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A Holistic Perception of Foreign Financing of Developing Countries' Private Sectors

Analysis and Description of Structure and Trends

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Abstract

The paper presents a comprehensive survey of the 'shopping list' of sources of external finance that are directly channelled to the business sector of developing countries. Generally, our analytical survey covers the 1970-2000 period, and includes the distribution of foreign resources classified according to the different income-based and geographical breakdown of developing countries. We examine aggregate net resource flows in the form of the saving-investment gap and current account surplus in the balance-of-payments of developed countries. Also examined is the institutionalized component of this aggregate, which encompasses both official and private flows. In addition, we discuss the different components of private flows, including unrequited private transfers (grants by NGOs and workers' remittances) and commercial capital flows (private flows to multilateral institutions and bilateral private capital flows in the form of foreign direct investments and portfolio capital flows) to developing countries.

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Keywords: saving-investment gap, NGO grants, workers' remittances, private sector development, donors, private capital flows, international banking, capital flight

JEL classification: F21, F22, F32, F34, F35, O19, O24

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Official foreign flows for business sector development are also discussed. The recent pre-occupation with assistance to microfinance and microenterprises in developing countries as a way of enhancing poverty reduction and gender balance in recipient countries is also highlighted. These official sources are bilateral and multilateral flows, including those from the International Finance Corporation. Items that are, by their nature, inherently net outflows from developing countries are also examined. These include the cross-border international banking transactions by residents of developing countries that often give rise to capital flight. Also included are the foreign currency and other liquid liabilities of developed countries, whose holding by the residents of developing countries seems be increasing.

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1 Introduction

The aim of this paper is to provide a 'guided tour' and an overview of the sources of external financial flows to and from the business sector in developing countries, and to describe the observed trends and patterns as well as to identify the reasons for the trends. There is no unanimity as to which type of foreign financial source promotes private sector development (PSD) in the recipient developing economies, nor is there unanimity with regard to their relative effectiveness in so doing. Some studies suggest that official sources (especially foreign aid, see Hansen and Tarp 2001; Burnside and Dollar 2000, and Morrissey 2002) promote growth and development in the recipient countries while others report contrary evidence. Similar contradictory findings characterize studies on the effects of private sources (particularly foreign direct investment, FDI) on growth and development. While this line of analysis on the effects of such foreign sources is important, the discussion here does not explore it. Rather, it aims to investigate how their volumes and forms can better be enhanced to make them usable in promoting development. This is based on the assumption taken here that even if there are incontrovertible historical facts (which hardly exist) that a particular form of foreign finance (say, portfolio capital flows) has not been conducive to growth and development of the recipients in the past, this does not necessarily mean that it should be discouraged. Instead, this should be perceived as a challenge for exploring how that form of foreign finance could be made development-friendly. Thus, practically all forms of foreign financial sources (conventional and non-conventional) are covered in this discussion, giving it a comprehensive, broad and holistic outlook.

External sources of finance to developing countries' private and public sectors come from either the public or private sectors of the developed countries. Official foreign sources can be in form of grants or loans, either concessional or non-concessional. The non-official sources can be of a non-commercial type (mainly, private remittances and NGO sources) or of a purely commercial type (mainly in the form of foreign direct investment and portfolio capital flows, broadly defined). Official recipients or destinations in the developing countries, on the other hand, are the governments at central and lower tiers as well as government agencies. Also included, for reason of expediency, are those finances that have to be routed through and, hence, guaranteed by governments or their agencies even when the ultimate destination is the private sector. Non-official or private recipients, within the present context, would be the business sector, including large-, medium-, small-, and microenterprises.[1] From the above, it can be seen that cross-border financial inflows to the developing countries have a 4-by-4 matrix nature, namely, foreign public sector to the domestic public sector; foreign private sector to the domestic public sector; foreign public sector to the domestic private sector, and foreign private sector to the domestic private sector. It is the last two that are the subject of discussion in this paper.

Most forms of foreign finance for PSD have gone through peaks and troughs over the years. The objective of the paper is to present not only a comprehensive picture of this pattern but also to describe its movement over the years and provide likely explanations. While our explanations are at times based on the findings reported in the existing

[1] The social sector (non-governmental and non-business, including religious, political, and other related outfits) belongs in its own separate class within this context. These, while not discountenancing their importance, are not covered in our discussion.

empirical literature, we also have recourse to some empirical tests, particularly in the cases where previous studies have insufficiently reported on factors affecting the cross-border flows of the type of finance under consideration.

The conventional balance-of-payments (BOP) accounts do not adequately classify financial flows according to whether these are destined for the government or private sector. Thus, with the exception of one or two instances, we do not have recourse to the BOP statistics. Nevertheless, we regard the BOP framework a suitable paradigm for describing the types of financial flows. In particular, the concept of BOP current account surplus in the source countries and the utilization of the surplus in the form of unrequited transfers, capital flows of various categories, monetary or reserve flows, etc. is profitably incorporated in our analyses. The next section, accordingly, covers the developed countries' overall resource transfers (in the from of BOP current account surplus) to the rest of the world and the relative shares of selected PSD finance in the total. In section 3, unrequited private transfers by NGOs as well as workers' remittances are discussed. Section 4 is on official sources (loans and grants) for PSD. Section 5 reviews private commercial flows to multilateral institutions, while section 6 is on FDI and portfolio capital flows. Some cross-border financial flows, by their nature, entail the net transfer of resources from the private sector of developing countries to developed countries. One such cross-border transaction is with international banks, which is examined in section 7, while the other is the cross-border flow of foreign currencies and related liabilities. These are discussed in section 8. Summary and conclusion are given in section 9.

2 Overall resource transfers from the developed countries

The objective here is to portray the overall picture of total resource transfers of the past decades and to situate the relative position of private sector-to-private sector transfers within this context. While the latter is not the totality of what finances the PSD, it constitutes the bulk of it. As is discussed later, a major role of foreign official sources for PSD is to act as a catalyst of foreign private sources. In other words, the ultimate concern is still largely foreign private sources.

2.1 Background information on the charts and statistical table

The totality of net financial transfers from developed to developing countries is, by definition, the current account surplus (before unrequited transfers) in the consolidated BOP account for the former and, hence, consolidated BOP current account deficit for the latter. In principle, this should also equal the combined excess of domestic saving over investment spending (i.e., saving-investment, S-I gap) for developed countries and, hence, the combined excess of investment spending over domestic saving for developing countries.

