Developing Countries Get More Private Investment, Less Aid

A World Bank report shows that while private investment flows to developing countries continued to grow in 1996, official flows declined.

A RECENTLY published World Bank report, *Global Development Finance*, shows that flows of private capital to developing countries increased for the sixth consecutive year in 1996, surging to $244 billion, up $60 billion over 1995. Private capital accounted for more than 80 percent of total net long-term flows to developing countries, which came to $285 billion in 1996 (Table 1).

The pie was not equally distributed among all developing countries, however—73 percent of foreign investment went to just 12 countries, with China receiving 52 percent of total flows (Table 2). Nonetheless, the situation has improved since 1990, when the top 12 beneficiaries received 84 percent of all foreign private investment. Even Africa, which receives only a modest share of total private capital flows, has enjoyed a tenfold increase in foreign private investment over the past six years.

Declining official flows were, however, a cause for serious concern because long-term development aid catalyzes and complements private investment. And aid cutbacks affect even countries that receive private investment—the most likely victims are health, education, and environment programs for which private sector financing is in short supply.

Private flows

Two factors were seen as driving foreign private investment toward emerging markets—investors' desire for portfolio diversification and higher profits, and macroeconomic and structural reforms in developing countries. Investors have become increasingly discriminating and show a marked preference for countries with sound policies.

All categories of private flows rose in 1996—portfolio investment (Chart 1), commercial lending, and foreign direct investment. Roughly half of new lending was for project finance—in large part, for infrastructure projects. Private financing for infrastructure projects in developing countries grew to $22 billion per year over the past three years. Most of this went to private sector projects in power generation, telecommunications, and transport, with East Asia receiving the lion's share (Chart 2). The availability of guarantees from host governments, export credit agencies, and multilateral institutions such as the World Bank did much to boost private sector interest in this area.

Official aid

The leveling off of official aid put pressure on a number of poor countries that were reliant on long-term development aid.

Table 1

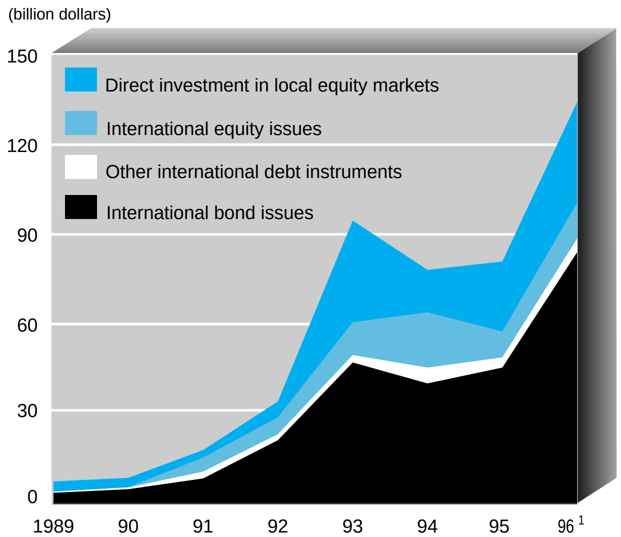
Financial flows to developing countries [1]

(billion dollars)

	1990	1992	1995	1996 [2]
Total flows	**100.6**	**146.0**	**237.2**	**284.6**
Official development finance	56.3	55.4	53.0	40.8
Grants	29.2	31.6	32.6	31.3
Loans	27.1	23.9	20.4	9.5
Total private flows	44.4	90.6	184.2	243.8
Debt	16.6	35.9	56.6	88.6
Commercial banks	3.0	12.5	26.5	34.2
Bonds	2.3	9.9	28.5	46.1
Others	11.3	13.5	1.7	8.3
Foreign direct investment	24.5	43.6	95.5	109.5
Portfolio equity flows	3.2	11.0	32.1	45.7

Source: World Bank, 1997, *Global Development Finance*.
Note: Low- and middle-income developing countries are defined as those having 1995 per capita incomes of less than $765 (low) and $9,385 (middle), respectively.
[1] Aggregate net long-term resource flows.
[2] Preliminary.

Chart 1
Portfolio investment flows to developing countries surged in 1996

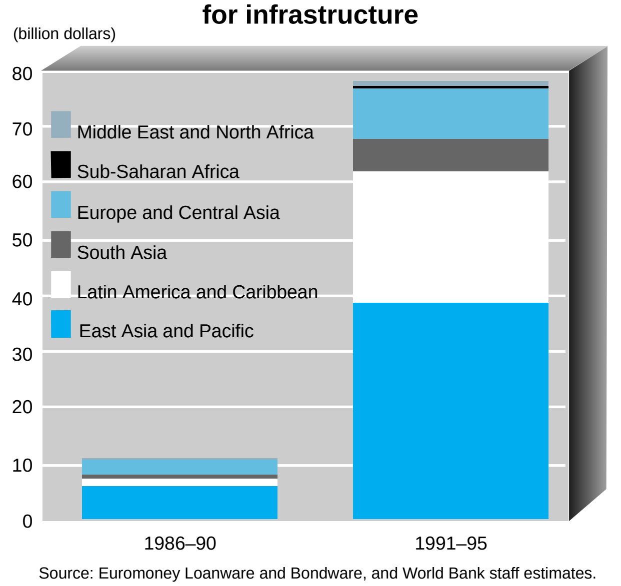


Source: World Bank, Debtor Reporting System.

Note: Funds raised on international capital markets on a gross basis, except for direct investment in equity markets, which is on a net basis.

1 Preliminary.

Chart 2
East Asia ahead in raising external funds for infrastructure



Source: Euromoney Loanware and Bondware, and World Bank staff estimates.

Table 2
Net private capital flows to developing countries
(billion dollars)

	1990	1992	1994	1996 [1]
All developing countries	**44.4**	**90.6**	**161.3**	**243.8**
Sub-Saharan Africa	0.3	-0.3	5.2	11.8
East Asia and Pacific	19.3	36.9	71.0	108.7
South Asia	2.2	2.9	8.5	10.7
Europe and Central Asia	9.5	21.8	17.2	31.2
Latin America and Caribbean	12.5	28.7	53.6	74.3
Middle East and North Africa	0.6	0.5	5.8	6.9
Income group				
Low-income countries	11.4	25.4	57.1	67.1
Middle-income countries	32.0	64.8	104.2	176.7
Top five country destinations [2]				
Brazil	0.5	9.8	12.2	14.7
China	8.8	21.3	44.4	52.0
Indonesia	3.2	4.6	7.7	17.9
Malaysia	1.8	6.0	8.9	16.0
Mexico	8.2	9.2	20.7	28.1

Source: World Bank, 1997, *Global Development Finance* .

Note: Low- and middle-income developing countries are defined as those having 1995 per capita incomes of less than $765 (low) and $9,385 (middle), respectively.

1 Preliminary.

2 Country ranking is based on cumulative 1990–95 private capital flows received. Private flows include commercial bank loans guaranteed by export credit agencies.

Concessional aid, which constitutes the bulk of development assistance to low- and middle-income countries, dropped by nearly $1 billion in 1996—in real terms, 3 percent less than in 1995. Moreover, there has been a marked shift in the composition of concessional flows over the past few years. Although the largest share of concessional aid is still devoted to poverty reduction and long-term economic assistance (for example, through the International Development Association (IDA), the World Bank's concessional lending arm), the amount targeted at refugee and emergency relief is growing. An estimated 12 percent of all official development assistance was devoted to emergency aid in 1996, compared with less than 2 percent in 1990. F&D

This article is based on World Bank, 1997, Global Development Finance *(Washington), which was formerly published by the World Bank under the title* World Debt Tables.