary income to sales	−12.0	8.0	3.0	7.0	−0.5	4.0	7.5	11.0
Interest expense to sales	13.0	3.0	4.5	1.7	7.8	3.0	8.2	1.0
Financial sector								
Commercial banks' return on assets	0.6	2.7	1.8	1.6	0.4	1.2	−0.2	1.5
Capital adequacy ratio	2.3	22.0	11.0	13.0	15.2	17.5	11.0	11.2

Source: World Bank.

Figure 4.4 Credit quality of emerging markets, 1997–2004



Note: The credit quality calculations are based on weighted averages of long-term foreign and local-currency credit-risk ratings of countries rated by Standard and Poor's. The weights applied are the total outstanding foreign-currency debt as reported in World Bank (2004).
Sources: Standard and Poor's; World Bank staff calculations.

Overall, these developments have reduced the incidences of contagion and systemic risk in market-based emerging-market finance. Nearly 60 developing countries now carry formal credit-risk ratings, almost four times the number in the mid-1990s. And as international banks have aligned their assets and liabilities more consistently, local-currency bank lending to developing countries grew to 40 percent of all bank lending in 2003, compared with 15 percent in 1995. The switch from cross-border (or international) to local-currency lending by banks permits better risk management and thus greater stability. At the same time, the base of investors interested in the developing countries has changed—in particular, the share of speculative capital has declined relative to the mid-to-late-1990s, which helps dampen excessive and potentially crippling volatility in capital flows (World Bank 2003).

A strengthened international framework

The international financial architecture, which aims to prevent sovereign debt defaults and facilitate orderly debt restructuring, has been strengthened in significant ways (Frankel and Roubini 2003) though the work is by no means complete (Peterson, Goldstein, and Hills 2004). Collective action clauses (CACs) have been introduced in bond-financing transactions, and discussions over a code

of conduct continue. The Capital Adequacy Accord (Basel II) offers the potential to strengthen the banking sector and enhance the ability of banks to take on and sustain riskier lending, through measures to mitigate and manage risk. Joint efforts on statistics and monitoring supported by the World Bank, the Organisation for Economic Co-operation and Development (OECD), the International Monetary Fund (IMF), and the Bank for International Settlements (BIS) are improving the quality and quantity of information available for assessing risk and managing approaching crises.

Despite these improvements, additional progress is needed. While CACs have emerged as the main vehicle for facilitating debt restructuring, they apply only to bond debt and even there the impact is limited. CACs have not been universally adopted in new developing-country bond issues, and they are absent from most bond debt issued before 2002. Thus debt restructuring remains a laborious and time-consuming process. For example, resolution of Argentina's default on its public sector debt, worth $102.5 billion, took more than three years. The government and creditors differed over the degree of reduction in the nominal value of debt, the treatment of past-due interest, and the capacity of the government to pay.

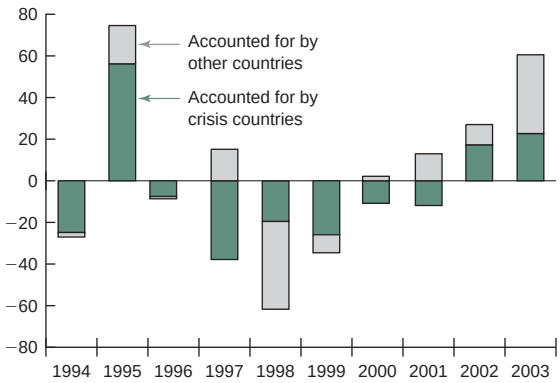
External debt trends in emerging markets

External debt burdens played a key role in precipitating the financial crises centered in emerging-market economies during the 1990s. As the current global growth cycle slows, and interest rates rise, it is worth considering how emerging-market economies' external debt burdens have evolved and how resilient their debt situation might be to changing external conditions.

Recent debt crises were concentrated in just a few countries, but the resulting tremors shaped the evolution of development finance—and continue to do so. In the mid-1990s, contagion from localized financial and economic pressures often led to broad market closures for developing countries. Even the level of official financing available to the developing world was affected, as financial rescue packages diverted resources from other countries. Since then, changes in net private debt flows for these countries have been the main drivers of private debt flows to all developing countries (figure 4.5).

Figure 4.5 Change in net private debt flows (long-term plus short-term) of crisis countries and others, 1994–2003

$ billions, year/ year



Sources: World Bank Debtor Reporting System and staff calculations.

Nine countries that have absorbed the bulk of market-based financing since the 1990s—Argentina, Brazil, Indonesia, Malaysia, Mexico, Philippines, the Russian Federation, Thailand, and Turkey—were also at the center of the crises of the 1990s. These countries still have the potential to trigger systemic crises in market-sourced development finance, not only as bellwethers, but also because together they account for almost 70 percent of all developing-country debt tradable in the secondary market and half of all privately sourced debt (in 2002).

Aside from their status as market leaders, the countries that have developed and exploited their access to capital markets are a diverse group. Countries such as Argentina, Brazil, and República Bolivariana de Venezuela have long struggled with high debt burdens in one form or another. After borrowing extensively from international banks during the 1970s, their bank debt was restructured in the 1980s, giving rise to the phenomenon of Brady bonds. The emerging-market economies of East Asia, by contrast, obtained greater access to capital markets as they matured. Until the early 1990s, the external debt burden of East Asia as a whole (in relation to GNI) was half of that for Latin America. A third group comprises relatively modest borrowers. Some, mostly high risk, have long maintained limited access to syndicated or structured bank credit, while others (for example, Estonia, Guatemala, Jamaica, and Lithuania),

Box 4.1 Currency valuation effects have significant impacts

Cross-currency valuation effects arising from movements in the value of the dollar against other world currencies, as well as debt forgiveness or reduction, have affected the value of developing-country debt from year to year (table).[a] For example, in 2002, the magnitude of the exchange-rate valuation effect for all developing countries ($71 billion) was almost equal to the nominal change in their total debt stock ($76 billion).

With almost 40 percent of developing-country debt denominated in nondollar currencies, cross-currency valuation can be significant. Regional variations exist as well—in Latin America and the Caribbean, only 25 percent of external debt is denominated in currencies other than the dollar, while in Middle East and North Africa, nondollar currencies account for 55 percent of outstanding debt. Cross-currency valuation effects have been particularly prominent since the late 1990s.

These revaluation effects are one way in which developing countries are exposed to the international financing environment (chapter 3). At times, currency effects dwarf actual changes in net cross-border debt flows. In Argentina, Indonesia, and Morocco, for example, unfavorable currency valuations neutralized the decline in their total outstanding debt in 2002 (figure). In Argentina, repayments and debt restructuring led to a decline in outstanding debt of $5.4 billion in 2002, while cross-currency valuations raised the price of that debt by almost $7 billion. In Brazil, debt repayments amounted to $1.4 billion in 2002, but cross-currency valuations added $4.2 billion to the outstanding debt burden.

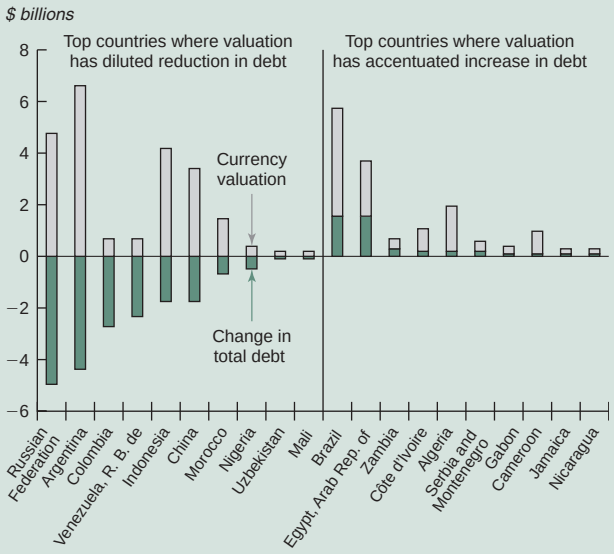
Composition of change in external debt in developing countries, 2000–3

$ billions	2000	2001	2002	2003
Change in total debt stock	−64	−22	76	219
Net flows on debt	−6	−4	7	62
Cross-currency valuation	−53	−41	71	87
Debt forgiveness or reduction	−26	−7	−7	−3
Net change in interest arrears	−7	3	1	11
Interest capitalized	14	1	4	1
Residual	14	26	0	61

a. Countries contract debt in various currencies. The debt data that countries report to the World Bank's Debtor Reporting System is expressed in the currencies in which the original debt was contracted or in currencies in which it is repayable. For purposes of standardization and aggregation, the DRS converts these amounts into dollar values. The exchange rates used are generally the par values or central rates specified by the International Monetary Fund or market rates when necessary. Exchange rates in effect at the end of any given year are used to convert the stock of debt outstanding for that year in various currencies into the nominal dollar value.

Source: World Bank Debtor Reporting System.

Magnitude of change in debt and currency valuations as of 2002



Sources: World Bank Debtor Reporting System and staff calculations.

have been able to penetrate the more discerning bond financing segment of the market.

Higher external debt in two-thirds of middle-income countries

The overall reduction in the external debt burden of middle-income countries since the crises of the 1990s masks diversity among individual countries. The aggregate reduction derives from reductions in a few countries—among them China, Mexico, and Thailand (table 4.3)—that together account for only about a third of outstanding developing-country debt. By contrast, in two-thirds of middle-income countries, the debt burden *increased* from 1997 to 2002, with the increase larger than 20 percentage points of GNI for more than one-quarter. Overall, for middle-income economies, the ratio of external debt to GNI remains at levels higher than

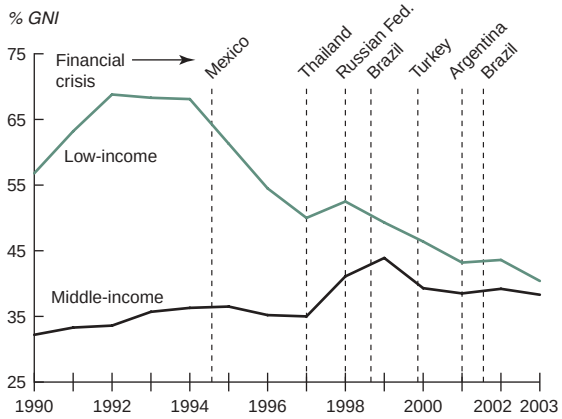
Table 4.3 External indebtedness of top 20 debtors, 1997 and 2003

Total external debt as percentage of GNI

	1997	2003
Brazil	25	50
China	17	14
Russian Federation	32	42
Argentina	45	136
Turkey	44	62
Mexico	38	23
Indonesia	65	68
India	23	19
Poland	27	46
Philippines	59	72
Thailand	75	37
Malaysia	50	50
Hungary	57	58
Chile	37	63
Pakistan	49	51
Czech Republic	42	40
Nigeria	84	70
Venezuela, R. B. de	41	42
Colombia	31	44
Egypt, Arab Rep. of	39	38

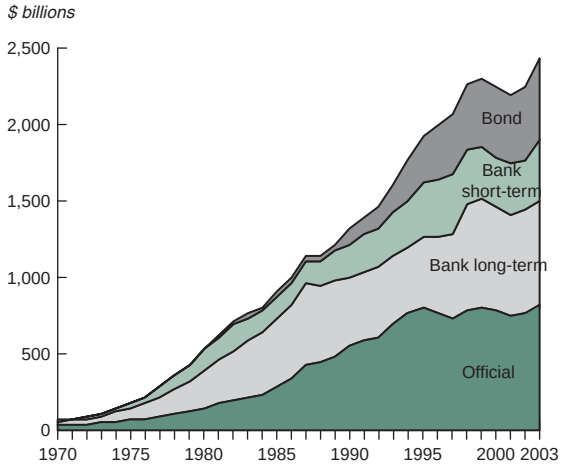
Note: Countries are ranked according to the nominal value of their total external debt stock as of 2003.
Source: World Bank Debtor Reporting System.

Figure 4.6 Total external debt of developing countries, 1990–2003



Sources: World Bank Debtor Reporting System and staff calculations.

Figure 4.7 Composition of outstanding external debt of developing countries, 1970–2003



Source: World Bank Debtor Reporting System.

those seen in the early 1990s (figure 4.6). The big increase in the debt-GNI ratio occurred in 1997–99, rising by nearly 8 percentage points (from 35 to 43 percent) with the combination of the Asian, Russian, and Brazilian crises.

Among the emerging-market economies in which external debt has risen, in some cases sharply, are Argentina, Brazil, Indonesia, Philippines, Poland, the Russian Federation, South Africa, and Turkey, several of which have had persistent debt problems. For this group, the ratio of external debt to GNI climbed on average by 21 percent between 1997 and 2002, while the ratio of debt to exports of goods and services also rose by 28 percentage points (to 181 percent in 2002).

In many cases, increased external debt has been accompanied by rising domestic debt, as we shall see.

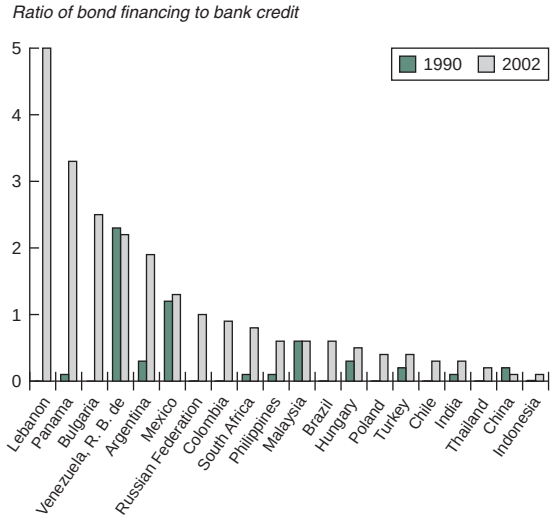
New vulnerabilities created by market changes

Developing-country debt crises became more market-driven in the 1990s. Bond debt and short-term bank credit, both of which are strongly affected by short-run developments in the external financing environment, now make up a much larger share of developing countries' external debt than at any point in the past three decades.[4] By the end of 2003, bond and short-term bank debts together accounted for 45 percent of the outstanding external debt of developing countries, compared with 29 percent in 1990, and an average of 24 percent during 1970–89 (figure 4.7, box 4.2). Particularly noteworthy has been the growth in bond debt, which mushroomed to 27 percent of the total outstanding debt in 2003, up from only 4 percent at the start of the 1990s. All of the countries that have faced debt pressures or crises since the 1990s vigorously substituted bond financing for bank credit during 1990–2002 (figure 4.8).

Box 4.2 The role of short-term bank credit in trade financing

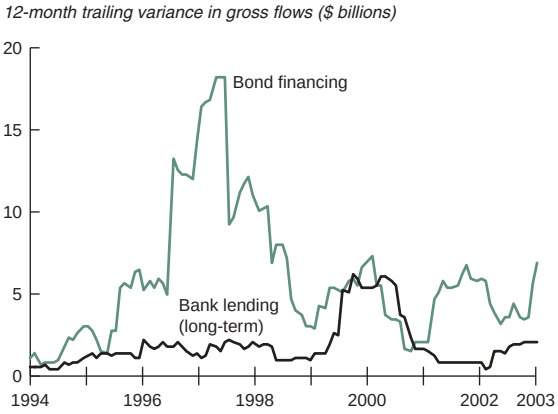
Trade financing plays a crucial role in facilitating international trade for developing countries. For many developing countries lacking access to capital markets, short-term bank credit is the primary source of market-based finance for facilitating cross-border movement of goods. Availability of long-term credit for this set of countries is severely restrained due to their credit risk (or its perception) and their minuscule share of international trade. This can lead to a build-up of primarily short-term debt for a country, which may be necessary for mobilizing trade. Short-term trade financing via commercial banks has reached developing countries owing to the mitigation of risk for creditors under security arrangements provided by the traded goods. Such financing is even more widely spread than general bank lending, which unlike other forms of market-based debt financing is relatively more easily accessible by developing countries. As shown in *Global Development Finance* 2004, the share of trade financing in total bank lending commitments has been higher for non-investment grade and unrated developing countries than for investment grade rated countries. Thus, along with possible vulnerabilities, the merits of short-term bank lending should also be acknowledged.

Figure 4.8 Substitution of bond financing for bank credit, 1990–2002



Note: Refers to countries that account for 90 percent of the bond debt outstanding as of 2002.
Sources: World Bank Debtor Reporting System and staff calculations.

Figure 4.9 Volatility in acquisition of new debt, 1994–2003



Sources: Dealogic; World Bank staff calculations.

Bond financing is more susceptible to pricing conditions (for new debt) and to risk perceptions in international capital markets than is long-term bank lending, where information asymmetry can be at least partly dealt with through syndication with local banks (Esty and Megginson 2003; Nini 2004).[5] New bond financing levels have fluctuated widely since 1994, often declining sharply in response to localized market seizures or voluntary postponement of issues to avoid a turbulent market environment, and sometimes spiking with short-run market euphoria (figure 4.9).

Volatility in new bond financing was high during the mid to late-1990s, largely because investors and borrowers were highly concentrated. At the same time, unfamiliarity with the market on both sides made bond financing vulnerable to systemic risk and contagion. Volatility has subsided since 2000, with a widening of the investor base, finer distinctions among credit risks, increased prudence in borrowing and expanded efforts by both the public and private sector to promote a new financial architecture.

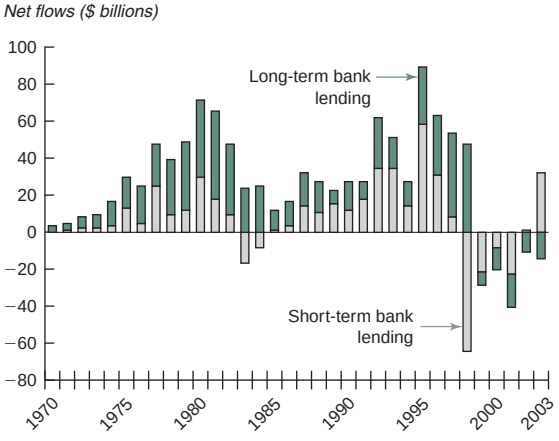
Short-term bank credit, the other segment of debt financing that can be highly sensitive to short-run market developments, has been motivated by the desire of international banks to limit

their medium-term exposure to developing countries (and by the growth in financing for international trade transactions). But such adjustments can accentuate a crisis. For example, banks may cut back on credit to a country facing tight credit conditions in other segments of the capital market to cover possible losses arising from that country's inability to service its overall debt. In fact, most fluctuations in bank lending to developing countries have been driven by sharp fluctuations in short-term lending (figure 4.10).

The increased external indebtedness of the private sector also has shaped the nature of financial crises in recent years. Although crises and episodes of contagion have been linked to countries' *overall* debt burdens and their sustainability, the level of private sector debt clearly matters. Investors perceive that sovereign and public sector debt are backed by a greater capacity to service obligations than is private debt. Thus, a larger private share in a country's external debt increases investors' *perceptions* of risk. This is true even if corporate sector vulnerability, as measured against private sector income and assets, shows improvement, as in East Asia, where most corporate debt-equity ratios have fallen in the period since the crisis.

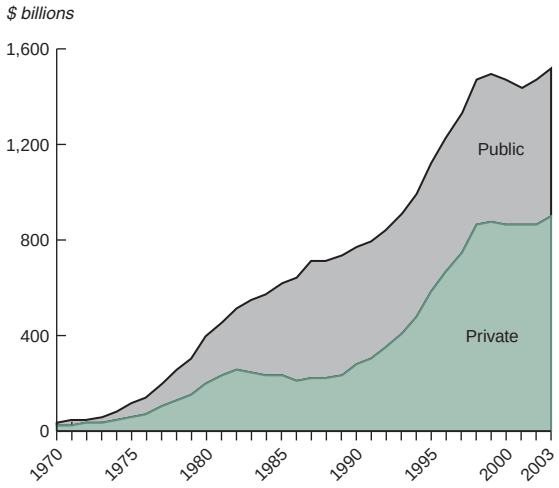
At the end of 2003, the private sector accounted for about 60 percent of all market-sourced debt outstanding, compared with 33 percent at the beginning of 1990 (figure 4.11). The current composition is similar to that of the 1970s, when the private sector accounted for about 57 percent of the total. The difference is that in the 1970s almost all market-sourced debt was in the form of bank loans, rather than bonds.

Figure 4.10 Bank credit to developing countries, 1970–2003



Source: World Bank Debtor Reporting System.

Figure 4.11 Composition of outstanding market-sourced debt in the developing world, 1970–2003



Source: World Bank Debtor Reporting System.

The private sector accounts for a rising share of both bond and bank financing. As access to international bond markets widened in the 1990s, the private sector's share in outstanding bond debt almost tripled—from about 8 percent in the early 1990s to an average of 22 percent since the mid-1990s. In bank lending, the share of the private sector has followed a more cyclical pattern. After averaging 57 percent in the 1970s, that share fell drastically in the 1980s (to 40 percent), as banks retrenched credit during and following the bank debt crisis. Lending was concentrated in the public sector as the banks reengaged with developing countries in the early 1990s. Lending to the private sector did not pick up until the mid-1990s. For the period 1993–2003, the private sector accounted for 70 percent of total outstanding bank debt.

The rise of domestic debt markets

The aggregate external debt burden of developing countries, expressed as a share of GNI or exports, has fallen since the late 1990s. Meanwhile, their domestic debt burden rose—from 19 percent of developing-country GDP in 1993/94 to 34 percent in 2002/03. This rise in domestic debt has thus kept the total public sector debt burden of

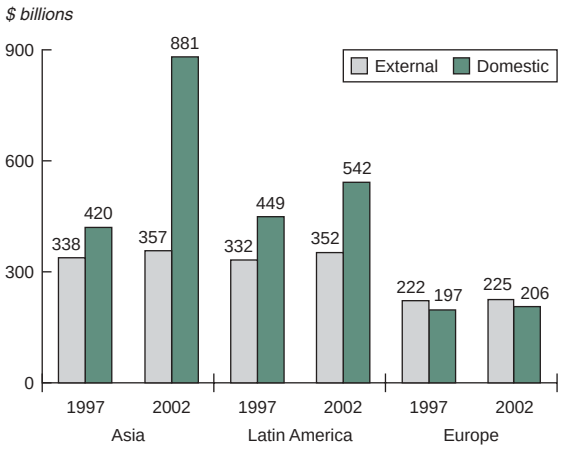
developing countries high, and in some cases has increased it.

The collection and official reporting of domestic debt statistics are subject to considerable lag. But estimates appearing in market sources suggest that the burden of domestic debt for developing countries as a whole continued to rise modestly in 2004. Most of the growth appears to be centered in Europe and Central Asia and in East Asia and the Pacific. In at least some countries, the capacity to service debt has increased with the debt burden.

Many governments, mostly in middle-income countries, have been able to finance their activities by drawing on growing domestic debt markets. The domestic finance pools have been fed by several years of record trade growth in the developing world, and, in many countries, by the liberalization of capital accounts and the adoption of sound macroeconomic, regulatory, and prudential policies that have stanched capital flight and attracted foreign investment in domestic debt markets in developing countries.

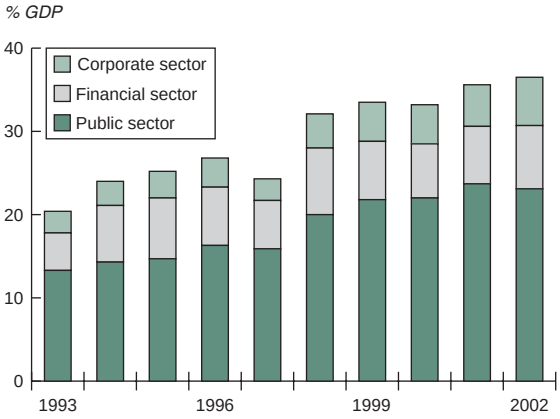
The effect has been a shift in the composition of public sector debt from external to domestic sources, particularly in the emerging-market economies. The magnitude of that shift has varied across regions (figure 4.12), depending on the significance of emerging-market economies in the region, national policies on the use of current account surpluses, and the state of development of national and regional debt markets.

Figure 4.12 Public debt stocks in emerging markets, 1997 and 2002



Note: Data are for 33 major developing countries that account for most developing country debt.
Sources: IMF; World Bank Debtor Reporting System.

Figure 4.13 Stock of outstanding domestic bonds, by sector, 1993–2002



Sources: Bank for International Settlements; IMF.

The stock of local bonds outstanding in developing countries almost doubled between 1993 and 2002—from 20 percent of GDP in 1993 to 37 percent in 2002 (figure 4.13). According to data from the Bank for International Settlements (BIS), the stock of domestic debt securities in 20 major developing countries continued to grow in 2003/04—at an average rate of 28 percent. Most of the growth reflects issues of securities by public sector borrowers, from an average of about 14 percent of GDP during 1993/94 to about 24 percent of GDP by 2001/02. During the same period, corporate bond issuance rose from about 3 percent to about 6 percent of GDP. The more measured growth in the corporate sector bond market partly reflects sequencing in market development.

The appearance and deepening of domestic bond markets in emerging-market economies has been among the most significant of the factors behind the growth in developing countries' domestic debt. Development of local bond markets reduces exposure to foreign currency–denominated debt and other pitfalls of the international financing environment (Jiang and McCauley 2004; Deutsche Bank 2003; Reserve Bank of Australia 2003). Local bond markets also offer governments an effective tool for conducting and managing domestic monetary policy (World Bank and IMF 2001) because issuing bonds can reduce the government's need to finance deficits by monetary means. A liquid bond market also can be used as a tool to target inflation, manage shocks, and help guide consumption and investment cycles. But the

Box 4.3 Foreign investment in developing countries' domestic debt markets

Where sound macroeconomic and financial policies are in place, foreign investment can catalyze the development of domestic debt markets, strengthening their key role in the national financial sector. Foreign investment can increase the depth, breadth, and liquidity of domestic markets, while enhancing their efficiency through the development of financial instruments, the diversification of portfolios, the encouragement of competition among local market intermediaries, and the promotion of international standards. In return, international investors can diversify their financing sources, increase yields, and establish strategic presence in local markets.

Strategic presence may become more important over time from the perspective of both borrowers and investors, as yield differentials between developing countries and industrial countries narrow. The differential shrank from about 7 percent in the mid-1990s to 4 percent by 2004. International liquidity played a role in reducing the gap, but better economic policies in developing countries, as reflected in improved domestic risk ratings, were important as well.

International financial institutions (IFIs), including the World Bank, have contributed to the development of domestic debt markets through their borrowing practices. IFI bonds denominated in developing-country currencies have helped decouple credit risk from currency risk, as these institutions command a solid presence in international bond markets. The decoupling imparts confidence to foreign investors, charting new territories of investment, while also providing creditworthy, liquid, and diverse investments to domestic investors.

The debt markets of developing countries are the new frontier for foreign investment. The trend started in the early 1990s with markets in the Czech Republic, Hungary, Poland, and the Slovak Republic. IFIs were the first foreign issuers of bonds in the Hungarian forint, whereas foreign corporations led with issues in other countries' currencies. In Asia, after the opening of markets in the Republic of Korea and the Philippines, the process stalled with the advent of the financial crisis of 1997/98. Since then IFIs have issued bonds in the Indian rupee market, and China, Malaysia, and Thailand have expressed interest in opening their markets to foreigners, especially IFIs. In Latin America, the growth of institutional funds, notably through the pension system, has encouraged the issuance of foreign bonds in domestic currencies. IFI bonds in Colombian pesos, Mexican pesos, and Peruvian soles have been eagerly subscribed to by local institutional investors.

Despite the growth in developing countries' domestic debt markets, and in international bonds denominated in developing country currencies, the share of foreign investors in domestic markets remains small and spotty. Nonetheless, given the improvements in settlement, clearing, and custodial services; regulatory frameworks; and investment climates, there is considerable potential for growth in that share.

Source: World Bank 2005.

benefits of domestic bond markets extend more broadly to the domestic financial system. Bond markets can complement structured financing and stimulate healthy competition, not just in terms of market intermediation, but in financial products as well. In addition, the infrastructure required to build and foster local bond markets, such as clearing and settlement systems and regulatory and legal frameworks, contribute to the overall soundness of the domestic financial system. Domestic debt markets also have become an increasingly attractive destination for foreign investors, with international financial institutions playing an important catalytic role (box 4.3).

Bond markets tend to bring increases in domestic public debt because, in their nascent stages, they almost always require support from public sector institutions. Short-term government securities trading at objective market-clearing prices become the foundation for larger and more diverse issues. Thus government debt provides the essential liquidity and pricing benchmark necessary for other forms of domestic bonds to take root.[6]

The switch to domestic debt—deliberate in Asia, less so elsewhere

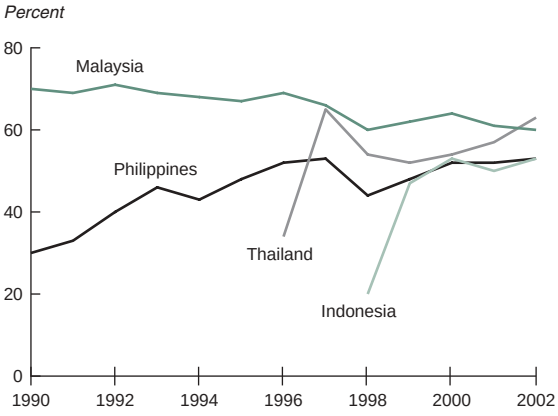
The switch from external to domestic debt in Asia was deliberate and pronounced following the market-enforced retrenchment of credit during the crisis of 1997/98. As of 2002, Asia accounted for half of all domestic debt in the developing world. The region's share continued to increase, marginally, in 2003/04, according to recent market estimates. The ratio of domestic to external debt for

the region increased from close to parity in 1997 to almost three to one by 2002, reflecting an annual growth in domestic debt of about 20 percent.

As the region's domestic debt stock soared, external debt fell by $25 billion, with net external debt flows reversing from an average inflow of $50 billion during 1995–97 annually to an outflow of $21 billion annually in 1998–2000. Since then outflows of external debt continued, arrested by modest net inflows in 2003. Since the 1997/98 crisis, the region has not only reduced its external debt, but also has accumulated substantial international reserves as a buffer against external shocks. Reserves in Asia nearly tripled to almost $760 billion in 2004 from $247 billion in 1998.

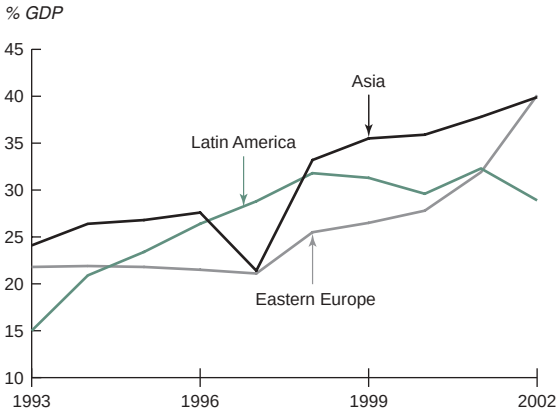
The buildup of domestic debt in crisis-affected countries began with the forced adjustment to the shocks of 1997/98 (including costly bailouts), but it has not slowed with the passing of the crisis, evolving instead into an explicit tool of debt management. Indonesia provides a good example of the managed rebalancing of public sector debt. Since the contagion-induced crisis in 1998, the country's domestic debt, almost nonexistent before the crisis, has averaged 42 percent of GDP, while the external portion of public sector debt has declined from 70 percent to 40 percent over the same period (figure 4.14). In Malaysia and the Philippines, the public sector relied on domestic debt throughout the 1990s; crisis-related costs associated with contingent liabilities and losses on assets due to exchange-rate movements, added to the burden. In Malaysia, such costs have even offset the benefits of a sizeable primary surplus. In India, domestic debt has been the primary source of financing for the government's deficit since the 1980s. The relatively high level of the domestic debt burden (about 75 percent of GDP) raises questions about its impact on the economy and domestic financial markets, as well as about its sustainability.

Figure 4.14 Share of domestic debt in total public debt in selected Asian countries, 1990–2003



Sources: IMF; World Bank Debtor Reporting System.

Figure 4.15 Stock of domestic bonds outstanding in emerging markets, by region, 1993–2002



Sources: BIS and IMF data as presented in World Bank/IMF/Brookings Institution 2003.

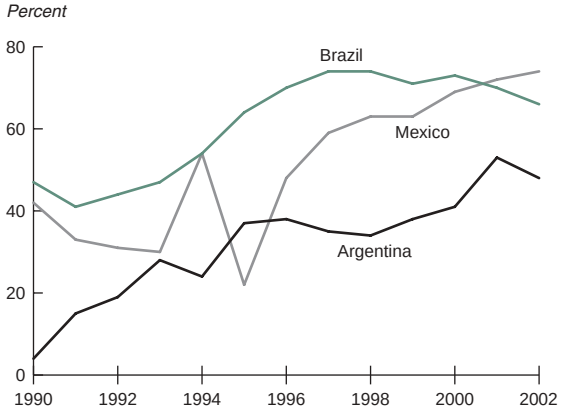
Asia also led developing-world regions in growth of outstanding domestic bonds (figure 4.15), in great part due to the fallout from the financial crisis of the late 1990s. Asia's stock of public sector bonds jumped from 7 percent of GDP in 1997 to 15 percent in 1999, reaching almost 19 percent by 2002 (IMF 2004). Meanwhile, corporate sector bonds jumped from 5 percent to 9 percent between 1997 and 1999, and then edged up further to 10 percent by 2002. Judging from trends in outstanding debt securities drawn from BIS data, bond stocks (public plus corporate) may have risen to 32 percent of GDP in 2003. In Asia, corporate sector bonds constitute a much a larger share of the domestic bond market than in other emerging-market regions, where local bond markets are still dominated by public sector securities. Since the Asian economic crisis, however, government bond issuance has grown significantly in a few countries, such as Malaysia and Thailand, where government issues have not only served as a vehicle for government financing, but also have developed into benchmarks for pricing corporate bonds.

In Latin America, where external debt financing has declined since 1999, the offsetting substitution of domestic debt has been less pronounced than in Asia—the ratio of domestic to external debt in the region rose only modestly from 1.35 in 1997 to 1.54 in 2002. Three-quarters of the region's domestic debt is concentrated in Brazil and Mexico. But the factors underlying the buildup in domestic debt differ in the two countries.

Mexico's reliance on domestic funding of government debt increased after the financial crisis of 1994, with the role of domestic debt growing steadily from 30 percent of total public debt in 1993 to 75 percent in 2002 (figure 4.16). During that period, stability-enhancing fiscal and monetary policies enabled the government to build credibility, reduce borrowing costs, and extend the maturity of its debt by almost ten times since 1995, to an average of 10 years. Low short-term interest rates, reflecting low inflationary measures, have enabled the government to continue relying on the domestic debt market. The stock of domestic government securities rose by some 10 percent in 2003/04.

The switch from external to domestic sources of debt in Brazil (and Argentina) has been less marked than in Mexico, and propelled more by economic and financial pressures than by deliberate strategy (Budina and Fiess 2004). Nevertheless, at 47 percent of GDP in 2002 (down from 61 percent in 2001), the domestic bond market in Brazil is among the largest in the region. Brazil's experience illustrates one of the pitfalls of reliance on domestic debt: The high costs of rolling over domestically sourced public debt continue to add to the debt burden of the Brazilian government, even as maturities have tripled to about three years since the rampant inflation of the late 1990s was tamed. Primary surpluses over the past few years, up to and including 2004, combined with reforms of pension systems, should add to the government's debt-servicing capacity. In Argentina the forced exchange of dollar assets into peso assets had the same effect.

Figure 4.16 Share of domestic debt in total public debt in selected Latin American countries, 1990–2003



Sources: IMF; World Bank Debtor Reporting System.

Poland and Turkey accounted for some 70 percent of total domestic debt in the Europe and Central Asia region in 2002. In the region as a whole, domestic debt grew at an annual average rate of just 5 percent from 1995 to 2002, but in Poland it jumped to 31 percent of GDP in 2002, after hovering around 21 percent during the mid- to late-1990s. It is estimated by market sources to have jumped to 35 percent in 2004, as the stock of domestic government securities rose to 24 billion between 2002 and 2004. High interest rates and loose fiscal policy, coupled with slow economic growth, have been the main reasons for debt accumulation. The rise in Turkey's domestic debt since 1999 was due to the combination of a high fiscal deficit (resulting in high domestic interest rates) and the costs of supporting the banking system during the exchange-rate and banking crisis of 2000/01. The burden of domestic debt declined noticeably in 2002/03, aided by primary surpluses and economic growth.

The other major debtor in the region is the Russian Federation. There, domestic debt fell substantially from 27 percent of GDP in 1998 to only 8 percent in 2002, as strong economic growth and currency appreciation helped reduce the public sector's financing demands. In countries preparing for entry into the European Union (Bulgaria, Croatia, and Hungary), EU accession policies have helped limit increases in domestic debt.

The development of local bond markets in Europe and Central Asia followed the establishment of the fundamentals required for a diverse and deep market and for the management of public sector debt. In Hungary, for example, efforts have focused on shifting from external to domestic sources of finance. As the country's external public sector debt declined from 54 percent of GDP in 1994/95 to 21 percent in 2002, the government's

issuance of local bonds increased from 27 percent of GDP to 46 percent. In the Czech Republic and Poland, the objective has been to finance government deficits and to reduce the rollover risk of debt. Trends in the Middle East and North Africa and Sub-Saharan Africa have varied.[7]

Domestic debt markets and the private sector: uncharted waters

The financial health of a country's corporate sector helps determine how an economy stands up to financial and economic pressures. During the Asian crisis, highly leveraged and nonperforming loans, contingent liabilities, and unhedged positions, accompanied by a cyclical deterioration in investment returns, worsened the crisis by adding to the liabilities of the public sector. (See World Bank 1998 for a detailed discussion.)

Although individual country cases differ and systematic data on private sector borrowing are lacking, high levels of domestic credit in the private sector have preceded many financial crises, as in Chile, Indonesia (Caprio and Klingebiel 1996), and Mexico. And a general linkage seems to exist between financial sector liberalization, credit booms, and banking crises (Demirguc-Kunt and Detragiache 1998). Often credit booms occur during buoyant economic times when domestic savings and private capital flows are strong. At such times, inflated asset values convey a false sense of corporate net worth (Gavin and Hausmann 1996). Abundant liquidity can encourage corporations to substitute high levels of debt for equity, leaving them—and governments—vulnerable to both domestic and external shocks. At the time of the Asian crisis, debt exceeded equity in the most-affected countries by two or three times.

In addition to overborrowing, derivative-type transactions by financial corporations can create contingent liabilities. The direct and indirect hazards of such exposures were clear in Thailand during the crisis of 1997/98, when the foreign currency exposure of corporations accelerated the decline of the Thai currency (IMF 1998).

Balancing external and domestically financed debt

The shift in the balance of external and domestic debt has transformed rather than eliminated the risks and challenges posed by debt. The advent of domestic debt brings into play an array of issues—management capacity, economic policy, financial infrastructure, regulation, and technical coordination—that previously had been in the background. External and domestic financing practices influence each other, and both are affected by the overall policy environment of individual countries. To understand those influences, one must consider:

- The policy environment
- The regulatory environment
- The interplay between the external and domestic debt
- The role of credit assessment
- The role of information.

The policy environment

Sound and credible economic, fiscal, and monetary policies are at the heart of debt sustainability and creditworthiness, whether debt is contracted in international or domestic markets. In their absence, efforts to mobilize domestic finance are unlikely to bear fruit. The public sector's fiscal position must rest on efficient revenue collection and well-aligned spending plans that factor in contingent liabilities. In addition to raising revenue, of course, tax policy can and should encourage the development of the domestic debt market.

The confidence of domestic and foreign investors alike is enhanced when monetary policy is pursued independently of public financing constraints. In particular, inflationary pressures (and expectations) should be carefully managed, as they can affect (through their effect on interest rates) the cost of borrowing to finance domestic debt—and thereby on the credibility and sustainability of the domestic borrowing program. Pressures on the exchange rate also have to be managed effectively, through economic policies that maintain the overall balance between the external and domestic sectors. For example, deterioration in a country's external position can affect credit-risk perceptions.

Once the basic foundation for the domestic debt market has been laid, other issues come into play—chief among them coordinating debt management with monetary policy, managing the implications of debt servicing on the budget, and controlling contingent liabilities (Currie, Dethier, and Togo 2003). Debt-management objectives must be chosen with an eye to cost effectiveness, sustainability, and resistance to shocks.