Figure 1 shows the patterns for the years 1970-2000 for the S-I gap (computed as the gross national income [GNI] minus gross national expenditure) and BOP current account balance (computed as the sum of balances in the goods, services and factor incomes) for the high-income OECD members (22 DAC members and Iceland). While the two patterns should in principle be the same, they differ slightly here. This is due to

statistical discrepancies, including the 'errors and omissions' item in the BOP. Decade averages are also shown in Table 1. The corresponding balances for developing countries, which in principle should be equal and opposite to those for the developed countries, differ substantially. Furthermore, statistics for developing countries' balances are available only for the 1990s. Consequently, it is not possible to plot the trend for these. The decade average for the BOP current account balance, however, is shown in Table 1, which indicates that the deficits, instead of being equal to the corresponding surpluses reported for the developed countries, are several multiples off. While it is difficult to know where the 'truth' lies between the two current account balances, it is probable that the balance reported for developed countries has a smaller margin of error.

The total institutionalized net financial transfers (in the form of official grants and loans and private flows in the form of grants by NGOs, FDI and portfolio capital, broadly defined) are also given in Figure 1. Decade averages are also presented in Table 1. It should be noted that these institutionalized forms of financial transfers are not the same as the total transfers being financed by the BOP current account surplus, due to a number of reasons. First, the institutionalized forms are from non-BOP *Development Finance Statistics* (online) of the DAC, which excludes short-term capital flows (of less than one year maturity). Second, increased foreign reserve accumulation by developed countries (or, correspondingly, decreased foreign reserve holding by developing countries) is an item financed by the BOP current account surplus of the developed countries, whereas it is omitted in the DAC's statistics on net institutionalized development finance. Third, many cross-border transactions financed from developed countries' BOP current account surplus are not institutionalized, as they generally constitute transfers between individuals or non-institutions. Workers' remittances is one notable example. Finally, some transactions recorded as aid or development finance transfers in the DAC data source do not transcend borders as such, and therefore should not be included in BOP records. Examples include support to developing country refugees who reside in the industrialized country providing the assistance, administrative aid-related expenses incurred by donors, subsidies provided by 'donors' to their own firms to facilitate certain business or export transactions with developing countries, etc.

Total net institutionalized transfers (grants from foreign NGOs, FDI, and portfolio capital, broadly defined) from source countries' private sector are identified separately. Its development in US dollars and as a percentage of the total institutionalized sources is given in Figure 2. See also Table 1 for the decade averages.

2.2 Overall resource transfers: the picture from the charts and statistical table

Based on the above-mentioned background information on the statistics, we can now examine the overall resource transfers in detail. As shown in Figure 1, developed countries' current account balance was negative (as was the S-I balance) for most of the 1970s and the 1980s, indicating that net resource flows during the period were actually from the developing to developed countries. This observation is supported by Table 1, which shows that the developed-to-developing country net resource transfers, in both nominal and real terms, were negative during 1980-89 decade, with the S-I gap deficit being as high as 0.4 per cent of the GDP of developed countries or 0.6 trillion in 1995 US dollars. The figure also shows that during the two decades, net institutionalized transfers, while positive, were also relatively low, more so during the 1970s. Also,

according to Table 1, the total volume of this in nominal term was US$ 756 million during the 1980s. This is about 0.8 per cent of developed countries' GDP or 2.3 per cent of the GDP of the developing countries.

But the situation changed suddenly in the early to mid-1990s. The current account and S-I balances turned positive and jumped very fast, attaining an all-time peak between 1997 and 1998. Thereafter, however, the balance fell just as fast as it had risen earlier, to nose-dive into an 'abyss' by the end of the 1999-2000 period. Despite this 'southward' movement during the late 1990s, net resource flows were still positive and fairly substantial, or in nominal term, about US$ 738 billion cumulative current account surplus (or US$ 606 billion S-I gap, equivalent to about 0.3 per cent of the developed countries' GDP). This trend is also portrayed by the movement of net institutionalized flows which experienced a fast and steady increase from 1990 to an all-time peak in 1999, after which it declined sharply in 2000. On the whole, net transfers during the decade totalled as much as US$ 2.2 trillion (in 1995 constant prices), compared with about US$ 1.3 trillion for the 1980s. However, while this constituted an increase in terms of the recipient countries' GDP (from 2.3 per cent in the 1980s to 3.6 per cent in the 1990s), as a fraction of the GDP of source countries, the amounts were almost unchanged, or 0.9 per cent in the 1990s vis-à-vis 0.8 per cent in the 1980s. This suggests that the observed upward trend in monetary value has merely kept pace with the source countries' GDP. Nevertheless, the general picture still indicates that overall resource flows from developed to developing countries were broadly on the increase.

Given the ups and downs in the volume of net flows, the question that naturally arises is the explanation or reason for this evolution. To address the issue, we have to examine the fundamentals affecting domestic saving and investment behaviours in the source (developed) countries, as these are the ultimate determinants of net resource flows. Within the life-cycle hypothesis framework, saving rates are generally regarded as being determined partly by the age structure of the population (see Robin 2000), with a higher proportion of those above working age leading to a reduction in saving rate. In general, this proportion has exhibited a secular increase in the developed countries, which apparently does not explain the post-1990 upsurge in S-I gap in these countries. Another factor often regarded as affecting the savings rate is the income level, with a high level of per capita income raising the fraction of income saved (see Loayza *et al*. 2000 and Browning and Lusardi 1996 for a review). Over time, the level of per capita income has been increasing in developed countries. However, rising income can also increase domestic investment through the usual accelerator process and whether the overall effect on S-I gap is positive is an empirical issue. But even assuming that it is positive, there was no spectacular increase in income during the 1990s to account for the upsurge observed in the S-I gap during that decade. Again, another factor that is often regarded as a determinant of the savings rate is the domestic (real) interest rate (see Browning and Lusardi, for a survey). A high interest rate is supposed to increase saving. By also reducing aggregate investment (in line with the received theory), high interest rates should provide a double stimulus to the S-I gap increase. But available evidence does not support domestic interest rates having played a role in the observed movements in the S-I gap. We calculated the (external trade) weighted-average discount rates for all 22 DAC member countries and find that the rate was the lowest during the S-I gap upsurge (1990s), or 6.3 per cent per annum versus 6.8 per cent in the 1970s and 9.2 per cent in the 1980s!

It thus appears that movements in aggregate domestic saving and investment in the developed countries over the past three decades are intriguing, and a more formalized empirical evidence-based explanation (which, albeit, is beyond the scope of this paper) is needed to clarify the puzzle. In the meantime, we are inclined to 'speculate' that most of the explanations can probably be found in factors other than in the developed countries, i.e., in the investment opportunities and other events in the developing countries. We are forced to this rather startling conclusion because the explanations in the orthodox macroeconomics of saving and investment do not appear adequate.

Over the decades the pattern of total institutionalized resource transfers seems to have been dictated and overshadowed by the private sector component, as is discussed below. This is not to suggest, however, that official components were constant over the period, and it is likely that their movement has been mainly determined by income and budgetary conditions in the source countries (Round and Odedokun 2002).

2.3 Private sector-to-private sector portion of the total resource transfers

The pattern in the private sector component of the institutionalized resource transfers mirrors movements in total resource transfers, as described above. Starting from a very low level in the early 1970s, the volume attained a peak in the early 1980s and then pummelled to a very low level in the mid-1980s. Zigzag movements characterized the remainder of the 1980s. Thereafter, it rose to an all-time peak around 1998, after which it started to fall again. But despite this fall, the 1990s recorded the highest volume of the three decades, if not in history. Thus, while the cumulative total during the 1980s was only US$ 579 billion (at 1995 constant US dollar value), it more than doubled during the 1990s, rising to US$ 1,235 billion (see Table 1). Movements in nominal and real (1995 US dollar) values indicate a similar pattern and are very close to each other (see Figure 2). In relation to the total institutionalized net flows (combined official and private), the private component first rose steadily until 1978, after which it recorded an upsurge and attained a peak in the early 1980s. It then fell before starting another steady upward trend in 1990, with a peak in a magnitude similar to the very early 1980s being reached again some 20 years later (see Figure 2). The relative size of private sources recorded an overall upward trend over the decades, rising from about 42 per cent in the 1980s to about 52 per cent in 1990s (see Table 1). An upward trend was also recorded in private source as a fraction of the GDP of both source and destination countries, from 0.3 per cent of the source countries' GDP in 1980s to 0.5 per cent in the 1990s and from 1.0 per cent of the recipient countries' GDP to 2.0 per cent in 1990s.

An insight into the reasons for the rising value and the relative importance of private institutionalized sources can be had only by examining the components comprising this aggregate. As already mentioned, these consist of grants by NGOs (discussed in the next section) as well as FDI and broad concept of portfolio capital flows, both of which are discussed in section 6.

Table 1
Total resource flows from the north to the south, 1980-99
(US$ billion, unless otherwise indicated)

	US$ billion			
	at current value		1995 constant value	
	1980-89	1990-99	1980-89	1990-99
Current account surplus (balance of payments) OECD countries	-151.6	737.9	-262.7	780.9
Net national saving (national accounts):				
OECD countries	-327.7	605.8	-591.6	628.3
OECD countries (% of GDP)	-0.4	0.3	-0.4	0.3
Developing countries	na	-4,620.9	na	-4,949.2
Institutionalized form of resource transfers:				
Total	756.3	1,997.8	1,301.8	2,162.1
Total (% of source countries' GDP)	0.8	0.9	0.8	0.9
Total (% of destination countries' GDP)	2.3	3.6	2.3	3.6
Institutionalized financial transfers:				
Private sources	327.7	1,152.2	579.2	1,235.3
Private sources as % of total	41.8	51.7	41.8	51.7
Private sources, % of source countries' GDP	0.3	0.5	0.3	0.5
Private sources, % of destination countries' GDP	1.0	2.0	1.0	2.0

Source: World Bank (2001) and OECD/DAC (online).

3 Private unrequited transfers: grants by NGOs and workers' remittances

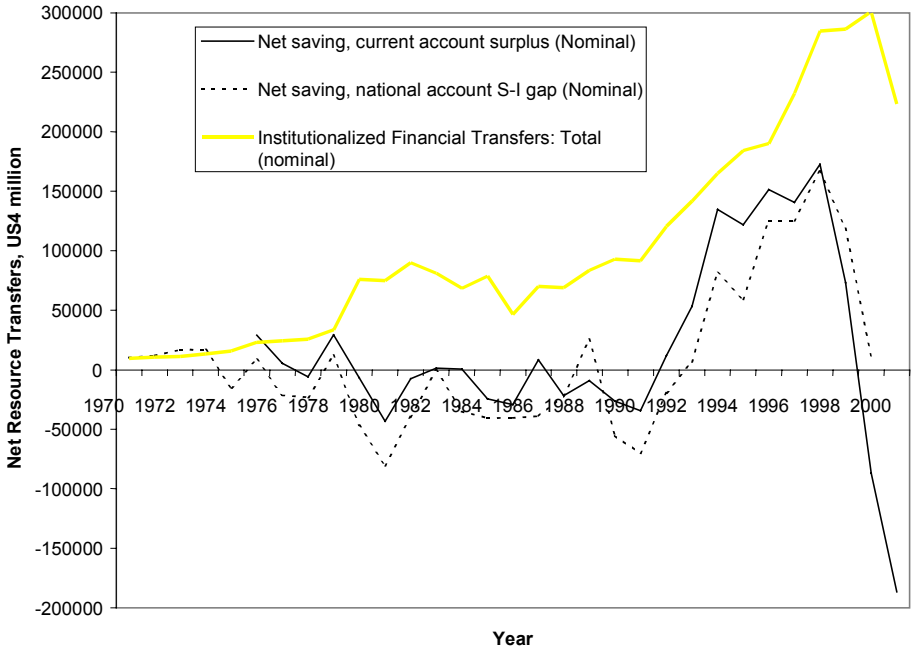
Private unrequited transfers having a bearing on PSD are grants by NGOs and home remittances by workers. While the former category is institutionalized, the latter is not since these constitute transfers from individuals, the migrant workers (discussed below). By their nature, they both tend to have a unidirectional flow, mainly from developed to developing countries. Reverse flows to developed countries, while possible, are not common.

3.1 Grants by NGOs

There are many types of developed country-based NGOs. Some promote religions and cultures, some exist for politics and human rights-related matters, some for social and gender-related missions, some conduct research, etc. But our interest here centres on those that have been established for the promotion of business (often, small-scale and microenterprises development) or PSD. Unfortunately, we do not have separate statistics on their activities. What we have, instead, are the resource transfers (grants) by all eligible NGOs, including those not necessarily targeted for PSD.