In the early stages of domestic debt market development, a significant portion of the debt carries a relatively shorter maturity than does external debt. Sound policies enable a government to build credibility, which helps it lengthen the borrowing tenure and minimize the frequency of risky and time-consuming rollovers of domestic debt.

The regulatory environment

A strong institutional framework is needed to manage the nation's financial infrastructure. Smooth operation of debt markets, in particular, depends on settlement, trading, and custodial services. More generally, the framework should foster transparency and availability of information to enable market participants to make fair and efficient decisions and to minimize systemic risk in the domestic financial environment. The institutional setup should include cross-checks between the agencies that deal with domestic debt. Interactions between the government and investors to match investment needs with borrowing objectives are an integral part of a public sector funding strategy.

Another challenge is to establish an effective regulatory and legal environment that underpins, as well as fosters, the smooth operation of the overall financial infrastructure. Laws and regulations should aim to balance functionality, safeguards, and practicality, while encouraging adequate mobilization of capital and the development of local debt markets. The authority, scope, and statutes of public borrowing need to be clearly defined and enforced through the legal framework (Prasad et al. 2004).

Good regulatory regimes instill confidence in investors; bad regimes shatter confidence, especially among domestic investors, who are less likely than external investors to have a widely diversified portfolio. Lack of diversity in domestic investment portfolios (along with restrictions on international diversification) may accentuate, or prolong, a distorted debt financing environment.

Governments should try to enlarge and diversify the investor base to ensure liquidity, and to spread the financing burden over different segments of the economy. An added dimension concerns foreign investments in domestic debt markets, which, despite the perils, also play an important role in enhancing the breadth, depth, and efficiency of domestic debt markets. Domestic exchange-rate and capital account policies are not only important in attracting foreign capital, but also in maintaining the stability of such flows.

Among the technical issues to be addressed in developing a domestic debt market are the methods and financial instruments used in public sector borrowing, the optimal sequence of development of various segments of local bond markets, coordination between primary and secondary markets for debt, adherence to market-clearing interest rates in financing budget gaps, and acceptable trading practices.

A major concern associated with high levels of public debt is the tendency of that debt to exert upward pressure on domestic interest rates and crowd out private investment. The boost to liquidity provided by the supply of government securities, however, may exert a countervailing effect.

The interplay between external and domestic debt

The tilt in the composition of debt from external to domestic sources has several advantages for borrowers, as long as fiscal and economic policies remain prudent. Reduced reliance on external debt, primarily debt denominated in foreign currency, lowers vulnerability to seizures in market-based financing and exchange-rate shocks, which can exacerbate debt and its servicing burden. The movement out of external debt has improved risk perceptions in the minds of external investors and credit raters, which must gauge the ability of countries to service external liabilities. Thus lower external debt improves the terms on which foreign-source capital may be obtained and reduces the overall vulnerability of developing countries to shocks from the external financing environment.

But risks accompany the benefits of greater reliance on domestic debt. High public sector debt burdens in individual countries have at times led to crises. Increased reliance on domestic debt raises debt rollover risks (because it is generally shorter in maturity than external debt), as well as interest-rate risks. Both may be affected by a variety of macroeconomic and debt management policies. For that reason, sustainability and management of debt and fiscal balances must remain at the forefront of national policy dialogue.

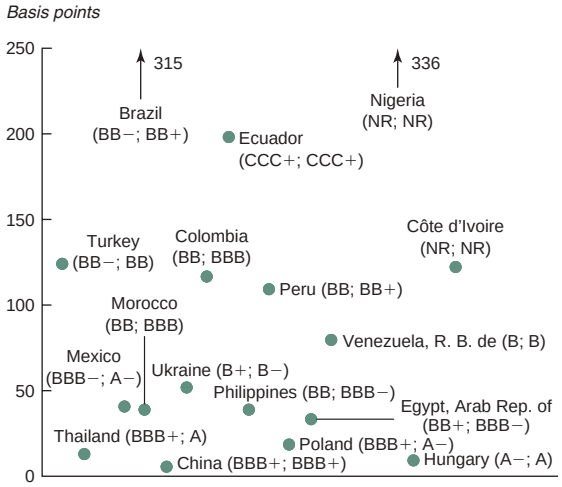
The external and domestic financing environments respond to many of the same influences. With significant capital account liberalization in

many countries, shocks from the external environment can easily spill over to domestic credit markets. Similarly, a loss of confidence in a country's policies among international investors, who may have direct exposure to credit risk in domestic debt markets, will raise pressure on domestic interest rates and affect the maturity structure of domestic debt.

In managing the overall shift in sources of finance, countries need to be aware of the possible deterioration in credit supply conditions. Of particular note is the pricing of debt, which reflects—among other things—the capital markets' perception of the probability of default (Merrick 2004; Ferrucci et al. 2004; Kamin 1999; and Min et al. 2003). Most pricing indicators, including the commonly used benchmark secondary-market spread, reflect not only country fundamentals but also the broader supply and demand for capital in financial markets. From 2002 onward, investor sentiment toward emerging markets has improved considerably, as reflected in historically low secondary market spreads or benchmark risk premiums. Because those spreads relate primarily to the probability of default on external debt, the buildup of reserves (as discussed in chapter 3) and the decline in external debt burdens have supported the improvement in sentiment. Spreads have declined universally across almost all countries where external indebtedness has declined, even as domestic public sector indebtedness has risen substantially for many countries. The betterment of external and domestic credit-risk ratings both reflects and supports that improvement in spreads.

The pricing of *new* debt remains of utmost importance. Swift and abrupt changes in the *external* environment can undermine investor confidence and exert pressure on *domestic* credit conditions and interest rates. Continued tight pricing of new external debt during times of market rally, such as 2003 and 2004, can increase pressures for adjustment of risk premiums, particularly for less creditworthy borrowers (figure 4.17). Thus, countries with lower creditworthiness may be more susceptible to market exuberance and closures and therefore subject to greater volatility in capital flows.

Figure 4.17 Distribution of volatility in risk premium for selected developing countries



Note: Higher volatility, primarily for low creditworthy countries, indicates greater vulnerability to market movements. Ratings are from Standard and Poor's. First rating = external debt; second = domestic debt. Volatility is calculated for periods March and September 2002 and February and May 2004, when spreads adjusted upwards.
Sources: J.P. Morgan Chase; Standard and Poor's; World Bank staff calculations.

Credit assessment

The probability of defaulting on a debt is indicated by long-term credit ratings, which reflect the rating agencies' assessments of a country's overall policies as well as its vulnerability to shocks (box 4.4). The distinction between external versus domestic debt is important, as a government's ability to service the two kinds of obligations varies vastly, especially in emerging-market economies. Servicing foreign-currency obligations requires liquid foreign-currency assets that have to be contracted or earned at international exchange rates. Servicing local-currency debt is directly associated with a government's power to tax, as well as its control over domestic financial systems and policies. Thus, the constraints for servicing foreign currency debt are more restrictive than those for servicing local currency debt.

The stance of institutional investors can greatly affect the availability and cost of capital for developing countries. In compliance with risk-management practices, such investors may be mandated to invest within (or no lower than) a specified class of credit risk, so that improved sovereign credit ratings translate directly into wider access to capital on better terms and thus greater ease in servicing debt. Credit-risk ratings may be employed in portfolio allocation and risk assessment models. They may also be used by banks to satisfy the Basel

Box 4.4 Assessing the risk of external versus domestic debt

Major credit-rating agencies assign risk ratings to governments' foreign (external) debt and their local-currency-denominated (domestic) debt. The factors considered by rating agencies in assigning risk ratings are political risk, income and economic structure of the economy, economic growth prospects, fiscal flexibility, general government debt burden, monetary flexibility, external liquidity, and public versus private sector external debt burden. Although all of the factors are relevant in assessing the probability of default, their relevance varies depending on whether the obligation is in local or foreign currency.

Assessing the probability of default on local-currency debt requires greater emphasis on a government's fiscal and monetary policies, likelihood of revenue generation from the privatization of state-owned enterprises, and other microeconomic reforms that affect a country's ability to service debt. Credit ratings for foreign-currency debt consider similar factors, while also taking into account the structure of the country's foreign obligations, its foreign exchange reserves, and its balance of payments.

regulations on capital adequacy and risk management, both domestically and internationally, thus affecting countries' and firms' ability to obtain financing from banks adhering to those regulations.

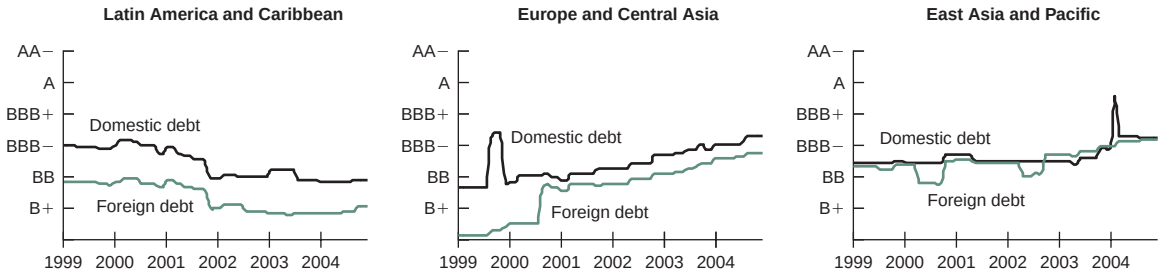
In recent years, credit ratings have improved markedly for many developing countries. Trends in average credit quality vary across regions (figure 4.18). East Asia scores the highest ratings among emerging-market regions and shows the least difference between the probabilities of default on external versus domestic debt. Credit ratings for Eastern European countries have improved continuously since 2001, with 60 percent of the rated countries in the region receiving upgrades. Ratings on domestic debt have remained about one notch higher than on foreign debt. On average, the region maintained a primary fiscal surplus of about 0.9 percent of GDP between 2001 and 2004. Average credit-risk ratings for Latin America, for both foreign and domestic debt, are the lowest among the emerging-market regions. Moreover, foreign debt in the region carries a much higher probability of default than does domestic debt. For example, foreign debt risk ratings for Brazil, Colombia, and Mexico are three notches below domestic debt ratings, even though all three countries were projected to run primary fiscal surpluses in 2004.

Notwithstanding the improvement in aggregate credit quality, various risks remain—among them vulnerability to external conditions that may deteriorate rapidly, leading to a downward spiral of confidence and credit cost, as seen in the late 1990s. Qualitative considerations, such as political uncertainty, may also influence the risk associated with a country's debt and affect the terms for rolling over that debt.

The role of information

Both external and domestic indebtedness require diligent monitoring. In the wake of crises connected

Figure 4.18 Average credit quality, by region, 1999–2004



Source: Standard and Poor's.

with external indebtedness, progress has been made to enhance the reliability, timeliness, and accessibility of information. Gaps remain, however, particularly in the supply of information on domestic debt markets and private sector borrowing, both of which were important in the East Asian crisis of 1997/98. In the absence of full information, public borrowers should acquire new liabilities and manage old ones with a high degree of prudence, while remaining alert for impending changes in financing environments.

Information on domestic debt is much less plentiful and consistent than is information on external debt. For that reason, domestic debt is not well handled by the risk-assessment models used to price new debt. To ensure that accumulations of domestic debt are visible (if they are not, savvy investors will assume the worst), policymakers in the emerging-market economies should enhance their national framework for collecting and reporting statistics on domestic debt.

No room for complacency, despite improvements

The development of domestic debt markets provides important benefits, laying a solid foundation for future growth and offering public borrowers a measure of protection against changes in the external environment. But the perils associated with debt cannot be avoided merely by switching from one type of debt to another. Excessive debt will soon curb growth, regardless of its source. Because a debt crisis driven by excessive domestic borrowing can be just as devastating as one created through excessive external debt, developing countries need to pursue fiscal policies that align liabilities and revenues against the backdrop of structural revenue reforms. They should persevere with policies and reforms that promote economic growth under sustainable levels of debt—domestic and external.

Notes

1. Developing countries are still split into two broad categories by their access to international capital markets and thus by the nature of their debt. The first category is the emerging-market economies—primarily middle-income countries with access to international capital markets. The second is other countries—primarily low-income—that have limited or no access to market-based international finance. This chapter is chiefly concerned with the first group.

2. The World Bank's Debtor Reporting System (DRS) is one of the most comprehensive databases on the external debt of 135 developing countries. The figures on external public sector debt offered in this chapter are drawn directly from the DRS data. The public-private composition of short-term debt is not known, because it is not reported to the DRS by member countries. Principal and interest arrears on official debt, a component of short-term debt, are treated as public sector debt in this chapter. Most of the rest of short-term debt is treated as private sector debt, based on information gathered from market data sources.

3. Estimating developing countries' public sector debt remains a challenging task, and estimates can differ from source to source. Among the major issues are lack of data (many countries have begun only recently to produce comprehensive measures of public debt), data coverage (especially with regard to contingent liabilities), and definitional questions that can vary vastly from country to country.

The International Monetary Fund's *World Economic Outlook* for 2003 estimates the 2002 public sector debt of emerging-market economies at around 70 percent of GDP, an average figure that differs from the one presented here. Several factors may account for the disparity:

- *Country coverage*. This can be a source of major difference. Economies such as those of the Republic of Korea and Taiwan (China), generally regarded as "emerging markets," may form part of dataset used in the IMF report, but they are not classified as "developing countries" by the World Bank. The analysis presented in WEO is based on two sets of data. The first (1990–2002) comprises just 34 countries; the second (1970–2002), 79 countries. It is important to maintain consistency while comparing data across sources.
- *Data sources*. The smaller of the WEO datasets is based on information from IMF staff reports and country economists. The larger dataset is a combination of World Bank data, IMF government finance statistics, and the OECD's analytical database.
- *Definitional issues*. The smaller WEO dataset is based on gross figures, while the World Bank data are for net debt outstanding.
- *Combination of external and domestic public debt*. Because the World Bank's Debtor Reporting System does not collect statistics on domestic debt, the figures on total public sector debt (external plus domestic) presented in this report are derived from several sources: World Bank data (DRS), IMF data, and market sources.

4. The growth in bond debt started with the transformation of distressed bank debt into bonds following the collapse of the bank credit boom of the 1970s, which had been driven by the "recycling" of foreign exchange earned by oil-producing countries following cartel-driven price increases. A simultaneous increase in real interest rates in industrial countries (also driven by high oil prices) and the decline in commodity prices in the 1980s made international bank debt unsustainable for many developing

countries. The defaulted bank debt was converted into Brady bonds, named for U.S. Treasury Secretary Nicholas Brady, beginning in the late 1980s. A beneficial side effect of that innovation was to provide a foundation for modern bond financing in developing countries.

Short-term credit grew during the early 1990s, as bond financing was still developing roots and banks were beginning to reengage with the developing countries following the debt restructuring of the late 1980s. Another boost to short-term lending came in 1995, following the successful resolution of the Mexican peso crisis.

5. Long-term bank credit can be more resilient than bonds during periods of stress for several reasons. Banks possess informational advantages on their borrowers that can be used not only to differentiate credit risk during a period of contagion, but also to exercise greater control over borrowers. And bank debt is easier to restructure than bond financing, for which default may be the only option. Also, banks can spread out risk over a syndicate of lenders and keep credit lines open even in suboptimal circumstances, especially when other segments of capital markets are experiencing stress.

6. Also important for bond-market development is the adoption of flexible exchange rates, which encourage governments to borrow in domestic markets to avoid the possibility of debt increases stemming from depreciation of the currency and may also reduce investors' fear of sharp depreciation of their real asset values (Claessens, Klingebiel, and Schmukler 2003).

7. In the Middle East and North Africa domestic debt rose from 18 percent of GDP in 1995 to 47 percent in 2002. To a great extent the rise is due to Lebanon, whose overall public sector debt, both domestic and external, has increased sharply since the early 1990s to finance the government's spending on infrastructure and other public sector facilities. In comparison, increases in domestic indebtedness have been much less notable in Egypt and Morocco. In Sub-Saharan Africa, domestic debt fell to 27 percent of the region's GDP from 37 percent in 1995, a movement ascribable largely to lower borrowing in South Africa.

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5

Meeting the Financing Needs of Poor Countries

THE WORLD'S POOREST COUNTRIES face severe challenges in their efforts to eradicate extreme poverty and meet basic human needs. Among the challenges is an external financing environment that is susceptible to sudden and sharp shifts.

From the United Nations Millennium Summit in 2000 emerged the Millennium Development Goals (MDGs), which established targets for progress on poverty, education, health, and sanitation. In March 2002, follow-up meetings in Monterrey addressed the challenges of *financing* the development priorities embodied in the MDG targets. Both conferences acknowledged that reaching the agreed goals would require actions by the developing countries themselves—such as pursuing sound domestic policies. But they also recognized the need for substantial *and stable* flows of external resources. Estimates of the additional resources that poor countries would require to reach the MDGs by 2015 vary widely, but all point to a dramatic shortfall unless current trends improve radically.[1]

The external financing environment facing the poor countries is more complex and fluid than generally recognized. In many cases official development assistance (ODA) is still the major external resource; in others, foreign direct investment (FDI) and private debt are also important. Private flows from nongovernmental organizations (NGOs) and migrants (transfers that are included in the current account) are sizeable in some countries. So-called South-South linkages among developing countries—and especially between larger middle-income countries and poor countries—are a growing source of trade, FDI, remittances, and development assistance.

This chapter examines broad changes in the pattern of development finance available to a sample of 28 poor countries (see note to table 5.1),[2] without explicit consideration of whether the available resources will be adequate to achieve the MDGs in individual countries or groups of countries. For a treatment of those issues, see the World Bank's *Global Monitoring Report 2005*.

The key messages of this chapter are:

- Aid flows to poor countries must increase significantly if the MDGs are to be met by 2015. ODA to poor countries has declined steadily over the last decade. Although other sources of finance have grown, the growth is not sufficient to fill the gap in official financing. Donors must scale up ODA and other resources substantially if developing countries are to achieve the MDGs. Current and impending fiscal pressures in donor countries and strategic factors that can influence the allocation of aid should not be allowed to curtail this effort.
- FDI to poor countries has increased significantly since the early 1990s, reflecting improving performance and a sounder investment climate. But much FDI to poor countries flows to enclave mining or natural resource projects, which may limit its benefits and add to volatility. Moreover, current flows fall far short of needs.
- Private transfers are much more important in poor countries than in other developing countries. The private sector component of grants from NGOs (mostly to poor countries) reached $10 billion in 2003, while workers' remittances reached $16 billion. Both are

Table 5.1 Net capital flows to poor countries, 1990–2004

$ billions

	1990	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004p
Current account balance	−7.1	−8.8	−12.4	−9.4	−11.1	−6.9	−3.6	−2.4	−0.3	−2.3	−8.7
as % of GDP	−4.3	−4.3	−5.6	−4.1	−4.8	−2.9	−1.5	−1.0	−0.1	−0.8	−2.7
Financed by:											
Net equity flows	0.7	3.9	5.4	6.5	5.3	5.0	4.2	4.0	5.9	7.7	**8.4**
Net FDI inflows	0.7	3.9	5.2	6.1	5.3	4.9	4.1	4.1	5.8	7.7	**8.4**
Net portfolio equity inflows	0.0	0.0	0.2	0.4	0.0	0.1	0.0	−0.1	0.1	0.0	**0.0**
Net debt flows	6.4	7.0	4.9	6.8	3.3	4.1	2.6	3.2	3.5	3.2	**4.3**
Official creditors	4.8	4.8	4.6	4.3	4.4	5.0	4.0	5.3	4.6	3.9	**4.2**
World Bank	2.2	2.1	2.6	2.7	2.2	2.6	2.2	2.9	3.1	3.0	**3.7**
IMF	−0.4	0.7	0.2	0.0	0.0	0.6	−0.1	0.6	0.2	−0.2	**−0.6**
Others	2.9	2.0	1.8	1.7	2.2	1.8	1.9	1.8	1.3	1.0	**1.1**
Private creditors	1.6	2.2	0.3	2.5	−1.1	−0.9	−1.3	−2.1	−1.0	−0.6	**0.1**
Net medium- and long-term debt flows	0.2	0.3	0.6	1.7	−0.1	−1.4	−1.1	−1.1	−1.4	−1.0	**0.3**
Bonds	0.0	0.0	0.4	0.5	0.0	−0.1	0.0	−0.1	−0.2	−0.4	**0.3**
Banks	−0.2	0.2	−0.1	0.5	−0.3	−0.9	−0.6	−0.8	−0.9	−0.3	**0.5**
Others	0.4	0.2	0.3	0.7	0.2	−0.4	−0.5	−0.2	−0.3	−0.4	**−0.5**
Net short-term debt flows	1.5	1.8	−0.3	0.8	−0.9	0.5	−0.3	−1.0	0.4	0.4	**−0.2**
Balancing item	0.3	−1.5	2.9	−2.4	2.1	0.7	−1.1	−0.6	−0.3	0.6	**—**
Change in reserves (− = increase)	−0.4	−0.6	−0.8	−1.5	0.3	−2.9	−2.1	−4.2	−8.8	−9.3	**—**
Memo items:											
Official development assistance	14.4	16.2	14.2	13.1	13.6	13.5	13.8	15.6	16.8	19.6	**—**
Grants (excluding technical cooperation)	8.4	7.4	6.5	5.9	6.7	6.6	6.7	7.7	8.2	10.4	**—**
Workers' remittances	5.5	5.4	5.2	6.0	5.6	6.1	6.7	9.6	13.9	15.0	**15.9**
Net private flows (debt + equity)	2.3	6.1	5.7	8.9	4.3	4.1	2.8	1.9	4.9	7.1	**8.7**
Exports	30.3	41.4	50.5	55.9	54.2	57.6	66.8	69.5	77.7	89.5	**106.6**
Imports	43.7	57.0	70.9	73.8	73.8	73.1	80.4	83.2	89.1	106.7	**130.0**

Note: — = not available. Country sample used in this table and throughout the chapter includes Azerbaijan, Bangladesh, Benin, Bhutan, Burkina Faso, Cameroon, Ethiopia, Ghana, Kenya, Kyrgyz Republic, Lesotho, Madagascar, Malawi, Mali, Mauritania, Moldova, Mongolia, Mozambique, Nepal, Nicaragua, Pakistan, Rwanda, Senegal, Tanzania, Uganda, Vietnam, the Republic of Yemen, and Zambia.
Sources: World Bank Debtor Reporting System and staff estimates; OECD; IMF, various years.

large, *stable* sources of foreign exchange for poor countries and may be more likely than other flows to reach poor households.

- To increase private capital flows to poor countries, the international community should support policies that lead to better market access for poor countries and encourage investment through the use of risk mitigation instruments. Financial instruments such as securitization (of flows of workers' remittances, for example) can expand the access of poor countries to international capital markets. Most important, poor countries should continue efforts to improve their investment climate, which remains crucial not only for attracting more resources, but also for ensuring their effective use.
- Other developing countries can be instrumental in widening the pool of development resources in poor countries. Initiatives undertaken by these countries to advance development in their low-income neighbors should be supported by the broader development community.

The external financing environment in poor countries

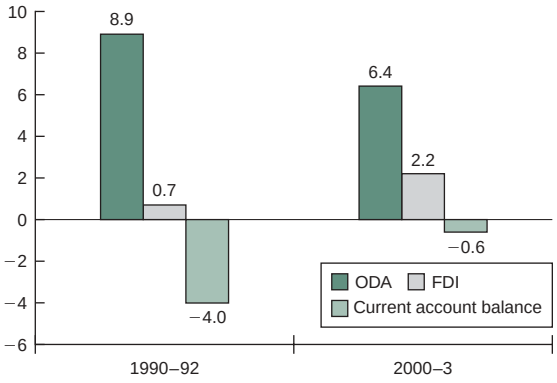
Foreign aid traditionally has been perceived as the primary source of external financing for poor countries. To some extent that view remains correct: poor countries rely on ODA more heavily than do other developing countries. Ratios of ODA to GDP are higher in poor countries than in the developing world as a whole. In 2003, ODA to the countries in our sample amounted to $19.6 billion (table 5.1).

Declining aid flows throughout the 1990s

Despite the recognized importance of aid, poor countries as a group are receiving less ODA today

Figure 5.1 Shift from aid toward FDI in poor countries, 1990–2003

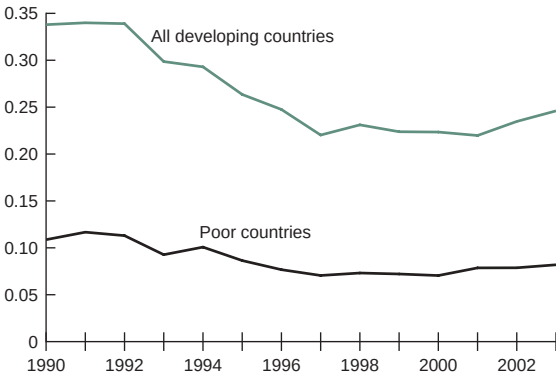
Percentage of recipients' GDP



Sources: OECD; IMF, various years; UNCTAD; World Bank staff estimates.

Figure 5.2 ODA to poor countries relative to total ODA, 1990–2003

ODA as percentage of donors' GNI



Source: World Bank staff estimates using data from OECD Development Assistance Committee.

than in the early 1990s (figure 5.1). In nominal terms, ODA to poor countries fell from $16.4 billion in 1992 to $13.8 billion in 2000, before recovering to $19.6 billion in 2003. As a share of GDP, ODA for the poorest countries declined by about one-third between 1990–92 and 2000–3. By contrast, FDI rose during the 1990s for the full sample, tripling its share to 2.2 percent of GDP. These aggregate movements mask significant country heterogeneity in the pattern of flows (box 5.1).

With the end of the Cold War came a decline in the strategic importance of aid, particularly its use in supporting "client states." But Cold War politics were not the only factor in the decline. The 1990s were a period of fiscal tightening in most donor countries. With the European Union's fiscal policy constrained by the terms of the Maastricht Treaty, and with political pressure in the United States for a balanced budget, cyclically adjusted fiscal positions of the OECD donors improved from an average deficit of 4.4 percent of GDP in 1992 to 0.8 percent in 2000, while ratios of ODA to GNI fell from 0.34 to 0.22 percent (figure 5.2).[3] The proportion of total ODA directed to the poorest countries has been remarkably stable since the early 1990s, at around one-third of the total, suggesting that ODA expenditures on this group by major donors are not protected from fiscal pressures. On a country-by-country basis, ratios of ODA to GDP declined throughout the 1990s in 63 percent of the poorest countries.

There has been a shift in the sectoral distribution of ODA in the poorest countries away from physical infrastructure and agriculture (figure 5.3). While education and health recorded an increase from 8 to 13 percent over the decade, the biggest increment went to debt relief, which rose from 8 to 22 percent. The shift in part reflects the introduction of the Heavily Indebted Poor Countries (HIPC) Initiative, launched by the World Bank and IMF in 1996 (and enhanced in 1999) to ease the crippling debt burden of some of the world's poorest countries (see box 1.2).[4]

During the 1990s, infrastructure financing to all developing countries from bilaterals and multilaterals declined as private flows rose—predominantly from a wave of privatizations and liberalization in the 1990s that encouraged private investors with limited investment prospects at home to invest in power plants, roads, and telecommunication facilities in the developing world (World Bank 2004a). The decrease in spending for agriculture was predominantly due to changes in India, related in part to the end of external assistance for the Green Revolution (OECD 2004), although agricultural aid to Sub-Saharan Africa and other poor South Asian countries also fell.

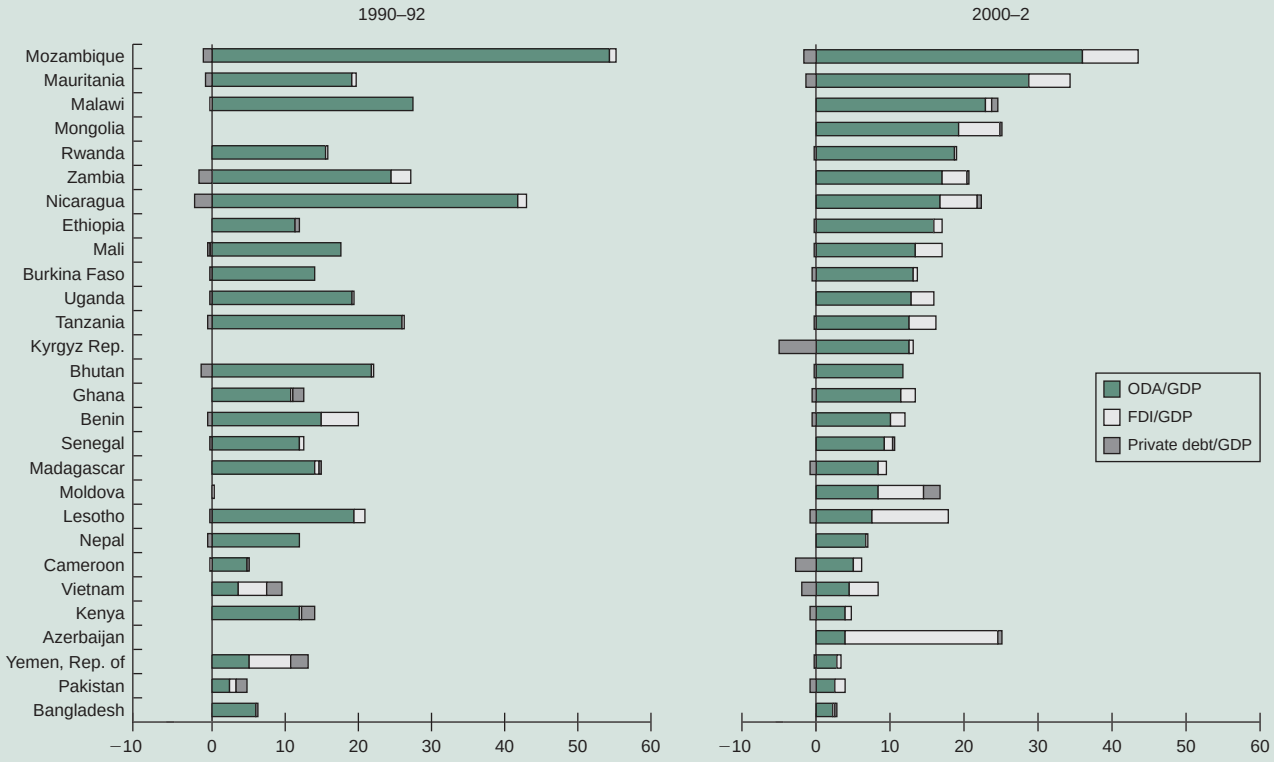
Some commentators find evidence of a more selective approach in the allocation of aid throughout the 1990s, with a better focus on poorer countries and better performers (World Bank 2004a; Dollar and Levine 2004). Dollar and Levine (2004) found that the giving patterns of

Box 5.1 Wide variations in the mix of external financing in poor countries

Average financing patterns mask enormous country variation. For example:

- Dependence on official development assistance (ODA) varies enormously in the countries of our sample—from a high of 36 percent of GDP for Mozambique to about 2.2 percent of GDP for Bangladesh and 2.7 percent for Pakistan. The pattern of allocation of ODA also changed over the past decade. Several countries (Kyrgyz Republic, Mongolia) that received no ODA during 1990–92 now receive significant amounts, whereas others (Nicaragua, Tanzania) have witnessed sharp declines.
- The size of and changes in the contribution of other financing sources—primarily foreign direct investment (FDI)—vary as well. FDI inflows were significant in just a few of our sample countries in 1990–92, whereas by 2000–2 many more were receiving substantial inflows. Few countries had significant private debt flows; for most that did, the net flows were negative.
- The picture that emerges is one of diversity and heterogeneity. Although these 28 poor countries share the challenge of reaching the MDGs over the next decade, the composition and level of external resources available to them differ enormously.

Country differences in importance of external financing as a share of GDP, 1990–92 and 2000–2

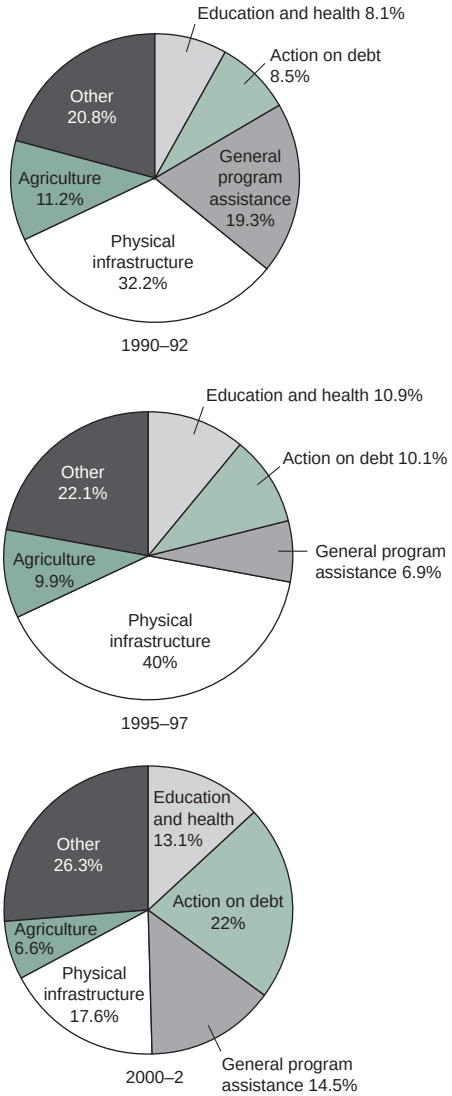


Sources: OECD DAC database; IMF, various years; World Bank Debtor Reporting System; staff estimates.

30 of 40 donors surveyed showed a positive relationship between aid allocations and the soundness of recipients' policies and institutions—a sharp improvement from a decade ago.

Partially compensating for the decline in ODA are nontraditional private resource flows. Classified as current account transfers (and therefore not as capital flows or external financing), these foreign

Figure 5.3 Sectoral distribution of ODA to poor countries, 1990–2002



Note: Data include Indonesia and India.
Source: World Bank staff estimates using data from OECD Development Assistance Committee.

exchange sources have grown steadily in importance in recent years. Grants from NGOs have emerged as a critical counterpart to official aid flows in some environments, just as NGOs have become key stakeholders and partners in many development programs and interventions (box 5.2). And the rapid growth in workers' remittances highlighted in previous editions of *Global Development Finance* has specific implications for some countries because of the pattern of their migrant flows (box 5.3).

FDI has grown in poor countries, and ratios of FDI to GDP are similar to those found in other developing countries

From an annual average of $0.5 billion in the 1980s, to $3.5 billion in the 1990s (before plummeting in 1998), FDI flows to poor countries rose to some $8.4 billion in 2004 (box 5.4). At present, the average ratio of FDI to GDP in poor countries is close to the developing-country average of 2.7 percent.

In absolute terms, FDI flows have been heavily concentrated in a few countries. In our sample, only Azerbaijan and Vietnam have annual FDI inflows exceeding $1 billion. However, relative to the size of the economy, FDI has been of considerable importance for some of the smaller poor countries, particularly Lesotho, Mauritania, Moldova, and Mozambique. FDI has also made a significant contribution to gross domestic capital formation in many poor countries. The share of FDI in gross capital formation averages 12 percent for the poorest countries (compared to 10 percent in middle-income countries); it is as high as 60 percent in some poor countries. This in part reflects a low savings ratio and limited access to international private debt flows.

The positive trend in FDI has emerged despite the existence of significant barriers to attracting external private finance. FDI and other types of private capital flows are strongly influenced by a country's investment climate, which is defined by its institutional and policy environment. Political and regulatory risks—among them the risk of confiscation, expropriation, nationalization, nonconvertibility of currency, losses to political violence, and lack of enforcement of regulatory rules—are believed to be higher in poor countries than in other developing countries and might be expected to discourage investment. Indeed, almost all poor countries score significantly lower than middle-income countries on measures of corruption, efficiency of bureaucracy, and law and order (OECD and AfDB 2003; UNCTAD 2003).

Inadequate infrastructure is cited as another key constraint to FDI. In most poor countries, foreign investors face unreliable and costly telecommunications services and electricity supply and also inefficient transportation links. Thirteen of the 28 poor countries are landlocked, so that goods produced for export must pass through another country as they travel to global markets, adding additional layers of cost and risk.

Box 5.2 Growing financing role for NGOs

Nongovernmental organizations (NGOs) play a growing role in funding development programs. The private-sector component of NGO grants to all developing countries increased from $5 billion in 1990 to $10 billion in 2003 (figure 1.16)—about 15 percent of the value of total ODA.[a] Although country breakdowns are not available, much of this assistance is directed toward poor countries. The number of global NGOs has increased by about half since the early 1990s (Union of International Associations 2002). In Bangladesh alone, the number of foreign-funded NGOs grew from 382 in 1990 to 1,652 in 2002. This rapid growth can be attributed to several factors:

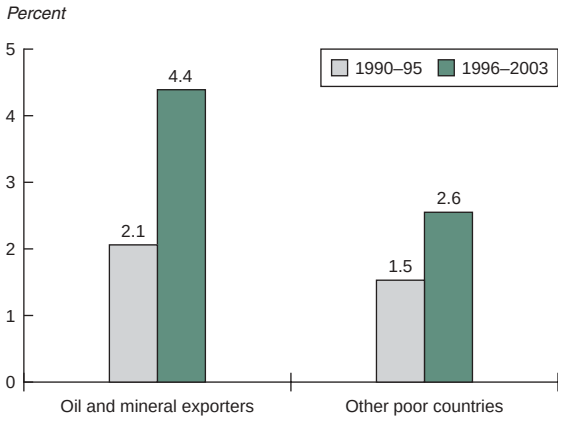
- Citizens of industrial countries are increasingly aware of events in the developing world, partly in response to more frequent and timely foreign news.
- Growing concern over the effectiveness of aid and limits to state-led development have encouraged more resources to be directed through nonstate actors. With greater emphasis on partnerships and shared ownership, NGOs are perceived to be in touch with the needs of the poor (Tevdt 1998). For official donors, international NGOs have become a means to improve aid effectiveness through their contacts with locals. Governments' increasing acceptance of NGOs as legitimate stakeholders has helped as well.
- Private philanthropy has increased sharply. International giving by the Bill and Melinda Gates Foundation to developing countries surpassed $1 billion in 2003. The Ford Foundation, the David and Lucile Packard Foundation, and the Rockefeller Foundation all provide more than $100 million annually in development assistance (OECD 2003a).

[a]ODA includes grants made by bilateral donors to NGOs, but not grants made by NGOs using private funds.

Countries that have taken steps to improve their investment climates and have opened up industries to privatization have been much more successful at attracting FDI (Pigato 2000). While FDI has been concentrated in the extractive sector—with major oil and mining exporters receiving significantly higher FDI relative to the size of their economy (figure 5.4) than other countries—the considerable difference in FDI performance between countries (even in the extractive sector) highlights that countries can influence, to some extent, the degree of inward FDI.

In recent years, a number of poor countries have improved their macroeconomic performance, with higher growth rates, lower inflation, greater openness to trade, and improved exchange-rate stability.[5] In addition, some countries have strengthened their foreign investment policy framework by expanding the number of industries open to foreign investment, easing sectoral restrictions and limits on foreign exchange, signing double taxation treaties to reduce tax burdens,[6] and improving corporate regulations. In addition, several countries established investment promotion agencies (UNCTAD 1998 and 1999; Collier and Gunning 1999), and signed multilateral agreements to resolve future investment disputes. The result has been an overall improvement in investment climate indicators for poor countries,[7] although risks are still higher there than in middle-income countries

Figure 5.4 Natural resource availability and ratios of FDI to GDP in poor countries, 1990–2003



Note: Oil and mineral exporters are countries in which oil and mineral exports accounted for at least 20 percent of total exports in 1996–2003. These countries include Azerbaijan, Bhutan, Cameroon, Ghana, Mauritania, Mongolia, the Republic of Yemen, and Zambia.
Sources: World Bank, *World Development Indicators* and *Global Development Finance*, various years.

Box 5.3 Workers' remittances to poor countries

After a dramatic rise in recent years, workers' remittances have emerged as a significant source of foreign exchange earnings for poor countries. Remittances are an "above-the-line" item feeding into the current account, not the capital account, of the balance of payments.