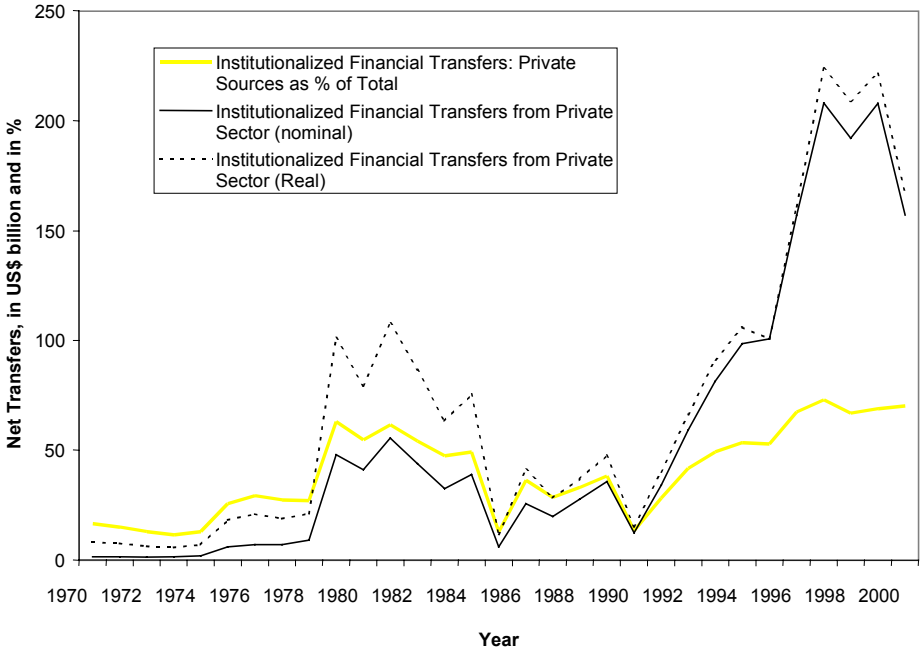
As can be seen from Figure 3, the volume has maintained a more or less log-linear trend over the years in both real and nominal terms. The trend is depicted in Table 2, which shows that the volume increased in nominal terms by about 9 per cent per annum during the 1970s and 1980s, before it dropped to just over 4 per cent per annum in the 1990s. In real terms, fastest average annual growth (4.5 per cent) was recorded during the 1980s, after having been more or less 'flat' during the 1970s. The pace of growth decelerated somewhat in real terms in the 1990s, to about 3 per cent per annum. In nominal US dollar terms, this development increased the decade totals from US$ 13.3 billion (or US$ 1.133 per annum) in the 1970s to US$ 30.1 billion (or US$ 3.01 per annum) in the 1980s and to US$ 68.7 billion (or US$ 6.87 per annum) in the 1990s. In 1995 constant US dollar terms, these translated to US$ 37.8, US$ 46.7 and US$ 73.2 billion, respectively.

Figure 1
Aggregate net resource flows from developed to developing countries, 1970-2000
(US$ million, current values)



Source: OECD/DAC (online) and the World Bank (2001).

Figure 2
Institutionalized private sector-to-private sector net flows to developing countries, 1970-2000
(US$ billion and % of total institutionalized transfers)



Source: OECD/DAC (online).

In general, compared to other financial and economic activities, the amounts involved appear not only rather insignificant, but also seem to have maintained a general downward trend, suggesting the need for further efforts at promoting the role and activities of these PSD development agents so as to keep pace with other economic and financial factors. While the transfers in the 1970s accounted for 6.9 per cent of the total institutionalized flows (slightly over 40 per cent of private institutionalized flows), this declined to 4.1 per cent in the 1980s (13.5 per cent for the private component) and further to 3.4 per cent (6.8 per cent for the private component) in the 1990s. In relation to the GDP of recipient economies, it decreased from 0.3 per cent in the 1970s to 0.14 per cent in the 1980s and 0.13 per cent in the 1990s. It maintained a measly and insignificant 0.03 per cent of the GDP of the source countries during the three decades (see Table 2).

Beyond what Jimoh (2002) has reported, it seems we have no previous studies on the likely explanations for the lack-lustre movements in the volume of transfers (and, hence, scale of activities) of NGOs. Thus, we make an attempt here towards complementing the results reported by Jimoh (2002) by running panel data regressions for what might be termed the 'NGOs aid effort', defined as the volume of NGO grants from each of the 22 DAC donor countries in relation to their respective GDP, over 1970-2000 period. We expect that the level of per capita income of the donors should have a positive effect on the NGO aid effort. On the other hand, the aggregate level of per capita income of the recipient countries, by reducing their 'charityworthiness' or need for NGO assistance, should have a negative effect. For broadly the same reason, we expect the adverse external economic circumstances (debt burden, high total debt/GDP ratio, and rising world price of oil) confronting developing countries to make them more 'charityworthy' and thus elicit more NGO grants. Also, the amount of ODA support received by the NGOs from home governments (alternatively proxied by the relative size of government and the actual ODA support received in relation to GDP) should positively affect the volume of grants. Globalization which gives rise to the world becoming a so-called 'global village' and its net effect on the volume of NGO assistance may be difficult to determine *a priori.* Because it raises the consciousness that potentially everyone is one another's 'brother's keeper', it can also crowd-out NGO finance to other forms of cross-border flows. Thus, we seek to confirm the overall effect empirically by testing for the degree of donor country's openness (and, hence, globalization) on the current account (measured as the volume of exports and imports of goods and services in relation to GDP) and on the capital account (measured as the volume of private capital inflow and outflow in relation to GDP). We also included a trend variable in the equations.

The findings are reported in Table 5, which shows some evidence of a positive effect of rising per capita income in NGO home countries, and much stronger evidence of a negative effect of rising per capita income of recipient countries. It also shows that a high level of ODA support from NGO home governments (whether measured directly or proxied by government expenditure/GDP ratio) has a decisive positive effect on their transfer volumes. This means that much of the responsibility for rejuvenating the tempo of NGO activities is on the donor governments. Table 5 also supports the view that rising hostile external circumstances confronting the developing countries tend to elicit more assistance from NGOs. On the other hand, an increasing degree of openness (and, hence, globalization) in each of the current and capital accounts of the NGOs' home economies is observed to retard the volume of NGO assistance, suggesting that, on the whole, increasing openness crowds-out financial resources away from NGO transfers.

Table 2
Grants from developed country-based NGOs, 1970-99

	1970-79	1980-89	1990-99
Grants by NGOs (US$ billion, current value)	13.3	30.1	68.7
Grants by NGOs (US$ billion, 1995 constant value)	37.8	46.7	73.2
Grants by NGOs:			
as % of total institutionalized flows	6.9	4.1	3.4
as % of private institutionalized flows	40.9	13.5	6.8
as % of source countries' GDP	0.03	0.03	0.03
as % of destination countries' GDP	0.30	0.14	0.13
Grants by NGOs (nominal value): average annual growth rate, %	8.73	8.80	4.19
Grants by NGOs (real value): average annual growth rate, %	-0.26	4.50	2.94

Note: US$ values are decade totals, not decade averages.
Source: OECD/DAC (online).

Table 3
Factors affecting the volume of NGOs' grants: some estimates

Trend variable	-0.0000	0.00001	0.0000	0.0001	0.000
	(-0.5)	(1.7)	(1.1)	(1.7)	(1.8)
Per capita income of source country	0.0002	0.0002	0.0003	0.0004	0.0002
	(1.6)	(1.6)	(1.9)	(3.3)	(1.1)
Per capital income average for recipient countries	0.0001	-0.0005	-0.001	-0.001	-0.001
	(0.3)	(-2.5)	(-3.4)	(-4.4)	(-3.5)
Degree of opennes of source country's economy in the current account	-0.0008	–	–	–	–
	(-4.2)				
Degree of opennes of source country's economy in the capital account	–	-0.0002	–	–	–
		(-2.1)			
Debt burden (total debt/GDP ratio) average for developing countries	–	–	0.001	–	–
			(2.8)		
Index of world price of petroleum oil	–	–	0.0001	–	–
			(3.1)		
Size of government (government expenditure/GDP ratio) in source country	–	–	–	0.0007	–
				(2.8)	
Support received by NGOs from home government/GDP ratio, 1 year lag	–	–	–	–	0.299
					(4.8)
Adjusted R^2	0.724	0.726	0.716	0.756	0.745
Number of observations	565	510	565	483	465

Notes: (a) The dependent variable is the volume of NGOs grants as a fraction of their home countries' GDP;
(b) The numbers in parentheses below the parameter estimates are the t-values. A parameter estimate is statistically significant at 1%; 5%; and 10% levels if its t-value is, in absolute sense, not less than 2.6; 2.0; and 1.6, respectively;
(c) The estimates were derived through fixed-effect OLS technique, based on heteroscedasticity correction technique suggested by White (1980);
(d) Per capita income and index of world price of petroleum are in logarithm. Because other variables are pure fractions, what is actually employed is *log (*1 + *x)*, where *x* is each variable in pure fraction form;

Sources: NGOs grants and support received from home governments are from OECD/DAC (online) while other variables are from the World Bank (2001) and *Global Financial Statistics* (online).

3.2 Workers' remittances

Remittances by migrant workers to their home countries can be made for personal purposes (e.g., to their relatives) or for business-related reasons, perhaps preparing for their eventual return (Ahlburg and Brown 1998; Lopez and Seligson 1991). Thus, workers' remittances (WRs), because of the latter motive, can be a veritable source of financing PSD.

We do not have access to comprehensive and continuous statistics on the volume of WRs being made to each developing country. The only regular statistical sources are the World Bank's *World Development Indicators* and *Global Development Finance* on *gross* (as opposed to *net*) WRs received. These, in addition to having several missing values, do not provide the source of the remittance. This can be a problem because a remittance can be from other developing (as opposed to developed) country. For example, the Gulf countries, which constitute developing countries themselves, host many migrant workers, and their numbers are probably comparable to those in the developed countries. Also the recorded amounts for each developing country can be questioned since not all WRs go through the official banking channels that provide the basis for the balance-of-payments statistics (and, hence, the World Bank sources). Some legitimate migrants, not to mention the illegals, by-pass banks in making remittances, so a gross underestimation by the BOP statistics is likely.

Bearing the foregoing data limitations in mind, the trend of WR volume over the period 1977-2000 is shown in Figure 4 for the developing countries. These are further analysed into two groups: low- and middle-income. Table 4 gives the movements in real terms and in relation to the GDP of the developing countries. As can be seen, an upward and ever-increasing trend in aggregate WRs volumes is noticeable. For the developing countries as a whole, WRs increased from about US$ 172 billion (or US$ 17.2 billion per year) in the 1980s to about US$ 388 billion (US$ 38.8 billion per annum) in the 1990s. This increase, in terms of the 1995 US dollar constant value, is from about US$ 293 billion to about US$ 421 billion, respectively. The bulk of the amounts, however, accrued to middle-income developing countries (i.e., relatively high-income), whose relative share of the total also increased. The share of the low-income developing countries of total volume is low and decreased between the two decades, notwithstanding the fact that they also recorded increasing volumes of WRs receipts (see Figure 4 and Table 4).

Table 5 gives a summary of recent surveys on remittances to Latin American and the Caribbean under the auspices of Multilateral Investment Funds (MIF 2002), and it can be seen that remittances (with about 80 per cent coming from the US) accounted for over 25 per cent of the GDP of recipient countries like Haiti and Nicaragua.