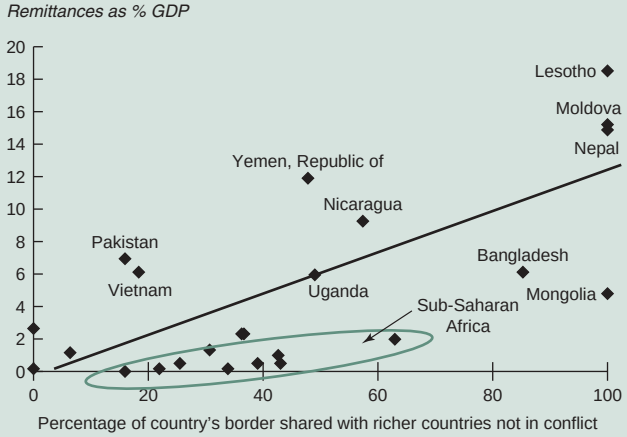
In 2004, remittances to poor countries reached $15.9 billion, averaging 5.1 percent of GDP in 2002/3, compared to just 2.8 percent in 1990/91. Because remittances generally flow from household to household (a private transaction), it is impossible to draw inferences from aggregate figures about their allocation between consumption and investment—or their eventual development impact. But their growth and relative size in poor countries provide ample justification for analyzing their determinants.

The surge in recorded remittance flows in part reflects better data gathering by central banks and statistical agencies in response to growing scrutiny of remittances flowing through alternative channels. But it also mirrors the rise in outward migration throughout the 1990s. Since the mid-1990s there has been an increase in temporary and permanent migrant workers across all skill and income categories, with OECD countries registering a 7.6 percent increase in migrant inflows from 1991 to 2000, and similar trends in many non-OECD countries (OECD 2003b). Finally, security concerns and heightened scrutiny by immigration authorities in rich countries may have encouraged some migrants who fear deportation or investigation to remit a larger portion of their savings back to their home country (World Bank 2004a).

Remittances sent to the poorest countries reflect the stock of emigrants, the work they undertake, and the links to their country of origin. Migration patterns are influenced by three key factors: the economic attractiveness of the destination country; the presence of family members or others of similar ethnic background in the destination country; and the distance between the destination and origin countries (OECD 2003b).

A large part of remittance flows to poor countries comes from other developing countries. Some countries with the highest ratio of remittances to GDP (Lesotho, Moldova, and Nepal) are those that are completely surrounded by richer neighbors that are not in conflict. In Lesotho, for example, 37 percent of households have a family member working in South Africa. Conversely, poorer countries receiving few remittances, such as Madagascar and Tanzania, do not share a common border with a significantly richer neighbor (see figure).

"Neighborhood" effect on remittances to the poorest countries, 2000–2



Sources: IMF, various years; World Bank staff estimates.

(figure 5.5). Mozambique and Uganda are two poor countries that increased FDI after improving their investment climate.

Trade policies and agreements have also played an important role in attracting export-oriented FDI by providing access to regional and larger markets (box 5.5). Recent initiatives to grant African manufacturers greater access to developed-country markets may lead to higher levels of FDI in affected sectors. The African Growth and Opportunity Act (AGOA) initiative by the United States and the European Union's Everything-but-Arms (EBA) program are expected to help in this respect. So far the impact of AGOA has been positive, but limited. According to AGOA progress reports in 2004, the Act continues to encourage new U.S. investment. In addition, it has stimulated African investments as firms work to access AGOA preferences through regional production. However, the effect of those investments may be temporary and limited to certain sectors. For example, the phasing out of Multi-Fibre Arrangement (MFA) in January 2005 may have repercussions for FDI flows to those

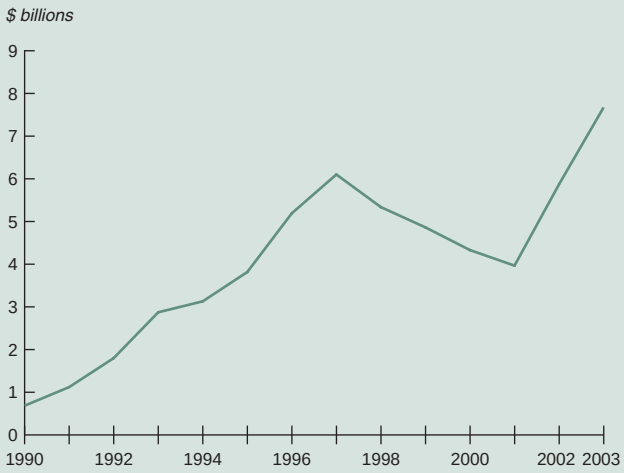
Box 5.4 The rise, fall, and recovery of FDI to poor countries, 1990–2003

The rise in FDI to poor countries in the early 1990s followed the pattern in FDI flows to all developing countries. A distinctive feature of the world economy in the past 15 years has been the growth in investments by multinational firms for the purpose of controlling assets and managing production in specific countries. Starting in the early 1990s, the poor countries, like many other developing countries, eased restrictions on foreign investments and liberalized their capital accounts. At the same time, the privatization process accelerated, particularly in the extractive and service sectors. Privatization stimulated FDI flows to poor countries, although to a lesser extent and more slowly than to middle-income countries. As macroeconomic and political conditions improved, governments undertook structural reforms to upgrade their investment climates. Some countries also made efforts to attract export-oriented FDI through export-processing zones, although with limited success.

Despite these developments, FDI in the poor countries fell sharply from 1998 to 2000 (see figure). The Asian crisis of 1997/98 had a significant impact on aggregate flows to the region. Of the poor countries in the region, Vietnam was hit particularly hard. The crisis also affected poor countries elsewhere, particularly in Africa, because a considerable portion of investments in countries such as Ethiopia and Malawi had come from Asian investors. In addition, FDI flows from the United States fell on the heels of an overall increase in dividend repatriation in 1998–99 (World Bank 2004a). Other reasons for the 1990s decline include deteriorations in the investment climate of countries such as Pakistan and Lesotho[a] and the end of large infrastructure and privatization projects elsewhere.

More recently, FDI flows to poor countries have increased, reaching an estimated $8.4 billion in 2004, up from $7.7 billion in 2003 and $5.8 billion in 2002. As a result, the share of the poor countries in FDI flows to developing countries rose to 8.3 percent in 2003. The rise can be attributed largely to the strong performance of FDI in the oil and gas sectors in Azerbaijan and Pakistan. That said, FDI flows to two-thirds of poor countries increased in 2003. All regions experienced an increase, except the Middle East and North Africa (largely because of ongoing disinvestments in Yemen).

FDI flows to poor countries, 1990–2003



[a]In Pakistan, a major dispute in 1997 between the government and the multinational energy company, Hub Power, led to a sharp decline in FDI. In Lesotho, political unrest following the presidential elections was instrumental in the FDI decrease.

Sources: World Bank, *Global Development Finance*, various years; World Bank, *World Development Indicators*, various years; UNCTAD, *World Investment Report*, various years; World Bank staff estimates.

poor countries that developed their garment industries in response to the MFA or other agreements. Their severity will be determined by a host of factors—among them labor productivity, the cost of labor, and proximity to large export markets. While preferential agreements are in force, it is essential that countries improve productivity and build the necessary infrastructure to advance international competitiveness.

The recent surge in outsourcing of business services to low-wage countries such as India may represent another opportunity to attract export-oriented FDI. Although poor telecommunications and an inadequate supply of skilled labor make it difficult to attract FDI in business services, poor countries can export low-skill services such as data entry. Recently, countries such as Ghana and Senegal have benefited from service outsourcing (UNCTAD 2004). Nevertheless, this type of FDI has limited linkages with the rest of the economy, despite a potentially significant impact on employment.

Box 5.5 Realizing the development promise of trade

Export earnings are an important source of foreign exchange for poor countries. Spurred by higher commodity prices, robust demand, better trade facilities, and more tightly integrated supply chains, the value of poor-country exports has tripled over the last decade, reaching $62 billion in 2003 from $21 billion in 1990. Even so, poor countries did not keep up with the explosion of international trade during the period: their global market share has declined over the years.

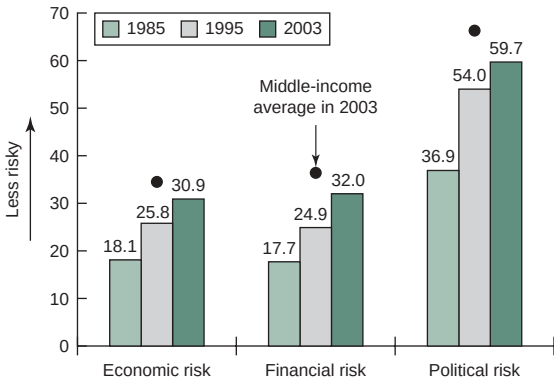
Trade has a significant potential to promote further development and poverty reduction in poor countries, as it has done in middle-income countries. A serious obstacle to the realization of that potential, however, are the restrictions and distortions that continue to hobble trade, notably the persistence of high subsidies for agricultural production and exports in rich countries. The potential gains for developing countries of reductions in those subsidies, accompanied by further multilateral liberalization of trade rules, are greater than those that could be obtained from any other source (World Bank 2003 and 2005).

The ongoing Doha Round of world trade talks offers an opportunity to increase the development potential of trade. Increasing market access for poor countries is especially critical: both developed and developing countries should reduce barriers to poor-country exports of food and agricultural products, labor-intensive manufactures, and services.

As a complement to further liberalization, "aid for trade" can help widen market access. Most poor countries suffer significant behind-the-border constraints such as poor trade-related infrastructure, lack of capacity in trade-related institutions, and poor access to information on new opportunities. Targeted aid can play a crucial role in strengthening critical trade-related infrastructure, such as transport, and making other improvements in trade logistics.

Poor countries can improve their competitiveness by eliminating trade restrictions and anti-export biases (such as export taxes and onerous administrative fees and procedures). In a broad sense, they can raise their productivity by improving their domestic investment climate. Improvements in investment climate and governance are essential in attracting export-oriented foreign direct investment, which in turn can improve trade logistics as world-standard technologies and know-how are applied to trade processes.

Figure 5.5 Improving risk conditions in poor countries, 1985–2003



Note: Economic risk index assesses current economic strengths and weaknesses (GDP per capita, GDP growth, inflation, budget and current account balance). Financial risk index reflects issues related to external debt (foreign debt, trade balance and exchange rate stability). Political risk index evaluates political stability (contract viability, profit repatriation, corruption, bureaucracy, and law and order).
Source: International Country Risk Guide Index (ICRG).

Despite such examples, the concentration of FDI in the extractive sector of poor countries remains high, pointing to several problems:

- In addition to having limited linkages with the rest of the economy, high resource flows to the extractive sector tend to reduce the country's competitiveness in other sectors (through the so-called Dutch disease), increase rent-seeking behavior, and cause institutions to deteriorate (Sachs and Warner 1995; Sala-i-Martin and Subramanian 2003)
- FDI flows to these sectors tend to be volatile. Most investments are large, but also very sensitive to world commodity prices (figure 5.6).[8] Given the large share of such investments in gross capital formation and their influence on exchange rates, volatility may cause further economic difficulties in some countries. But such a negative impact is not inevitable. For example, with strong policy and a sound institutional framework, Botswana relied on large

Box 5.6 Collapse in international bank lending to poor countries

Poor countries have been affected by a reversal in bank lending. From 1991 to 1993, medium- and long-term net bank lending averaged $0.6 billion. By 2001–3 that figure had fallen to −$1.2 billion.

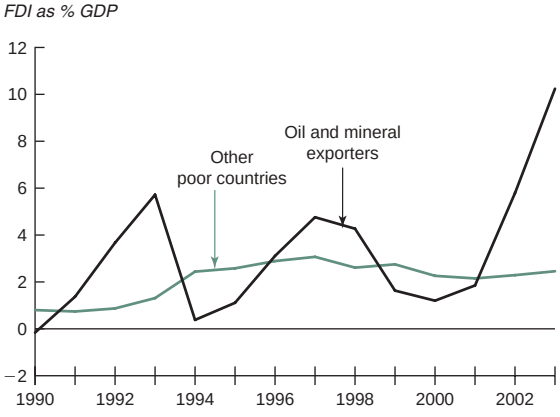
Bank lending collapsed across all developing countries in the years following the Asian crisis, but the decline was far deeper in poor countries. Behind this substantial retrenchment lay a heightened perception of the risk of lending to developing countries in the wake of the multiple crises of the 1990s and the 2001–2 slowdown in the global economy. Increased risk sensitivity has made lenders more cautious, especially toward poor countries, which tend to be perceived as high-risk borrowers. According to *Institutional Investor,* of the 28 poor countries, only four—Ghana, Kenya, Pakistan, and Vietnam—obtained an average risk rating during the 1990s of more than 25 (on a scale of 0 to 100, with 100 representing the highest credit quality). This is far below the ratings of developing countries that received significant capital inflows. Between 1990 and 2003, most bank lending to poor countries went to countries rated higher than 20 on the *Institutional Investor* scale.

The privatization of failed financial institutions and the removal of entry barriers for foreign banks in the wake of recent crises drew international banks into poor countries, thus reducing international lending. Although local-currency lending could potentially be additional to international lending, recent trends suggest that banks have substituted in-country lending for traditional cross-border lending. The share of local currency lending in total foreign claims nearly doubled between 1990–2003, from 23 to 44 percent. There is a strong incentive for foreign banks not to make cross-border lending on a significant scale, especially as local-currency lending largely eliminates exchange-rate risk and facilitates penetration of the local retail market.

Part of the reason for the decline in international bank lending also lies on the demand side, with poor countries reacting cautiously in the wake of financial crises. Some countries have acted to limit short-term bank lending and lengthen the maturity of bank loans. Since 1999, declining interest margins and lower syndicated loan volumes also suggest that demand for loans by poor-country borrowers has declined.

Source: World Bank staff.

Figure 5.6 FDI in oil- and mineral-exporting poor countries, 1990–2003



Note: See note to figure 5.4.
Sources: World Bank, *World Development Indicators* and *Global Development Finance,* various years.

FDI flows into its diamond and other mining industries to become a middle-income country in one generation. Export receipts and government revenues boosted by FDI were invested wisely to create the momentum and the infrastructure for more broad-based economic growth (UNCTAD 2003).

With the limited exception of FDI, the worldwide expansion of private capital flows during the 1990s largely bypassed the poor countries. Private equity flows to all developing countries tripled from $55 to $192 billion from 1990 to 2004—yet the poor countries' combined 4.3 percent share of this total remains small (see table 5.1).

Most poor countries have few prospects of attracting private debt flows or portfolio equity. In our sample, only Pakistan received sizeable non-FDI flows because Pakistan was the only country in the group, according to the S&P/IFC index, that had companies considered investment-worthy in the late 1990s—a key indicator for portfolio equity flows. The general collapse in international bank lending to poor countries in the course of the 1990s further limited flows of private debt (box 5.6).

Other developing countries as a source of finance for poor countries

Developing countries are often perceived as recipients and not providers of financial flows. The final report of the 2002 UN Conference on Financing for Development in Monterrey contained only a brief mention of the importance of encouraging cooperation between developing countries. However, with respect to poor countries, other developing countries (especially larger countries such as Brazil, China, India, Saudi Arabia, and South Africa) are becoming increasingly important financial players. With wealth increasing and capital controls lifted in the 1990s, developing countries have emerged as significant sources of FDI—and even of aid. (New aid donors include Brazil, China, India, and South Africa.) Finally, the developing South is the primary destination for poor country migrants and also the major source of workers' remittances. Below we examine what is known about the growing South-South financial interdependence. We suggest that South-South flows represent an under-recognized pool of development resources for the poor countries. The international community should encourage developing countries to develop policies to enhance the development of their poorer neighbors.

South-South FDI

South-South FDI appears significant in the poorest countries, although precise estimates of its magnitude are not available. Companies from China, India, Malaysia, the Russian Federation, and South Africa have become important investors in many poor countries. To minimize risk—and the cost of acquiring information—they tend to invest in resource- and market-seeking activities in neighboring countries before expanding on a global basis. Ethnic and cultural ties often play a role in the choice of trading partners, particularly for Asian companies (Aykut and Ratha 2004).

Privatization programs have been especially important in attracting FDI from these companies, in particular for Malaysian and South African investors, who contributed almost a third of the foreign exchange raised by privatization efforts in the poorest countries between 1989 and 1998. Regional companies also expanded their operations in retailing, banking, brewing, satellite television, and tourism. All the major players in the African telecommunications sector are from other developing countries.[9]

Proximity to larger economies has helped some poor countries such as Lesotho, Mongolia, and Nepal attract FDI. Nepal, India (in hotels and manufacturing), and China (manufacturing) account for more than half of FDI. Most FDI in Mongolia originates from China and Russia.

Companies from the South have comparative advantages when investing in poor countries. Such firms often have lower overhead costs and managers indigenous to the region. In addition, geographical proximity and cultural similarities can make coordination of foreign operations less expensive. Companies from the South may also have greater experience than companies from developed countries with the economic and political conditions of the host country (Wells 1983; Aykut and Ratha 2004). The relative success of the South African telecommunications company, MTN, in Uganda, compared to its competitors from developed countries, is traceable to its in-house expertise in managing pertinent economic and political risks (Goldstein 2004).[10]

Like FDI from the North, South-South FDI can raise productivity and tax revenue when the environment is favorable. Following South African Brewery's purchase of a controlling share of the state-owned Tanzanian Brewery Limited in cooperation with the IFC in 1993, productivity and capacity utilization increased dramatically while output tripled in five years (Pigato 2000). Following the privatization of one Mozambican state-owned company, taxes paid by the company rose more than fivefold and by 1998 provided about 5 percent of the country's total tax revenues.

However, firms from the South may have comparatively limited investment capacity, as their cost of capital is usually higher and affected by business cycles in their home country.

South-South development assistance

South-South development assistance has expanded in parallel with South-South FDI, although here, too, data are lacking.[11] But the potential relevance of South-South aid in generating economic growth in the world's poorest countries should not be underestimated.[12] Other developing countries can be instrumental in widening the pool of development resources—and in creating pressure on industrial-country donors to do more.

With many developing countries experiencing strong economic growth in recent years and seeking new markets, as well as new spheres of economic and political influence, it is logical that their role in providing development assistance should expand. India's minister of finance announced in his 2003/4 budget speech that India intended to increase its development assistance to other developing countries, including debt relief to HIPC countries. Grants and loans from India to other developing countries grew sharply in the past five years—from $83 million to $140 million.[13] China, too, has become increasingly involved in technical cooperation projects developed by the United Nations Development Programme (UNDP), becoming the first developing country to donate to the Voluntary Trust Fund for the Promotion of South-South Cooperation. In mid-2004, the Chinese government also offered $610,000 in humanitarian aid to the troubled Darfur region of Sudan. Other developments point in the same direction:

- In early 2005, developing countries pledged $173 million of emergency assistance in the wake of the Asian tsunami.
- Since 1976, Nigeria has promoted South-South cooperation through the Nigeria Trust Fund, operated by the African Development Bank, with current resources of $432 million.
- Brazil and Morocco sponsor extensive university scholarship programs and support technical and professional training for students of developing countries.
- The government of India has provided financial assistance for the construction of all major hydroelectric power plants in Bhutan.[14]
- South Africa cofinanced the $2.3 billion construction of the Mozal aluminum smelter in Mozambique.

Within developing countries, the Arab nations have long been an important source of development financing. By the end of 2002, the Arab national and regional development institutions together had extended $76 billion in development assistance.[15] Those resources have supported some 4,500 operations in more than 130 countries around the world, mostly in low-income countries. Half of the total went to Africa and most of the remainder to 36 Asian and Middle Eastern countries.

Cooperative exchange between two developing countries can help both countries in their development process. The capacities of the recipient are strengthened, while the donor country gains an understanding of the development challenges of the recipient—and possibly insight into challenges at home. The donor may also be able to identify future market opportunities. By increasing the national and collective self-reliance of developing countries, South-South development assistance can strengthen the voice of developing countries in negotiations with the North. But it also has features that make it a valuable complement to North-South cooperation. First, cooperation between countries with similar conditions of natural environment, culture, and economic development is likely to result in more appropriate technology transfer. Second, when a developing country offers assistance to neighboring countries, personnel and transportation costs, as well as other expenses, often are relatively low. Third, when developing countries take responsibility for development assistance and become donors in their own right, aid resources can expand.

Because the resources available for South-South cooperation will remain low compared to North-South flows, there is clear scope for coordinating South-South and North-South flows. Among the impediments to greater South-South cooperation are limited institutional capacity and lack of resources. One means to alleviate both constraints is to leverage potential projects with money from the North, an arrangement called triangular cooperation. Triangular cooperation occurs when a group of developing countries working together to address a common problem obtains additional financial, technical, and logistical resources from a developed-country partner or group of partners. The actors involved are various: traditional donors, multilateral agencies, private sector firms, academic institutions, and civil society organizations. In policy circles this approach is looked on as an important way to achieve the goals of South-South cooperation (Teheran Consensus 2001). Both the UNDP and Japan are active in South-South cooperation (box 5.7).

The collaboration between the South and the North has produced some success stories. One is the New Rice for Africa (NERICA) initiative. Collaboration among African, Asian, European, and North American scientists under the auspices of

Box 5.7 UNDP, Japan, and triangular cooperation

The Special Unit for South-South cooperation of the United Nations Development Programme (UNDP) plays an important role in financing South-South cooperation through UNDP country allocations and program resources and, indirectly, through the mobilization of funds from NGOs and the private sector. In the UNDP, two funds have been established to which developed and some developing countries have contributed: the Voluntary Trust Fund for the Promotion of South-South Cooperation and the Perez-Guerrero Trust Fund for Economic and Technical Cooperation among Developing Countries. Between 1996 and 2002, the Voluntary Trust Fund attracted $33 million, with most of the money coming from Japan. In 2002 the UNDP Executive Board approved an annual allocation of $3.5 million for technical cooperation among developing countries over the coming years.

Japan's support for South-South cooperation includes the following elements:

- Japan has partnership programs to encourage economically robust developing countries to become donors themselves. Since 1975 the Japan International Cooperation Agency (JICA) has sponsored third-country training programs to help developing countries become donors. Under the program personnel in developing countries who were previously trained in Japanese technical cooperation programs train technicians and administrators from other developing countries. In fiscal 2003, 2,335 people attended 151 third-country training courses. Developing countries offering eight or more courses under the program included Brazil, Indonesia, Kenya, Malaysia, Philippines, and Thailand. The costs of the program are shared between Japan and the host country.
- Japan expanded its assistance for South-South cooperation by introducing the third-country expert program in 1995. The program involves sending experts from countries with similar natural environments, languages, technical levels, and cultures to recipient countries to enable the smooth transfer of technology. There has been a steady increase in both the number of requests received and the number of countries expressing interest in either sending or receiving experts. In fiscal 2003, 117 new experts were sent to Africa, Asia, Latin America, and the Middle East.
- Since the establishment of the Human Resources Development Fund within UNDP in 1996, Japan has made special contributions to South-South cooperation by earmarking about half of the Fund for that purpose. In 2002, the Fund was integrated into the Japan-UNDP Partnership Fund, an important goal of which is to promote South-South cooperation.

Other developed countries have provided vital support for South-South cooperation. The Netherlands has cofinanced sectoral programs in 22 developing countries through multidonor basket funds, providing support for the use of developing-country technical resources in the programs. Sweden has financed knowledge networks, three in Asia (on renewable energy technologies, energy research, and environment) and two in Africa (on energy policy and biotechnology). Australia has set up training arrangements with ASEAN, Fiji, Papua New Guinea, Samoa, and Vanuatu. The Organization of American States, through the Inter-American Agency for Cooperation and Development (IACD), coordinates cooperation among the member states and forges partnerships with the private sector and civil society. Most of the IACD technical cooperation grants are supplemented by other donors.

the West Africa Rice Development Association (WARDA) developed new, high-yielding rice varieties for Africa by combining the best traits of African and Asian rice species. Growing demand for NERICA in turn led to the creation of the African Rice Initiative, a consortium of partners that includes the Government of Japan, UNDP, the World Bank, the Rockefeller Foundation, USAID, the UN Food and Agriculture Organization, and the African Development Bank (AfDB). According to the African Rice Initiative, nearly 210,000 hectares in West and Central Africa will be under NERICA cultivation by 2006, raising local African rice production and saving nearly $90 million per year on rice imports. By 2006, 1.7 million African farmers will have been exposed to the advantages of NERICA, increasing food security in dozens of African nations.

In another sign that the idea of complementing North-South with South-South development assistance seems to be gaining momentum, the Commonwealth Secretariat now advocates direct

cooperation and support between Commonwealth countries without the involvement of the United Kingdom.

Four of the 10 largest economies today (measured using purchasing power parity weights) are developing countries that offer significant export markets to many poor countries. If larger developing countries (such as Brazil, China, India, and South Africa) were to reduce trade barriers against products from the poorest countries, the additional resources generated for meeting development needs and reducing poverty could easily dwarf aid and other flows.

The South as a source of workers' remittances

For developing countries overall, industrialized countries are the major source of remittance payments, but in the poor countries, other developing countries are most prominent. While comprehensive data are not available, estimates are that in poor countries in East Asia, South Asia, and Sub-Saharan Africa, more than two-thirds of emigrants migrate to a country in the same region, while in South Asia and Sub-Saharan Africa, most of them migrate to another developing country (OECD 2003b).

The substantial income gap between the poorest countries and their larger neighbors affects the decision to migrate. For the four poorest countries with the largest ratio of remittances to GDP (Lesotho, Moldova, Nepal, and Republic of Yemen), the income gap with their largest developing-country neighbors ranges from $281 per capita in the case of Nepal and India, to $7,230 per capita for the Republic of Yemen and Saudi Arabia.

Transport costs and restrictions on migration also have been important in encouraging migrants to remain closer to home. OECD countries have increased restrictions on the admission of immigrants over the last three decades (UN 2002b). Since 2002, 70 percent of all legislation on migrant workers has originated in OECD countries (ILO 2004), making other developing countries an easier destination, although restrictions are in place in the developing world as well.

As a result of the concentration of poor country migrants in other developing countries, events affecting richer neighbors can have a significant impact on the workers' remittances flowing to poor countries. Remittances to Burkina Faso have been adversely affected by conflict in neighboring Côte d'Ivoire, falling from 4.5 percent of GDP in 1990 to 1.2 percent in 2003. Lesotho has been affected by a decline in mining employment in neighboring South Africa. In 1990, an estimated 127,000 ethnic Basothos were employed in South African mines (providing some 20 percent of the work force). Since then, however, new recruitment for the mines has virtually ceased, and total mine employment started falling, mainly due to the declining profitability of gold mines. As the number of Basotho emigrant workers declined to 60,000 by 2003 (Cobbe 2004), remittances fell from 69.6 percent of GDP in 1990 to 18.5 in 2003. In the Republic of Yemen, remittances as a share of GDP fell from 31.0 to 11.9 percent over the same period, reflecting the regional situation in the aftermath of the first Gulf War.

Informal channels of remittances are extremely important in poor countries, as when migrants carry funds on trips home or when they call on hand couriers. Cost, speed, convenience, and trust are key in determining the channel through which migrants choose to remit money. Speed and convenience have favored more formal channels, including wire transfer agencies and banks. But as with remittances from industrial countries, lack of competition and inefficiencies in the regulatory framework for money-transfer operations raise costs to senders and recipients (Ratha and Riedberg 2004). South-South cooperation to address such issues could yield sizable gains to participants.

Meeting the Monterrey challenge—an agenda for donors and recipients

The South is becoming a more important partner for poor countries in financing development, and poor countries are less exclusively dependent on aid, but industrialized country governments continue to play the leading role in mobilizing finance and managing the vulnerabilities of these countries. Looking ahead, action is needed on four fronts if progress toward the MDGs is not to be derailed by a shortage of external resources. First, donors must scale up ODA and other resources substantially—overcoming the distractions of changing fiscal pressures and shifting

strategic considerations. Second, they should strive to make aid more stable and predictable and less procyclical. Third, they should press for better donor coordination, selectivity, and country ownership to improve the effectiveness of aid and increase the focus on results. And fourth, they should seek opportunities to engage the private sector in development efforts. To justify and effectively absorb increases in aid and attract more private-sector finance, poor countries, for their part, need to pursue effective economic and pro-poor policies.

Commitments to support the MDGs

Despite the decline in aid over the past 15 years that has only recently been reversed (see chapter 1), the outlook for aid flows is positive. There was agreement at the UN Conference on Financing for Development in Monterrey in March 2002 that ODA and other resources had to be increased substantially to provide developing countries with the financial resources required to meet the MDGs. Developed countries that had not already done so were urged to "make concrete efforts" toward increasing ODA to the UN target of 0.7 percent of GNP.

The OECD (2005) projects that total ODA disbursements (to all developing countries) will increase from 0.25 percent of GNI in donor countries in 2003 to 0.30 percent by 2006, still significantly less than the 0.34 percent level reached in the early 1990s (see figure 1.14). The projection assumes an average 9 percent annual increase in ODA in real terms over the period 2004–6, well above the average rate of real increases for the past two years (6 percent).

The case is strong for directing increased resources to poor countries whose economic and social policies allow them to make effective use of aid—because they have the greatest potential to reach the MDGs. In countries with low capacity to attract private investment, ODA is particularly important, both in itself and as an essential complement to other sources of development finance.

The G-8 Africa Action Plan announced at the 2002 G-8 Leaders Summit in Kananaskis (Canada) suggested that "in aggregate half or more of our new development assistance could be directed to African nations that govern justly, invest in their own people and promote economic freedom." Sub-Saharan Africa received 60 percent of increases in ODA disbursements over the five years from 1998 to 2003, raising its share of total ODA disbursements by DAC donors from 24 percent to 34 percent (see figure 1.15). (In 2003, one-third of ODA was allocated to the poorest countries, unchanged from its average share over the previous 10 years.) However, most of these funds were allocated to postconflict situations, leaving little for development aid.

A March 2005 report by the Commission for Africa urged a doubling of aid to Sub-Saharan Africa, including an investment of $150 billion in infrastructure over the next decade. The report calls for an additional $25 billion per year in aid through 2010 and, subject to a review of progress, a further $25 billion per year through 2015.

Raising resource flows to the world's poorest countries to levels required to support the MDGs requires donors to remain committed to financing for development, even in the face of fiscal pressures and strategic considerations, both of which have had an increasingly important influence on the distribution of foreign aid.

The budget deficit for the OECD countries as a group increased from 2.8 percent of GDP in 2002 to 3.4 percent in 2003. The gap is projected to widen to 3.5 percent in 2004. While countercyclical expansionary fiscal policies helped prevent the recent global slowdown from deepening, the same policies, by increasing deficits to unsustainable levels, have created risks with clear implications for developing countries—for example, the risk that real interest rates could be pushed higher globally, dampening capital flows to developing countries as the public sector in advanced economies competes with developing countries for global savings (see chapter 3). With aging populations expected to place a rising fiscal burden on advanced economies in coming years, the pressure for fiscal consolidation is not likely to wane anytime soon.

Historically, as donors' fiscal deficits have been reduced, the ratio of ODA to GNI has fallen in tandem. At a time of fiscal consolidation, in other words, foreign aid budgets appear particularly vulnerable. Cuts in foreign aid are often more palatable to the electorate than cuts in domestic programs. In the face of claims from domestic

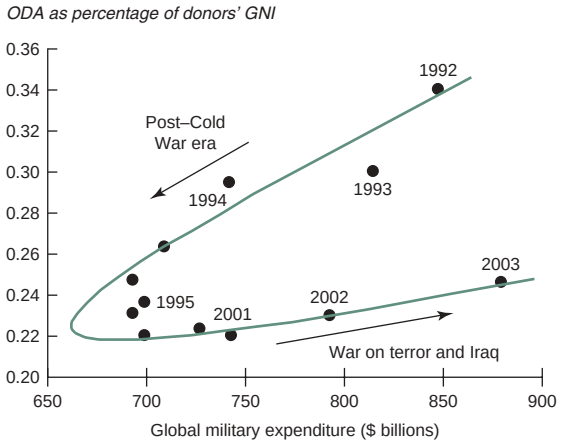
constituencies, donors may be tempted to overlook pledges made at events such as the Monterrey Conference, which are not legally binding under international law.

The threat to future aid flows appears even more serious when one considers that in 2003, eight DAC member countries reported budget deficits that exceeded 3 percent of their GDP. Those eight countries account for roughly three-quarters of ODA. Fiscal consolidation will be a key element of the policy agenda in many developed countries over the medium term. In this environment, increasing ODA and other resource flows to the poorest countries must be given high priority if the developed countries are to hold up their end of the Monterrey bargain by providing the financial resources required to support the MDGs.

The war on terror and the conflict in Iraq will continue to divert donor attention. While disbursements have fallen considerably short of commitments in Iraq and Afghanistan, they have been significant. The share of ODA allocated to Iraq increased from an average of 0.3 percent between 1980 and 2000 to 4.2 percent in 2003. Its share is expected to be significantly higher in 2004. More broadly, the share of ODA allocated to five countries—Afghanistan, Columbia, Iraq, Jordan, and Pakistan—increased from 3 percent over the period 1980–2000 to more than 11 percent in 2003. This pattern is consistent with the idea that "strategic considerations" are more important in determining aid flows than are development needs (McKinlay and Little 1979; Alesina and Dollar 1998).

Further evidence of diverted attention is shown by the link between aid and military expenditure. Since 2001, aid flows have not increased with military expenditures to the extent that had been expected. In the immediate post–Cold War world, global military expenditures fell from $847 billion in 1992 to $693 billion in 1998. During the same period aid fell from 0.34 to 0.22 percent of donors' GNI, a drop attributable to efforts to balance the budget and to the perceived decline in the strategic importance of aid following the end of the Cold War. However, since September 11, as military expenditures have increased from $743 to 879 billion, the ratio of ODA to GNI has not made up the decline suffered in the 1990s (figure 5.7).

Figure 5.7 Global military spending and aid, 1992–2003



Sources: Stockholm International Peace Research Institute; OECD Development Assistance Committee.

If the world is to meet the MDGs, substantial increases in ODA and other resources are certain to be needed (World Bank 2004b). Innovative methods of development finance may help to enrich the aid effort (box 5.8).

Most important of all, developed countries could spur development by reducing agricultural subsidies and trade barriers that discriminate against developing countries' exports. Industrial countries spend more than $300 billion each year to subsidize domestic agriculture, more than five times the amount they spend on foreign aid. Unless progress is made in the Doha round of trade talks on agricultural protection and subsidies, negotiations within the World Trade Organization (WTO) are likely to be stalled, to the detriment of growth and development.

Making aid more predictable and less procyclical

Aid can be better used if it is predictable. When aid flows wax and wane with international economic cycles or with unexpected shifts in donor policy, recipients often see aid decline when they need it most. If aid is used for domestic investment, volatility can generate uncertainty, discourage investment, and impede growth.[16] Aid volatility also complicates the conduct of fiscal and monetary policy. Tax increases and

Box 5.8 New sources of financing

Proponents of innovative financing mechanisms—such as the International Finance Facility, global taxes, and various voluntary giving arrangements—argue that such mechanisms can partly offset shortfalls in official development assistance (ODA).

International Finance Facility. As proposed by the British government, the IFF is designed to front-load aid flows in the short term to help reach the MDGs. Donors' multiyear aid commitments would be used to back AAA-rated bonds. Bond proceeds would be channeled through existing aid programs. Over time, the IFF would draw down the donor pledges to pay off its bonds. Future aid budgets would thus be used to support aid disbursements as and when they are needed in the short term. Critics of the proposal charge that bond repayments, as well as the transaction costs of issuing the bonds, would put pressure on aid budgets in the years ahead.

Technical aspects of the IFF proposal are being worked through in a pilot project. The IFF for Immunization (IFFIm) seeks to raise front-loaded, reliable funding over several years to expand global immunization and so help achieve the MDG on child health. IFFIm will use off-budget donor pledges of future aid increases as backing for AAA bonds, relying largely on the existing governance structure and country programs of the Global Alliance for Vaccines and Immunization (GAVI) and the Vaccine Fund.

Global taxes. Proposals have been made in the past to raise funds for development through new global tax instruments, but most have suffered from technical obstacles and all have faced varying degrees of political opposition. One prominent example is the proposed "carbon tax" on consumption of hydrocarbons. Such a tax could generate substantial revenue and help arrest climate change, but it would be very difficult to achieve politically. On a smaller scale, a recent proposal in the European Union would, for the first time, tax the jet fuel used in airliners and address the environmental harm caused by air transportation. Proponents observe that the revenues raised from global taxes could complement the IFF by generating aid funds in the medium to long term, as IFF flows diminish with repayment of bonds.

Voluntary contributions. Private contributions already fund development in various ways (see box 5.2) that could be expanded, encouraged, or made more effective. Some mechanisms, such as the establishment of affinity credit cards that provide funding for development through voluntary surcharges, could be undertaken by interested banks or companies. Others, such as the creation of a special-purpose global lottery or premium bond, would require regulatory action by participating countries, either unilaterally or acting in concert. As with global tax mechanisms, it would be important—and not easy—to ensure that voluntary contributions resulted in *additional* flows, rather than substituting for some portion of existing flows or overemphasizing some needs at the expense of others.

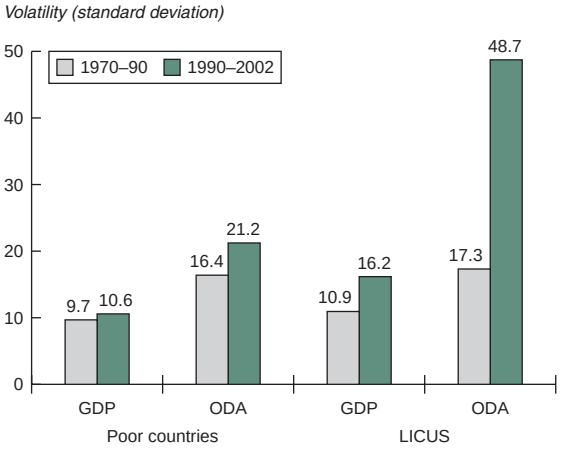
Although such innovative mechanisms offer some potential to expand the resources available to support development efforts, the legal and political obstacles to their implementation suggest that their practical significance in the short term will likely be limited.

government spending cuts frequently follow aid shortfalls (Gemmell and McGillivray 1998). Furthermore, aid-dependent countries are often unable to offset an unexpected aid shortfall by borrowing and must resort to unplanned and costly fiscal adjustment—especially damaging when aid flows are procyclical.

Despite these damaging effects, aid to poor countries tends to be volatile.[17]

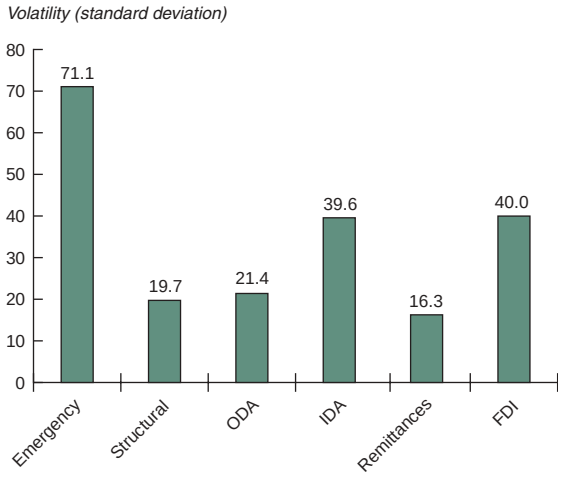
- Aid has been more volatile than GDP (figure 5.8) in virtually all of the poor countries in our sample. Earlier studies showed similar results. Pallage and Robe (2001) showed that aid was highly volatile compared to recipients' output. Bulir and Hamann (2003) found that it was more volatile than fiscal revenues, particularly in highly aid-dependent countries. Gemmel and McGillivray (1998) found that aid was significantly more volatile than revenue. Only Collier (1999) found that aid (to Sub-Saharan Africa) was less volatile than tax revenues.
- Aid flows to poor countries have become more volatile over the 1990–2002 period (figure 5.8), although they are less volatile than for other low-income countries.[18] The increased volatility could reflect changing donor sentiments, better linkages with country performance, or other factors. For the

Figure 5.8 Change in volatility of aid, 1970–2002



Note: LICUS = Low-Income Countries Under Stress. Figure measures median volatility for each group of countries. Volatility is equal to the standard deviation of the cyclical component of the Holdrick-Prescott filtered indexed series. Only countries with data available for both periods are included.
Source: World Bank staff estimates.

Figure 5.9 Volatility of different components of aid, remittances, and FDI, 1990–2002



Note: IDA = International Development Association. Figure measures median volatility for each group of countries. Volatility is equal to the standard deviation of the cyclical component of the Holdrick-Prescott filtered indexed series. Only countries with data available for both periods are included.
Source: World Bank staff estimates.

other low-income countries, this rise in aid volatility may be explained by the fact that many of these countries experienced conflict in 1990–2002 period, which disrupts aid operations and disbursements.