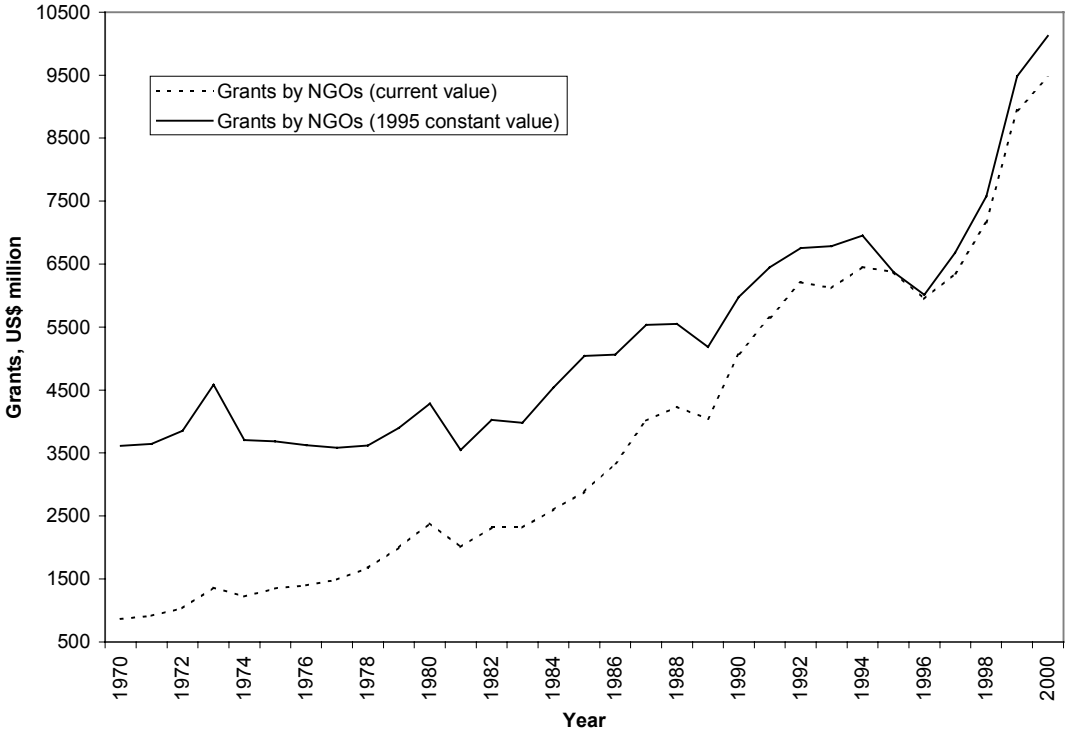
Some studies have previously analysed factors affecting WRs but these are mostly from a micro-perspective, and are based on microdata for migrants (Ahlburg and Brown 1998; Brown 1997; Funkhouser 1995; and Nishat and Bilgrami 1993). Remittance determinants in these studies include factors such as the intention to eventually return to the home country, family background, etc. Very few studies have used macroeconomic framework and macrodata.[2] Consequently, we have very few studies to fall on in trying

[2] For example, El-Sakka and McNabb (1999) who reported exchange rate and interest rate differentials as remittance determinants.

to explain the observed trend movements and cross-country variations from a macroeconomic perspective (which we believe to be relevant in the present context) and thus we have had to resort to some empirical tests. Again, this is accomplished by running panel regressions for WRs received (scaled by the GDP of receiving countries) over the 1977-2000 period for all developing countries (with one or more non-missing values on WRs), yielding close to 1,000 pooled cross-country and annual data points. The choice of the explanatory factors is based on the assumption that the volume of WRs is determined by the number of migrant workers as well as factors that motivate or deter the decision to send remittances home. Within this context, we postulate the gap between the per capita income of each developing country and the average per capita income of developed countries combined to be a factor. A potential migrant is tempted to travel to seek better opportunities if the per capita income is high in the envisaged destination (developed) country and/or, particularly, if the per capita income in the home country is low. Also, since some degree of literacy is often a requirement for entry, we postulate a high level of illiteracy (an inhibiting factor) to reduce migration and, hence, WRs. Also, in small countries opportunities for gainful employment at one's level of skill are limited and skilled workers are more tempted to migrate to find suitable employment. Hence, outward migration (and WRs) is expected to be higher in relation to GDP for small countries (proxied here by population size). In addition, the degree to which the world is being integrated into a 'global village' can also affect not only migration but also the propensity of migrants to send home remittances in general or to make them through a banking channel (as opposed to hand-to-hand sending of cash). Thus, we posit a rising degree of economic openness in the developed countries as a group, as well as for each individual developing country to exert positive effects on actual WRs (and a stronger impact on the recorded remittances). One measure of the economic openness used is that of the BOP current account, computed as the sum of export and import of goods and services in relation to GDP. Another measure is the openness of the BOP capital account, computed as the ratio of private capital inflows and outflows to GDP. Since home remittances may also be motivated by business-related purposes, migrants are more likely to make remittances during the home country's rising or prosperity phase of the economic cycle than during economic slumps. Although we have no specific reasons to hypothesize a definite direction of the effect of prosperity in the migrant's host country on home remittances, we still test for such an effect all the same, similar to the manner in which a trend variable was included in the equations.

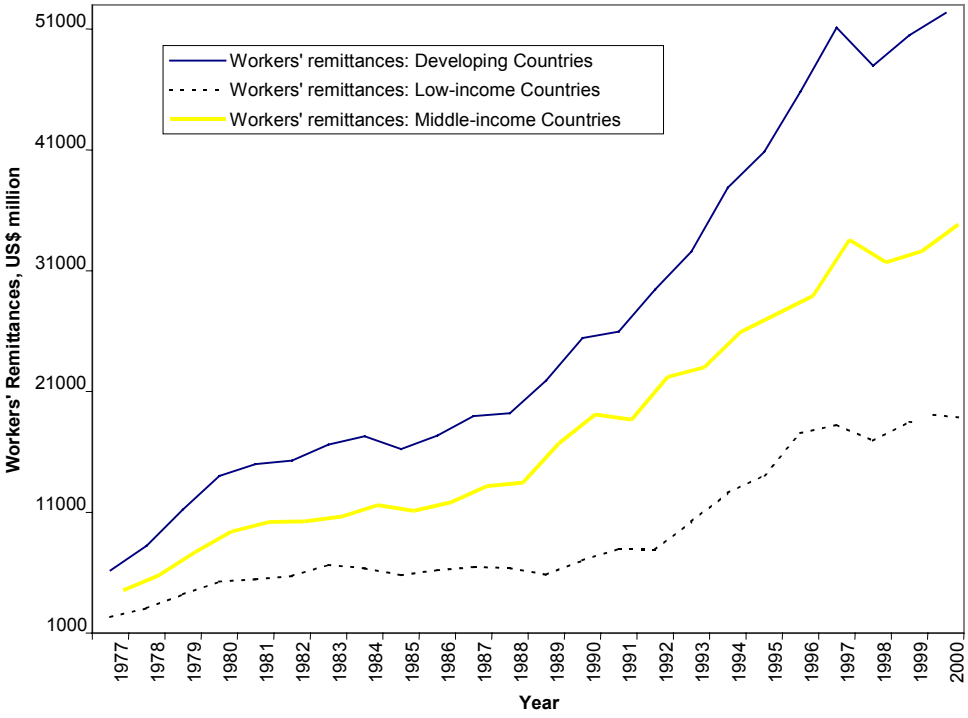
The results are reported in Table 6, and the expected effects of all the factors are confirmed. Each of the following factors is found to have a negative effect on the WRs received (in relation to recipient GDP): a high level of illiteracy; narrowing affluence gap defined as the per capita income of each developing country relative to the per capita income level for all developed countries combined; and country (population) size. On the other hand, a positive effect on the WRs is induced by each of the following: high degree of openness in the current and capital accounts in each developing country (just as the corresponding degree of openness for the developed countries as a group, but which do not show a statistically significant effect); and favourable home country conditions such as high economic growth and a rising prosperity phase of the economy. Finally, economic indicators such as high economic growth in the migrant's host country and rising phase of economic cycle in the country, are observed to have negative effects on WRs. These, however, are statistically significant for the latter only.