- Among the several types of aid, humanitarian aid and emergency assistance are by their nature volatile (figure 5.9).[19] But even when emergency aid is excluded, aid disbursements are more volatile than other flows, such as remittances.

Greater predictability in aid flows is one of the touted benefits of the proposed International Finance Facility (IFF), sponsored by the British government. The IFF would require donors to outline their intended contributions to aid over the long term and would then issue bonds backed by those pledges (see box 5.8).

Volatility of aid need not seriously affect output or growth in developing countries, provided it offsets fluctuations in GDP. Intuitively, this makes sense—if flows of external finance are countercyclical to the business cycle (and thus help offset the downturns), they can help to smooth out fluctuations. But ensuring that aid will be countercyclical implies donor control over volatility, which, of course, has been lacking. In fact, there are good reasons why aid flows tend to be procyclical. First, when donors are unable to adequately monitor the recipient country's reform effort, aid disbursements may be implicitly tied to economic performance, thus making aid procyclical (Svensson 2000). Second, donors may try to link aid flows to country performance using measures that are independent of domestic economic cycles. When countries are hit by unforeseen adverse shocks, compliance with donor conditionality may be affected, which may reduce aid disbursements. Finally, some donors require matching grants by the recipient. If more matching resources are available during cyclical upturns, some procyclicality of foreign aid disbursements may follow.

In recent years there appears to have been a shift away from procyclical aid flows—which should be encouraged.[20] Ratha (2001) found that multilateral lending played a countercyclical (stabilizing) role relative to private flows, with rising official flows during periods of private credit reduction. Multilateral lending also complemented private flows with a time lag. Empirical work on the cyclical character of ODA flows in 1970–90 and 1990–2002 found less evidence of procyclicality in the latter period, although short estimation periods affect the robustness of these estimates.

Strengthening the framework for aid effectiveness

Improving the effectiveness of aid involves four key steps—donor coordination, aid selectivity, country ownership, and a focus on results.

- *Strengthening donor coordination.* Ongoing efforts to align and harmonize aid currently involve 60 developed and developing countries and at least 40 bilateral aid agencies and multilateral organizations. Harmonization initiatives may involve joint analytical work, joint preparation of country assistance strategies, and joint reviews of implementation. The benefits of successful coordination are to reduce duplication of effort among donors and to reduce the bureaucratic burden on recipients.
- *Improving aid selectivity.* A scarce resource, aid should be directed toward two classes of countries: those that need it most and those that can use it to best effect—in other words, the poorest countries and those with the best records of using aid to spur growth and reduce poverty. Good performers will use significant increases in aid to improve their prospects of reaching the MDGs and their own development goals (Dollar and Levine 2004). At present, donors differ widely in how they measure performance and select "merit-based" aid recipients. Initiatives such as the United States Millennium Challenge Account, which is intended to provide additional aid based on 16 economic and political indicators (including control of corruption, the rule of law, primary education completion rate, country credit rating, and trade policy), have the potential to improve the application of aid selectivity, but a proliferation of competing criteria among donors raises renewed concerns about harmonization.
- *Country ownership.* Countries that embrace development programs as their own will use aid more carefully and more effectively. With guidance from the World Bank and the participation of civil society, member governments now prepare poverty reduction strategy papers (PRSPs), which set forth an agreed program of action to reduce poverty with help from development partners.
- *Focus on results.* By targeting assistance to meet clearly defined goals—a practice known as "managing for results"—the international community can focus on national development needs and objectives under the ownership of the recipient country. Bilateral and multilateral development agencies agreed in Marrakech in February 2004 to a set of principles that include focusing on results at all stages of the assistance process, including planning, implementation, and completion; and keeping reporting systems simple, cost-effective, and user friendly.

Progress has been made in all these areas over the past decade, but more needs to be done to make aid more effective in supporting attainment of the MDGs (World Bank 2004a and 2004b). The ongoing replenishment of the International Development Association (IDA) also has stressed the link between new resources and effectiveness.

Leveraging private capital flows to poor countries

Most poor countries will remain heavily reliant on traditional financing sources for the next few years. A long-term challenge is to tap the potential of international capital markets to provide greater private participation in financing for the poorest countries. A key role for multilateral institutions is to devise frameworks for private sector involvement and to find ways to mitigate the risks associated with investing in poor countries.

Improving the access of poor countries to markets in developed and some large developing countries could help to facilitate investment in poor countries. Programs such as AGOA and EBA that provide preferential access to poor countries are one component of this story, but of greater long-run importance will be multilateral liberalization of trade, as is currently being pursued through the WTO-sponsored Doha negotiations (box 5.5). Curbing the use of antidumping and similar instruments of contingent protection, eliminating certain repatriation taxes, and liberalizing rules of origin have the potential to promote trade and investment in poor countries (World Bank 2005; Commission on Capital Flows to Africa 2003).

Loans and guarantees to mitigate political, contractual, regulatory, and foreign-exchange risks—as currently provided by the International Financial Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA)—are

crucial, particularly for investment in infrastructure in poor countries (World Bank 2004a). Bilateral agencies from developed countries, such as the U.S. Overseas Private Investment Corporation (OPIC), Export Development Canada, and the U.K. Export Credit Guarantee Department should intensify their assistance to private investments in poor countries that support the development goals of the recipient countries. Easing restrictions (such as on sectoral coverage) and offering broader and more flexible risk insurance products could extend the impact of these programs.

Regional export credit agencies can also facilitate private sector access. One example is the African Trade Insurance Agency, established in 2001. The agency provides insurance for exports from and within Africa and imports to the continent and as such facilitate trade flows to Africa. The body was established with World Bank loans underwritten by Lloyd's of London. The member countries (originally Burundi, Kenya, Malawi, Rwanda, Tanzania, Uganda, and Zambia) are financially responsible for losses.

Poor countries need help in using financial innovations to improve their access to international capital markets. In recent years, the securitization of future resource flows, such as remittances and export receipts, has helped several middle-income countries to raise external financing and might also be implemented for poor countries (box 5.9). Among the policy hurdles to be addressed are the lack of legal infrastructure in many poor countries and the high fixed cost of necessary legal, investment banking, and credit-rating services.

Box 5.9 Securitization of future workers' remittances and other external flows

Developing countries can raise external capital on the strength of current account flows from workers' remittances, tourism receipts, and export receipts. Securities issued on such flows are typically structured to obtain an investment-grade rating, which allows issuers to pay a lower interest rate and obtain longer maturity. It also makes them attractive to a wide range of "buy-and-hold" investors such as insurance companies, which may face limitations on buying issues below investment grade. Because they are free of currency convertibility risk, a key component of sovereign risk, securities based on current account flows may be rated better than sovereign credit.

One important reason for governments to promote this asset class stems from the related externalities. Such deals bring closer scrutiny of the legal and institutional environment (for example, laws relating to property rights and bankruptcy procedures) than do unsecured transactions. Securitization transactions backed by governments can thus help usher in reforms of the legal and institutional environment.

Remittance-backed securities often work as follows. The borrowing entity, such as a bank, pledges its future remittance receivables to an offshore Special Purpose Vehicle, which issues the debt. Designated correspondent banks are directed to channel all remittance flows of the borrowing bank directly to an offshore collection account managed by a trustee. The collection agent makes principal and interest payments to the investors and sends excess collections to the borrowing bank. Since remittances do not enter the issuer's home country, the rating agencies believe that the structure mitigates the usual sovereign transfer and convertibility risks. Such transactions also often build in excess coverage to mitigate the risk of volatility and seasonality in remittances.

The first major securitization deal involving international migrant remittances occurred in 1994 in Mexico. Since then the volume of transactions has grown rapidly. Using this instrument, El Salvador, Mexico, and Turkey raised about $2.3 billion during 1994–2000.

As electronic transfers became more prevalent and made it easier to track complex transactions, remittances securitization gave way to securitization of diversified payment rights (DPRs) including mainly migrant remittances, but also certain payments related to exports and foreign direct investment. During 2000–4, a total of $10.4 billion was raised through securitization of DPRs by Brazil ($5.3 billion), Turkey ($4.1 billion), El Salvador, Kazakhstan, Mexico, and Peru. Following a sharp increase in borrowing costs in 2002, Brazil has raised more than $4 billion by issuing bonds backed by DPRs. These bonds resulted in a saving of more than 700 basis points compared with Brazil's sovereign spread.

As experience with DPRs broadens, and investors become more comfortable with them, it is possible that they could be used in a wider range of countries (including poor countries) and for a broader range of external flows (such as tourism receipts and commodity earnings).

Box 5.9 *(continued)*

It is not easy to estimate the potential of future-flow securitization. But preliminary calculations, using an overcollateralization ratio of 5 to 1 and migrant remittance figures for 2003, show that developing countries could potentially issue nearly $9 billion a year. Low-income countries could raise up to $3 billion annually.

Several policy hurdles remain to be addressed before securitization deals can approach that potential. Long lead times and the high fixed costs of legal, investment banking, and credit-rating services can pose difficulties for developing countries with few large institutions and high borrowing needs. A master trust arrangement can permit issuers to structure a large deal but tap the market in several tranches. Pooling receivables of several branches (or even several borrowers) could also help defray large fixed costs.

The absence of an appropriate legal framework for such transactions is yet another constraint on issuance. Overcoming it need not require a grand overhaul of the entire legal system, however. A more focused approach concentrating on bankruptcy law may suffice, by making sure that pledged assets remain pledged in the event of default. Finally, at a broader level, remittance securitization can potentially conflict with the negative-pledge provision included in the IBRD's (or other multilateral agencies') loan and guarantee agreements, which prohibits the establishment of a priority for other debts over the debts due to the IBRD.

But as the recent upsurge in securitization suggests, none of these hurdles is insurmountable, and there would appear to be ample opportunity for future growth in such deals, with corresponding benefits to a broad range of developing countries.

Sources: Ketkar and Ratha (2001, 2004).

Sound economic and pro-poor policies in recipient countries

The consensus reached in Monterrey in 2002 centered on a partnership between donors and recipients. Donors agreed to increase assistance to developing countries if the latter would pursue economic policies to improve the effectiveness of the additional resources. Moreover, by taking steps to improve their business and investment climate, countries could expect to attract private capital.

Many developing countries have held up their end of the partnership. The World Bank's Country Policy and Institutional Assessment—the CPIA—shows an upward trend in economic management, structural policies, policies for social inclusion and equity, and public sector management in the poorest countries since 1995. The broad improvement in the policies of the world's poorest countries is shown in the robustness of average annual GDP growth over the last decade (5.9 percent). Inflation rates, too, have declined by more than half and now stand at an average of 6 percent. The current account moved from a deficit of about 3 percent of GDP in the early and mid-1990s to a surplus of 1 percent in 2003. Fiscal deficits have been cut in half.

It is not surprising that those poor countries that have been most successful at undertaking economic reforms and creating a sounder climate for investment, such as Mozambique, Uganda, and Vietnam, have been among the most successful at attracting external finance in the form of FDI, ODA, and South-South financial flows.

The New Partnership for Africa's Development (NEPAD), launched in July 2001, is another positive step by the poorest countries. NEPAD is an expression of Africa's will to improve its own policies and institutions so as to justify a rise in aid levels. One especially critical focus of NEPAD is to strengthen economic, corporate, and political governance through targets and a peer review mechanism in which the peer reviewers come from other poor countries.

The poorest countries in the world remain vulnerable to external shocks, but they are discovering new ways to shape their own destiny. The donor community and other developing countries should be ready to help the poorest as they continue to move in promising new directions.

The G-8 Africa Action Plan announced at the 2002 G-8 Leaders Summit in Kananaskis aimed to "ensure that no country genuinely committed to poverty reduction, good governance, and economic reform will be denied the chance to achieve the Millennium Goals through lack of finance." More recently, the Commission for Africa urged a doubling of aid to Sub-Saharan Africa. A key theme of the 2005 G-8 Leaders Summit to be held in Gleneagles will be to strengthen international

cooperation in support of greater progress on the MDGs in Africa. The next few years will determine whether developed countries will hold up their end of the partnership forged at Monterrey.

Notes

1. The Report of the High-level Panel on Financing for Development estimated that $50 billion in additional development assistance would be required to meet the Millennium Development Goals, in addition to humanitarian assistance and additional resources for global public goods (UN 2002a). According to the African Development Bank, Africa needs $20–25 billion per year in addition to current resources. A recently completed UN report comes up with even higher financing requirements (UN Millennium Project 2004).

2. The sample consists of low-income countries (with GNI per capita of $735 or less), but *excludes* two larger economies (India and Indonesia) that in many respects more closely resemble middle-income emerging-market economies. It also excludes countries that suffer from ongoing or recent conflict—the so-called LICUS group. Our 28-country sample thus includes countries in which concerted efforts are underway to reach the MDG deadline a decade from now (in 2015), and for which the availability of resources may be a binding constraint. About half of the countries in our sample are in Sub-Saharan Africa, with the remainder scattered throughout other regions.

3. For donors, the traditional means of representing ODA disbursements is as a percentage of donors' GNI, not GDP.

4. Twenty-seven countries have reached the HIPC decision point. The decision point is reached if countries are considered heavily indebted, once traditional debt relief mechanisms have been taken into account. To qualify countries usually must have a debt-to-export ratio of averaging 150 percent over the previous three years. Alternatively, countries considered to have an open economy (defined as an export-to-GDP ratio of over 30 percent) and a ratio of debt to government revenue of more than 250 percent despite a strong revenue collection system may also qualify. Countries need to have pursued World Bank and IMF adjustment and reform programs for at least three years. During this time they must have completed at least an interim poverty reduction strategy paper. Once the decision point has been reached, further satisfactory performance in World Bank and IMF reform and poverty-reduction programs leads to the completion point. At this point assistance is provided in the form of relief from up to 90 percent of the present value of debt.

5. The ratio of trade to GDP increased to 44 percent in 1996–2003. It was 35 percent in the first half of the decade.

6. According to the UNCTAD database, from 1990 to 2002, 161 national laws passed by eight poor countries in our sample were favorable to FDI (out of 168 total). During the same period, the poor countries signed 3,052 double taxation treaties and 2,465 bilateral investment treaties.

7. In addition to the ICRG indicator used for the discussion, the World Bank's Country Policy and Institutional Assessment (CPIA) indicator and the *Institutional Investor Rating* indicate significant improvements in many of the poor countries.

8. Another reason for high volatility is that this type of flow is highly skewed toward intercompany loans, which tend to be as volatile as private debt flows. In addition, many countries do not report reinvested earnings that might bring some level of stability.

9. South Africa's Vodacom and MTN, Orascom from Egypt, and Telekom from Malaysia have large subscriber bases in the region.

10. The main competitor is Celtel, controlled by Vodafone of the United Kingdom. South African MTN managed to develop a subscriber base 22 times larger than Celtel's despite the monopoly position of the latter prior to MTN's penetration of the market (Goldstein 2004).

11. South-South development assistance refers to aid from developing countries to poor countries. It is part of a concept referred to as South-South cooperation, a broad term used to describe a variety of strands of cooperation among developing countries. Included are economic cooperation among developing countries, technical cooperation among developing countries, cooperation among developing states in multilateral negotiations with the developed countries, promotion of South-South trade, and the development of regional political and economic associations.

12. Data are not available to capture the magnitude of South-South development assistance, but it is clear that the resources involved are small compared to total ODA. South-South resources appear to be growing. For example, grants and loans from India to other developing countries grew sharply in the five years from 1997 to 2002 (from $83 million to $140 million). During the same period, disbursements from non-DAC donors almost tripled, from $1.2 billion in 1997 to $3.2 billion in 2002, with the bulk of the money coming from Arab countries, followed by Korea. Other contributors are the Czech Republic, Latvia, Lithuania, Poland, the Slovak Republic, and Turkey. Figures on non-DAC ODA understate the true volume of resources flowing from developing countries to other developing countries, because some potentially important donors (Brazil, China, India, and South Africa) are not included.

13. Through its Technical and Economic Cooperation Program, India has spent nearly $2 billion on technical assistance to 130 developing countries in all regions over the past four decades.

14. Except for the Basuchu Project.

15. These include the Arab Bank for Economic Development in Africa (BADEA), the Special Arab Fund for Economic and Social Development, the Arab Gulf Program for United Nations Development Organizations (AGFUND), the Islamic Development Bank, the OPEC Fund, the Abu Dhabi Fund for Development, the Kuwait Fund for Arab Economic Development, and the Saudi Fund for Development.

16. Lensink and Morrissey (2000) show that uncertainty in aid flows, as measured by deviations from expected inflows, reduces the effectiveness of aid.

17. An important question in discussions of volatility is how to measure the "volatility" of a particular variable. Even though the measure is in principle built around the standard deviation of the variable in question, the correct standard

deviation may be difficult to determine, as a single best measure is not available. Several considerations can affect the choice. First, the standard deviation of any variable is determined both by the trend of the variable as well as the cyclical behavior around that trend. A strongly trending variable that shows no cyclical fluctuations will still have a relatively high standard deviation. If one is interested in the true volatility of the variable from year to year, it is necessary to correct for the trending behavior of the variable. Seminal papers, such as those of Lucas (1977) and Kydland and Prescott (1990), have defined business cycles as the deviations of output from trend. A well-established method to detrend a series is using the Hodrick and Prescott (HP) filter. Second, the standard deviation of a variable (whether the series is detrended or not) is a function of the level of the variable. To make a sensible comparison between the standard deviations of several variables, one has to standardize the series. One way to do that is to detrend the log of the series; another is to detrend the indexed series. Third, sample length will have an impact on the standard deviation measured. The appropriate length reflects a cost-benefit trade-off—a longer sample length increases measurement accuracy, but only if the underlying volatility has been stable over the sample period. If the sample length is too long the assumption of stable volatility is unlikely to hold, as transmission mechanisms are likely to change. The choice in volatility measure is important and needs to be driven by careful considerations, because results can be sensitive to the choice. Following Pallage and Robe (2001) and Bulir and Hamann (2003), we define volatility as fluctuations in the business cycles of the different flows defined as the deviation of the flow from its trend. To estimate the volatility, we first detrend each data series using the HP filter. To ensure that the volatility of the different series remains unaffected by differences in scaling, we use indexed series instead of levels.

18. The average volatility of exports and government revenues is lower in this group of countries. Our results are not driven by outliers. Of the countries in the first quarter of the distribution of GDP volatility, almost 80 percent belong to our group of poorest countries, while from the 75th percentile onwards, 35 percent of the countries are part of the group of poorest countries.

19. ODA consists of several different types of aid: balance-of-payments support, investment projects, food aid, emergency assistance, debt relief, peacemaking efforts, and technical assistance. There is no reason to expect that the volatility of each component is similar or, as pointed out by Clemens, Radelet, and Bhavnani (2004), that the impact on economic performance will be the same. Following Clemens, Radelet, and Bhavnani (2004), aggregate aid flows can be divided into three categories: short-impact aid, long-impact aid, and humanitarian/emergency aid. The first two categories consist of aid disbursements aimed at creating economic growth either in the short run or after a longer period. The latter category is aimed at very short-term consumption smoothing and is not intended to directly promote increases in income per capita.

20. Many studies have found evidence of pro-cyclicality of aid flows in developing countries. Pallage and Robe (2001) find that aid and output are procyclical. Bulir and Hamann (2003) and Gemmell and McGillivray (1998) find evidence of pro-cyclicality between aid and domestic revenue.

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Statistical Appendix

THE SUMMARY STATISTICAL TABLES are divided into six sections (see index of tables overleaf for full details):

- **Summary tables**. These tables provide a snapshot of recent history and the outlook for the global economy and each of the six developing country regions (for the full World Bank classification of countries by region and income level, see table A.51).
- **Key macro variables**. These provide detail on growth and inflation indicators by region and (historically) for selected economies. Although detailed country forecasts form the basis for the regional growth and inflation projections, detailed developing country forecasts are not shown separately.
- **Current account tables**. These tables combine data from the IMF's balance of payments statistics, with aid-related data from the OECD's Development Assistance Committee publications, and our own preferred measure of workers' remittances.
- **Capital account tables**. New external financing tables have been developed. They combine the IMF's current account, foreign exchange reserve and net inward foreign direct investment data with the World Bank's portfolio equity and debtor reporting system (DRS) data to produce an overall tabulation of how regions finance themselves externally.
- **External liabilities and assets**. These provide a summary of the DRS debt data that is provided on a country-by-country basis in volume 2.
- **Key debt ratios and country classifications**. These tables provide a summary of indicators typically used by country risk analysts to monitor and classify countries. The World Bank's own debt classifications are defined and tabulated. The precise method used to categorize countries as severely, moderately or less indebted is shown by a box in table A.50. The two key ingredients used are the present value of future debt-service streams to (i) gross national income and (ii) to exports of goods and services. These variables are averaged over the three years, 2001–2003.

The use of critical values to define the boundaries between indebtedness categories implies that changes in country classifications should be interpreted with caution. If a country has an indicator that is close to the critical value, a small change in the indicator may trigger a change in indebtedness classification even if economic fundamentals have not changed significantly. Moreover, these indicators do not represent an exhaustive set of useful indicators of external debt. They may not, for example, adequately capture the debt servicing capacity of countries in which government budget constraints are key to debt service difficulties. Moreover, rising external debt may not necessarily imply payment difficulties, especially if there is a commensurate increase in the country's debt servicing capacity. Thus, these indicators should be used in the broader context of a country-specific analysis of debt sustainability.

Contents

Table A.1 Global outlook in summary, 2003–2007

% change from previous year, except interest rates and oil price

						GEP 2005 forecasts	
	2003	2004e	2005f	2006f	2007f	2004	2005
Global Conditions							
World Trade Volume	5.6	10.3	7.7	7.7	8.0	10.2	8.4
Consumer Prices							
G-7 Countries[a,b]	1.6	1.8	1.6	1.6	1.6	1.7	1.4
United States	2.3	2.7	2.0	3.5	3.2	2.7	2.2
Commodity Prices ($ terms)							
Non-oil commodities	10.2	17.5	4.7	−5.2	−5.4	17.0	−3.1
Oil Price (OPEC average)	28.9	37.7	42.0	36.0	33.0	39.0	36.0
Oil price (percent change)	15.9	30.6	11.3	−14.3	−8.3	35.0	−7.7
Manufactures unit export value[c]	7.5	7.0	3.0	2.8	1.9	5.2	−0.8
Interest Rates							
$, 6-month (%)	1.2	1.6	3.5	4.6	5.0	1.6	3.5
€, 6-month (%)	2.3	2.1	2.1	2.8	3.2	2.1	2.4
Real GDP growth[d]							
World	**2.5**	**3.8**	**3.1**	**3.1**	**3.2**	**4.0**	**3.2**
Memo item: World (PPP weights)[e]	3.9	5.0	4.3	4.2	4.3	4.9	4.2
High income	**1.9**	**3.2**	**2.4**	**2.6**	**2.6**	**3.5**	**2.7**
OECD Countries[f]	1.8	3.1	2.4	2.5	2.6	3.5	2.6
Euro Area	0.5	1.8	1.3	2.1	2.6	1.8	2.1
Japan	1.4	2.6	0.8	1.9	1.9	4.3	1.8
United States	3.0	4.4	3.9	3.0	2.6	4.3	3.2
Non-OECD countries	3.2	6.2	4.4	4.5	4.1	5.9	4.6
Developing countries	**5.3**	**6.6**	**5.7**	**5.2**	**5.4**	**6.1**	**5.4**
East Asia and Pacific	8.0	8.3	7.4	6.9	7.2	7.8	7.1
Europe and Central Asia	5.9	6.8	5.5	4.9	5.0	7.0	5.6
Latin America and Caribbean	1.7	5.7	4.3	3.7	3.7	4.7	3.7
Middle East and N. Africa	5.8	5.1	4.9	4.3	4.3	4.7	4.7
South Asia	7.8	6.6	6.2	6.4	6.7	6.0	6.3
Sub-Saharan Africa	3.4	3.8	4.1	4.0	4.1	3.2	3.6
Memorandum items							
Developing countries							
Excluding transition countries	5.2	6.7	5.7	5.3	5.5	5.9	5.4
Excluding China and India	3.9	5.8	4.8	4.4	4.4	5.4	4.6

Note: PPP = purchasing power parity; *e* = estimate; *f* = forecast; GEP 2005 = *Global Economic Prospects and the Developing Countries,* World Bank, January 2005.

a. Canada, France, Germany, Italy, Japan, the UK, and the United States.

b. In local currency, aggregated using 1995 GDP Weights.

c. Unit value index of manufactured exports from major economies, expressed in $.

d. GDP in 1995 constant $; 1995 prices and market exchange rates.

e. GDP mesaured at 1995 PPP weights.

f. Now excludes the Republic of Korea, which has been reclassified as high-income OECD.

Table A.2 East Asia and Pacific outlook in summary, 1981–2005

Real economy *(% change, unless stated)*	**1981–90**	**1991–2000**	**1999**	**2000**	**2001**	**2002**	**2003**	**Estimate 2004**	**Forecast 2005**
Real GDP growth	7.3	7.7	5.6	7.2	5.6	6.9	8.0	8.3	7.4
Private consumption per capita	5.1	5.5	4.9	5.4	3.6	4.4	4.9	6.0	6.3
GDP per capita	5.6	6.4	4.4	5.9	4.6	6.0	7.0	7.4	6.5
Population	1.6	1.2	1.2	1.3	0.9	0.9	0.9	0.9	0.8
Gross domestic investment/GDP[a]	26.8	31.9	30.1	31.1	32.1	34.0	37.4	40.9	42.8
Inflation[b]	5.5	5.6	2.9	4.1	2.0	3.9	3.6	5.3	2.2
Central Government Budget Balance/GDP	−1.3	−1.2	−2.7	−3.1	−3.1	−3.3	−2.8	−2.4	−2.4
Export market growth[c]	6.9	8.2	7.2	14.1	−1.8	4.3	8.2	12.1	8.3
Export volume[d]	8.4	12.0	4.2	22.8	2.4	14.8	21.2	23.1	14.9
Terms of Trade/GDP[e]	−0.2	0.1	−0.6	−0.3	−0.3	0.5	−0.2	−0.9	0.8
Current Account/GDP	−0.3	0.4	4.1	3.4	2.4	3.4	3.7	3.1	2.5
Workers remittances ($, billions)	2.4	8.5	11.4	11.2	12.9	16.5	19.7	20.3	—
Memorandum items									
GDP growth: East Asia excluding China	5.7	4.6	3.2	5.9	2.4	4.6	5.4	6.0	5.4

External Financing and debt *($ billions, unless stated)*	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004e**
Net inward fixed direct investment (FDI)	58.6	62.1	57.7	49.9	44.2	48.2	55.6	59.6	63.6
Net inward portfolio equity flows	9.7	−3.9	−3.4	2.3	4.8	1.4	4.0	11.8	13.6
Net inward debt flows	52.2	44.9	−32.5	−12.2	−16.2	−9.1	−13.2	1.7	17.2
From public sources	3.6	17.3	14.7	12.6	7.0	3.2	−7.9	−7.5	−9.2
From private sources	48.6	27.6	−47.1	−24.7	−23.2	−12.3	−5.3	9.3	26.4
Gross market-based capital flows	69.2	73.1	31.6	32.4	49.7	21.8	44.5	53.1	60.0
Total external debt	494.0	526.3	533.2	538.6	500.7	502.0	498.2	525.5	536.5
Medium- and long-term	365.3	394.3	447.3	464.9	437.5	411.2	399.3	400.1	391.1
Short-term	128.7	132.1	85.9	73.8	63.2	90.8	99.0	125.5	145.4
Owed by public-sector borrowers	256.8	272.0	288.6	307.5	288.1	277.8	277.7	279.6	272.6
Owed by private-sector borrowers	237.2	254.4	244.6	231.1	212.6	224.2	220.6	246.0	263.9
Owed to public-sector creditors	153.7	152.5	179.1	200.3	188.2	180.6	183.4	190.8	179.4
Owed by private-sector creditors	340.3	373.8	354.1	338.3	312.5	321.4	314.8	334.8	357.2
Gross foreign exchange reserves	199.7	212.5	233.2	262.5	272.6	320.3	408.2	544.8	775.1

Note: — = not available; *e* = estimate; *f* = forecast.
a. Fixed investment, measured in real terms.
b. Local currency GDP deflator, median.
c. Weighted average growth of import demand in export markets.
d. Goods and non-factor services.
e. Change in terms of trade, measured as a percentage of GDP.

Table A.3 Europe and Central Asia outlook in summary, 1981–2005

Real economy *(% change, unless stated)*	**1981–90**	**1991–2000**	**1999**	**2000**	**2001**	**2002**	**2003**	**Estimate 2004**	**Forecast 2005**
Real GDP growth	1.8	−1.4	3.0	6.7	2.4	4.6	5.9	6.8	5.5
Private consumption per capita	0.6	−0.3	−0.2	4.4	3.4	5.7	6.7	7.0	6.3
GDP per capita	0.9	−1.6	2.8	6.2	2.4	4.6	5.9	6.8	5.4
Population	0.9	0.2	0.2	0.5	0.0	0.0	0.0	0.0	0.0
Gross domestic investment/GDP[a]	40.6	23.9	20.9	21.5	20.6	20.3	21.0	22.2	22.7
Inflation[b]	1.1	52.5	6.0	7.6	6.5	4.2	5.4	6.8	6.2
Central Government Budget Balance/GDP	−0.5	−4.4	−4.2	−2.5	−3.5	−3.7	−3.1	−2.1	−2.5
Export market growth[c]	3.9	5.4	−0.5	11.4	4.9	5.9	8.5	10.5	6.7
Export volume[d]	3.1	1.3	4.0	15.9	6.3	7.9	12.0	15.3	9.4
Terms of Trade/GDP[e]	−0.3	−0.7	−0.5	2.5	−0.6	−0.7	0.4	−0.7	0.6
Current Account/GDP	−0.3	−1.1	−0.1	1.8	2.0	0.5	0.0	0.6	−0.1
Workers remittances ($, billions)	2.1	8.0	10.7	11.0	11.4	11.5	12.9	12.9	—
Memorandum items									
GDP growth: Transition countries	1.4	−2.2	4.7	6.6	4.4	4.0	6.0	6.5	5.5
Central and Eastern Europe	0.4	1.0	4.0	3.7	2.8	2.9	4.0	5.0	4.5
Commonwealth of Independent States (CIS)	2.0	−4.2	5.4	9.2	5.8	5.0	7.6	7.7	6.2

External Financing and debt *($ billions, unless stated)*	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004e**
Net inward FDI	16.4	22.6	26.1	28.4	29.2	31.4	35.0	35.6	37.6
Net inward portfolio equity flows	4.3	4.0	4.0	2.0	1.3	0.4	−0.1	0.6	3.6
Net inward debt flows	24.1	35.3	43.0	18.9	19.9	2.7	28.0	56.9	56.0
From public sources	8.6	6.6	7.5	−0.6	0.0	2.2	2.6	−6.2	−6.2
From private sources	15.4	28.7	35.5	19.5	19.9	0.6	25.4	63.1	62.3
Gross market-based capital flows	25.7	46.0	42.9	30.1	45.5	26.0	34.6	58.5	87.0
Total external debt	368.3	391.2	490.3	503.5	510.8	507.8	560.2	676.0	728.5
Medium- and long-term	315.1	331.7	414.8	423.7	424.1	425.1	472.0	541.2	562.9
Short-term	53.2	59.5	75.5	79.7	86.7	82.6	88.2	134.8	165.6
Owed by public-sector borrowers	286.9	288.9	321.2	316.5	305.0	292.6	309.8	334.6	340.3
Owed by private-sector borrowers	81.5	102.3	169.1	186.9	205.8	215.2	250.4	341.4	388.2
Owed to public-sector creditors	160.0	156.2	172.4	171.4	166.8	159.2	165.4	176.2	169.6
Owed by private-sector creditors	208.3	235.0	317.9	332.1	344.0	348.6	394.8	499.8	558.9
Gross foreign exchange reserves	83.4	90.8	95.9	102.3	120.4	131.5	175.3	236.2	303.8

Note: — = not available; *e* = estimate; *f* = forecast.
a. Fixed investment, measured in real terms.
b. Local currency GDP deflator, median.
c. Weighted average growth of import demand in export markets.
d. Goods and non-factor services.
e. Change in terms of trade, measured as a percentage of GDP.

Table A.4 Latin America and the Caribbean outlook in summary, 1981–2005

Real economy *(% change, unless stated)*	**1981–90**	**1991–2000**	**1999**	**2000**	**2001**	**2002**	**2003**	**Estimate 2004**	**Forecast 2005**
Real GDP growth	1.1	3.3	0.1	3.7	0.3	−0.8	1.7	5.7	4.3
Private consumption per capita	−1.1	2.3	−1.8	1.8	−0.9	−3.3	−0.2	3.2	2.0
GDP per capita	−0.9	1.6	−1.5	1.8	−1.2	−2.3	0.3	4.2	2.9
Population	2.0	1.7	1.6	1.8	1.5	1.5	1.4	1.4	1.4
Gross domestic investment/GDP[a]	20.2	20.0	19.9	19.8	19.1	17.9	17.7	18.6	19.3
Inflation[b]	17.3	11.9	5.4	7.6	5.7	6.4	8.4	4.0	4.0
Central Government Budget Balance/GDP	−9.1	−3.3	−3.1	−2.4	−2.8	−3.0	−2.8	−1.4	−1.6
Export market growth[c]	4.5	9.1	5.1	11.7	−1.1	0.7	6.9	10.9	6.8
Export volume[d]	5.4	8.7	7.2	10.3	0.6	1.9	4.8	11.9	6.1
Terms of Trade/GDP[e]	−0.4	0.1	0.2	1.1	−0.7	−0.1	−0.1	0.4	−0.2
Current Account/GDP	−0.3	−2.8	−3.1	−2.4	−2.8	−1.0	0.5	1.5	0.7
Workers remittances ($, billions)	3.3	13.0	17.7	20.2	24.2	28.1	34.4	36.9	—
Memorandum items									
GDP growth: Central America	1.0	4.5	4.6	2.9	1.7	2.3	3.4	3.0	3.2
Caribbean	1.1	4.1	5.7	5.8	2.8	3.2	2.8	2.2	3.4

External Financing and debt *($ billions, unless stated)*	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004e**
Net inward FDI	44.2	66.7	74.0	88.2	78.9	70.2	45.7	36.5	42.4
Net inward portfolio equity flows	12.2	13.3	−2.2	−3.6	−0.6	2.5	1.4	3.4	−1.5
Net inward debt flows	40.8	25.2	37.3	12.1	−8.4	5.4	−8.5	3.3	2.5
From public sources	−10.7	−8.6	10.9	1.6	−11.1	20.4	13.0	4.9	−10.3
From private sources	51.5	33.8	26.4	10.5	2.8	−15.0	−21.5	−1.6	12.8
Gross market-based capital flows	75.7	105.4	74.8	67.0	85.5	71.1	44.3	63.3	77.7
Total external debt	638.5	670.4	752.2	771.8	755.1	749.2	746.2	779.6	773.5
Medium- and long-term	517.1	542.2	633.2	662.5	647.6	655.7	667.3	696.3	680.0
Short-term	121.4	128.2	119.0	109.3	107.5	93.5	78.9	83.3	93.5
Owed by public-sector borrowers	399.9	379.6	413.1	420.1	406.2	417.2	441.5	468.5	484.3
Owed by private-sector borrowers	238.6	290.8	339.1	351.7	348.9	332.0	304.7	311.2	289.1
Owed to public-sector creditors	164.1	145.9	161.0	163.2	150.1	162.9	183.1	196.9	189.2
Owed by private-sector creditors	474.3	524.5	591.2	608.6	605.0	586.3	563.1	582.8	584.2
Gross foreign exchange reserves	153.0	166.5	157.3	149.9	152.8	155.7	156.5	189.7	211.5

Note: — = not available; *e* = estimate; *f* = forecast.
a. Fixed investment, measured in real terms.
b. Local currency GDP deflator, median.
c. Weighted average growth of import demand in export markets.
d. Goods and non-factor services.
e. Change in terms of trade, measured as a percentage of GDP.

Table A.5 Middle East and North Africa outlook in summary, 1981–2005

Real economy *(% change, unless stated)*	**1981–90**	**1991–2000**	**1999**	**2000**	**2001**	**2002**	**2003**	**Estimate 2004**	**Forecast 2005**
Real GDP growth	3.6	3.7	2.8	4.0	4.0	4.5	5.2	5.1	5.0
Private consumption per capita	1.7	−0.2	0.2	1.3	2.3	1.3	2.9	1.6	1.9
GDP per capita	−1.1	1.2	−0.4	2.1	1.2	1.3	3.9	3.1	2.9
Population	3.1	2.1	2.1	2.2	1.7	1.8	1.9	1.9	1.9
Gross domestic investment/GDP[a]	25.5	20.5	21.0	20.7	21.2	21.7	21.7	22.3	22.9
Inflation[b]	8.4	6.4	7.5	10.7	1.9	2.0	3.6	4.2	4.0
Central Government Budget Balance/GDP	−3.9	−0.9	−0.6	1.4	−2.4	−3.0	−0.6	0.0	−0.5
Export market growth[c]	2.9	6.9	7.0	13.2	−1.0	4.9	7.9	10.0	7.5
Export volume[d]	0.8	4.8	0.2	8.1	0.9	−2.9	9.4	5.9	4.0
Terms of Trade/GDP[e]	−0.6	0.1	4.5	4.2	−0.2	1.1	1.7	4.1	−0.1
Current Account/GDP	−0.3	−0.2	1.3	6.7	4.5	4.2	6.1	9.3	8.0
Workers remittances ($, billions)	6.7	13.3	12.2	12.3	14.4	14.8	16.1	17.0	—
Memorandum items									
GDP growth: Resource poor, labor abundant	4.5	3.8	4.3	3.9	4.5	3.0	4.1	4.3	4.6
Resource rich, labor abundant	2.8	3.4	1.9	4.0	3.2	6.1	6.3	6.0	5.5
Resource rich, labor importing	−0.6	3.5	0.3	6.2	1.4	0.5	7.2	5.2	4.8

External Financing and debt *($ billions, unless stated)*	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004e**
Net inward FDI	1.7	3.2	3.1	3.7	4.3	5.7	3.8	4.8	4.1
Net inward portfolio equity flows	0.2	0.7	0.2	0.6	0.2	−0.1	−0.2	0.1	0.2
Net inward debt flows	0.7	−3.5	3.6	−3.0	−4.5	0.1	2.1	−0.7	−0.1
From public sources	−0.8	−4.0	−1.6	−2.5	−2.8	−1.2	−2.6	−2.5	−2.6
From private sources	1.5	0.5	5.2	−0.5	−1.8	1.3	4.6	1.8	2.6
Gross market-based capital flows	3.2	7.9	4.8	8.7	6.5	10.1	8.8	7.3	15.5
Total external debt	163.2	151.3	160.9	155.8	144.6	142.1	150.2	158.8	155.5
Medium- and long-term	144.4	132.7	138.9	132.6	123.8	123.8	131.7	138.5	134.9
Short-term	18.8	18.6	22.1	23.2	20.8	18.3	18.5	20.3	20.5
Owed by public-sector borrowers	140.3	127.7	131.8	125.6	117.2	117.2	125.2	131.8	127.4
Owed by private-sector borrowers	22.9	23.6	29.1	30.2	27.3	24.9	24.9	27.0	28.1
Owed to public-sector creditors	107.3	99.6	103.9	98.3	90.7	88.3	91.3	96.2	93.1
Owed by private-sector creditors	55.9	51.7	57.0	57.5	53.8	53.9	58.8	62.7	62.4
Gross foreign exchange reserves	37.6	43.7	42.0	40.8	45.6	55.1	67.1	89.1	101.3

Note: — = not available; *e* = estimate; *f* = forecast.
a. Fixed investment, measured in real terms.
b. Local currency GDP deflator, median.
c. Weighted average growth of import demand in export markets.
d. Goods and non-factor services.
e. Change in terms of trade, measured as a percentage of GDP.