Figure 3
Grants by developed country-based NGOs, 1970-2000
(US$ million)



Source: OECD/DAC (online).

Figure 4
Workers' remittances, 1977-2000
(US$ million, current values)



Source: OECD/DAC (online).

Table 4
Workers' remittances, 1980-99
(US$ billion, unless otherwise indicated)

	US$ billion			
	current value		1995 constant value	
	1980-89	1990-99	1980-89	1990-99
Low-income developing countries	60.0	130.9	103.7	141.5
Middle-income developing countries	111.7	256.6	189.1	279.0
All developing countries	171.7	387.5	292.7	420.6
All developing countries, % of GDP	2.5	2.9	2.5	2.9

Note: US$ values are decade totals, not decade averages.

Source: The World Bank (2001) (on line).

Table 5
Remittances to Latin America and the Caribbean, 2001
(US$ million and % of GDP)

	Amount	%		Amount	%		Amount	%
Bolivia	103	1.33	El Salvador	1,972	14.45	Jamaica	959	13.15
Brazil	2,600	0.54	Equador	1,400	8.36	Mexico	9,273	1.53
Colombia	670	0.83	Guatemala	584	2.85	Nicaragua	610	25.42
Cuba	930	–	Haiti	810	21.42	Peru	905	1.72
Dominican Rep.	1,807	8.99	Honduras	460	7.38			

Source: Remittances to Latin America and the Caribbean, Multilateral Investment Fund (2002).

Table 6
Factors affecting workers' remittances: some estimates

Trend variable	0.002 (4.3)	0.003 (4.9)
Level of Illiteracy	-0.016 (-2.2)	-0.022 (-3.0)
Differential in per capita income, as compared with developed countries' average	-0.026 (-6.2)	-0.058 (-10.3)
Recipient country's population size	-0.104 (-6.1)	-0.154 (-7.9)
Degree of openness of recipient country's economy in current account	0.026 (3.3)	–
Average of degree of openness of source country' economy in current account	0.026 (0.9)	–
Degree of openness of recipient country's economy in capital account	–	0.012 (2.2)
Average of degree of openness of source country's economy in capital account	–	0.028 (1.4)
Economic (real GDP): growth of the recipient country	0.025 (2.4)	–
Economic (real GDP): growth of developed country	-0.0001 (-0.3)	–
Phase of economic cycle that the recipient country is experiencing	–	0.088 (8.9)
Phase of economic cycle that the developed countries are experiencing	–	-0.115 (-4.9)
Adjusted R^2	0.863	0.884
Number of observations	991	958

Notes: (a) The dependent variable is the workers' remittances received by each developing country in relation to its GDP;

(b) See Table 3 for interpretation of t-values as well as for the econometrics used for the estimates;

(c) Level of illiteracy, per capita income (as a ratio of that of developed countries' average) and population size are in logarithm. Economic growth is given as a percentage. Phase of economic cycle is derived as the residuals generated from regressing the logarithm of index of real GDP on a time trend while other variables, being pure fractions, were employed as *log (1 + x)* as in Table 3.

Source: All data are from the World Bank sources indicated in Table 3.

4 Official sources for PSD in recipient countries

4.1 Reasons for and nature of foreign official finance for PSD

Theories and policy prescriptions for economic development have gone through a number of paradigms (see Adelman 1999 and Thorbecke 2000 for surveys). One of these is based on the dual gap analysis of Chenery and Strout (1966), which perceives the major developmental obstacle of a typical developing country to be either capital or foreign exchange shortage. Another paradigm focuses specifically on the private sector, contending that it is the private sector entrepreneurial shortage that constitutes the major obstacle to development.

The implicit rationale for foreign official assistance to be aimed at PSD is based on these capital/foreign exchange obstacles and especially the entrepreneurial obstacle to development. Related to the above rationale seems to be the development philosophy of the 1980s which considers the private sector to be the engine of growth. Given these premises, it follows that the government sector should no longer be the more or less exclusive beneficiary of foreign official sources. Arising from the current development philosophy of poverty reduction and gender gap reduction is the increasing focus on small scale- and micro-enterprises in recipient countries. Both bilateral and multilateral donors now earmark increasing portions of their foreign transfers to this end. At the bilateral level, there is also a practical factor that could have given rise to foreign official sources being directed at recipient countries' PSD. These transfers confer greater self-interest on the 'donor' country's private sector by providing it with more foreign investment opportunities and export markets than could be induced by a similar volume targeted to the public sector. This is particularly the case for export-related transactions which seek to promote the exports of the donor country. And such official transfers cost the source countries little: they are rarely in the form of grants, or the grant element of any loans involved is, in most cases, minimal. Thus, foreign resource transfers for PSD can be said to be mutually beneficial to both the source and destination countries.

There seems to be no consensus as to what constitutes official financial flows for PSD. In a sense, conventional flows to (and for the exclusive use of) the government sector can arguably be described as being targeted for PSD, since what is good for the government sector (and for non-business segments of the society) should also be good for the business sector. Viewed from this perspective, all forms of official foreign inflows, including military assistance, can be said to be for PSD. However, this extremely wide conception of PSD flows has never been used in the literature.

But, another, equally broad conception exists that has been used particularly by multilateral development banks. Accordingly, foreign official sources destined to the recipient government sector are classified as being earmarked for PSD if they have some identifiable (and sometimes, incidental) benefits to the private sector. According to the World Bank (2002: 27):

> PSD activities are carried out all over the Bank. [...] Today, adjustment lending supports a PSD agenda that enhances the foundations of a positive investment climate in the Bank's client countries: a wide array of procedural, regulatory and legal reforms have come to the fore that are critical to foster private-sector led growth, including removing exit and

entry barriers, reducing market rigidities, simplifying tax systems, safeguarding property rights, and liberalizing trade barriers.