Table A.6 South Asia outlook in summary, 1981–2005

Real Economy *(% change, unless stated)*	**1981–90**	**1991–2000**	**1999**	**2000**	**2001**	**2002**	**2003**	**Estimate 2004**	**Forecast 2005**
Real GDP growth	5.6	5.2	6.4	4.2	4.7	4.6	7.8	6.6	6.2
Private consumption per capita	1.7	2.3	3.9	0.9	3.1	2.2	6.0	4.3	3.5
GDP per capita	3.3	3.3	4.5	2.3	2.9	2.9	6.1	4.9	4.6
Population	2.2	1.9	1.8	1.9	1.7	1.7	1.6	1.6	1.6
Gross domestic investment/GDP[a]	20.2	21.6	22.3	22.5	22.3	23.1	23.4	23.7	24.0
Inflation[b]	8.9	8.1	4.4	3.9	3.8	3.6	4.7	4.4	7.2
Central Government Budget Balance/GDP	−12.6	−10.3	−12.2	−9.1	−8.5	−9.1	−7.9	−8.3	−8.3
Export market growth[c]	6.3	7.2	5.5	12.5	0.3	3.9	7.9	10.3	6.9
Export volume[d]	5.7	11.1	12.5	21.2	7.3	18.3	13.0	13.3	12.4
Terms of Trade/GDP[e]	0.0	0.1	−1.2	−0.9	−0.4	−1.2	−0.1	−1.2	−0.8
Current Account/GDP	−0.3	−1.5	−0.9	−1.0	0.2	1.6	1.6	−0.1	−0.7
Workers remittances ($, billions)	5.7	10.9	15.1	16.0	16.0	22.2	26.8	32.7	—
Memorandum items									
GDP growth: South Asia excluding India	5.1	4.4	4.2	5.1	3.1	4.5	5.7	5.9	5.8

External Financing and debt *($ billions, unless stated)*	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004e**
Net inward FDI	3.5	4.9	3.5	3.1	3.3	4.4	4.8	5.2	6.5
Net inward portfolio equity flows	4.1	2.9	−0.6	2.4	2.5	2.8	1.1	8.2	7.5
Net inward debt flows	2.7	0.7	4.7	0.5	3.5	−0.9	0.4	−4.0	4.4
From public sources	1.0	0.3	2.3	2.5	0.5	2.2	−2.4	−1.8	1.6
From private sources	1.6	0.4	2.4	−2.0	3.0	−3.1	2.9	−2.2	2.8
Gross market-based capital flows	10.3	12.4	4.9	4.1	4.3	3.2	2.5	7.0	17.5
Total external debt	149.6	149.6	157.6	162.0	160.0	156.2	170.2	182.8	184.7
Medium- and long-term	139.3	141.4	150.5	155.0	154.0	151.3	162.9	175.6	178.2
Short-term	10.3	8.2	7.1	7.0	6.1	5.0	7.3	7.2	6.5
Owed by public-sector borrowers	129.9	129.7	139.3	144.6	138.6	137.1	147.0	157.8	158.8
Owed by private-sector borrowers	19.8	19.9	18.3	17.4	21.5	19.1	23.2	25.0	25.9
Owed to public-sector creditors	104.1	98.9	104.6	113.3	102.7	101.1	106.3	113.8	113.7
Owed by private-sector creditors	45.5	50.7	53.0	48.7	57.3	55.1	63.9	68.9	71.0
Gross foreign exchange reserves	24.8	30.0	32.9	37.9	42.6	52.8	79.8	114.8	141.7

Note: — = not available; *e* = estimate; *f* = forecast.
a. Fixed investment, measured in real terms.
b. Local currency GDP deflator, median.
c. Weighted average growth of import demand in export markets.
d. Goods and non-factor services.
e. Change in terms of trade, measured as a percentage of GDP.

Table A.7 Sub-Saharan Africa outlook in summary, 1981–2005

Real economy *(% change, unless stated)*	**1981–90**	**1991–2000**	**1999**	**2000**	**2001**	**2002**	**2003**	**Estimate 2004**	**Forecast 2005**
Real GDP growth	1.6	2.3	2.5	3.6	3.1	2.8	3.4	3.8	4.1
Private consumption per capita	−1.0	−0.4	0.1	−2.2	3.8	5.9	−2.5	2.8	2.0
GDP per capita	−1.3	−0.3	−0.1	0.8	0.8	0.7	1.2	1.7	2.1
Population	3.0	2.6	2.6	2.7	2.3	2.2	2.1	2.0	2.0
Gross domestic investment/GDP[a]	19.0	17.1	17.9	18.1	18.1	19.4	19.4	19.9	20.2
Inflation[b]	9.6	9.5	5.8	7.5	6.0	6.5	8.2	4.1	4.0
Central Government Budget Balance/GDP	−4.5	−4.6	−3.0	−2.7	−2.4	−2.7	−2.7	−2.9	−3.0
Export market growth[c]	3.2	7.0	6.8	11.1	0.4	3.2	6.9	9.6	6.8
Export volume[d]	0.8	4.9	2.5	8.4	0.8	−0.4	5.7	7.3	8.4
Terms of Trade/GDP[e]	−1.0	0.2	−0.9	2.1	0.6	0.2	1.2	0.5	0.1
Current Account/GDP	−0.3	−1.5	−2.1	1.2	−0.8	−0.3	−0.8	0.6	0.3
Workers remittances ($, billions)	1.3	3.3	4.7	4.9	4.9	5.2	6.0	6.1	—
Memorandum items									
GDP growth: Sub-Saharan Africa excluding South Africa	2.3	3.3	3.7	2.4	3.4	2.0	1.7	4.2	4.6
Oil exporters	1.6	2.3	0.9	3.9	3.5	1.9	8.5	3.5	5.1

External financing and debt *($ billions, unless stated)*	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004e**
Net inward FDI	4.2	8.4	7.0	9.1	6.3	14.9	9.0	10.1	11.3
Net inward portfolio equity flows	2.4	5.6	8.7	9.0	4.2	−1.0	−0.4	0.7	3.5
Net inward debt flows	3.2	4.4	−1.3	−1.0	−0.5	−1.7	−0.3	2.7	3.6
From public sources	2.0	1.4	0.5	0.3	0.7	0.3	2.5	1.3	1.4
From private sources	1.2	3.0	−1.8	−1.3	−1.2	−2.0	−2.8	1.5	2.2
Gross market-based capital flows	7.5	9.3	7.9	9.2	13.9	11.9	8.6	13.7	11.1
Total external debt	231.3	220.8	228.6	215.0	211.3	203.2	211.4	231.4	218.4
Medium- and long-term	188.8	180.0	186.2	174.0	178.2	171.5	182.4	200.3	189.6
Short-term	42.6	40.8	42.4	41.0	33.1	31.7	29.0	31.1	28.8
Owed by public-sector borrowers	178.5	171.1	177.9	163.6	166.9	159.1	170.0	184.7	171.5
Owed by private-sector borrowers	52.9	49.7	50.7	51.4	44.5	44.1	41.5	46.7	46.9
Owed to public-sector creditors	144.0	138.2	145.7	135.2	140.9	134.9	145.1	159.6	151.6
Owed by private-sector creditors	87.3	82.6	82.9	79.8	70.4	68.3	66.3	71.8	66.8
Gross foreign exchange reserves	20.6	28.2	26.7	28.0	34.2	34.5	34.8	39.0	58.4

Note: — = not available; *e* = estimate; *f* = forecast.
a. Fixed investment, measured in real terms.
b. Local currency GDP deflator, median.
c. Weighted average growth of import demand in export markets.
d. Goods and non-factor services.
e. Change in terms of trade, measured as a percentage of GDP.

Table A.8 Global real GDP growth, 1981–2005

GDP in 1995 prices and exchange rates, average annual growth (%)

	GDP 2003 (1995 $)	Average 1981–90	Average 1991–2000	1999	2000	2001	2002	2003	Estimate 2004	Forecast 2005
World	**35,249**	**3.1**	**2.7**	**3.0**	**4.0**	**1.4**	**1.7**	**2.5**	**3.8**	**3.1**
High income	**28,448**	**3.1**	**2.6**	**3.0**	**3.7**	**1.1**	**1.3**	**1.9**	**3.2**	**2.4**
Industrial countries	27,556	3.1	2.5	2.9	3.5	1.1	1.3	1.8	3.1	2.4
European Union (15)	9,675	2.4	2.1	2.8	3.7	1.8	1.0	0.8	2.0	1.5
Japan	5,702	4.0	1.4	−0.1	2.4	0.2	−0.3	1.4	2.6	0.8
United States	9,562	3.2	3.3	4.4	3.7	0.8	1.9	3.0	4.4	3.9
Other high income	892	4.9	5.6	4.5	7.7	−0.9	2.4	3.2	6.2	4.4
Asian newly industrialized economies (NIEs)	657	7.3	6.0	5.1	7.6	−1.5	3.1	2.9	6.7	4.4
Developing countries	**6,801**	**2.7**	**3.2**	**3.0**	**5.3**	**3.0**	**3.5**	**5.3**	**6.6**	**5.7**
Excluding China	5,477	2.2	2.2	2.2	4.7	2.0	2.4	4.3	6.0	5.0
Excl. C.E. Europe/C.I.S.	5,641	3.2	4.7	2.7	5.0	2.7	3.4	5.1	6.7	5.7
Severely indebted	1,650	1.5	3.3	0.1	3.4	0.9	0.1	2.8	5.7	4.9
Moderately indebted	1,722	2.8	0.8	1.9	6.3	1.7	3.6	5.0	6.8	5.3
Less indebted	3,429	3.4	4.7	5.4	5.8	4.7	5.2	6.6	7.0	6.3
Middle-income countries	5,590	2.4	3.2	2.7	5.5	2.6	3.3	5.0	6.7	5.7
Upper middle-income countries	2,216	1.1	3.2	0.9	4.1	0.6	−0.4	2.1	5.8	4.5
Lower middle-income countries	3,374	3.4	3.1	4.2	6.6	4.2	6.0	6.9	7.3	6.4
Low-income countries	1,210	4.4	3.3	4.4	4.4	4.6	4.2	6.7	6.2	5.9
East Asia and Pacific	2,010	7.3	7.7	5.6	7.2	5.6	6.9	8.0	8.3	7.4
China	1,324	9.3	10.1	7.1	8.0	7.5	8.3	9.4	9.5	—
Indonesia	263	6.4	4.3	0.8	5.4	3.8	4.3	4.5	5.4	—
Europe and Central Asia	1,376	1.8	−1.4	3.0	6.7	2.4	4.6	5.9	6.8	5.5
Russian Federation	506	2.0	−3.9	6.4	10.0	5.1	4.7	7.3	7.1	—
Turkey	216	5.2	3.6	−4.7	7.4	−7.5	7.9	5.5	8.2	—
Poland	186	−0.3	3.7	4.1	4.0	1.0	1.4	3.8	5.4	—
Latin America and Caribbean	1,954	1.1	3.3	0.1	3.7	0.3	−0.8	1.7	5.7	4.3
Brazil	807	1.5	2.7	0.8	4.4	1.4	1.5	−0.2	5.1	—
Mexico	380	1.8	3.5	3.7	6.6	−0.3	0.7	1.3	4.1	—
Argentina	272	−1.5	4.5	−3.4	−0.8	−4.4	−10.9	8.8	8.6	—
Middle East and North Africa	393	3.6	3.7	2.8	4.0	4.0	4.5	5.2	5.1	5.0
Algeria	56	2.8	1.7	3.2	2.4	2.6	4.1	6.8	5.9	—
Iran, Islamic Rep. of	134	2.7	4.0	1.7	5.0	3.4	7.4	6.6	6.5	—
Egypt, Arab Rep. of	86	5.5	4.3	6.3	5.1	3.5	3.2	3.2	4.3	—
South Asia	723	5.6	5.2	6.4	4.2	4.7	4.6	7.8	6.6	6.2
India	561	5.8	5.5	7.1	3.9	5.2	4.6	8.4	6.8	—
Sub-Saharan Africa	344	1.6	2.3	2.5	3.6	3.1	2.8	3.4	3.8	4.1
South Africa	190	1.3	1.8	2.4	4.2	2.7	3.6	2.8	3.6	—
Nigeria	37	1.1	2.7	1.1	4.2	3.1	1.5	10.7	3.6	—

Note: — = not available.

Table A.9 Global inflation, 1991–2004

Consumer price indexes; local currency (% change)[a]

	Weights 1995	Average 1991–00	1998	1999	2000	2001	2002	2003	Estimate 2004
World	**100.0**	**3.3**	**2.0**	**1.7**	**2.6**	**1.5**	**2.0**	**1.8**	**2.6**
High income	**82.4**	**2.2**	**1.2**	**1.3**	**2.1**	**1.0**	**1.7**	**1.3**	**2.1**
Industrial countries	80.2	2.2	1.2	1.4	2.1	1.1	1.8	1.3	2.1
European Union (15)	29.8	2.6	1.0	1.6	2.3	1.9	2.2	1.8	2.2
Japan	18.3	0.7	0.6	−1.1	−0.2	−1.2	−0.3	−0.4	0.2
United States	25.3	2.7	1.6	2.7	3.4	1.6	2.4	1.9	3.3
Other high income	2.2	3.9	1.8	−0.1	0.8	−1.0	1.2	−0.4	1.3
Asian NIEs	1.7	3.1	0.4	−1.0	0.7	−2.0	0.0	−0.4	1.2
Developing countries	**17.6**	**8.6**	**5.6**	**3.3**	**5.1**	**3.9**	**3.4**	**3.9**	**5.0**
Excluding China	15.1	8.6	5.6	3.3	5.1	4.0	3.6	3.9	5.1
Excl. C.E. Europe/C.I.S.	14.8	8.5	5.8	3.2	4.9	4.1	4.1	3.9	5.3
Severely indebted	4.9	13.4	5.9	2.8	5.9	3.8	6.2	5.2	6.1
Moderately indebted	4.7	8.2	4.5	4.2	4.9	4.5	3.8	3.9	5.0
Less indebted	8.0	7.7	6.4	3.2	4.3	3.6	3.0	3.7	4.0
Middle-income countries	14.6	8.2	4.5	3.3	4.6	4.1	3.0	3.6	4.6
Upper middle-income countries	6.8	7.3	4.3	3.3	4.3	3.2	1.9	2.6	5.0
Lower middle-income countries	7.8	8.3	6.0	3.7	6.1	4.6	3.8	4.2	4.0
Low-income countries	3.0	10.2	6.4	3.3	5.8	3.8	3.9	5.2	6.4
East Asia and Pacific	4.4	4.3	7.0	1.3	2.7	3.2	3.2	3.3	2.9
China	2.4	7.1	−1.0	−1.0	1.5	−0.3	−0.4	3.2	2.4
Indonesia	0.7	13.4	77.7	1.9	9.3	12.6	10.0	5.1	6.4
Europe and Central Asia	3.4	49.4	5.3	7.0	6.1	3.6	2.1	3.6	4.6
Russian Federation	1.4	—	84.4	36.5	20.2	18.6	15.1	12.0	11.7
Turkey	0.6	74.7	69.7	68.8	39.0	68.5	29.7	12.7	9.4
Poland	0.4	24.2	8.4	9.6	8.4	3.6	0.8	1.6	4.2
Latin America and Caribbean	5.8	13.6	7.4	4.9	5.3	4.4	7.0	5.7	5.3
Brazil	2.4	180.2	2.4	8.4	5.3	9.4	14.7	10.4	6.1
Mexico	1.0	17.5	18.6	12.3	9.0	4.4	5.7	4.0	5.2
Argentina, R. B. de	0.9	9.2	0.7	−1.8	−0.7	−1.5	41.0	3.7	6.1
Middle East and North Africa	1.4	4.0	1.8	2.0	0.6	2.7	1.0	3.6	—
Algeria	0.5	15.0	3.9	1.2	0.1	7.5	−1.5	3.9	—
Iran, Islamic Rep. of	0.3	24.1	20.2	19.0	12.8	10.6	16.4	15.9	—
Egypt, Arab Rep. of	0.2	8.6	3.6	3.1	2.3	2.4	3.0	5.8	—
South Asia	1.6	8.6	12.7	3.0	3.5	2.7	3.3	4.9	7.4
India	1.2	8.4	15.3	0.5	3.5	5.2	3.2	3.7	3.8
Sub-Saharan Africa	1.0	8.5	5.6	4.5	7.0	4.7	5.0	3.9	—
South Africa	0.5	8.5	9.0	2.2	7.0	4.6	12.4	0.3	3.4
Nigeria	0.1	29.0	11.9	0.2	14.5	16.5	12.2	23.8	—

Note: — = not available.

a. Developing country aggregates computed using median. Industrial aggregates use 1995 $ GDP weights. World total is GDP weighted average of developing and high-income total. Inflation is calculated on a December/December basis. Where country CPI series ended before December 2004, estimates were made by extending the index series using the last available y/y change (effectively making the December inflation reading identical with the latest available one). These were then aggregated.

Table A.10 Commodity prices, 1980–2005

Current $

	Unit	1980	1990	1999	2000	2001	2002	2003	2004	Forecast 2005
Energy										
Coal, Australia	$/mt	29.4	39.7	25.9	26.3	32.3	27.1	27.8	54.7	50.0
Crude oil, average	$/bbl	36.9	22.9	18.1	28.2	24.4	24.9	28.9	37.7	42.0
Natural gas, Europe	$/mmbtu	3.4	2.5	2.1	3.9	4.1	3.1	3.9	4.3	5.3
Non-energy										
Agriculture										
Beverages										
Cocoa	¢/kg	260.3	126.7	113.5	90.6	106.9	177.8	175.1	155.0	162.0
Coffee, arabica	¢/kg	346.6	197.2	229.1	192.0	137.3	135.7	141.5	177.4	198.4
Coffee, robusta	¢/kg	324.3	118.2	148.9	91.3	60.7	66.2	81.4	79.3	88.2
Food										
Fats and oils										
Palm oil	$/mt	583.7	289.8	436.0	310.3	285.7	390.3	443.3	471.3	450.0
Soybean meal	$/mt	262.4	200.2	152.2	189.2	181.0	175.2	210.9	241.2	200.0
Soybeans	$/mt	296.2	246.8	201.7	211.8	195.8	212.7	264.0	306.5	240.0
Grains										
Maize	$/mt	125.3	109.3	90.2	88.5	89.6	99.3	105.4	111.8	100.0
Rice, Thailand, 5%	$/mt	410.7	270.9	248.4	202.4	172.8	191.9	197.6	237.7	250.0
Wheat, U.S., HRW	$/mt	172.7	135.5	112.0	114.1	126.8	148.1	146.1	156.9	145.0
Other food										
Bananas, U.S.	$/mt	377.3	540.9	373.8	424.0	583.2	528.6	374.8	524.6	460.0
Sugar, world	¢/kg	63.2	27.7	13.8	18.0	19.0	15.2	15.6	15.8	19.0
Raw materials										
Cotton ("A" Index)	¢/kg	206.2	181.9	117.1	130.2	105.8	101.9	139.9	136.6	116.8
Rubber, Malaysia	¢/kg	142.5	86.5	62.8	69.1	60.0	77.1	105.6	144.7	198.3
Sawnwood, Malaysia	$/cum	536.5	814.5	507.8	664.3	517.3	452.3	525.7	640.8	110.3
Fertilizers										
Triple superphosphate	$/mt	180.3	131.8	154.5	137.7	126.9	133.1	149.3	186.3	185.0
Metals and minerals										
Aluminum	$/mt	1,456.0	1,639.4	1,361.1	1,549.1	1,443.6	1,349.9	1,431.3	1,715.5	1,900.0
Copper	$/mt	2,182.1	2,661.5	1,572.9	1,813.5	1,578.3	1,559.5	1,779.1	2,865.9	3,000.0
Gold	$/toz	607.9	383.5	278.8	279.0	271.0	310.0	363.5	409.2	435.0
Nickel	$/mt	6,518.7	8,864.1	6,011.2	8,637.7	5,944.7	6,771.8	9,629.5	13,823.2	14,000.0
Memo:										
Deflator Index (MUV 1990 = 100)[a]		78.8	100.0	99.3	97.2	94.3	93.1	100.1	107.1	110.7
Reuters/CRB Commodity Futures Index (1967 = 100)										

Note: bbl = barrel; cum = cubic meter; kg = kilogram; mmbtu = million British thermal units; mt = metric ton; n.a. = not available; toz = troy oz.

a. Unit value index in $ terms of manufactures exported from the G-5 countries weighted by exports to developing countries.

Table A.11 Commodity price indexes, 1980–2005

Real dollar terms, deflated by $MUV (1990 = 100)

	Weights	1980	1990	1999	2000	2001	2002	2003	2004	Forecast 2005
Energy										
Coal, Australia		29.4	39.7	25.9	66.2	81.5	68.2	70.2	137.9	134.2
Crude oil, average		36.9	22.9	18.1	123.4	106.4	109.0	126.3	164.9	191.9
Natural gas, Europe		3.4	100.0	2.1	151.3	159.1	119.7	153.2	167.7	214.7
Non-energy		**125.5**	**100.0**	**88.0**	**86.7**	**78.8**	**83.0**	**91.5**	**107.4**	**112.5**
Agriculture		**138.1**	**100.0**	**92.8**	**87.5**	**79.5**	**86.4**	**94.7**	**104.7**	**103.3**
Beverages		**181.4**	**100.0**	**107.7**	**88.4**	**72.1**	**84.6**	**87.1**	**94.0**	**102.4**
Cocoa		260.3	126.7	113.5	71.5	84.4	140.4	138.2	122.4	125.8
Coffee, arabica		346.6	197.2	229.1	97.3	69.6	68.8	71.8	89.9	127.4
Coffee, robusta		324.3	118.2	148.9	77.3	51.4	56.0	68.9	67.1	72.9
Food		**139.3**	**100.0**	**87.6**	**84.5**	**86.0**	**90.1**	**96.4**	**110.0**	**102.5**
Fats and oils		**148.7**	**100.0**	**105.0**	**96.2**	**89.0**	**101.2**	**120.6**	**137.1**	**118.4**
Palm oil		583.7	289.8	436.0	107.1	98.6	134.7	153.0	162.7	132.0
Soybean meal		262.4	200.2	152.2	94.5	90.4	87.5	105.4	120.5	102.5
Soybeans		296.2	246.8	201.7	85.8	79.4	86.2	107.0	124.2	105.7
Grains		**134.3**	**100.0**	**86.4**	**79.5**	**78.2**	**88.1**	**90.2**	**100.2**	**96.5**
Maize		125.3	109.3	90.2	81.0	82.0	90.8	96.4	102.3	87.1
Rice, Thailand, 5%		410.7	270.9	248.4	74.7	63.8	70.8	73.0	87.7	106.5
Wheat, U.S., HRW		172.7	135.5	112.0	84.2	93.6	109.3	107.8	115.8	112.4
Other food		**134.3**	**100.0**	**74.0**	**77.7**	**87.9**	**82.1**	**80.1**	**93.2**	**92.7**
Bananas, U.S.		377.3	540.9	373.8	78.4	107.8	97.7	69.3	97.0	135.0
Sugar, world		63.2	27.7	13.8	65.2	68.8	54.9	56.5	57.1	71.0
Raw materials		**104.6**	**100.0**	**88.5**	**90.8**	**76.7**	**83.1**	**98.2**	**105.8**	**104.9**
Cotton ("A" Index)		206.2	181.9	117.1	71.6	58.2	56.0	76.9	75.1	62.8
Rubber, Malaysia		142.5	86.5	62.8	79.9	69.4	89.1	122.1	191.2	264.8
Sawnwood, Malaysia		536.5	814.5	507.8	81.6	63.5	55.5	64.5	78.7	81.2
Fertilizers		**128.9**	**100.0**	**114.1**	**105.8**	**98.8**	**100.5**	**106.2**	**126.6**	**126.9**
Triple superphosphate		180.3	131.8	154.5	104.5	96.2	100.9	113.3	141.3	153.2
Metals and minerals		**94.2**	**100.0**	**73.7**	**83.0**	**75.1**	**72.8**	**82.0**	**112.4**	**133.8**
Aluminum		1,456.0	1,639.4	1,361.1	94.5	88.1	82.3	87.3	104.6	113.4
Copper		2,182.1	2,661.5	1,572.9	68.1	59.3	58.6	66.8	107.7	120.7
Gold		607.9	383.5	278.8	72.8	70.7	80.8	94.8	106.7	110.5
Nickel		6,518.7	8,864.1	6,011.2	97.4	67.1	76.4	108.6	155.9	168.4
Memo:										
Deflator Index (MUV 1990 = 100)[a]		78.8	100.0	99.3	97.2	94.3	93.1	100.1	107.1	110.7
Reuters/CRB Commodity Futures Index (1967 = 100)										

Note: [a] = unit value index in dollar terms of manufactures exported from the G-7 countries, weighted by exports to developing countries.

Table A.12 Global nominal GDP growth, 1981–2005

% change from a year earlier

	Average								Estimate	Forecast
	1981–90	1991–2000	1998	1999	2000	2001	2002	2003	2004	2005
World	**9.7**	**6.7**	**4.8**	**4.4**	**6.1**	**3.6**	**3.5**	**4.3**	**5.4**	**4.7**
High income	**8.5**	**4.6**	**3.6**	**3.4**	**4.8**	**2.5**	**2.5**	**3.0**	**4.4**	**3.7**
Industrial countries	8.0	4.5	3.6	3.4	4.7	2.6	2.5	3.0	4.4	3.6
European Union (15)	8.8	5.0	5.5	3.4	5.1	4.1	3.5	2.9	3.8	3.3
Japan	6.2	1.5	−1.2	−1.4	0.8	−1.1	−1.6	−0.1	1.4	−0.3
United States	7.6	5.4	5.3	6.0	5.9	3.2	3.5	4.9	6.6	6.2
Other high income	25.5	9.6	1.9	4.3	8.5	−1.7	1.9	1.7	6.6	6.7
Asian NIEs	12.2	8.5	1.9	1.6	5.6	−1.9	1.6	0.1	5.7	5.8
Developing countries	**15.3**	**16.7**	**10.5**	**9.2**	**12.0**	**8.8**	**8.5**	**10.5**	**10.2**	**9.4**
Excluding China	15.3	16.7	10.8	9.4	12.1	8.9	8.6	10.5	10.2	9.4
Excl. C.E. Europe/C.I.S.	16.6	14.4	9.5	9.2	11.8	8.5	8.1	10.7	9.2	9.0
Severely indebted	19.0	15.7	8.1	8.2	12.3	8.8	8.4	10.3	10.5	9.7
Moderately indebted	15.4	19.0	12.1	8.0	12.6	9.2	8.9	11.2	10.2	8.8
Less indebted	14.1	15.5	10.8	10.9	11.5	9.2	8.2	10.5	9.8	9.5
Middle-income countries	14.4	17.2	9.8	8.5	12.0	8.4	8.7	9.8	9.5	9.0
Upper middle-income countries	14.0	17.4	9.9	6.5	11.0	7.7	8.1	9.0	9.0	8.4
Lower middle-income countries	14.6	16.8	9.8	9.1	12.1	9.9	9.4	10.4	10.2	9.4
Low-income countries	16.0	16.9	12.0	12.4	11.6	9.8	8.3	13.2	10.4	11.5
East Asia and Pacific	12.2	12.1	6.2	8.9	10.9	7.7	8.1	9.1	12.5	11.5
China	15.2	17.0	5.2	4.8	9.0	8.8	8.1	11.5	12.9	—
Indonesia	15.7	19.6	52.3	15.1	14.4	21.2	12.7	10.0	11.3	—
Europe and Central Asia	11.2	48.4	14.6	10.9	12.1	12.7	12.0	10.5	13.3	11.7
Russian Federation	40.0	99.6	12.3	83.5	51.5	22.4	21.1	22.6	18.3	—
Turkey	54.0	77.9	81.2	47.9	61.8	42.9	55.7	31.7	19.4	—
Poland	71.8	29.2	16.8	10.9	11.0	4.9	2.7	3.2	8.3	—
Latin America and Caribbean	25.1	17.3	12.2	6.6	11.1	7.6	8.3	12.2	8.0	7.7
Brazil	337.4	214.7	5.0	6.5	13.1	8.9	12.3	15.6	12.6	—
Mexico	66.7	22.2	21.0	19.5	19.4	5.1	5.9	10.5	8.0	—
Argentina, R. B. de	431.4	15.2	2.1	−5.2	0.2	−5.5	16.3	20.3	17.4	—
Middle East and North Africa	13.0	13.3	8.0	9.4	12.1	5.7	5.2	7.1	8.5	9.2
Algeria	13.1	21.9	0.7	13.9	27.0	5.3	5.2	15.6	11.2	—
Iran, Islamic Rep. of	18.6	31.1	9.8	18.2	42.2	23.9	32.5	24.1	14.1	—
Egypt, Arab Rep. of	19.3	13.4	8.1	8.6	12.1	6.8	7.1	7.1	8.5	—
South Asia	14.7	13.1	10.8	9.8	7.9	8.8	8.2	10.4	10.2	12.8
India	14.7	13.9	14.4	11.2	7.9	9.2	8.2	14.3	10.2	—
Sub-Saharan Africa	17.1	15.5	11.4	9.6	13.0	10.6	9.1	13.2	10.2	9.5
South Africa	16.5	12.3	8.3	9.6	13.3	10.6	14.2	7.4	9.8	—
Nigeria	17.9	32.3	−3.8	13.5	33.3	24.8	5.5	34.0	13.2	—

Note: — = not available. Developing counties aggregated using median growth rates. Industrial aggregates use 1995 $ GDP weights. World total is GDP weighted average of developing and high-income total.

Table A.13 Global goods export growth, 1981–2005

BOP goods exports (current $); average annual growth (%)

	Exports 2002 ($ bn.)	Average 1981–90	Average 1991–2000	1999	2000	2001	2002	2003	Estimate 2004	Forecast 2005
World	**6,025**	**6.1**	**6.5**	**3.2**	**12.4**	**−3.8**	**4.4**	**15.6**	**20.6**	**12.1**
High income	**4,480**	**6.8**	**5.6**	**2.4**	**9.6**	**−4.7**	**2.9**	**14.2**	**17.8**	**11.8**
Industrial countries	3,916	7.3	5.4	2.1	7.9	−3.9	2.8	14.2	17.4	12.1
European Union (15)	2,185	7.5	4.3	−0.7	2.8	0.5	5.8	18.0	17.1	12.7
Japan	395	8.3	5.0	7.4	14.0	−16.2	2.8	13.5	19.8	8.8
United States	697	5.7	7.2	2.4	12.5	−6.8	−4.7	4.2	12.3	9.7
Other high income	564	3.4	7.4	4.2	22.0	−9.7	4.1	13.8	21.3	9.5
Asian NIEs	468	5.0	7.2	4.0	19.0	−9.8	6.1	12.4	19.5	10.3
Developing countries	**1,545**	**3.4**	**10.0**	**6.3**	**22.4**	**−1.1**	**9.0**	**19.9**	**28.0**	**13.1**
Excluding China	1,219	2.9	9.0	6.3	21.3	−2.8	5.9	16.0	25.9	9.5
Excl. C.E. Europe/C.I.S.	1,225	4.3	10.4	7.9	22.0	−2.7	8.7	19.9	28.4	13.5
Severely indebted	207	1.5	6.3	−0.6	20.5	−1.8	2.7	14.8	26.1	4.5
Moderately indebted	502	3.9	9.9	7.1	23.0	−5.9	5.8	16.4	27.2	10.9
Less indebted	836	4.1	11.5	7.9	22.6	2.3	12.7	23.3	29.0	16.3
Middle-income countries	1,360	3.9	10.4	6.2	22.1	−0.7	9.4	20.1	28.8	13.4
Upper middle-income countries	569	3.8	10.4	6.7	19.5	−1.7	4.9	11.6	26.8	8.7
Lower middle-income countries	790	4.0	10.4	5.7	24.3	0.0	12.9	26.2	30.0	16.3
Low-income countries	185	1.2	7.9	7.2	24.5	−4.0	6.2	18.9	22.5	11.1
East Asia and Pacific	597	8.5	14.2	8.6	23.0	−1.8	14.3	24.0	28.0	20.1
China	326	11.8	17.1	6.1	27.9	6.8	22.4	34.6	34.8	—
Indonesia	57	3.3	9.2	−0.4	27.6	−9.3	1.5	6.8	14.4	—
Europe and Central Asia	360	1.5	8.8	−0.9	22.4	6.0	10.9	20.4	26.2	11.2
Russian Federation	107	—	10.8	1.5	39.0	−3.0	5.3	26.7	34.3	—
Turkey	40	16.2	9.0	−5.9	6.5	11.9	16.7	24.3	22.6	—
Poland	47	—	8.5	−7.4	19.4	16.0	12.2	21.7	20.7	—
Latin America and Caribbean	352	3.9	10.1	5.7	20.1	−4.3	0.9	9.4	30.4	6.6
Brazil	60	4.5	5.8	−6.1	14.7	5.7	3.7	21.1	29.8	—
Mexico	161	8.5	15.1	16.1	22.0	−4.8	1.5	2.6	29.1	—
Argentina, R. B. de	26	4.4	7.9	−11.8	13.0	0.8	−3.1	15.0	16.6	—
Middle East and North Africa	93	3.2	5.1	28.3	37.3	−6.8	7.7	24.4	29.5	4.2
Algeria	18	−0.5	5.2	21.5	75.7	−11.8	−2.4	35.4	32.5	—
Iran, Islamic Rep. of	28	—	3.9	60.3	34.8	−16.0	17.9	42.2	33.5	—
Egypt, Arab Rep. of	7	0.2	6.1	18.9	34.8	−0.5	1.3	26.3	25.0	—
South Asia	73	7.9	8.9	5.5	16.8	1.4	11.4	26.7	19.8	12.0
India	51	8.2	9.0	8.2	17.0	3.4	13.6	32.0	20.8	—
Sub-Saharan Africa	71	−2.1	3.1	5.7	18.6	−5.5	0.4	22.3	34.0	6.5
South Africa	31	−0.7	2.7	−2.0	11.0	−2.7	1.4	23.2	26.2	—
Nigeria	14	−6.3	3.7	43.5	51.4	−17.7	−12.5	31.6	58.0	—

Note: — = not available.

Table A.14 Global goods import growth, 1981–2005

BOP goods imports (current $); average annual growth (%)

	Imports 2002 ($ bn.)	Average 1981–90	Average 1991–2000	1999	2000	2001	2002	2003	Estimate 2004	Forecast 2005
World	**6,062**	**5.8**	**6.7**	**4.2**	**14.0**	**−3.8**	**3.7**	**15.6**	**20.4**	**11.9**
High income	**4,647**	**6.5**	**6.0**	**5.7**	**12.5**	**−5.2**	**2.8**	**14.3**	**18.5**	**11.0**
Industrial countries	4,125	6.8	5.8	6.1	11.6	−4.4	2.6	14.6	18.0	11.2
European Union (15)	2,065	6.8	4.2	1.6	5.5	−1.8	3.8	18.9	18.5	12.0
Japan	301	5.5	4.9	11.4	23.0	−8.6	−4.1	13.5	18.7	12.0
United States	1,190	7.2	9.4	12.5	18.9	−6.1	1.9	7.8	16.1	7.0
Other high income	522	4.2	7.2	2.6	19.8	−10.8	4.0	11.6	22.6	9.6
Asian NIEs	436	5.0	7.2	2.6	21.7	−12.2	3.9	11.6	23.8	10.2
Developing countries	**1,416**	**2.9**	**9.7**	**−1.2**	**19.6**	**1.0**	**6.8**	**20.0**	**26.1**	**14.5**
Excluding China	1,134	2.5	8.7	−3.6	17.0	−0.4	3.7	15.1	22.9	10.4
Excl. C.E. Europe/C.I.S.	1,112	3.7	10.2	1.3	21.4	−1.3	5.6	20.1	27.2	15.6
Severely indebted	143	−1.1	7.7	−13.4	12.6	−1.1	−11.7	12.6	31.2	10.8
Moderately indebted	433	4.5	7.7	−5.3	18.3	−2.0	6.7	16.6	23.5	10.7
Less indebted	840	3.4	11.6	5.1	22.1	3.1	10.7	23.1	26.6	16.9
Middle-income countries	1,246	3.2	10.2	−1.0	19.5	1.1	7.1	19.8	25.7	14.3
Upper middle-income countries	531	1.8	12.5	−0.3	16.2	−1.1	−0.2	9.1	21.1	8.8
Lower middle-income countries	715	4.2	8.5	−1.6	22.5	3.0	13.1	27.7	28.7	17.6
Low-income countries	170	1.7	6.7	−2.7	20.5	0.2	4.7	22.1	29.1	16.2
East Asia and Pacific	505	9.1	12.2	11.0	30.3	1.3	14.3	26.9	32.5	22.6
China	281	9.3	17.6	15.9	35.2	8.1	21.3	39.8	37.1	—
Indonesia	31	6.5	4.6	−12.2	38.9	−7.1	1.1	4.0	42.8	—
Europe and Central Asia	352	1.7	7.9	−10.4	15.9	3.9	12.9	22.1	23.9	10.2
Russian Federation	61	—	4.2	−31.8	13.5	19.8	13.4	25.3	24.2	—
Turkey	47	11.6	8.9	−12.7	35.0	−27.7	24.4	37.6	33.6	—
Poland	54	−2.5	14.7	−0.4	6.8	2.3	9.5	18.5	19.7	—
Latin America and Caribbean	329	1.3	12.9	−4.0	16.2	−2.2	−6.7	4.6	18.4	6.0
Brazil	47	−1.0	10.4	−14.6	13.3	−0.5	−15.0	2.2	28.0	—
Mexico	169	7.0	15.4	13.2	22.9	−3.5	0.2	1.1	11.9	—
Argentina, R. B. de	8	−8.8	20.4	−18.4	−0.9	−19.8	−55.8	54.8	65.6	—
Middle East and North Africa	82	2.7	2.4	−0.4	6.9	5.8	7.3	20.3	16.1	6.4
Algeria	10	−0.9	−0.6	3.8	4.3	1.5	13.8	30.3	16.0	—
Iran, Islamic Rep. of	22	5.3	−1.9	−6.0	13.2	22.9	20.2	37.1	15.0	—
Egypt, Arab Rep. of	13	4.2	4.1	3.7	1.4	−9.2	−7.7	2.4	16.0	—
South Asia	87	4.7	8.5	2.3	23.0	−3.9	6.5	25.9	31.0	17.2
India	63	5.3	9.8	1.6	30.4	−3.5	9.4	27.3	31.9	—
Sub-Saharan Africa	60	−2.4	4.1	−7.5	3.7	4.5	−1.8	26.4	26.5	8.6
South Africa	27	−0.9	4.7	−9.9	11.1	−5.3	3.8	30.6	36.1	—
Nigeria	8	−10.4	5.9	−6.8	1.6	32.8	−34.9	43.8	17.7	—

Note: — = not available.

Table A.15 Global goods trade balances, 1997–2005

$ billions

	% of GDP 2002	1997	1998	1999	2000	2001	2002	2003	Estimate 2004	Forecast 2005
World	**0.1**	**105.4**	**79.7**	**42.1**	**−19.9**	**−26.3**	**23.2**	**41.2**	**45.7**	**50.3**
High income	**−0.6**	**85.3**	**76.4**	**−56.8**	**−190.2**	**−156.9**	**−148.6**	**−173.7**	**−244.1**	**−227.1**
Industrial countries	−0.8	88.7	61.9	−79.1	−227.9	−197.4	−191.1	−233.5	−308.5	−297.2
European Union (15)	1.6	158.8	136.0	92.9	40.1	88.4	138.0	142.3	129.6	166.4
Japan	2.4	103.1	123.9	123.2	115.3	70.9	94.4	106.8	131.8	130.2
United States	−4.7	−197.7	−248.1	−348.3	−459.1	−436.7	−492.7	−555.6	−673.2	−697.8
Other high income	5.5	−3.4	14.5	22.4	37.7	40.5	42.5	59.7	64.4	70.1
Asian NIEs	6.2	−9.0	12.6	18.6	11.5	22.0	32.6	40.1	27.3	30.8
Developing countries	**2.6**	**13.3**	**−14.1**	**76.5**	**145.1**	**108.4**	**150.4**	**192.9**	**275.3**	**266.5**
Excluding China	2.7	−26.2	−43.3	62.9	135.9	96.5	127.6	170.2	238.5	227.3
Excl. C.E. Europe/C.I.S.	3.0	40.3	24.3	96.7	142.0	114.1	156.6	195.5	249.1	227.8
Severely indebted	6.0	5.5	3.2	24.7	41.2	39.2	63.6	76.2	87.7	48.5
Moderately indebted	5.0	−17.1	12.8	59.7	90.1	68.8	69.0	79.2	118.8	132.9
Less indebted	1.1	31.7	−12.7	14.5	39.0	22.6	39.3	59.5	83.3	66.0
Middle-income countries	3.2	26.1	7.0	89.8	154.5	122.4	160.1	205.6	291.7	293.6
Upper middle-income countries	4.1	19.4	−13.3	25.8	65.1	47.9	68.1	92.8	133.0	134.5
Lower middle-income countries	3.2	15.3	39.2	85.9	114.8	96.6	114.7	138.1	179.0	180.0
Low-income countries	−1.2	−12.8	−21.0	−13.3	−9.4	−14.0	−9.6	−12.7	−16.5	−27.1
East Asia and Pacific	5.1	44.4	96.7	97.8	95.9	81.0	92.3	99.8	99.2	97.3
China	3.5	46.2	46.6	36.0	34.5	34.0	44.2	44.7	51.3	—
Indonesia	12.7	11.9	21.5	24.7	28.8	25.4	25.9	28.5	23.4	—
Europe and Central Asia	0.7	−35.3	−35.0	−8.0	6.4	12.7	7.9	4.0	14.7	20.7
Russian Federation	13.4	14.9	16.4	36.0	60.2	48.1	46.3	59.6	87.8	—
Turkey	−4.0	−15.0	−14.1	−10.2	−22.0	−3.7	−7.3	−15.3	−26.0	—
Poland	−3.8	−9.8	−12.8	−15.1	−12.3	−7.7	−7.2	−7.1	−7.9	—
Latin America and Caribbean	1.4	−14.5	−36.5	−7.3	3.6	−4.2	22.5	40.8	64.8	55.7
Brazil	2.8	−6.8	−6.6	−1.3	−0.8	2.7	13.1	24.8	33.1	—
Mexico	−1.3	0.6	−7.9	−5.6	−8.0	−10.0	−7.9	−5.6	−7.3	—
Argentina, R. B. de	16.9	−2.1	−3.1	−0.8	2.5	7.4	17.2	16.5	12.8	—
Middle East and North Africa	9.4	34.2	−4.4	24.5	69.7	48.7	53.2	77.7	125.1	130.0
Algeria	4.7	6.5	2.4	4.3	13.2	10.6	8.9	12.6	18.7	—
Iran, Islamic Rep. of	4.9	4.3	−1.2	7.6	13.1	5.1	5.6	9.2	17.9	—
Egypt, Arab Rep. of	−6.4	−8.6	−10.2	−9.9	−8.3	−6.9	−5.8	−4.2	−4.1	—
South Asia	−2.3	−16.1	−15.6	−14.3	−21.0	−16.7	−14.6	−17.8	−33.6	−45.3
India	−2.4	−10.0	−10.8	−8.7	−16.3	−12.7	−12.0	−13.0	−24.6	—
Sub-Saharan Africa	3.8	7.4	−1.9	6.1	15.8	9.1	10.5	10.4	19.6	18.8
South Africa	4.2	2.3	2.1	4.2	4.6	5.2	4.6	3.7	1.2	—
Nigeria	13.9	5.7	−0.2	4.3	10.8	4.5	6.5	7.6	16.4	—

Note: — = not available.

Table A.16 Global trade prices and volumes, 1981–2005

Average annual % change

	Average change								Estimate	Forecast
	1981–90	1991–2000	1998	1999	2000	2001	2002	2003	2004	2005
Trade prices										
Manufactured goods prices	2.4	−0.3	−3.8	−0.3	−2.1	−2.9	−1.3	7.5	7.0	3.3
Developing countries' export price	−1.7	1.1	−8.2	−1.3	4.8	−3.5	0.4	5.5	9.2	1.6
Oil price	−4.7	2.1	−31.9	38.3	56.2	−13.7	2.4	15.9	30.6	11.3
Non-oil commodity prices	−2.2	−1.4	−15.7	−11.2	−1.4	−9.1	5.3	10.2	17.5	4.7
Terms of trade										
World	−0.2	−0.2	0.1	−0.3	−0.9	−0.4	0.5	0.5	−0.4	0.5
High income	0.7	0.0	0.9	−0.5	−2.3	−0.1	0.7	0.4	−0.4	0.5
Developing countries	−2.7	−1.0	−3.6	0.8	4.3	−1.6	0.0	0.9	−0.1	0.8
Severely indebted	−3.7	−0.2	−4.7	−3.0	3.5	−1.7	−2.6	−0.1	−3.1	−2.4
Moderately indebted	−2.2	−1.1	−4.4	0.4	8.2	−3.5	0.2	1.5	0.4	1.5
Less indebted	−2.5	−1.0	−2.1	2.2	1.6	−0.4	0.3	0.3	−0.6	0.6
Middle-income countries	−2.6	−1.2	−3.9	1.7	4.5	−1.6	0.6	1.0	0.2	1.0
Upper middle-income countries	−2.4	0.5	−6.6	6.1	6.8	−2.5	1.4	0.9	2.7	0.0
Lower middle-income countries	−2.3	−1.9	−1.3	−1.8	2.4	−0.8	0.0	0.9	−1.5	1.3
Low-income countries	−3.5	0.8	−1.1	−6.8	1.9	−1.9	−5.6	0.3	−3.6	−2.3
East Asia and Pacific	−1.5	0.2	1.0	−2.2	−1.1	−0.8	1.5	−0.6	−2.6	1.8
Europe and Central Asia	−1.6	−2.2	−1.1	−1.5	6.7	−1.4	−1.7	1.1	−1.7	1.5
Latin America and Caribbean	−2.8	0.1	−5.0	1.3	5.5	−3.0	−0.4	−0.5	1.7	−0.7
Middle East and North Africa	−3.2	−0.2	−15.0	16.9	15.1	−0.8	3.9	5.6	12.8	−0.3
South Asia	0.5	1.0	5.9	−8.5	−6.0	−2.7	−7.8	−0.7	−7.0	−4.0
Sub-Saharan Africa	−4.1	0.0	−7.0	−3.4	7.6	1.9	0.7	4.0	1.6	0.3
Global export volumes										
World	4.8	6.8	4.2	5.4	12.9	0.4	3.8	5.4	10.4	7.4
High income	5.1	6.9	4.1	5.5	12.1	−0.3	2.6	3.1	8.5	6.3
Developing countries	4.2	7.0	4.6	6.5	15.3	3.1	8.4	13.5	16.6	10.6
Severely indebted	3.0	6.3	6.1	−6.3	14.0	5.1	3.5	9.3	13.2	9.4
Moderately indebted	4.8	4.7	3.0	6.4	13.2	0.7	5.9	8.4	13.6	8.6
Less indebted	3.5	8.0	5.9	6.9	18.4	4.2	10.9	17.5	18.9	12.3
Middle-income countries	4.4	6.9	4.4	6.3	15.2	2.9	8.1	13.5	17.1	10.5
Upper middle-income countries	2.9	8.9	7.5	5.0	13.6	−0.2	1.6	6.9	12.4	8.5
Lower middle-income countries	4.6	4.9	2.9	3.7	17.1	4.8	11.6	16.7	19.2	11.8
Low-income countries	2.4	8.0	6.6	9.6	16.8	4.9	11.1	13.0	12.0	11.4
East Asia and Pacific	8.4	12.0	3.1	4.2	22.8	2.4	14.8	21.2	23.1	14.9
Europe and Central Asia	3.1	1.3	6.0	4.0	15.9	6.3	7.9	12.0	15.3	9.4
Latin America and Caribbean	5.4	8.7	7.8	7.2	10.3	0.6	1.9	4.8	11.9	6.1
Middle East and North Africa	0.8	4.8	−1.2	0.2	8.1	0.9	−2.9	9.4	5.9	4.0
South Asia	5.7	11.1	9.1	12.5	21.2	7.3	18.3	13.0	13.3	12.4
Sub-Saharan Africa	0.8	4.9	4.4	2.5	8.4	0.8	−0.4	5.7	7.3	8.4

Note: Prices are in $ terms unless otherwise indicated.

Table A.17 Global current account balances, 1999–2005

$ billions

	Percent of GDP (2002)									
	Merchandise balance	Services balance	Income balance and net transfers	1999	2000	2001	2002	2003	Estimate 2004	Forecast 2005
World	**−0.2**	**0.1**	**−0.4**	**−155.9**	**−214.0**	**−200.8**	**−184.5**	**−150.0**	**−167.2**	**−216.5**
High income	**−0.7**	**0.2**	**−0.5**	**−147.9**	**−257.6**	**−217.7**	**−256.6**	**−263.8**	**−319.9**	**−331.1**
Industrial countries	−0.8	0.1	−0.5	−175.5	−291.6	−250.7	−290.3	−316.1	−377.1	−391.6
European Union (15)	1.3	0.2	−1.2	−29.4	−69.4	−15.2	21.3	11.5	19.3	50.6
Japan	2.4	−1.1	1.5	114.6	119.7	87.8	112.4	136.2	172.2	164.0
United States	−4.6	0.6	−0.5	−296.8	−413.4	−385.7	−473.9	−530.7	−660.4	−691.1
Other high income	2.4	1.8	0.1	27.6	34.1	32.9	33.7	52.3	57.2	61.5
Asian NIEs	2.8	3.3	−0.2	25.6	20.3	26.0	31.5	44.9	33.5	36.9
Developing countries	**1.9**	**−0.5**	**−0.3**	**−8.0**	**43.6**	**16.9**	**72.0**	**112.8**	**152.7**	**114.6**
excluding China	1.4	−0.5	−0.3	−29.1	23.0	−0.5	36.6	66.9	105.3	70.8
excl. C.E. Europe /C.I.S.	1.9	−0.5	−0.2	−6.9	18.3	2.9	66.7	108.6	128.2	96.0
Severely indebted	6.1	−2.6	−2.3	−38.6	−21.0	−23.3	9.7	20.1	29.4	19.3
Moderately indebted	4.4	−0.3	−1.2	43.8	70.8	48.3	44.4	55.7	90.3	86.3
Less indebted	−0.4	0.1	0.7	−13.1	−6.2	−8.2	17.9	37.0	33.0	9.0
Middle-income countries	2.1	−0.3	−0.8	−0.7	35.4	13.7	56.7	100.7	145.0	118.5
Upper middle-income countries	1.6	−0.3	−2.2	−61.3	−49.0	−49.2	−17.1	5.4	22.7	7.9
Lower middle-income countries	2.4	−0.3	0.3	60.5	84.4	62.9	73.9	95.3	122.3	110.6
Low-income countries	1.0	−1.2	1.8	−7.3	8.2	3.2	15.3	12.1	7.6	−3.9
East Asia and Pacific	5.3	−1.2	−0.6	60.2	53.5	39.6	61.4	74.7	71.3	65.6
China	3.5	−0.5	−0.2	21.1	20.5	17.4	35.4	45.9	47.3	—
Indonesia	—	—	—	5.8	8.0	6.9	8.1	7.5	3.7	—
Europe and Central Asia	0.7	0.4	−0.7	−2.5	15.5	17.4	3.8	−2.6	9.6	1.7
Russian Federation	13.4	−2.9	−2.1	24.6	46.8	33.8	29.1	35.8	55.4	—
Turkey	−4.0	4.3	−1.2	−1.3	−9.8	3.4	−1.5	−6.8	−14.9	—
Poland	−3.8	0.4	0.7	−12.5	−10.0	−5.4	−5.0	−4.6	−4.4	—
Latin America and Caribbean	1.4	−0.8	−1.4	−55.5	−46.9	−53.4	−15.8	7.9	28.2	14.2
Brazil	2.8	−1.1	−3.4	−25.4	−24.2	−23.2	−7.6	4.0	11.1	—
Mexico	−1.2	−0.8	−0.1	−14.0	−18.2	−18.2	−14.1	−9.2	−8.3	—
Argentina, R. B. de	16.9	−1.6	−6.3	−11.9	−9.0	−3.9	9.1	7.8	3.2	—
Middle East and North Africa	−5.2	2.4	4.8	4.2	24.1	17.3	15.6	25.7	41.7	38.3
Algeria	—	—	—	−0.8	8.0	7.6	6.0	9.8	14.9	—
Iran, Islamic Rep. of	—	—	—	6.6	12.6	5.4	4.1	8.0	16.2	—
Egypt, Arab Rep. of	−6.4	3.0	4.1	−1.6	−1.0	−0.4	0.6	3.7	3.3	—
South Asia	−2.5	1.0	3.1	−5.2	−5.8	1.2	10.1	11.6	−0.7	−6.8
India	−2.4	1.3	2.2	−3.2	−4.3	0.2	5.8	8.0	−1.1	—
Sub-Saharan Africa	3.2	−3.1	−1.4	−9.3	3.2	−5.1	−3.1	−4.5	2.6	1.5
South Africa	4.4	−0.6	−3.2	−0.5	−0.3	0.1	0.6	−1.5	−5.6	—
Nigeria	—	—	—	0.5	6.5	0.0	1.6	2.3	9.9	—

Note: — = not available.

Table A.18 Global current account balances, 1981–2005

% of GDP

	Average								Estimate	Forecast
	1981–90	1991–2000	1998	1999	2000	2001	2002	2003	2004	2005
World	**−0.7**	**−0.4**	**−0.3**	**−0.5**	**−0.7**	**−0.6**	**−0.6**	**−0.4**	**−0.4**	**−0.5**
High income	**−0.4**	**−0.2**	**0.1**	**−0.6**	**−1.0**	**−0.9**	**−1.0**	**−0.9**	**−1.0**	**−1.0**
Industrial countries	−0.5	−0.2	0.0	−0.7	−1.2	−1.0	−1.2	−1.1	−1.2	−1.2
European Union (15)	0.0	−0.1	0.6	−0.4	−0.9	−0.2	0.3	0.1	0.2	0.3
Japan	2.3	2.5	3.0	2.6	2.5	2.1	2.8	3.2	3.7	3.4
United States	−1.9	−1.8	−2.4	−3.2	−4.2	−3.8	−4.5	−4.8	−5.6	−5.5
Other high income	3.2	1.7	2.9	3.7	4.2	4.3	4.4	6.6	6.6	6.4
Asian NIEs	−0.1	3.4	4.1	4.8	3.6	4.9	5.9	8.4	5.8	5.9
Developing countries	**−1.7**	**−1.3**	**−1.6**	**−0.1**	**0.8**	**0.4**	**1.3**	**1.8**	**2.0**	**1.3**
excluding China	−1.8	−1.9	−2.7	−0.6	0.5	0.1	0.9	1.4	1.8	1.1
excl. C.E. Europe /C.I.S.	−1.8	−1.4	−1.3	−0.1	0.4	0.1	1.4	2.0	2.1	1.4
Severely indebted	−2.5	−2.5	−4.2	−2.9	−1.7	−1.8	1.0	1.7	2.2	1.3
Moderately indebted	−2.1	−0.6	0.0	3.9	5.7	4.0	3.5	3.8	4.9	3.9
Less indebted	−1.0	−1.0	−1.0	−0.5	−0.2	−0.3	0.5	1.0	0.8	0.2
Middle-income countries	−1.4	−1.2	−1.5	0.0	0.8	0.3	1.2	1.9	2.4	1.7
Upper middle-income countries	−1.4	−2.8	−4.0	−3.1	−2.3	−2.3	−0.9	0.3	1.0	0.3
Lower middle-income countries	−1.4	0.1	0.8	2.6	3.4	2.4	2.7	3.0	3.3	2.5
Low-income countries	−2.7	−1.8	−2.6	−0.3	0.9	0.7	1.6	1.1	0.5	−0.2
East Asia and Pacific	−1.7	0.4	4.5	4.1	3.4	2.4	3.4	3.7	3.1	2.5
China	0.2	1.6	3.3	2.1	1.9	1.5	2.8	3.2	3.0	2.3
Indonesia	−2.8	−0.3	3.9	3.7	4.8	4.2	4.0	3.1	1.4	2.2
Europe and Central Asia	−0.7	−1.1	−2.5	−0.1	1.8	2.0	0.5	0.0	0.6	0.1
Russian Federation	—	—	0.1	12.6	18.0	11.0	8.4	8.3	10.7	7.7
Turkey	−1.3	−1.1	1.0	−0.7	−4.9	2.3	−0.8	−2.8	−4.8	−4.2
Poland	−1.4	−3.5	−4.1	−7.6	−6.0	−2.9	−2.6	−2.2	−1.9	−2.1
Latin America and Caribbean	−1.8	−2.8	−4.5	−3.1	−2.4	−2.8	−1.0	0.5	1.5	0.7
Brazil	−1.6	−2.1	−4.3	−4.7	−4.0	−4.6	−1.7	0.8	1.9	0.8
Mexico	−0.8	−3.7	−3.8	−2.9	−3.1	−2.9	−2.2	−1.5	−1.3	−1.8
Argentina, R. B. de	−2.2	−3.2	−4.9	−4.2	−3.2	−1.4	9.0	6.0	2.1	−0.6
Middle East and North Africa	−1.0	−0.2	−3.5	1.3	6.7	4.5	4.2	6.1	9.3	8.0
Algeria	−0.5	−0.3	−5.7	−1.7	15.0	13.8	10.8	14.7	18.7	15.2
Iran, Islamic Rep. of	−0.4	2.0	−2.1	7.1	13.1	4.6	3.6	5.9	10.9	9.0
Egypt, Arab Rep. of	−3.4	1.5	−3.1	−1.8	−1.0	−0.4	0.7	4.5	4.6	4.2
South Asia	−2.0	−1.5	−1.8	−0.9	−1.0	0.2	1.6	1.6	−0.1	−0.7
India	−1.7	−1.2	−1.7	−0.7	−1.0	0.0	1.1	1.3	−0.1	−0.7
Sub-Saharan Africa	−2.2	−1.5	−5.0	−2.1	1.2	−0.8	−0.3	−0.8	0.6	0.3
South Africa	0.4	−0.2	−1.6	−0.4	−0.2	0.0	0.6	−0.9	−2.6	−1.8
Nigeria	−0.7	0.5	−13.2	1.5	15.4	−0.1	3.4	4.0	16.4	15.2

Note: — = not available.

Table A.19 Workers' remittances received by developing countries, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004e
All developing countries	**61.2**	**70.9**	**68.0**	**71.9**	**75.6**	**83.8**	**98.2**	**115.9**	**125.8**
East Asia and the Pacific	10.3	15.2	9.1	11.4	11.2	12.9	16.5	19.7	20.3
China	1.7	4.6	0.3	0.5	0.8	1.2	2.4	4.6	4.6
Indonesia	0.8	0.7	1.0	1.1	1.2	1.0	1.3	1.3	1.3
Malaysia	0.9	1.1	0.9	1.0	1.0	0.8	1.0	1.0	1.0
Philippines	4.9	6.8	5.1	6.9	6.2	6.2	7.4	7.9	8.1
Thailand	1.8	1.7	1.4	1.5	1.7	1.3	1.4	1.6	1.6
Europe and Central Asia	9.4	9.7	12.8	10.7	11.0	11.4	11.5	12.9	12.9
Albania	0.6	0.3	0.5	0.4	0.6	0.7	0.7	0.9	0.9
Croatia	0.7	0.6	0.6	0.6	0.6	0.7	0.9	1.1	1.1
Poland	0.8	0.8	1.1	0.8	0.8	1.1	1.4	2.3	2.3
Russian Federation	2.8	2.3	1.9	1.3	1.3	1.4	1.4	1.5	1.5
Turkey	3.5	4.2	5.4	4.5	4.6	2.8	1.9	0.7	0.7
Latin America and the Caribbean	13.6	14.5	15.9	17.7	20.2	24.2	28.1	34.4	36.9
Brazil	2.5	2.0	1.6	1.9	1.6	1.8	2.4	2.8	2.8
Colombia	0.8	0.8	0.8	1.3	1.6	2.1	2.5	3.1	3.1
Dominican Republic	1.0	1.1	1.4	1.6	1.8	2.0	2.2	2.3	2.3
El Salvador	1.1	1.2	1.3	1.4	1.8	1.9	2.0	2.1	2.5
Mexico	5.0	5.5	6.5	6.6	7.6	9.9	11.0	14.6	17.0
Middle East and North Africa	12.4	12.7	12.5	12.2	12.3	14.4	14.8	16.1	17.0
Egypt, Arab Rep. of	3.1	3.7	3.4	3.2	2.9	2.9	2.9	3.0	3.0
Jordon	1.7	1.8	1.6	1.8	1.8	2.0	2.1	2.2	2.2
Lebanon	1.2	1.2	1.2	1.4	1.6	2.3	2.5	2.7	2.7
Morocco	2.2	1.9	2.0	1.9	2.2	3.3	2.9	3.6	3.6
South Asia	12.3	14.6	13.4	15.1	16.0	16.0	22.2	26.8	32.7
Bangladesh	1.3	1.5	1.6	1.8	2.0	2.1	2.9	3.2	3.4
India	8.8	10.3	9.5	11.1	11.7	11.1	13.8	17.4	23.0
Pakistan	1.3	1.7	1.2	1.0	1.1	1.5	3.6	4.0	4.1
Sri Lanka	0.9	0.9	1.0	1.1	1.2	1.2	1.3	1.3	1.3
Sub-Saharan Africa	3.2	4.4	4.3	4.7	4.9	4.9	5.2	6.0	6.1
Lesotho	0.4	0.4	0.3	0.3	0.3	0.2	0.2	0.2	0.2
Nigeria	0.9	1.9	1.5	1.6	1.7	1.3	1.4	1.7	1.8
Senegal	0.2	0.2	0.1	0.2	0.2	0.3	0.3	0.3	0.3
Sudan	0.2	0.4	0.7	0.7	0.6	0.7	1.0	1.2	1.2

Note: e = estimate.

Table A.20 Net official development assistance from DAC countries, 1996–2003

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003
Total ODA	**55.6**	**48.5**	**52.1**	**56.4**	**53.7**	**52.3**	**58.3**	**69.0**
Australia	1.1	1.1	1.0	1.0	1.0	0.9	1.0	1.2
Austria	0.6	0.5	0.5	0.5	0.4	0.5	0.5	0.5
Belgium	0.9	0.8	0.9	0.8	0.8	0.9	1.1	1.9
Canada	1.8	2.0	1.7	1.7	1.7	1.5	2.0	2.0
Denmark	1.8	1.6	1.7	1.7	1.7	1.6	1.6	1.7
Finland	0.4	0.4	0.4	0.4	0.4	0.4	0.5	0.6
France	7.5	6.3	5.7	5.6	4.1	4.2	5.5	7.3
Germany	7.6	5.9	5.6	5.5	5.0	5.0	5.3	6.8
Greece	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.4
Ireland	0.2	0.2	0.2	0.2	0.2	0.3	0.4	0.5
Italy	2.4	1.3	2.3	1.8	1.4	1.6	2.3	2.4
Japan	9.4	9.4	10.6	15.3	13.5	9.8	9.3	8.9
Luxembourg	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2
Netherlands	3.2	2.9	3.0	3.1	3.1	3.2	3.3	4.0
New Zealand	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.2
Norway	1.3	1.3	1.3	1.4	1.3	1.3	1.7	2.0
Portugal	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Spain	1.3	1.2	1.4	1.4	1.2	1.7	1.7	2.0
Sweden	2.0	1.7	1.6	1.6	1.8	1.7	2.0	2.4
Switzerland	1.0	0.9	0.9	1.0	0.9	0.9	0.9	1.3
United Kingdom	3.2	3.4	3.9	3.4	4.5	4.6	4.9	6.3
United States	9.4	6.9	8.8	9.1	10.0	11.4	13.3	16.3

Table A.21 External financing: all developing countries, 1998–2004

$ billions

	1998	1999	2000	2001	2002	2003	2004e
Current account balance	−93.7	−8.0	43.6	16.9	72.0	112.8	152.7
as % GDP	−1.6	−0.1	0.8	0.4	1.3	1.8	2.0
Financed by:							
Net equity flows	178.1	195.1	178.6	180.9	159.8	176.6	192.3
Net FDI inflows	171.5	182.4	166.2	174.8	154.0	151.8	165.5
Net portfolio equity inflows	6.6	12.7	12.4	6.0	5.8	24.8	26.8
Net debt flows	54.9	15.4	−6.2	−3.5	8.5	60.0	83.7
Official creditors	34.4	13.9	−5.8	27.0	5.2	−11.9	−25.3
World Bank	8.7	8.8	7.9	7.5	−0.2	−1.2	−1.4
IMF	14.1	−2.2	−10.7	19.5	14.0	2.4	−10.9
Others	11.6	7.3	−3.0	0.0	−8.6	−13.1	−13.1
Private creditors	20.5	1.5	−0.4	−30.5	3.3	71.8	109.0
Net M-L term debt flows	85.0	21.6	7.4	−6.6	0.5	22.9	55.4
Bonds	39.7	29.8	17.5	11.0	11.2	26.6	63.0
Banks	50.4	−6.8	−5.8	−11.0	−4.2	2.5	−1.8
Others	−5.2	−1.5	−4.3	−6.6	−6.5	−6.3	−5.7
Net short-term debt flows	−64.5	−20.1	−7.9	−23.9	2.8	49.0	53.6
Balancing item*	−122.9	−169.1	−169.1	−112.6	−68.6	−57.4	−50.4
Change in reserves (− = increase)	−16.3	−33.4	−46.8	−81.7	−171.7	−291.9	−378.2
Memo items:							
Bilateral aid grants (ex technical cooperation grants)	26.7	28.5	28.7	27.9	32.2	43.4	47.4
Net private flows (debt + equity)	198.6	196.6	178.1	150.4	163.1	248.4	301.3
Net official flows (aid + debt)	61.1	42.4	23.0	54.9	37.4	31.5	22.1
Workers' remittances	68.0	71.9	75.6	83.8	98.2	115.9	125.8

Note: e = estimate.
*Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries.

Table A.22 External financing: East Asia and Pacific, 1998–2004

$ billions

	1998	1999	2000	2001	2002	2003	2004e
Current account balance	59.6	60.2	53.5	39.6	61.4	74.7	71.3
as % GDP	4.5	4.1	3.4	2.4	3.4	3.7	3.1
Financed by:							
Net equity flows	54.2	52.3	49.0	49.6	59.7	71.5	77.2
Net FDI inflows	57.7	49.9	44.2	48.2	55.6	59.6	63.6
Net portfolio equity inflows	−3.4	2.3	4.8	1.4	4.0	11.8	13.6
Net debt flows	−32.5	−12.2	−16.2	−9.1	−13.2	1.7	17.2
Official creditors	14.7	12.6	7.0	3.2	−7.9	−7.5	−9.2
World Bank	2.8	2.4	1.8	0.9	−1.7	−1.5	−2.4
IMF	7.0	1.9	1.2	−2.5	−2.7	−0.5	−1.3
Others	4.8	8.2	3.9	4.8	−3.4	−5.6	−5.5
Private creditors	−47.1	−24.7	−23.2	−12.3	−5.3	9.3	26.4
Net M-L term debt flows	−3.8	−10.9	−13.1	−13.0	−12.6	−9.4	6.3
Bonds	0.7	0.9	−0.7	0.4	0.1	2.0	11.9
Banks	−4.8	−12.0	−11.3	−11.8	−10.5	−8.4	−2.1
Others	0.3	0.2	−1.0	−1.6	−2.2	−3.0	−3.5
Net short-term debt flows	−43.3	−13.9	−10.1	0.7	7.3	18.7	20.1
Balancing item*	−60.6	−70.9	−76.3	−32.4	−20.0	−11.3	64.6
Change in reserves (− = increase)	−20.7	−29.3	−10.1	−47.7	−87.9	−136.7	−230.3
Memo items:							
Bilateral aid grants (ex technical cooperation grants)	2.5	2.5	2.5	2.2	2.2	2.5	2.7
Net private flows (debt + equity)	7.1	27.5	25.8	37.3	54.3	80.7	103.5
Net official flows (aid + debt)	17.1	15.1	9.5	5.4	−5.6	−5.0	−6.4
Workers' remittances	9.1	11.4	11.2	12.9	16.5	19.7	20.3

Note: e = estimate.
*Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries.

Table A.23 External financing: Europe and Central Asia, 1998–2004

$ billions

	1998	1999	2000	2001	2002	2003	2004e
Current account balance	−25.8	−2.5	15.5	17.4	3.8	−2.6	9.6
as % GDP	−2.5	−0.1	1.8	2.0	0.5	0.0	0.6
Financed by:							
Net equity flows	30.1	30.4	30.4	31.8	34.9	36.2	41.2
Net FDI inflows	26.1	28.4	29.2	31.4	35.0	35.6	37.6
Net portfolio equity inflows	4.0	2.0	1.3	0.4	−0.1	0.6	3.6
Net debt flows	43.0	18.9	19.9	2.7	28.0	56.9	56.0
Official creditors	7.5	−0.6	0.0	2.2	2.6	−6.2	−6.2
World Bank	1.5	1.9	2.1	2.1	1.0	−0.7	0.6
IMF	5.3	−3.1	−0.7	6.1	4.6	−2.0	−4.4
Others	0.6	0.7	−1.4	−6.0	−3.0	−3.5	−2.4
Private creditors	35.5	19.5	19.9	0.6	25.4	63.1	62.3
Net M-L term debt flows	29.8	17.9	11.6	5.9	20.5	30.9	33.4
Bonds	16.0	8.2	5.3	1.6	4.0	9.6	30.2
Banks	14.7	10.4	7.9	6.6	18.1	23.3	5.0
Others	−0.9	−0.8	−1.6	−2.2	−1.6	−2.0	−1.7
Net short-term debt flows	5.7	1.6	8.3	−5.4	4.9	32.2	28.8
Balancing item*	−42.2	−40.5	−47.7	−40.8	−23.0	−29.6	−39.2
Change in reserves (− = increase)	−5.1	−6.4	−18.2	−11.1	−43.7	−60.9	−67.6
Memo items:							
Bilateral aid grants (ex technical cooperation grants)	5.4	8.2	8.6	7.1	8.6	8.7	9.0
Net private flows (debt + equity)	65.6	49.9	50.4	32.4	60.4	99.3	103.4
Net official flows (aid + debt)	12.9	7.7	8.6	9.3	11.2	2.4	2.7
Workers' remittances	12.8	10.7	11.0	11.4	11.5	12.9	12.9

Note: e = estimate.
*Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries.

Table A.24 External financing: Latin America and the Caribbean, 1998–2004

$ billions

	1998	1999	2000	2001	2002	2003	2004e
Current account balance	−89.5	−55.5	−46.9	−53.4	−15.8	7.9	28.2
as % GDP	−4.5	−3.1	−2.4	−2.8	−1.0	0.5	1.5
Financed by:							
Net equity flows	71.8	84.5	78.4	72.7	47.2	39.9	40.9
Net FDI inflows	74.0	88.2	78.9	70.2	45.7	36.5	42.4
Net portfolio equity inflows	−2.2	−3.6	−0.6	2.5	1.4	3.4	−1.5
Net debt flows	37.3	12.1	−8.4	5.4	−8.5	3.3	2.5
Official creditors	10.9	1.6	−11.1	20.4	13.0	4.9	−10.3
World Bank	2.4	2.1	2.0	1.3	−0.3	−0.4	−1.9
IMF	2.5	−0.9	−10.7	15.6	11.9	5.6	−4.6
Others	6.0	0.3	−2.4	3.5	1.4	−0.2	−3.8
Private creditors	26.4	10.5	2.8	−15.0	−21.5	−1.6	12.8
Net M-L term debt flows	54.7	18.8	4.3	−1.5	−11.5	1.2	9.7
Bonds	17.3	19.3	5.3	2.8	−0.2	12.9	17.7
Banks	39.1	−1.4	−0.2	−2.6	−9.7	−10.8	−7.8
Others	−1.7	0.9	−0.8	−1.6	−1.6	−0.9	−0.2
Net short-term debt flows	−28.3	−8.3	−1.6	−13.6	−10.0	−2.8	3.1
Balancing item*	−28.8	−48.6	−20.2	−21.8	−22.0	−17.9	−49.8
Change in reserves (− = increase)	9.2	7.4	−2.9	−2.9	−0.8	−33.2	−21.8
Memo items:							
Bilateral aid grants (ex technical cooperation grants)	3.2	2.9	2.5	3.2	2.8	3.1	3.2
Net private flows (debt + equity)	98.3	95.0	81.1	57.7	25.6	38.3	53.6
Net official flows (aid + debt)	14.1	4.5	−8.7	23.6	15.7	7.9	−7.1
Workers' remittances	15.9	17.7	20.2	24.2	28.1	34.4	36.9

Note: e = estimate.
*Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries.

Table A.25 External financing: Middle East and North Africa, 1998–2004

$ billions

	1998	1999	2000	2001	2002	2003	2004e
Current account balance	−11.6	4.2	24.1	17.3	15.6	25.7	41.7
as % GDP	−3.5	1.3	6.7	4.5	4.2	6.1	9.3
Financed by:							
Net equity flows	3.4	4.4	4.5	5.6	3.6	4.9	4.3
Net FDI inflows	3.1	3.7	4.3	5.7	3.8	4.8	4.1
Net portfolio equity inflows	0.2	0.6	0.2	−0.1	−0.2	0.1	0.2
Net debt flows	3.6	−3.0	−4.5	0.1	2.1	−0.7	−0.1
Official creditors	−1.6	−2.5	−2.8	−1.2	−2.6	−2.5	−2.6
World Bank	−0.2	0.2	−0.3	−0.1	−0.3	−0.3	−0.6
IMF	0.0	0.0	−0.2	−0.1	−0.3	−0.6	−0.4
Others	−1.3	−2.7	−2.3	−1.0	−2.0	−1.6	−1.6
Private creditors	5.2	−0.5	−1.8	1.3	4.6	1.8	2.6
Net M-L term debt flows	1.8	−1.5	0.8	3.8	4.5	0.0	2.4
Bonds	1.3	1.4	1.2	4.4	5.0	0.7	1.5
Banks	2.0	−1.6	0.5	−0.1	−0.3	−1.1	0.9
Others	−1.5	−1.2	−0.9	−0.4	−0.2	0.4	0.0
Net short-term debt flows	3.3	1.0	−2.5	−2.5	0.1	1.8	0.2
Balancing item*	3.0	−6.8	−19.3	−13.5	−9.2	−7.9	−33.7
Change in reserves (− = increase)	1.7	1.2	−4.8	−9.5	−12.0	−22.0	−12.2
Memo items:							
Bilateral aid grants (ex technical cooperation grants)	3.5	2.7	3.1	2.2	2.4	3.6	4.0
Net private flows (debt + equity)	8.5	3.9	2.8	6.9	8.2	6.7	6.8
Net official flows (aid + debt)	1.9	0.2	0.3	1.1	−0.1	1.1	1.3
Workers' remittances	12.5	12.2	12.3	14.4	14.8	16.1	17.0

Note: e = estimate.
*Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries.

Table A.26 External financing: South Asia, 1998–2004

$ billions

	1998	1999	2000	2001	2002	2003	2004e
Current account balance	−9.4	−5.2	−5.8	1.2	10.1	11.6	−0.7
as % GDP	−1.8	−0.9	−1.0	0.2	1.6	1.6	−0.1
Financed by:							
Net equity flows	2.9	5.5	5.8	7.2	5.9	13.4	14.0
Net FDI inflows	3.5	3.1	3.3	4.4	4.8	5.2	6.5
Net portfolio equity inflows	−0.6	2.4	2.5	2.8	1.1	8.2	7.5
Net debt flows	4.7	0.5	3.5	−0.9	0.4	−4.0	4.4
Official creditors	2.3	2.5	0.5	2.2	−2.4	−1.8	1.6
World Bank	0.8	1.0	0.7	1.5	−1.0	−0.4	1.1
IMF	−0.4	−0.1	−0.3	0.3	0.1	−0.1	−0.2
Others	2.0	1.6	0.0	0.4	−1.4	−1.3	0.7
Private creditors	2.4	−2.0	3.0	−3.1	2.9	−2.2	2.8
Net M-L term debt flows	3.7	−2.1	3.9	−2.0	0.6	−2.2	3.0
Bonds	4.2	−1.2	5.4	−0.2	−0.5	−3.1	3.2
Banks	0.7	−0.5	−2.0	−1.4	1.2	0.8	−0.3
Others	−1.1	−0.4	0.5	−0.3	−0.1	0.1	0.1
Net short-term debt flows	−1.3	0.1	−0.9	−1.1	2.3	0.0	−0.2
Balancing item*	4.8	4.1	1.3	2.7	10.5	14.0	9.2
Change in reserves (− = increase)	−3.0	−5.0	−4.7	−10.2	−27.0	−35.0	−26.9
Memo items:							
Bilateral aid grants (ex technical cooperation grants)	2.1	2.3	2.1	3.2	2.5	3.9	4.3
Net private flows (debt + equity)	5.3	3.5	8.8	4.1	8.7	11.2	16.7
Net official flows (aid + debt)	4.5	4.8	2.6	5.3	0.1	2.2	5.9
Workers' remittances	13.4	15.1	16.0	16.0	22.2	26.8	32.7

Note: e = estimate.
*Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries.

Table A.27 External financing: Sub-Saharan Africa, 1998–2004

$ billions

	1998	1999	2000	2001	2002	2003	2004e
Current account balance	−16.9	−9.3	3.2	−5.1	−3.1	−4.5	2.6
as % GDP	−5.0	−2.1	1.2	−0.8	−0.3	−0.8	0.6
Financed by:							
Net equity flows	15.6	18.1	10.5	13.9	8.6	10.8	14.8
Net FDI inflows	7.0	9.1	6.3	14.9	9.0	10.1	11.3
Net portfolio equity inflows	8.7	9.0	4.2	−1.0	−0.4	0.7	3.5
Net debt flows	−1.3	−1.0	−0.5	−1.7	−0.3	2.7	3.6
Official creditors	0.5	0.3	0.7	0.3	2.5	1.3	1.4
World Bank	1.3	1.1	1.5	1.8	2.2	2.2	1.8
IMF	−0.3	0.0	0.1	0.1	0.5	−0.1	0.0
Others	−0.5	−0.8	−0.9	−1.7	−0.1	−0.9	−0.4
Private creditors	−1.8	−1.3	−1.2	−2.0	−2.8	1.5	2.2
Net M-L term debt flows	−1.3	−0.7	−0.1	0.1	−1.0	2.4	0.7
Bonds	0.3	1.2	1.0	1.9	2.7	4.6	−1.6
Banks	−1.3	−1.7	−0.7	−1.5	−3.0	−1.4	2.6
Others	−0.2	−0.2	−0.5	−0.3	−0.8	−0.8	−0.3
Net short-term debt flows	−0.5	−0.6	−1.0	−2.0	−1.8	−0.9	1.6
Balancing item*	1.1	−6.5	−7.0	−6.8	−4.9	−4.8	−1.6
Change in reserves (− = increase)	1.5	−1.4	−6.1	−0.3	−0.3	−4.2	−19.4
Memo items:							
Bilateral aid grants (ex technical cooperation grants)	10.1	9.9	10.0	10.0	13.6	21.6	24.2
Net private flows (debt + equity)	13.8	16.8	9.3	12.0	5.8	12.3	17.1
Net official flows (aid + debt)	10.6	10.2	10.6	10.3	16.1	22.9	25.6
Workers' remittances	4.3	4.7	4.9	4.9	5.2	6.0	6.1

Note: e = estimate.
*Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries.

Table A.28 Net inward foreign direct investment, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004e
All developing countries	**128.6**	**168.1**	**171.5**	**182.4**	**166.2**	**174.8**	**154.0**	**151.8**	**165.5**
East Asia and Pacific	58.6	62.1	57.7	49.9	44.2	48.2	55.6	59.6	63.6
China	40.2	44.2	43.8	38.8	38.4	44.2	49.3	53.5	56.0
Indonesia	6.2	4.7	−0.4	−2.7	−4.6	−3.3	−1.5	−0.6	0.5
Malaysia	5.1	5.1	2.2	3.9	3.8	0.6	3.2	2.5	2.8
Philippines	1.5	1.2	2.3	1.7	1.3	1.0	1.8	0.3	0.1
Thailand	2.3	3.9	7.3	6.1	3.4	3.9	1.0	2.0	1.7
Vietnam	2.4	2.2	1.7	1.4	1.3	1.3	1.4	1.5	1.8
East Europe and Central Asia	16.4	22.6	26.1	28.4	29.2	31.4	35.0	35.6	37.6
Bulgaria	0.1	0.5	0.5	0.8	1.0	0.8	0.9	1.4	1.6
Czech Republic	1.4	1.3	3.7	6.3	5.0	5.6	8.5	2.5	3.8
Hungary	2.4	2.2	2.1	2.0	1.7	2.6	2.9	2.5	2.9
Poland	4.5	4.9	6.4	7.3	9.3	5.7	4.1	4.1	4.7
Russian Federation	2.6	4.9	2.8	3.3	2.7	2.5	3.5	8.0	7.8
Turkey	0.7	0.8	0.9	0.8	1.0	3.3	1.0	1.6	2.4
Latin America and Caribbean	44.2	66.7	74.0	88.2	78.9	70.2	45.7	36.5	42.4
Argentina	7.0	9.2	7.3	24.0	10.4	2.2	1.1	1.0	0.6
Brazil	11.2	19.7	31.9	28.6	32.8	22.5	16.6	10.1	15.3
Chile	4.8	5.3	4.6	8.8	4.9	4.2	1.9	3.0	5.6
Mexico	9.2	12.8	12.4	13.2	16.6	26.8	14.8	10.8	14.1
Venezuela, R. B. de	2.2	6.2	5.0	2.9	4.7	3.7	0.8	2.5	0.7
Middle East and North Africa	1.7	3.2	3.1	3.7	4.3	5.7	3.8	4.8	4.1
Algeria	0.3	0.3	0.5	0.5	0.4	1.2	1.1	0.6	0.9
Egypt, Arab Rep. of	0.6	0.9	1.1	1.1	1.2	0.5	0.7	0.2	0.6
Morocco	0.3	1.2	0.4	1.4	0.4	2.8	0.5	2.3	1.6
Tunisia	0.2	0.3	0.7	0.4	0.8	0.5	0.8	0.5	0.4
South Asia	3.5	4.9	3.5	3.1	3.3	4.4	4.8	5.2	6.5
India	2.4	3.6	2.6	2.2	2.5	3.8	3.7	4.3	5.3
Pakistan	0.9	0.7	0.5	0.5	0.3	0.4	0.8	0.5	0.9
Sub-Saharan Africa	4.2	8.4	7.0	9.1	6.3	14.9	9.0	10.1	11.3
Angola	0.2	0.4	1.1	2.5	0.9	2.2	1.7	1.4	1.6
Nigeria	1.6	1.5	1.1	1.0	0.9	1.1	1.3	1.2	1.4
South Africa	0.8	3.8	0.6	1.5	1.0	7.3	0.7	0.8	1.1

Note: e = estimate.

Table A.29 Net inward portfolio equity flows, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004e
All developing countries	**32.9**	**22.6**	**6.6**	**12.7**	**12.4**	**6.0**	**5.8**	**24.8**	**26.8**
East Asia and the Pacific	9.7	−3.9	−3.4	2.3	4.8	1.4	4.0	11.8	13.6
China	1.9	5.7	0.8	0.6	6.9	0.8	2.2	7.7	10.5
Indonesia	1.8	−5.0	−4.4	−0.8	−1.0	0.4	0.9	1.1	1.1
Malaysia	2.7	−8.0	−0.4	0.1	−1.8	−0.7	−0.1	1.3	1.7
Philippines	2.1	−0.4	0.3	1.4	−0.2	0.4	0.4	0.5	0.5
Thailand	1.2	3.9	0.3	0.9	0.9	0.4	0.5	1.2	−0.2
Europe and Central Asia	4.3	4.0	4.0	2.0	1.3	0.4	−0.1	0.6	3.6
Czech Republic	0.6	0.4	1.1	0.1	0.6	0.6	−0.3	1.1	0.8
Hungary	0.4	1.0	0.6	1.2	−0.4	0.1	−0.1	0.3	0.8
Poland	0.7	0.6	1.7	0.0	0.4	−0.3	−0.5	−0.8	0.8
Russian Federation	2.2	1.3	0.7	−0.3	0.2	0.5	2.6	0.4	1.0
Turkey	0.2	0.0	−0.5	0.4	0.5	−0.1	0.0	1.0	1.0
Latin America and the Caribbean	12.2	13.3	−2.2	−3.6	−0.6	2.5	1.4	3.4	−1.5
Argentina	1.0	1.4	−0.2	−10.8	−3.2	0.0	−0.1	0.1	0.0
Brazil	5.8	5.1	−1.8	2.6	3.1	2.5	2.0	3.0	0.9
Chile	0.7	1.7	0.6	0.5	−0.4	−0.2	−0.3	0.3	−0.1
Mexico	2.8	3.2	−0.7	3.8	0.4	0.2	−0.1	−0.1	−2.3
Venezuela, R. B. de	1.3	1.4	0.2	0.4	−0.6	0.0	0.0	0.1	−0.2
Middle East and North Africa	0.2	0.7	0.2	0.6	0.2	−0.1	−0.2	0.1	0.2
Egypt, Arab Rep. of	0.0	0.5	−0.2	0.7	0.3	0.0	−0.2	0.0	0.1
South Asia	4.1	2.9	−0.6	2.4	2.5	2.8	1.1	8.2	7.5
India	4.0	2.6	−0.6	2.3	2.5	3.0	1.1	8.2	7.5
Sub-Saharan Africa	2.4	5.6	8.7	9.0	4.2	−1.0	−0.4	0.7	3.5
South Africa	2.3	5.5	8.6	9.0	4.2	−1.0	−0.4	0.7	3.5

Note: e = estimate.

Table A.30 Net inward debt flows to developing countries, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004e
All developing countries	**123.7**	**106.9**	**54.9**	**15.4**	**−6.2**	**−3.5**	**8.5**	**60.0**	**83.7**
East Asia and Pacific	52.2	44.9	−32.5	−12.2	−16.2	−9.1	−13.2	1.7	17.2
China	13.9	18.5	−14.2	−1.6	−5.2	0.0	0.6	13.5	—
Indonesia	12.3	10.1	−4.6	−3.8	−0.7	−6.0	−7.5	−5.5	—
Malaysia	6.4	8.4	−3.6	−0.7	0.4	4.7	4.0	−1.2	—
Philippines	4.5	7.6	−3.1	3.1	2.3	1.7	−0.9	0.6	—
Thailand	13.9	−1.3	−7.9	−9.4	−13.7	−10.0	−9.9	−7.6	—
Eastern Europe and Central Asia	24.1	35.3	43.0	18.9	19.9	2.7	28.0	56.9	56.0
Bulgaria	0.2	1.0	0.2	0.3	0.5	−0.2	0.6	1.0	—
Czech Republic	4.1	3.2	1.4	−0.2	−1.7	−0.5	1.0	3.5	—
Hungary	−2.0	−1.4	2.7	2.0	0.4	1.7	0.5	4.4	—
Poland	1.0	3.8	5.1	4.8	0.8	2.5	1.2	7.0	—
Russian Federation	7.3	7.6	21.9	−4.2	−2.8	−3.9	−2.6	12.8	—
Turkey	3.1	4.2	5.5	10.9	18.2	−4.5	13.2	4.9	—
Latin America and Caribbean	40.8	25.2	37.3	12.1	−8.4	5.4	−8.5	3.3	2.5
Argentina	14.1	17.1	11.7	6.3	4.3	−5.7	−1.8	−0.1	—
Brazil	19.2	−1.3	6.7	−5.6	−4.0	5.2	−1.2	−0.5	—
Chile	5.6	1.8	4.0	1.7	2.9	0.5	1.6	2.1	—
Colombia	4.4	3.6	0.8	1.3	−0.2	2.8	−0.9	−0.9	—
Mexico	−4.9	−4.9	9.0	6.9	−16.4	−3.2	−8.7	−2.2	—
Venezuela, R. B. de	−0.2	2.6	1.7	0.2	0.9	−1.1	−3.2	0.1	—
Middle East and North Africa	0.7	−3.5	3.6	−3.0	−4.5	0.1	2.1	−0.7	−0.1
Algeria	1.6	−0.4	−1.6	−1.9	−1.6	−2.0	−1.4	−1.4	—
Egypt, Arab Rep. of	−0.5	0.6	1.1	−0.6	−0.7	0.1	−0.7	−1.1	—
Lebanon	1.1	1.1	1.7	1.5	1.8	2.7	4.4	1.2	—
South Asia	2.7	0.7	4.7	0.5	3.5	−0.9	0.4	−4.0	4.4
India	0.7	−1.6	3.0	−1.1	3.4	−1.9	−1.0	−4.5	—
Pakistan	1.1	1.6	0.7	0.7	−0.3	0.3	0.6	−0.9	—
Sub-Saharan Africa	3.2	4.4	−1.3	−1.0	−0.5	−1.7	−0.3	2.7	3.6
South Africa	0.7	−0.4	−0.3	−0.7	1.2	−0.8	−0.5	2.7	—

Note: — = not available; *e* = estimate.

Table A.31 Net inward short-term debt flows to developing countries, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004e
All developing countries	**37.4**	**9.2**	**−64.5**	**−20.1**	**−7.9**	**−23.9**	**2.8**	**49.0**	**53.6**
East Asia and Pacific	19.6	4.7	−43.3	−13.9	−10.1	0.7	7.3	18.7	20.1
China	3.1	6.1	−14.1	−2.2	−2.1	1.8	6.3	18.4	—
Indonesia	6.3	0.6	−9.7	−1.6	1.5	−1.0	0.2	−0.9	—
Malaysia	3.8	3.9	−6.5	−2.5	−1.4	1.7	2.1	0.5	—
Philippines	2.7	3.8	−4.6	−1.4	0.2	0.1	−0.4	0.6	—
Thailand	3.6	−9.9	−8.2	−6.2	−8.5	−1.7	−1.3	−1.0	—
Eastern Europe and Central Asia	7.8	10.9	5.7	1.6	8.3	−5.4	4.9	32.2	28.8
Bulgaria	0.6	0.8	−0.2	−0.3	0.2	−0.2	0.6	0.6	—
Czech Republic	0.7	2.4	−0.5	1.1	0.2	0.6	−0.3	1.6	—
Hungary	0.2	0.0	1.4	−1.2	0.6	0.5	1.0	2.5	—
Poland	0.6	2.5	3.3	2.8	−1.7	1.5	0.4	4.8	—
Russian Federation	0.3	−1.4	−0.5	−1.0	2.0	2.5	−1.6	9.6	—
Turkey	1.6	0.6	3.2	2.3	5.4	−12.6	0.1	4.4	—
Latin America and Caribbean	4.6	−7.8	−28.3	−8.3	−1.6	−13.6	−10.0	−2.8	3.1
Argentina	2.1	8.5	−1.0	−1.5	−1.1	−8.3	−0.4	0.7	—
Brazil	4.3	−16.0	−24.0	0.7	1.8	−2.5	−4.9	−3.8	—
Chile	3.6	−1.5	−0.4	−0.8	1.9	−0.9	0.5	1.7	—
Colombia	0.3	−0.1	0.5	−2.3	−1.1	0.4	0.4	−0.1	—
Mexico	−7.5	−2.0	−1.5	−2.3	−5.1	−4.4	−4.7	−0.7	—
Venezuela, R. B. de	−0.2	1.5	−2.0	−0.1	2.0	0.7	−0.2	−0.2	—
Middle East and North Africa	1.9	0.0	3.3	1.0	−2.5	−2.5	0.1	1.8	0.2
Algeria	0.1	−0.2	0.0	0.0	0.0	0.0	−0.1	0.0	—
Egypt, Arab Rep. of	0.0	0.6	1.3	0.0	−0.2	−0.7	0.1	0.3	—
Lebanon	0.3	0.1	0.2	0.2	0.3	0.1	−0.1	0.6	—
South Asia	1.2	−2.1	−1.3	0.1	−0.9	−1.1	2.3	0.0	−0.2
India	1.7	−1.7	−0.7	−0.4	−0.5	−0.7	1.8	0.2	—
Pakistan	−0.4	−0.3	−0.5	−0.1	−0.3	−0.2	0.2	−0.3	—
Sub-Saharan Africa	2.4	3.5	−0.5	−0.6	−1.0	−2.0	−1.8	−0.9	1.6
South Africa	1.2	0.1	0.5	−0.6	0.3	−1.2	−1.0	0.0	—

Note: — = not available; *e* = estimate.

Table A.32 Net inward debt flows to public sector and publicly guaranteed borrowers, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004e
All developing countries	**39.1**	**42.0**	**68.5**	**30.3**	**5.0**	**18.9**	**4.5**	**−17.0**	**22.3**
East Asia and Pacific	12.8	29.0	18.8	11.2	4.7	−0.8	−11.8	−12.7	−1.5
China	10.7	11.1	2.5	1.6	−1.1	0.0	−5.3	−5.9	—
Indonesia	−0.6	3.6	9.0	2.0	0.9	−2.2	−3.1	−0.9	—
Malaysia	0.3	1.7	0.5	0.9	1.4	3.1	2.1	−2.0	—
Philippines	0.3	1.8	1.3	4.6	3.1	0.2	0.5	0.7	—
Thailand	1.3	9.4	4.6	1.9	−0.2	−2.7	−6.2	−5.6	—
Eastern Europe and Central Asia	11.8	15.5	21.8	7.0	5.2	−1.5	3.3	−5.9	8.5
Bulgaria	−0.4	0.2	0.3	0.4	0.2	−0.1	−0.3	0.0	—
Czech Republic	2.8	0.9	1.0	−1.0	−1.0	−0.9	0.1	0.5	—
Hungary	−3.1	−1.8	−0.4	1.5	−1.4	−0.8	−0.8	−1.4	—
Poland	0.2	0.5	−0.1	−0.3	−1.4	−3.3	0.1	1.7	—
Russian Federation	7.0	7.1	16.2	−3.5	−3.9	−7.0	−4.1	−7.1	—
Turkey	0.5	2.5	−1.0	4.6	11.3	9.2	7.5	−1.3	—
Latin America and Caribbean	13.7	−2.0	24.6	11.7	−6.6	18.6	9.6	8.5	14.5
Argentina	10.1	4.9	8.3	8.7	6.4	6.6	−1.4	−0.9	—
Brazil	2.7	−0.3	12.1	0.8	−6.5	9.4	10.8	3.7	—
Chile	−2.0	−0.3	0.6	0.6	−0.4	0.4	1.1	1.1	—
Colombia	1.4	1.1	1.0	3.4	0.9	2.5	−1.3	1.4	—
Mexico	0.6	−9.9	0.7	−3.7	−9.8	−3.3	−2.4	−1.5	—
Venezuela, R. B. de	0.2	0.4	0.2	−0.6	−0.5	−1.7	−2.6	0.3	—
Middle East and North Africa	−1.4	−4.1	−1.9	−2.9	−2.6	2.3	2.2	−2.6	−1.7
Algeria	1.5	−0.3	−1.6	−2.0	−1.6	−1.9	−1.4	−1.9	—
Egypt, Arab Rep. of	−0.2	−0.1	−0.5	−0.7	−0.6	0.8	−0.8	−1.1	—
Lebanon	0.4	0.5	1.7	1.4	1.4	2.5	4.7	0.6	—
South Asia	0.5	0.8	5.5	1.4	4.5	0.5	−1.7	−5.7	2.8
India	−1.5	−1.5	3.6	−0.1	3.8	−1.2	−2.7	−6.7	—
Pakistan	1.1	1.6	0.9	1.2	0.3	0.9	0.4	−0.3	—
Sub-Saharan Africa	1.6	2.8	−0.4	1.8	−0.2	−0.1	2.8	1.5	−0.3
South Africa	0.6	1.1	−1.0	1.6	0.0	−0.4	1.4	0.0	—

Note: — = not available; *e* = estimate.

Table A.33 Net inward debt flows to private sector borrowers, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004e
All developing countries	**84.6**	**65.0**	**−13.6**	**−14.9**	**−11.2**	**−22.3**	**3.9**	**76.9**	**61.4**
East Asia and Pacific	39.3	15.9	−51.3	−23.4	−20.9	−8.3	−1.5	14.4	18.7
China	3.2	7.4	−16.7	−3.2	−4.1	−0.1	5.9	19.4	—
Indonesia	12.9	6.5	−13.6	−5.8	−1.6	−3.8	−4.4	−4.6	—
Malaysia	6.1	6.7	−4.0	−1.6	−1.0	1.6	1.9	0.8	—
Philippines	4.2	5.8	−4.3	−1.4	−0.8	1.5	−1.5	−0.1	—
Thailand	12.6	−10.7	−12.5	−11.3	−13.5	−7.3	−3.7	−2.1	—
Eastern Europe and Central Asia	12.3	19.8	21.1	11.9	14.7	4.2	24.7	62.8	47.5
Bulgaria	0.6	0.8	−0.1	−0.1	0.3	−0.1	0.9	1.0	—
Czech Republic	1.3	2.3	0.4	0.8	−0.6	0.4	1.6	3.0	—
Hungary	1.1	0.5	3.1	0.5	1.8	2.5	1.3	5.8	—
Poland	0.8	3.3	5.2	5.1	2.2	5.8	1.0	5.3	—
Russian Federation	0.3	0.5	2.4	−0.7	1.1	3.1	1.5	20.0	—
Turkey	2.7	1.8	6.5	6.3	6.8	−13.7	5.7	4.7	—
Latin America and Caribbean	27.1	27.2	12.7	0.4	−1.8	−13.2	−18.1	−5.2	−12.0
Argentina	3.9	12.3	3.4	−2.4	−2.1	−12.3	−0.5	0.8	—
Brazil	16.5	−1.0	−5.3	−6.4	2.4	−4.2	−11.9	−4.2	—
Chile	7.6	2.1	3.5	1.1	3.3	0.1	0.5	1.0	—
Colombia	3.0	2.5	−0.2	−2.1	−1.1	0.3	0.4	−2.4	—
Mexico	−5.5	5.0	8.3	10.5	−6.6	0.1	−6.2	−0.7	—
Venezuela, R. B. de	−0.4	2.2	1.5	0.7	1.4	0.6	−0.6	−0.2	—
Middle East and North Africa	2.1	0.6	5.5	−0.1	−1.9	−2.1	−0.2	1.9	1.7
Algeria	0.1	−0.2	0.0	0.0	0.0	0.0	−0.1	0.5	—
Egypt, Arab Rep. of	−0.2	0.6	1.5	0.1	−0.1	−0.7	0.1	0.0	—
Lebanon	0.7	0.6	0.1	0.1	0.4	0.2	−0.2	0.6	—
South Asia	2.1	−0.1	−0.8	−0.9	−1.1	−1.4	2.1	1.8	1.5
India	2.2	−0.1	−0.5	−1.0	−0.4	−0.7	1.7	2.3	—
Pakistan	0.0	0.0	−0.2	−0.5	−0.6	−0.5	0.1	−0.6	—
Sub-Saharan Africa	1.6	1.6	−0.9	−2.7	−0.3	−1.6	−3.1	1.2	3.9
South Africa	0.1	−1.5	0.7	−2.3	1.3	−0.4	−1.9	2.6	—

Note: — = not available; *e* = estimate.

Table A.34 Net inward debt flows from public sector creditors, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004e
All developing countries	**3.8**	**12.9**	**34.4**	**13.9**	**−5.8**	**27.0**	**5.2**	**−11.9**	**−25.3**
East Asia and Pacific	3.6	17.3	14.7	12.6	7.0	3.2	−7.9	−7.5	−9.2
China	4.4	4.3	2.3	3.4	1.5	2.2	−1.2	−3.1	—
Indonesia	−0.8	3.6	8.5	4.8	2.9	−0.8	−1.4	−0.3	—
Malaysia	−0.8	−0.2	0.2	0.6	0.6	2.1	−0.2	−0.1	—
Philippines	−0.3	0.6	0.7	0.2	0.3	−0.3	−0.4	−0.6	—
Thailand	0.4	8.4	1.8	2.5	0.3	−1.5	−5.5	−4.6	—
Eastern Europe and Central Asia	8.6	6.6	7.5	−0.6	0.0	2.2	2.6	−6.2	−6.2
Bulgaria	−0.1	0.3	0.4	0.3	0.2	−0.3	−0.3	0.1	—
Czech Republic	0.1	−0.1	0.0	0.0	0.1	0.2	0.0	0.2	—
Hungary	−0.9	−0.1	−1.1	0.2	−0.2	−0.2	0.0	−0.5	—
Poland	0.2	−0.1	−0.5	−0.4	−0.5	−4.1	−1.1	−1.7	—
Russian Federation	6.8	4.2	6.3	−3.0	−3.3	−4.8	−3.3	−4.2	—
Turkey	−0.8	−0.2	−0.4	−0.1	4.4	10.4	6.7	−1.3	—
Latin America and Caribbean	−10.7	−8.6	10.9	1.6	−11.1	20.4	13.0	4.9	−10.3
Argentina	0.4	−0.1	1.0	−0.1	0.9	10.3	−1.4	−0.9	—
Brazil	−0.8	−1.2	9.5	4.5	−8.5	9.5	12.1	3.0	—
Chile	−0.6	−0.4	−0.1	−0.1	−0.1	−0.1	−0.3	−0.1	—
Colombia	−0.1	−0.5	0.2	1.0	0.1	1.1	0.0	2.1	—
Mexico	−9.6	−8.0	−1.9	−5.4	−4.8	−0.7	0.2	−0.3	—
Venezuela, R. B. de	−0.1	−0.3	1.0	−0.1	−0.3	−1.1	−0.6	−0.6	—
Middle East and North Africa	−0.8	−4.0	−1.6	−2.5	−2.8	−1.2	−2.6	−2.5	−2.6
Algeria	1.5	0.3	−0.3	−0.4	−0.4	−1.0	−1.3	−1.4	—
Egypt, Arab Rep. of	0.0	0.0	−0.2	−0.5	−0.6	−0.7	−0.8	−0.8	—
Lebanon	0.2	0.1	0.2	0.1	0.1	0.1	0.0	0.6	—
South Asia	1.0	0.3	2.3	2.5	0.5	2.2	−2.4	−1.8	1.6
India	−0.8	−1.0	0.6	0.8	−0.3	0.4	−3.8	−2.8	—
Pakistan	0.9	0.7	0.9	1.2	0.3	1.1	0.9	−0.2	—
Sub-Saharan Africa	2.0	1.4	0.5	0.3	0.7	0.3	2.5	1.3	1.4
South Africa	0.0	−0.4	−0.4	0.0	0.1	0.0	0.0	0.1	—

Note: — = not available; *e* = estimate.

Table A.35 Net inward debt flows from private sector creditors, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004e
All developing countries	**119.9**	**94.0**	**20.5**	**1.5**	**−0.4**	**−30.5**	**3.3**	**71.8**	**109.0**
East Asia and Pacific	48.6	27.6	−47.1	−24.7	−23.2	−12.3	−5.3	9.3	26.4
China	9.5	14.2	−16.5	−5.0	−6.8	−2.2	1.8	16.6	—
Indonesia	13.1	6.5	−13.0	−8.6	−3.6	−5.2	−6.1	−5.1	—
Malaysia	7.2	8.6	−3.8	−1.3	−0.2	2.6	4.2	−1.1	—
Philippines	4.9	7.0	−3.7	2.9	1.9	2.0	−0.5	1.2	—
Thailand	13.4	−9.7	−9.6	−11.9	−14.0	−8.5	−4.4	−3.0	—
Eastern Europe and Central Asia	15.4	28.7	35.5	19.5	19.9	0.6	25.4	63.1	62.3
Bulgaria	0.3	0.7	−0.2	−0.1	0.2	0.1	0.9	0.9	—
Czech Republic	4.0	3.2	1.4	−0.2	−1.7	−0.7	1.7	3.3	—
Hungary	−1.1	−1.3	3.8	1.8	0.7	1.9	0.6	4.9	—
Poland	0.7	3.9	5.6	5.2	1.3	6.6	2.2	8.7	—
Russian Federation	0.5	3.4	12.3	−1.2	0.5	0.9	0.8	17.0	—
Turkey	4.0	4.4	5.9	11.0	13.8	−14.9	6.5	4.7	—
Latin America and Caribbean	51.5	33.8	26.4	10.5	2.8	−15.0	−21.5	−1.6	12.8
Argentina	13.7	17.3	10.7	6.4	3.4	−16.0	−0.5	0.8	—
Brazil	20.1	−0.1	−2.7	−10.1	4.4	−4.2	−13.2	−3.5	—
Chile	6.2	2.2	4.1	1.8	3.0	0.6	1.9	2.2	—
Colombia	4.5	4.1	0.6	0.2	−0.3	1.7	−0.9	−3.0	—
Mexico	4.8	3.1	10.8	12.2	−11.6	−2.5	−8.9	−1.8	—
Venezuela, R. B. de	0.0	2.9	0.7	0.3	1.2	0.0	−2.6	0.7	—
Middle East and North Africa	1.5	0.5	5.2	−0.5	−1.8	1.3	4.6	1.8	2.6
Algeria	0.1	−0.7	−1.3	−1.5	−1.2	−1.0	−0.1	0.0	—
Egypt, Arab Rep. of	−0.4	0.6	1.3	−0.1	−0.1	0.8	0.1	−0.3	—
Lebanon	0.8	1.0	1.6	1.4	1.7	2.6	4.4	0.6	—
South Asia	1.6	0.4	2.4	−2.0	3.0	−3.1	2.9	−2.2	2.8
India	1.5	−0.6	2.5	−1.9	3.6	−2.3	2.9	−1.7	—
Pakistan	0.1	0.9	−0.2	−0.6	−0.7	−0.7	−0.3	−0.7	—
Sub-Saharan Africa	1.2	3.0	−1.8	−1.3	−1.2	−2.0	−2.8	1.5	2.2
South Africa	0.7	0.0	0.1	−0.7	1.2	−0.8	−0.5	2.6	—

Note: — = not available; *e* = estimate.

Table A.36 Gross market-based capital flows to developing countries, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004
All developing countries	**196.1**	**264.5**	**176.9**	**160.0**	**213.5**	**151.6**	**146.5**	**206.5**	**269.4**
East Asia and the Pacific	69.2	73.1	31.6	32.4	49.7	21.8	44.5	53.1	60.0
China	16.6	25.9	8.9	8.4	29.0	7.3	15.6	25.1	30.5
Indonesia	21.9	17.6	0.7	2.4	1.1	1.0	1.6	6.6	4.4
Malaysia	10.7	11.5	3.4	7.4	7.0	5.1	12.8	7.7	12.5
Philippines	6.0	9.2	11.7	11.9	8.5	5.8	10.1	8.9	8.1
Thailand	13.2	8.7	6.8	2.0	4.1	2.5	3.6	4.3	4.3
Europe and Central Asia	25.7	46.0	42.9	30.1	45.5	26.0	34.6	58.5	87.0
Hungary	3.5	3.3	3.8	3.4	2.1	2.7	1.8	6.5	9.3
Poland	0.8	4.3	3.6	4.5	3.8	5.4	6.4	10.2	6.8
Russian Federation	5.7	16.9	15.0	0.7	10.0	4.7	10.1	17.0	28.4
Turkey	8.6	9.9	9.7	12.9	22.4	6.9	7.4	10.2	15.7
Latin America and the Caribbean	75.7	105.4	74.8	67.0	85.5	71.1	44.3	63.3	77.7
Argentina	23.2	25.5	26.0	20.9	18.8	8.4	2.0	0.7	2.0
Brazil	13.7	32.7	18.1	15.0	28.7	24.9	15.0	19.1	22.4
Chile	3.7	6.5	3.8	7.2	7.3	3.9	2.3	2.7	5.8
Mexico	29.2	30.7	19.8	17.5	23.2	18.8	13.8	28.0	30.0
Middle East and North Africa	3.2	7.9	4.8	8.7	6.5	10.1	8.8	7.3	15.5
Egypt, Arab Rep. of	0.2	1.5	1.8	4.6	1.1	2.5	1.0	2.0	1.7
Lebanon	0.5	1.1	1.5	1.4	1.9	3.3	1.0	0.2	3.3
South Asia	10.3	12.4	4.9	4.1	4.3	3.2	2.5	7.0	17.5
India	7.4	10.5	3.8	3.7	3.9	2.7	2.1	5.2	15.9
Pakistan	2.9	1.7	0.9	0.0	0.0	0.2	0.4	1.5	1.4
Sub-Saharan Africa	7.5	9.3	7.9	9.2	13.9	11.9	8.6	13.7	11.1
South Africa	5.7	7.1	4.9	5.6	10.9	7.5	4.7	7.8	5.5

Table A.37 Gross international equity issuance by developing countries, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004
All developing countries	**12.9**	**19.9**	**7.5**	**10.9**	**35.0**	**5.9**	**10.4**	**16.7**	**33.4**
East Asia and the Pacific	6.5	11.6	4.3	5.7	21.6	3.4	7.0	12.0	19.0
China	3.3	10.1	1.4	3.6	21.1	2.9	5.5	8.9	16.6
Indonesia	1.3	0.8	0.0	0.8	0.0	0.3	0.2	0.9	0.5
Malaysia	0.6	0.4	0.2	0.1	0.2	0.0	1.2	0.6	0.7
Philippines	1.0	0.3	0.5	0.2	0.2	0.0	0.0	0.1	0.1
Thailand	0.2	0.0	2.3	0.8	0.0	0.2	0.1	1.5	1.0
Europe and Central Asia	1.3	1.7	2.2	1.0	3.3	0.3	1.6	1.2	5.2
Hungary	0.4	0.8	0.2	0.2	0.0	0.0	0.0	0.0	0.8
Poland	0.0	0.5	0.8	0.3	0.1	0.0	0.2	0.6	0.8
Russian Federation	0.8	0.1	0.0	0.1	0.5	0.2	1.3	0.5	2.6
Turkey	0.0	0.3	0.8	0.0	2.4	0.0	0.1	0.1	0.8
Latin America and the Caribbean	2.7	4.1	0.2	0.7	6.7	1.3	1.1	1.1	2.3
Argentina	0.4	0.5	0.0	0.3	0.2	0.0	0.0	0.0	0.1
Brazil	0.4	2.3	0.0	0.2	3.1	1.2	1.1	0.5	1.9
Chile	0.1	0.5	0.1	0.0	1.7	0.0	0.0	0.1	0.1
Mexico	0.7	0.8	0.0	0.2	1.6	0.0	0.0	0.5	0.2
Middle East and North Africa	0.4	0.4	0.4	0.3	0.3	0.0	0.0	0.0	1.0
Egypt, Arab Rep. of	0.2	0.3	0.1	0.3	0.3	0.0	0.0	0.0	0.1
South Asia	1.3	1.1	0.0	0.9	0.9	0.5	0.2	1.3	4.6
India	1.3	1.0	0.0	0.9	0.9	0.5	0.2	1.3	4.6
Sub-Saharan Africa	0.7	1.0	0.4	2.3	2.2	0.5	0.5	1.1	1.2
South Africa	0.6	1.0	0.4	0.8	2.0	0.5	0.4	1.1	1.1

Table A.38 Gross international bond issues in developing countries, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004
All developing countries	**71.6**	**90.8**	**70.9**	**67.5**	**67.2**	**65.4**	**59.9**	**87.5**	**110.7**
East Asia and the Pacific	17.3	15.8	10.1	12.9	6.7	8.1	16.1	13.4	19.6
China	3.9	5.0	1.9	1.4	1.3	2.6	0.9	3.4	6.4
Indonesia	2.8	1.6	0.0	0.0	0.0	0.1	0.8	1.5	1.7
Malaysia	2.5	2.4	0.1	2.6	1.4	2.4	6.0	1.5	4.1
Philippines	3.7	4.7	7.8	8.9	4.0	2.8	8.4	6.8	6.0
Thailand	4.4	2.1	0.3	0.0	0.0	0.3	0.0	0.3	1.4
Europe and Central Asia	6.2	15.2	21.8	12.9	19.5	10.3	15.1	26.4	39.2
Croatia	0.1	0.5	0.1	0.6	0.9	0.9	0.8	0.8	1.1
Hungary	0.3	0.4	1.7	2.3	0.5	1.2	0.0	2.3	5.1
Poland	0.2	1.4	1.1	1.6	1.4	2.5	2.7	4.7	3.9
Russian Federation	1.1	6.9	12.2	0.0	4.8	1.4	3.7	8.3	10.5
Turkey	2.9	3.9	3.2	5.7	8.7	2.2	3.6	5.5	6.4
Latin America and the Caribbean	45.0	54.3	36.5	38.0	37.2	39.5	23.9	41.6	40.4
Argentina	13.1	13.5	14.2	13.3	11.9	3.3	0.0	0.0	1.0
Brazil	10.0	15.5	6.4	7.8	11.4	12.8	7.4	14.9	11.5
Colombia	1.9	1.3	1.4	1.7	1.5	4.3	1.0	1.8	1.5
Mexico	17.8	15.2	8.3	8.8	8.5	8.2	7.4	14.1	15.7
Venezuela, R. B. de	0.5	4.5	3.3	1.4	0.5	1.7	0.0	3.7	4.3
Middle East and North Africa	0.9	2.0	1.5	1.9	2.4	5.3	2.7	1.0	4.6
Egypt, Arab Rep. of	0.0	0.0	0.0	0.1	0.0	1.5	0.0	0.0	0.0
Lebanon	0.5	1.1	1.5	1.4	1.9	3.3	1.0	0.2	3.3
Tunisia	0.1	0.5	0.0	0.2	0.5	0.5	0.7	0.4	0.5
South Asia	1.2	2.5	0.0	0.0	0.0	0.1	0.2	0.5	5.0
India	1.1	2.0	0.0	0.0	0.0	0.1	0.2	0.5	4.4
Pakistan	0.1	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.5
Sub-Saharan Africa	1.0	1.1	1.0	1.8	1.5	2.2	1.9	4.7	2.0
South Africa	1.0	1.1	1.0	1.8	1.5	1.5	1.5	3.4	2.0

Table A.39 Gross international bank lending to developing country borrower, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004
All developing countries	**111.6**	**153.8**	**98.5**	**81.6**	**111.3**	**80.2**	**76.2**	**102.2**	**125.3**
East Asia and the Pacific	45.4	45.7	17.2	13.8	21.4	10.2	21.4	27.7	21.4
China	9.4	10.8	5.5	3.4	6.6	1.9	9.3	12.8	7.5
Indonesia	17.8	15.3	0.7	1.6	1.0	0.5	0.5	4.2	2.1
Malaysia	7.6	8.7	3.2	4.7	5.4	2.7	5.6	5.7	7.6
Philippines	1.3	4.2	3.4	2.8	4.3	3.1	1.7	2.0	2.1
Thailand	8.7	6.5	4.3	1.2	4.1	2.0	3.5	2.5	1.9
Europe and Central Asia	18.2	29.1	18.9	16.2	22.8	15.4	17.9	30.9	42.7
Czech Republic	3.2	3.6	2.4	0.6	1.2	0.9	0.3	2.2	1.8
Hungary	2.8	2.1	1.9	0.9	1.5	1.5	1.8	4.2	3.3
Poland	0.6	2.5	1.6	2.6	2.3	2.9	3.5	4.9	2.2
Russian Federation	3.8	9.9	2.7	0.7	4.7	3.1	5.1	8.2	15.3
Turkey	5.7	5.7	5.7	7.1	11.3	4.7	3.8	4.7	8.5
Latin America and the Caribbean	28.1	47.0	38.1	28.4	41.6	30.3	19.3	20.6	35.1
Argentina	9.8	11.5	11.8	7.2	6.7	5.0	2.0	0.7	0.9
Brazil	3.3	14.9	11.7	7.1	14.2	10.8	6.5	3.8	8.9
Chile	3.6	6.0	3.7	7.2	5.6	3.9	2.3	2.6	5.7
Colombia	2.3	4.9	1.8	2.0	2.3	0.6	1.3	0.2	0.4
Mexico	10.6	14.7	11.5	8.6	13.2	10.6	6.4	13.4	14.2
Middle East and North Africa	1.9	5.5	2.9	6.5	3.8	4.8	6.1	6.3	10.0
Egypt, Arab Rep. of	0.0	1.2	1.6	4.2	0.8	1.0	1.0	2.0	1.5
Iran	0.6	0.5	0.5	0.7	1.0	1.0	3.0	2.2	5.7
South Asia	7.8	8.9	4.9	3.2	3.4	2.6	2.2	5.2	7.9
India	5.0	7.5	3.8	2.8	3.0	2.1	1.8	3.5	7.0
Pakistan	2.8	1.3	0.9	0.0	0.0	0.2	0.4	1.5	0.9
Sub-Saharan Africa	5.8	7.2	6.5	5.1	10.3	9.2	6.2	7.9	7.9
South Africa	4.1	5.1	3.5	3.1	7.4	5.5	2.8	3.3	2.5

Table A.40 Change in foreign exchange reserves, 1996–2004

$ billions (− = increase)

	Gross foreign exchange reserves									
	2003	1996	1997	1998	1999	2000	2001	2002	2003	2004e
All developing countries	**1,213.6**	**−84.6**	**−52.5**	**−16.3**	**−33.4**	**−46.8**	**−81.7**	**−171.7**	**−291.9**	**−378.2**
East Asia and the Pacific	544.8	−45.2	−12.8	−20.7	−29.3	−10.1	−47.7	−87.9	−136.7	−230.3
China	403.3	−31.5	−34.9	−5.1	−9.7	−10.9	−46.6	−74.2	−116.8	−206.7
Indonesia	34.7	−4.5	1.7	−6.3	−3.8	−2.0	1.2	−3.7	−4.0	0.5
Malaysia	43.5	−3.2	6.1	−4.7	−4.9	1.0	−1.0	−3.7	−10.2	−18.2
Philippines	13.3	−3.7	2.8	−2.0	−4.0	0.2	−0.4	0.3	−0.3	0.8
Thailand	41.0	−1.7	11.5	−2.7	−5.4	1.9	−0.4	−5.7	−2.9	−6.0
Europe and Central Asia	236.2	−2.3	−7.4	−5.1	−6.4	−18.2	−11.1	−43.7	−60.9	−67.6
Czech Republic	26.3	1.5	2.6	−2.8	−0.3	−0.2	−1.2	−9.1	−3.0	−1.1
Hungary	12.0	2.3	1.3	−0.9	−1.5	−0.2	0.6	0.6	−2.3	−2.6
Poland	31.7	−3.1	−2.6	−6.9	1.1	−0.2	1.2	−2.8	−3.8	−3.3
Russian Federation	73.2	3.0	−1.5	5.0	−0.7	−15.8	−8.3	−11.5	−29.1	−40.5
Turkey	33.8	−4.0	−2.2	−0.8	−3.7	0.9	3.6	−8.2	−6.9	−2.1
Latin America and the Caribbean	189.7	−28.1	−13.5	9.2	7.4	−2.9	−2.9	−0.8	−33.2	−21.8
Argentina	13.1	−4.0	−4.4	−2.3	−1.6	1.7	9.9	4.1	−2.7	−4.2
Brazil	49.1	−8.6	7.5	8.2	7.8	2.3	−3.2	−1.7	−11.7	−3.6
Chile	15.2	−0.8	−2.3	2.0	1.1	−0.5	0.6	−0.8	−0.4	−0.3
Mexico	57.7	−3.9	−9.0	−3.3	0.5	−4.2	−9.2	−5.5	−7.8	−5.0
Venezuela, R. B. de	15.5	−5.4	−2.9	2.4	−0.1	−0.9	3.8	0.8	−7.5	−2.1
Middle East and North Africa	89.1	−5.6	−6.0	1.7	1.2	−4.8	−9.5	−12.0	−22.0	−12.2
Algeria	32.9	−2.2	−3.8	1.2	2.4	−7.5	−6.1	−5.1	−9.8	−8.4
Egypt, Arab Rep. of	13.4	−1.2	−1.3	0.6	3.6	1.4	0.0	−0.3	−0.2	0.0
Lebanon	12.5	−1.4	0.0	−0.6	−1.2	1.8	0.9	−2.2	−5.3	0.3
South Asia	114.8	−0.6	−5.2	−3.0	−5.0	−4.7	−10.2	−27.0	−35.0	−26.9
Bangladesh	2.6	0.5	0.2	−0.3	0.3	0.1	0.2	−0.4	−0.9	−0.5
India	97.6	−2.3	−4.6	−2.6	−5.0	−5.3	−8.0	−21.7	−30.6	−27.5
Pakistan	10.7	1.2	−0.6	0.2	−0.5	0.0	−2.1	−4.4	−2.6	1.1
Sub-Saharan Africa	39.0	−2.8	−7.6	1.5	−1.4	−6.1	−0.3	−0.3	−4.2	−19.4
Botswana	5.2	−0.3	−0.7	−0.2	−0.4	0.0	0.4	0.4	0.2	0.1
Nigeria	7.1	−2.6	−3.5	0.5	1.7	−4.5	−0.5	3.1	0.2	−9.8
South Africa	6.2	1.9	−3.8	0.6	−1.9	0.3	0.0	0.2	−0.6	−6.1

Note: e = estimate.

Table A.41 Total external debt of developing countries, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004e
All developing countries	**2,045.0**	**2,109.7**	**2,322.9**	**2,346.6**	**2,282.6**	**2,260.5**	**2,336.5**	**2,554.1**	**2,597.1**
East Asia and Pacific	494.0	526.3	533.2	538.6	500.7	502.0	498.2	525.5	536.5
China	128.8	146.7	144.0	152.1	145.7	170.1	168.3	193.6	—
Indonesia	128.9	136.2	151.2	151.2	144.4	134.0	131.8	134.4	—
Malaysia	39.7	47.2	42.4	41.9	41.9	44.6	48.8	49.1	—
Philippines	44.0	50.7	53.5	58.1	60.9	58.5	60.1	62.7	—
Thailand	112.8	109.7	104.9	96.8	79.7	67.2	59.5	51.8	—
Eastern Europe and Central Asia	368.3	391.2	490.3	503.5	510.8	507.8	560.2	676.0	728.5
Bulgaria	10.4	11.1	11.4	11.0	11.2	10.5	11.5	13.3	—
Czech Republic	20.1	23.1	24.2	22.8	21.5	22.7	27.6	34.6	—
Hungary	27.3	24.6	28.5	29.9	29.5	30.3	35.0	45.8	—
Poland	43.5	41.7	57.7	65.9	65.8	67.4	78.5	95.2	—
Russian Federation	126.4	127.6	177.9	174.8	160.0	152.5	147.4	175.3	—
Turkey	79.8	84.8	97.1	102.2	117.3	113.4	131.2	145.7	—
Latin America and Caribbean	638.5	670.4	752.2	771.8	755.1	749.2	746.2	779.6	773.5
Argentina	111.4	128.4	141.5	145.8	147.5	154.1	150.0	166.2	—
Brazil	181.3	198.0	241.0	244.0	239.2	226.8	228.6	235.4	—
Chile	27.5	27.0	33.7	34.8	37.3	38.6	41.2	43.2	—
Colombia	28.9	31.9	33.1	34.4	33.9	36.2	33.2	33.0	—
Mexico	156.3	147.6	159.0	166.5	150.3	145.7	140.2	140.0	—
Venezuela, R. B. de	34.5	35.7	37.8	37.6	38.2	36.0	34.0	34.9	—
Middle East and North Africa	163.2	151.3	160.9	155.8	144.6	142.1	150.2	158.8	155.5
Algeria	33.6	30.9	30.7	28.0	25.3	22.6	22.9	23.4	—
Egypt, Arab Rep. of	31.5	30.1	32.4	31.0	29.2	29.3	30.0	31.4	—
Lebanon	4.0	5.0	6.8	8.2	9.9	12.4	17.1	18.6	—
South Asia	149.6	149.6	157.6	162.0	160.0	156.2	170.2	182.8	184.7
India	93.5	94.3	97.6	98.3	99.1	97.5	106.3	113.5	—
Pakistan	29.8	30.1	32.3	33.9	32.8	31.7	33.7	36.3	—
Sub-Saharan Africa	231.3	220.8	228.6	215.0	211.3	203.2	211.4	231.4	218.4
South Africa	26.1	25.3	24.8	23.9	24.9	24.1	25.0	27.8	—

Note: — = not available; *e* = estimate.

Table A.42 Total external medium- and long-term debt of developing countries, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004e
All developing countries	**1,670.0**	**1,722.2**	**1,970.9**	**2,012.6**	**1,965.2**	**1,938.6**	**2,015.6**	**2,152.1**	**2,136.7**
East Asia and Pacific	365.3	394.3	447.3	464.9	437.5	411.2	399.3	400.1	391.1
China	103.4	115.2	126.7	136.9	132.6	128.5	120.5	120.6	—
Indonesia	96.7	103.3	131.1	131.2	121.8	112.2	108.9	111.5	—
Malaysia	28.6	32.3	33.9	35.9	37.3	38.3	40.5	40.2	—
Philippines	36.1	39.0	46.3	52.3	54.9	52.5	54.5	56.5	—
Thailand	65.1	71.9	75.3	73.4	64.8	54.0	47.5	40.9	—
Eastern Europe and Central Asia	315.1	331.7	414.8	423.7	424.1	425.1	472.0	541.2	562.9
Bulgaria	9.2	9.1	9.6	9.7	9.8	9.3	9.6	10.6	—
Czech Republic	14.3	15.0	16.6	14.0	12.5	13.2	16.8	20.7	—
Hungary	23.9	21.2	23.7	26.3	25.4	25.7	29.3	36.8	—
Poland	40.8	36.6	49.3	54.6	56.2	56.3	64.6	75.7	—
Russian Federation	114.5	121.7	163.1	159.0	144.4	133.5	131.1	144.5	—
Turkey	62.5	66.8	75.9	78.8	88.4	97.0	114.8	122.6	—
Latin America and Caribbean	517.1	542.2	633.2	662.5	647.6	655.7	667.3	696.3	680.0
Argentina	87.9	96.4	110.6	116.3	119.2	134.1	134.9	143.2	—
Brazil	145.4	163.2	211.1	214.7	208.2	198.5	205.2	215.8	—
Chile	20.4	21.5	28.6	30.5	31.1	33.3	35.4	35.7	—
Colombia	23.0	26.2	26.9	30.5	31.1	33.0	29.5	29.4	—
Mexico	126.4	119.8	132.7	142.4	131.4	131.1	130.3	130.8	—
Venezuela, R. B. de	31.8	31.5	35.5	35.5	34.1	31.2	29.4	30.5	—
Middle East and North Africa	144.4	132.7	138.9	132.6	123.8	123.8	131.7	138.5	134.9
Algeria	33.3	30.7	30.5	27.8	25.0	22.4	22.8	23.2	—
Egypt, Arab Rep. of	29.2	27.1	28.2	26.8	25.1	26.0	26.5	27.6	—
Lebanon	2.3	3.2	4.8	6.0	7.3	9.8	14.5	15.5	—
South Asia	139.3	141.4	150.5	155.0	154.0	151.3	162.9	175.6	178.2
India	86.7	89.3	93.3	94.4	95.6	94.8	101.7	108.7	—
Pakistan	27.0	27.6	30.1	32.1	31.3	30.4	32.1	35.1	—
Sub-Saharan Africa	188.8	180.0	186.2	174.0	178.2	171.5	182.4	200.3	189.6
South Africa	15.2	14.3	13.3	13.1	15.3	15.7	17.6	20.4	—

Note: — = not available; *e* = estimate.

Table A.43 Total external short-term debt of developing countries, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004e
All developing countries	**375.0**	**387.4**	**352.0**	**334.0**	**317.3**	**321.9**	**320.8**	**402.1**	**460.4**
East Asia and Pacific	128.7	132.1	85.9	73.8	63.2	90.8	99.0	125.5	145.4
China	25.4	31.5	17.3	15.2	13.1	41.6	47.9	73.0	—
Indonesia	32.2	32.9	20.1	20.0	22.6	21.8	22.8	22.9	—
Malaysia	11.1	14.9	8.5	6.0	4.6	6.3	8.4	8.8	—
Philippines	8.0	11.8	7.2	5.7	5.9	6.0	5.6	6.2	—
Thailand	47.7	37.8	29.7	23.4	14.9	13.2	11.9	10.9	—
Eastern Europe and Central Asia	53.2	59.5	75.5	79.7	86.7	82.6	88.2	134.8	165.6
Bulgaria	1.1	2.0	1.8	1.3	1.5	1.2	1.8	2.7	—
Czech Republic	5.7	8.1	7.6	8.8	9.0	9.6	10.8	14.0	—
Hungary	3.4	3.4	4.8	3.5	4.2	4.6	5.7	9.0	—
Poland	2.7	5.1	8.4	11.3	9.7	11.1	13.9	19.5	—
Russian Federation	12.0	5.9	14.8	15.7	15.6	19.0	16.3	30.8	—
Turkey	17.3	18.0	21.2	23.5	28.9	16.3	16.4	23.0	—
Latin America and Caribbean	121.4	128.2	119.0	109.3	107.5	93.5	78.9	83.3	93.5
Argentina	23.5	32.0	31.0	29.4	28.3	20.0	15.1	23.0	—
Brazil	35.9	34.9	29.9	29.2	31.0	28.3	23.4	19.6	—
Chile	7.0	5.5	5.1	4.3	6.2	5.3	5.8	7.5	—
Colombia	5.9	5.8	6.2	4.0	2.9	3.3	3.7	3.6	—
Mexico	29.8	27.9	26.3	24.1	18.9	14.6	9.9	9.2	—
Venezuela, R. B. de	2.7	4.2	2.2	2.1	4.1	4.8	4.6	4.3	—
Middle East and North Africa	18.8	18.6	22.1	23.2	20.8	18.3	18.5	20.3	20.5
Algeria	0.3	0.2	0.2	0.2	0.2	0.2	0.1	0.1	—
Egypt, Arab Rep. of	2.3	3.0	4.3	4.3	4.1	3.4	3.5	3.8	—
Lebanon	1.7	1.8	2.0	2.2	2.5	2.7	2.5	3.1	—
South Asia	10.3	8.2	7.1	7.0	6.1	5.0	7.3	7.2	6.5
India	6.7	5.0	4.3	3.9	3.5	2.7	4.6	4.7	—
Pakistan	2.8	2.5	2.2	1.8	1.5	1.3	1.5	1.2	—
Sub-Saharan Africa	42.6	40.8	42.4	41.0	33.1	31.7	29.0	31.1	28.8
South Africa	10.8	10.9	11.4	10.8	9.6	8.4	7.4	7.4	—

Note: — = not available; *e* = estimate.

Table A.44 Total external debt of developing countries owed by public and publicly guaranteed borrowers, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004e
All developing countries	**1,392.2**	**1,369.1**	**1,471.9**	**1,477.9**	**1,421.9**	**1,400.9**	**1,471.2**	**1,557.0**	**1,555.0**
East Asia and Pacific	256.8	272.0	288.6	307.5	288.1	277.8	277.7	279.6	272.6
China	102.3	112.8	99.4	99.2	94.9	91.8	88.6	85.6	—
Indonesia	60.0	58.8	76.4	83.9	80.6	77.8	78.9	83.7	—
Malaysia	15.7	16.8	18.2	18.9	19.2	24.1	26.5	25.5	—
Philippines	27.5	27.3	30.5	36.6	35.9	31.4	34.2	37.4	—
Thailand	16.9	24.7	31.3	34.7	32.5	27.9	23.0	17.8	—
Eastern Europe and Central Asia	286.9	288.9	321.2	316.5	305.0	292.6	309.8	334.6	340.3
Bulgaria	8.8	8.7	9.1	9.0	9.0	8.5	8.5	8.9	—
Czech Republic	12.2	12.8	11.6	7.7	6.5	5.7	7.0	8.6	—
Hungary	18.9	15.3	15.9	16.9	14.4	12.7	13.6	14.8	—
Poland	39.2	34.2	35.1	33.2	30.8	25.7	29.4	35.0	—
Russian Federation	114.5	119.8	140.9	136.4	122.6	111.2	102.6	103.3	—
Turkey	49.1	48.1	50.6	51.6	60.6	68.4	82.3	88.8	—
Latin America and Caribbean	399.9	379.6	413.1	420.1	406.2	417.2	441.5	468.5	484.3
Argentina	68.8	73.0	82.7	89.0	93.2	102.4	106.4	114.8	—
Brazil	96.4	87.4	103.0	101.2	95.5	102.2	117.8	123.3	—
Chile	4.9	4.4	5.0	5.7	5.3	5.6	6.8	8.1	—
Colombia	14.9	15.4	16.7	20.2	20.8	21.8	20.7	22.8	—
Mexico	106.1	92.4	95.4	92.4	81.5	77.0	76.3	77.5	—
Venezuela, R. B. de	29.9	29.0	29.6	28.7	28.0	25.2	23.4	24.5	—
Middle East and North Africa	140.3	127.7	131.8	125.6	117.2	117.2	125.2	131.8	127.4
Algeria	33.3	30.7	30.5	27.8	25.0	22.4	22.7	22.7	—
Egypt, Arab Rep. of	29.1	27.0	27.8	26.3	24.5	25.3	25.9	27.3	—
Lebanon	1.9	2.3	4.0	5.3	6.6	9.0	13.8	14.8	—
South Asia	129.9	129.7	139.3	144.6	138.6	137.1	147.0	157.8	158.8
India	79.4	80.1	84.9	86.4	83.2	83.1	88.2	92.8	—
Pakistan	25.0	25.3	27.5	29.8	28.7	28.3	30.1	33.5	—
Sub-Saharan Africa	178.5	171.1	177.9	163.6	166.9	159.1	170.0	184.7	171.5
South Africa	11.2	11.9	10.7	8.2	9.1	7.9	9.4	9.1	—

Note: — = not available; *e* = estimate.

Table A.45 Total external debt of developing countries owed by private sector borrowers, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004e
All developing countries	**652.8**	**740.6**	**851.0**	**868.7**	**860.7**	**859.6**	**865.2**	**997.2**	**1,042.1**
East Asia and Pacific	237.2	254.4	244.6	231.1	212.6	224.2	220.6	246.0	263.9
China	26.6	33.9	44.6	52.9	50.9	78.4	79.7	108.0	—
Indonesia	68.9	77.3	74.8	67.3	63.8	56.2	52.8	50.7	—
Malaysia	24.0	30.4	24.3	23.0	22.7	20.5	22.4	23.6	—
Philippines	16.5	23.5	23.0	21.4	25.0	27.1	25.9	25.2	—
Thailand	96.0	85.0	73.6	62.0	47.2	39.3	36.5	34.0	—
Eastern Europe and Central Asia	81.5	102.3	169.1	186.9	205.8	215.2	250.4	341.4	388.2
Bulgaria	1.6	2.4	2.3	2.0	2.2	2.0	2.9	4.4	—
Czech Republic	7.8	10.2	12.7	15.1	15.0	17.1	20.6	26.1	—
Hungary	8.4	9.3	12.6	13.0	15.2	17.6	21.4	31.0	—
Poland	4.3	7.5	22.6	32.8	35.1	41.7	49.1	60.3	—
Russian Federation	12.0	7.8	36.9	38.3	37.4	41.3	44.8	71.9	—
Turkey	30.8	36.7	46.6	50.6	56.7	45.0	48.9	56.8	—
Latin America and Caribbean	238.6	290.8	339.1	351.7	348.9	332.0	304.7	311.2	289.1
Argentina	42.6	55.4	58.8	56.7	54.2	51.6	43.6	51.4	—
Brazil	84.9	110.7	138.0	142.8	143.7	124.6	110.8	112.1	—
Chile	22.6	22.7	28.7	29.2	32.0	33.0	34.4	35.2	—
Colombia	14.0	16.5	16.3	14.2	13.1	14.5	12.5	10.2	—
Mexico	50.2	55.2	63.5	74.1	68.8	68.6	63.8	62.5	—
Venezuela, R. B. de	4.5	6.7	8.2	8.9	10.2	10.8	10.6	10.4	—
Middle East and North Africa	22.9	23.6	29.1	30.2	27.3	24.9	24.9	27.0	28.1
Algeria	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.7	—
Egypt, Arab Rep. of	2.5	3.1	4.6	4.8	4.7	4.0	4.1	4.1	—
Lebanon	2.1	2.7	2.7	2.9	3.3	3.5	3.2	3.8	—
South Asia	19.8	19.9	18.3	17.4	21.5	19.1	23.2	25.0	25.9
India	14.1	14.3	12.7	11.9	15.9	14.4	18.1	20.6	—
Pakistan	4.8	4.8	4.8	4.1	4.1	3.4	3.5	2.9	—
Sub-Saharan Africa	52.9	49.7	50.7	51.4	44.5	44.1	41.5	46.7	46.9
South Africa	14.8	13.3	14.1	15.7	15.8	16.1	15.6	18.7	—

Note: — = not available; *e* = estimate.

Table A.46 Total external debt of developing countries owed to public sector creditors, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004e
All developing countries	**833.3**	**791.3**	**866.8**	**881.8**	**839.5**	**826.9**	**874.7**	**933.3**	**896.6**
East Asia and Pacific	153.7	152.5	179.1	200.3	188.2	180.6	183.4	190.8	179.4
China	39.4	39.8	45.1	50.4	50.4	50.6	50.8	51.5	—
Indonesia	46.1	45.5	58.2	66.3	65.9	62.1	65.2	70.5	—
Malaysia	4.2	4.0	4.5	4.8	5.0	5.9	5.8	6.1	—
Philippines	21.0	19.7	22.2	23.6	22.0	19.8	21.0	22.3	—
Thailand	10.6	17.8	21.4	25.3	23.9	20.8	16.7	13.2	—
Eastern Europe and Central Asia	160.0	156.2	172.4	171.4	166.8	159.2	165.4	176.2	169.6
Bulgaria	3.4	3.4	3.9	3.9	3.9	3.4	3.5	4.1	—
Czech Republic	1.3	1.1	1.1	1.1	1.1	1.2	1.5	1.9	—
Hungary	3.7	3.3	2.3	2.3	1.9	1.7	1.9	1.8	—
Poland	30.5	26.6	27.1	25.1	23.7	17.8	19.7	20.4	—
Russian Federation	75.6	76.8	88.3	86.7	82.5	71.7	62.2	64.7	—
Turkey	15.9	14.3	15.0	13.8	17.3	26.9	35.8	37.5	—
Latin America and Caribbean	164.1	145.9	161.0	163.2	150.1	162.9	183.1	196.9	189.2
Argentina	26.1	24.2	25.9	25.5	25.6	35.2	35.6	36.9	—
Brazil	25.4	22.2	32.7	37.7	31.1	37.2	52.1	58.2	—
Chile	2.7	2.2	2.2	2.1	1.9	1.7	1.5	1.4	—
Colombia	6.5	5.6	6.0	7.8	7.7	8.6	8.9	11.4	—
Mexico	42.6	32.1	31.4	26.3	20.8	19.9	20.5	20.6	—
Venezuela, R. B. de	6.3	5.5	6.7	6.6	6.1	4.9	4.4	3.9	—
Middle East and North Africa	107.3	99.6	103.9	98.3	90.7	88.3	91.3	96.2	93.1
Algeria	20.2	20.3	21.5	20.4	19.2	17.7	17.7	17.8	—
Egypt, Arab Rep. of	27.7	25.9	26.9	25.7	24.0	23.4	24.7	26.4	—
Lebanon	0.6	0.7	0.9	0.9	0.9	1.0	1.0	1.7	—
South Asia	104.1	98.9	104.6	113.3	102.7	101.1	106.3	113.8	113.7
India	55.9	52.8	53.9	58.6	50.6	49.8	49.8	50.9	—
Pakistan	23.8	22.8	25.1	27.7	26.6	27.0	29.3	32.7	—
Sub-Saharan Africa	144.0	138.2	145.7	135.2	140.9	134.9	145.1	159.6	151.6
South Africa	0.9	0.4	0.0	0.0	0.1	0.1	0.1	0.2	—

Note: — = not available; *e* = estimate.

Table A.47 Total external debt of developing countries owed to private sector creditors, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004e
All developing countries	**1,211.7**	**1,318.4**	**1,456.1**	**1,464.9**	**1,443.1**	**1,433.6**	**1,461.8**	**1,620.8**	**1,700.5**
East Asia and Pacific	340.3	373.8	354.1	338.3	312.5	321.4	314.8	334.8	357.2
China	89.4	106.9	98.9	101.6	95.3	119.6	117.5	142.1	—
Indonesia	82.8	90.7	93.1	84.9	78.5	72.0	66.5	63.9	—
Malaysia	35.5	43.2	37.9	37.1	37.0	38.8	43.1	43.0	—
Philippines	23.0	31.1	31.4	34.4	38.8	38.7	39.1	40.3	—
Thailand	102.3	91.9	83.5	71.5	55.8	46.4	42.7	38.6	—
Eastern Europe and Central Asia	208.3	235.0	317.9	332.1	344.0	348.6	394.8	499.8	558.9
Bulgaria	7.0	7.7	7.5	7.1	7.3	7.1	8.0	9.2	—
Czech Republic	18.7	22.0	23.1	21.7	20.4	21.5	26.0	32.7	—
Hungary	23.6	21.3	26.2	27.6	27.6	28.6	33.1	44.0	—
Poland	13.0	15.1	30.6	40.9	42.2	49.6	58.8	74.9	—
Russian Federation	50.8	50.8	89.6	88.1	77.6	80.8	85.3	110.6	—
Turkey	64.0	70.5	82.2	88.4	100.0	86.5	95.4	108.2	—
Latin America and Caribbean	474.3	524.5	591.2	608.6	605.0	586.3	563.1	582.8	584.2
Argentina	85.3	104.2	115.6	120.3	121.9	118.9	114.3	129.3	—
Brazil	155.9	175.8	208.4	206.3	208.1	189.6	176.5	177.2	—
Chile	24.7	24.9	31.5	32.7	35.4	36.9	39.7	41.8	—
Colombia	22.4	26.3	27.1	26.6	26.2	27.7	24.3	21.6	—
Mexico	113.6	115.6	127.5	140.2	129.5	125.8	119.6	119.4	—
Venezuela, R. B. de	28.2	30.2	31.0	31.0	32.0	31.1	29.6	31.0	—
Middle East and North Africa	55.9	51.7	57.0	57.5	53.8	53.9	58.8	62.7	62.4
Algeria	13.4	10.6	9.2	7.6	6.1	4.9	5.2	5.6	—
Egypt, Arab Rep. of	3.8	4.2	5.5	5.3	5.2	6.0	5.3	5.0	—
Lebanon	3.4	4.3	5.9	7.3	8.9	11.5	16.1	16.9	—
South Asia	45.5	50.7	53.0	48.7	57.3	55.1	63.9	68.9	71.0
India	37.6	41.5	43.7	39.7	48.5	47.7	56.5	62.6	—
Pakistan	6.0	7.2	7.2	6.2	6.1	4.7	4.4	3.7	—
Sub-Saharan Africa	87.3	82.6	82.9	79.8	70.4	68.3	66.3	71.8	66.8
South Africa	25.2	24.9	24.8	23.9	24.7	23.9	24.9	27.6	—

Note: — = not available; *e* = estimate.

Table A.48 Gross foreign exchange reserves of developing countries, 1996–2004

$ billions

	1996	1997	1998	1999	2000	2001	2002	2003	2004e
All developing countries	**519.2**	**571.7**	**588.0**	**621.5**	**668.3**	**750.0**	**921.7**	**1,213.6**	**1,591.8**
East Asia and the Pacific	199.7	212.5	233.2	262.5	272.6	320.3	408.2	544.8	775.1
China	105.0	139.9	145.0	154.7	165.6	212.2	286.4	403.3	610.0
Indonesia	17.8	16.1	22.4	26.2	28.3	27.0	30.8	34.7	34.3
Malaysia	26.2	20.0	24.7	29.7	28.6	29.6	33.3	43.5	61.7
Philippines	9.9	7.1	9.1	13.1	12.9	13.3	13.0	13.3	12.5
Thailand	37.2	25.7	28.4	33.8	31.9	32.3	38.0	41.0	46.9
Europe and Central Asia	83.4	90.8	95.9	102.3	120.4	131.5	175.3	236.2	303.8
Czech Republic	12.4	9.7	12.5	12.8	13.0	14.2	23.3	26.3	27.4
Hungary	9.6	8.3	9.2	10.7	10.9	10.3	9.7	12.0	14.6
Poland	17.7	20.3	27.2	26.1	26.3	25.2	28.0	31.7	35.0
Russian Federation	11.3	12.8	7.8	8.5	24.3	32.5	44.1	73.2	113.7
Turkey	16.4	18.6	19.4	23.2	22.3	18.7	26.9	33.8	35.9
Latin America and the Caribbean	153.0	166.5	157.3	149.9	152.8	155.7	156.5	189.7	211.5
Argentina	17.7	22.2	24.5	26.1	24.4	14.5	10.4	13.1	17.3
Brazil	58.3	50.8	42.6	34.8	32.5	35.7	37.4	49.1	52.7
Chile	14.9	17.3	15.3	14.2	14.7	14.0	14.8	15.2	15.5
Mexico	19.2	28.1	31.5	31.0	35.1	44.4	49.9	57.7	62.8
Venezuela, R. B. de	11.1	14.0	11.6	11.7	12.6	8.8	8.0	15.5	17.7
Middle East and North Africa	37.6	43.7	42.0	40.8	45.6	55.1	67.1	89.1	101.3
Algeria	4.2	8.0	6.8	4.4	11.9	18.0	23.1	32.9	41.4
Egypt, Arab Rep. of	17.2	18.5	17.9	14.3	12.9	12.9	13.2	13.4	13.4
South Asia	24.8	30.0	32.9	37.9	42.6	52.8	79.8	114.8	141.7
Bangladesh	1.7	1.6	1.9	1.6	1.5	1.3	1.7	2.6	3.1
India	19.7	24.3	27.0	32.0	37.3	45.3	67.0	97.6	125.2
Pakistan	0.5	1.2	1.0	1.5	1.5	3.6	8.1	10.7	9.6
Sub-Saharan Africa	20.6	28.2	26.7	28.0	34.2	34.5	34.8	39.0	58.4
Botswana	5.0	5.6	5.9	6.2	6.3	5.8	5.4	5.2	5.1
Nigeria	4.1	7.6	7.1	5.5	9.9	10.5	7.3	7.1	16.9
South Africa	0.9	4.8	4.2	6.1	5.8	5.8	5.6	6.2	12.3

Note: e = estimate.

Table A.49 Key external debt ratios for developing countries

%, averages for 2001–3

	Total external debt (EDT) to exports of G&S (XGS)	Present value (PV) of EDT as % of XGS	EDT as % of gross national income (GNI)	PV as % of GNI	Total debt service as % of XGS	Interest service as % of XGS
Albania	81	57	28	20	3	1
Algeria	103	100	41	40	19	5
Angola	120	117	104	102	17	2
Argentina	473	531	104	117	40	6
Armenia	131	85	45	29	11	1
Azerbaijan	58	47	28	23	9	1
Bangladesh	188	128	37	25	7	2
Barbados	47	53	29	33	5	3
Belarus	27	27	18	18	3	1
Belize	206	241	125	146	26	13
Benin	347	*151*	65	*28*	11	3
Bhutan	270	252	79	74	5	1
Bolivia	308	*157*	74	*38*	23	7
Bosnia and Herzegovina	102	78	48	37	6	2
Botswana	16	13	9	8	2	0
Brazil	299	323	50	54	72	19
Bulgaria	148	152	83	86	13	5
Burkina Faso	497	*178*	54	*19*	14	5
Burundi	3,051	*2,182*	210	*150*	68	18
Cambodia	125	107	82	70	1	0
Cameroon	335	*185*	96	*53*	16	7
Cape Verde	156	107	74	51	7	2
Central African Republic	1,061	1,319	125	155	0	0
Chad	427	*254*	75	*45*	13	4
Chile	174	178	66	67	34	8
China	49	48	15	15	9	2
Colombia	182	200	43	47	46	12
Comoros	397	289	109	79	4	1
Congo, Dem. Rep.	923	625	222	*150*	12	8
Congo, Rep.	266	*404*	242	*368*	3	1
Costa Rica	69	74	34	36	11	4
Côte d'Ivoire	210	176	107	90	10	2
Croatia	183	183	102	102	26	6
Czech Republic	69	69	48	48	11	2
Djibouti	141	95	65	44	6	1
Dominica	243	234	123	119	14	7
Dominican Republic	59	58	34	33	9	3
Ecuador	217	240	74	82	31	14
Egypt, Arab Rep. of	147	131	35	31	13	4
El Salvador	119	132	50	55	9	5
Equatorial Guinea	15	13	—	—	—	—
Eritrea	543	333	76	47	10	5
Estonia	118	119	100	101	21	5
Ethiopia	621	*135*	112	*24*	8	4
Fiji	25	24	15	15	3	1
Gabon	111	114	87	89	11	4
Gambia, The	379	*202*	170	*90*	12	5
Georgia	155	122	54	43	14	3
Ghana	285	*85*	128	*38*	17	3
Grenada	205	190	99	92	17	10
Guatemala	88	86	22	21	8	3
Guinea	408	*225*	106	59	15	4
Guinea-Bissau	891	*594*	369	*246*	18	5
Guyana	198	*78*	215	*84*	8	3
Haiti	114	83	39	29	5	1
Honduras	171	106	87	*54*	13	3
Hungary	102	99	73	71	34	3
India	120	*106*	22	19	22	6
Indonesia	196	200	80	82	27	6
Iran, Islamic Rep. of	33	30	9	8	5	1

(Table continues on next page)

Table A.49 Key external debt ratios for developing countries (*continued*)

%, averages for 2001–3

	Total external debt (EDT) to exports of G&S (XGS)	Present value (PV) of EDT as % of XGS	EDT as % of gross national income (GNI)	PV as % of GNI	Total debt service as % of XGS	Interest service as % of XGS
Jamaica	119	131	73	80	18	7
Jordan	125	117	90	84	17	3
Kazakhstan	181	183	94	95	42	6
Kenya	206	162	54	43	17	4
Kyrgyz Republic	282	221	125	98	19	2
Lao PDR	611	356	155	91	11	3
Latvia	206	204	93	92	22	4
Lebanon	458	482	104	110	80	35
Lesotho	112	80	66	47	11	2
Liberia	1,522	1,630	603	646	0	0
Lithuania	105	106	58	58	84	4
Macedonia, FYR	112	97	47	40	15	3
Madagascar	466	*138*	105	31	7	3
Malawi	660	*393*	181	*108*	7	4
Malaysia	44	45	55	56	8	2
Maldives	54	41	45	35	4	1
Mali	282	*124*	97	*42*	7	2
Mauritania	459	*153*	218	*73*	11	3
Mauritius	83	81	54	52	8	3
Mexico	74	83	23	25	22	6
Moldova	154	146	100	95	13	4
Mongolia[1]	188	140	127	95	37	2
Morocco	116	109	51	47	27	8
Mozambique	430	*118*	139	*38*	8	2
Myanmar	247	187	—	—	4	1
Nepal	200	131	57	38	7	2
Nicaragua	436	*98*	178	*40*	13	4
Niger	542	*148*	93	*26*	9	3
Nigeria	153	148	78	76	7	2
Oman	32	32	19	19	11	1
Pakistan	232	189	50	41	19	5
Panama	99	123	75	93	11	6
Papua New Guinea	113	104	87	80	14	3
Paraguay	111	107	52	51	11	4
Peru	279	311	54	60	24	13
Philippines	141	147	77	80	23	6
Poland	150	147	49	48	30	4
Romania	124	126	45	46	21	5
Russian Federation	128	135	50	52	14	6
Rwanda	974	*615*	91	*57*	13	5
Samoa	253	209	148	122	9	6
Sao Tome and Principe	1,773	*770*	723	*314*	35	15
Senegal	222	*96*	84	36	12	4
Serbia and Montenegro	268	238	94	83	17	6
Seychelles	100	103	87	89	14	3
Sierra Leone	1,152	*632*	216	*118*	18	8
Slovak Republic	93	90	72	70	18	3
Solomon Islands	224	176	76	60	11	5
Somalia	—	—	—	—	—	—
South Africa	67	69	23	23	10	3
Sri Lanka	134	110	62	51	8	2
St. Kitts and Nevis	210	212	102	103	29	14
St. Lucia	106	104	59	58	9	5
St. Vincent and the Grenadines	128	107	67	56	8	3
Sudan	561	550	123	120	1	0
Swaziland	28	28	27	26	2	1
Syrian Arab Republic	264	262	112	111	4	2
Tajikistan	139	112	96	77	11	2
Tanzania	457	*132*	77	*22*	6	2
Thailand	59	59	41	41	17	2

(Table continues on next page)

Table A.49 Key external debt ratios for developing countries (*continued*)

%, averages for 2001–3

	Total external debt (EDT) to exports of G&S (XGS)	Present value (PV) of EDT as % of XGS	EDT as % of gross national income (GNI)	PV as % of GNI	Total debt service as % of XGS	Interest service as % of XGS
Togo	259	203	116	91	2	0
Tonga	106	74	57	40	5	1
Trinidad and Tobago	52	59	31	35	5	3
Tunisia	139	140	74	75	14	5
Turkey	232	243	77	81	45	11
Turkmenistan	—	—	—	—	—	—
Uganda	408	*170*	78	*33*	8	2
Ukraine	66	64	38	37	15	2
Uruguay	334	351	86	90	25	9
Uzbekistan	149	142	49	47	24	5
Vanuatu	64	46	39	28	1	1
Venezuela, R. B. de	117	139	35	42	30	8
Vietnam	77	67	45	39	4	1
Yemen, Rep. of	102	72	57	40	3	1
Zambia	529	*372*	172	*121*	32	12
Zimbabwe	274	272	50	50	3	1

Notes: — = not available. For definition of indicators, see Sources and Definitions section. Numbers in italics include the effects of traditional relief and HIPC relief and are based on public and publicly guaranteed debt only. Exports comprise the total value of goods and services exported, receipts of compensations of employees and investment income and worker's remittances. In the ratios, the numerator refers to the 2003 data and the denominator is an average of 2001 to 2003 data.

Table A.50 Classification of countries by levels of external indebtedness

136 economies in the World Bank Debtor Reporting System

Severely indebted low-income	Severely indebted middle-income	Moderately indebted low-income	Moderately indebted middle-income	Less indebted low-income	Less indebted middle-income
Angola	Argentina	Benin	Bolivia	Bangladesh	Albania
Bhutan	Belize	Burkina Faso	Cape Verde	Equatorial Guinea	Algeria
Burundi	Brazil	Cambodia	Chile	Ghana	Armenia
Central African Republic	Bulgaria	Cameroon	Colombia	Haiti	Azerbaijan
Chad	Croatia	Ethiopia	El Salvador	India	Barbados
Comoros	Dominica	Kenya	Honduras	Lesotho	Belarus
Congo, Dem. Rep. of	Ecuador	Madagascar	Hungary	Mali	Bosnia and Herzegovina
Congo, Rep. of	Estonia	Mauritania	Jamaica	Mozambique	Botswana
Côte d'Ivoire	Gabon	Moldova	Lithuania	Nepal	China
Eritrea	Grenada	Mongolia[a]	Malaysia	Nicaragua	Costa Rica
Gambia, The	Guyana	Niger	Mauritius	Senegal	Czech Republic
Guinea	Indonesia	Nigeria	Paraguay	Tanzania	Djibouti
Guinea-Bissau	Jordan	Pakistan	Philippines	Vietnam	Dominican Republic
Kyrgyz Republic	Kazakhstan	Papua New Guinea	Poland	Yemen, Rep. of	Egypt, Arab Rep. of
Lao PDR	Latvia	Solomon Islands	Russian Federation		Fiji
Liberia	Lebanon	Uganda	Slovak Republic		Georgia
Malawi	Maldives	Uzbekistan	Sri Lanka		Guatemala
Myanmar	Panama		St. Lucia		Iran, Islamic Rep. of
Rwanda	Peru		St. Vincent and the Grenadines		Macedonia, FYR
São Tomé and Principe	Samoa		Tunisia		Mexico
Sierra Leone	Serbia and Montenegro		Turkmenistan		Morocco
Somalia	Seychelles		Venezuela, R. B. de		Oman
Sudan	St. Kitts and Nevis				Romania
Tajikistan	Syrian Arab Republic				South Africa
Togo	Turkey				Swaziland
Zambia	Uruguay				Thailand
Zimbabwe					Tonga
					Trinidad and Tobago
					Ukraine

Notes: Tables classify all World Bank member economies and all other economies with populations more than 30,000. Economies are divided among income groups according to 2003 GNI per capita, calculated using the World Bank Atlas method. Income groups are low income, $765 or less; lower middle-income, $766–$3,035; upper middle-income, $3,036–$9,385; and high income, $9,386 or more.

a. Classification excludes the effect of Russian debt settlement.

Table A.51 Classification of countries by region and level of income

Income group	Subgroup	Sub-Saharan Africa: East and Southern Africa	Sub-Saharan Africa: West Africa	Asia: East Asia and Pacific	Asia: South Asia	Europe and Central Asia: Eastern Europe and Central Asia	Europe and Central Asia: Rest of Europe	Middle East and North Africa: Middle East	Middle East and North Africa: North Africa	Americas
Low-income		Angola Burundi Comoros Congo, Dem. Rep. of Eritrea Ethiopia Kenya Lesotho Madagascar Malawi Mozambique Rwanda Somalia Sudan Tanzania Uganda Zambia Zimbabwe	Benin Burkina Faso Cameroon Central African Republic Chad Congo, Rep. Côte d'Ivoire Equatorial Guinea Gambia, The Ghana Guinea Guinea-Bissau Liberia Mali Mauritania Niger Nigeria São Tomé and Principe Senegal Sierra Leone Togo	Cambodia Korea, Dem. Rep. of Lao PDR Mongolia Myanmar Papua New Guinea Solomon Islands Timor-Leste Vietnam	Afghanistan Bangladesh Bhutan India Nepal Pakistan	Kyrgyz Republic Moldova Tajikistan Uzbekistan		Yemen, Rep. of		Haiti Nicaragua
Middle-income	*Lower*	Namibia South Africa Swaziland	Cape Verde	China Fiji Indonesia Kiribati Marshall Islands Micronesia, Fed. Sts. of Philippines Samoa Thailand Tonga Vanuatu	Maldives Sri Lanka	Albania Armenia Azerbaijan Belarus Bosnia and Herzegovina Bulgaria Georgia Kazakhstan Macedonia, FYR[a] Romania Russian Federation Serbia and Montenegro Turkmenistan Ukraine	Turkey	Iran, Islamic Rep. of Iraq Jordan Syrian Arab Republic West Bank and Gaza	Algeria Djibouti Egypt, Arab Rep. of Morocco Tunisia	Bolivia Brazil Colombia Cuba Dominican Republic Ecuador El Salvador Guatemala Guyana Honduras Jamaica Paraguay Peru Suriname
	Upper	Botswana Mauritius Mayotte Seychelles	Gabon	American Samoa Malaysia N. Mariana Islands Palau		Croatia Czech Republic Estonia Hungary Latvia Lithuania Poland Slovak Republic		Lebanon Oman Saudi Arabia	Libya	Antigua and Barbuda Argentina Barbados Belize Chile Costa Rica Dominica Grenada Mexico Panama St. Kitts and Nevis St. Lucia St. Vincent and the Grenadines Trinidad and Tobago Uruguay Venezuela, R. B. de

Table A.51 Classification of countries by region and level of income (*continued*)

Income group	Subgroup	Sub-Saharan Africa: East and Southern Africa	Sub-Saharan Africa: West Africa	Asia: East Asia and Pacific	Asia: South Asia	Europe and Central Asia: Eastern Europe and Central Asia	Europe and Central Asia: Rest of Europe	Middle East and North Africa: Middle East	Middle East and North Africa: North Africa	Americas
High-income	*OECD*			Australia Japan Korea, Rep. of New Zealand			Austria Belgium Denmark Finland France[b] Germany Greece Iceland Ireland Italy Luxembourg Netherlands Norway Portugal Spain Sweden Switzerland United Kingdom			Canada United States
	Non-OECD			Brunei French Polynesia Guam Hong Kong, China[c] Macao, China[d] New Caledonia Singapore Taiwan, China		Slovenia	Andorra Channel Islands Cyprus Faeroe Islands Greenland Isle of Man Liechtenstein Monaco San Marino	Bahrain Israel Kuwait Qatar United Arab Emirates	Malta	Aruba Bahamas, The Bermuda Cayman Islands Netherlands Antilles Puerto Rico Virgin Islands (U.S.)

Note: For operational and analytical purposes, the World Bank's main criterion for classifying economies is GNI per capita. Every economy is classified as low income, middle income (subdivided into lower middle and upper middle), or high income. Other analytical groups, based on geographic regions and levels of external debt, are also used.

Low-income and middle-income economies are sometimes referred to as developing economies. The use of the term is convenient; it is not intended to imply that all economies in the group are experiencing similar development or that other economies have reached a preferred or final stage of development. Classification by income does not necessarily reflect development status.

This table classifies all World Bank member economies, and all other economies with populations of more than 30,000. Economies are divided among income groups according to 2003 GNI per capita, calculated using the World Bank Atlas method. The groups are: low income, $765 or less; lower middle–income, $766–3,035; upper middle-income, $3,036–9,385; and high income, $9,386 or more.

a. Former Yugoslav Republic of Macedonia.
b. The French overseas departments French Guiana, Guadeloupe, Martinique, and Réunion are included in France.
c. On July 1, 1997 China resumed its exercise of sovereignty over Hong Kong.
d. On December 20, 1999 China resumed its exercise of sovereignty over Macao.
Source: World Bank data.