It should be noted that while such a wide conception of PSD financial support may be convenient for the purpose at hand, it can pose a problem in some cases. For instance, this World Bank definition also qualifies even IMF lending as a form of PSD support, since the enhancement of business macroeconomic environment and investment climate is a centrepiece of IMF lending conditionalities. Furthermore, many such sectors and activities currently financed cannot pass the exclusivity test, i.e., whether the business sector is the exclusive or major beneficiary. For example, it is doubtful that the business sector could be the major beneficiary (not to mention being the substantially exclusive beneficiary) of conditionality lending to improve public sector management, social protection, etc. that the World Bank includes in its PSD lending. They do not seem to benefit the business sector any better than, say, military assistance against an external aggression to the country (including its private sector). Despite the all-embracing nature of this definition, it lacks a clear and functional delineation from other forms of official financial flows like IMF lending, military aid, etc.

Thus, a narrower definition of PSD support is often adopted and this refers essentially to support aimed at individual businesses (and, in some cases, business sectors or group of actors like chambers of commerce, entrepreneur groups, etc.) in the recipient countries. Because this assistance to individual businesses and business sectors generally does not require or even entail guaranteeing by the government sector (particularly when it takes the form of lending), it is often referred to as direct support. While this concept of foreign official financing for PSD may be too narrow (by not recognizing support to improve the environment necessary for PSD), it has a clear demarcation for the present discussion and is, therefore, the concept adopted here unless explicitly mentioned to the contrary.[3]

It should be realized within the context of this narrow concept that it is not just the volume of official financial flow that matter. First, the type and extent of entrepreneurial assistance packaged with it also count. In the context of multilateral sources, such entrepreneurial support (which includes the provision of a 'template' for private investors to replicate and the undertaking of pioneering experimental projects) is actually a part of their role as a development bank.

Second, the investment banking role (co-financing, loan syndication, risk and credit guarantees, etc.) is also important due to the catalytic effect it might have.[4] Such a

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3 This, however, does not infer that the aforementioned wider concept is not useful within some contexts (as are used by Jimoh 2002 and Gibbon and Schulpen 2002).

4 This cross-border catalytic effect, together with additionality effect of their role, seem to lack precise usage in the literature. Within the context of this paper, we are interested in the cross-border catalytic, crowding-out and additional effects of PSD support and we adhere to their concepts as explained below: If US$ 1 direct foreign official PSD support is able to fund, say, a project costing US$ 13 through co-financing, loan syndication, etc, then the leverage ratio or multiplier would be said to be 13. But, let us assume that US$ 2 out of the US$ 13 project cost comes from domestic sources (government and private sector), then the cross-border leverage ratio or multiplier would be just 11. For a number of reasons, this is only a pragmatic definition, at best. First, the increased domestic investment opportunity brought about by the existence of the project could have prevented some domestic sources from finding their way outside the country (like through capital flight). This, if known, should be added to the cross-border leverage ratio. Second, some of the foreign sources that are now mobilized through co-financing, loan syndication, etc would still have likely found their way

catalytic effect (foreign source or cross-border) is expected to be high (in sectors and/or countries) where foreign private investors (including foreign banks) are likely to be interested in or where they can be relatively easily 'cajoled' into committing funds. Thus, middle-income developing countries may have an advantage over low-income ones in this respect, just as telecommunication and extractive industries—even in low-income countries. And here exists an inherent conflict between achieving a high foreign-source catalytic effect or leverage ratio and the need to reduce crowding-out of foreign private sources through foreign official financing of PSD. Countries and sectors that naturally appeal to foreign private investors are those where foreign official support for PSD can 'cajole' such investors with relative ease and, hence, achieve maximum catalytic effects. But at the same time, foreign private investors may already be present in these same countries and sectors, and these can be displaced or crowded-out through the same process of official foreign support for PSD. There is virtually no scope for such crowding-out if, as in the case of low-income countries (without mining sector), no foreign private investors are present, or in sectors like small-scale and microenterprises even in middle-income countries. This is where a high catalytic effect is most difficult to achieve. Maximum additionality (defined here as the difference between cross-border catalytic effect and cross-border crowding-out effect) is attained conceptually by striking a proper balance between the two. The issues of catalytic effect, crowding-out and additionality have recently attracted the attention of policymakers and donor agencies concerned with PSD.[5]

A similar balance has to be maintained between profitability (to ensure continuity and growth in the scale of operations) and the social or developmental roles.[6] More important, Nissanke (2002) has brought to the fore the inherent conflicts between the targets of financial *sustainability* and the *outreach* of the poor that donors supporting microfinance institutions in developing countries often expect these organizations to achieve.

There are both bilateral and multilateral official foreign sources for PSD, as discussed below. The magnitudes, trends and structure of some of the bilateral and multilateral instruments of direct financial support are given in Tables 7 to 9 and Figures 5 and 6.

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into the country in other forms, so that, at best, the foreign official PSD support merely affect the timing of their availability. To the extent that the amounts involved are known or can be estimated, they should be used in adjusting (by being deducted from) the cross-border leverage ratio above. But, in real life, the above two adjusting factors cannot often be known or reasonably estimated. Hence, we stick to the pragmatic cross-border leverage ratio of 11 mentioned above, which then constitutes the cross-border catalytic effect (albeit, pragmatic or practical) of foreign official financing of PSD. But undertaking of the project can displace existing foreign investors already undertaking the same or similar activities and discourage potential investors contemplating doing so. The foreign investments so displaced and discouraged would then be the cross-border crowding-out effect. The difference between the catalytic and crowding-out effects constitutes the (net) additionality of the official support for the PSD.

5 Attempts at making conceptual distinctions between the concepts and efforts aimed at maximizing additionality are discussed in Inter-American Investment Corporation, IIC (2002, online)

6 Mavrotas (2002) discusses how the International Finance Corporation, IFC, has been performing on this score.

4.2 Bilateral official sources for PSD

Bilateral donors have various instruments through which they support PSD in developing countries (see Jimoh 2002; Gibbon and Schulpen 2002, and Nissanke 2000 for details). The specific instruments used would, presumably, depend on the self-interests of the donors concerned (see Table 8).

Table 8 shows that equity acquisition on a concessional basis (qualifying it as ODA) is one such instrument. This can take the form, among others, of debt swaps or participation in joint ventures with the recipients. Another broad instrument is investment-related transactions (IRTs), which are non-concessional in nature (or, at least, not enough to qualify them as ODA). Because of limited or nil concessionality, IRTs are simply called other official flows (OOF), as opposed to ODA. There are two broad types of IRT. The first entails direct financial flows to developing countries and these can be loans or equity investments that are a part of joint venture with the recipients. Thus, there are two forms of equity investment, the first one being the concessional type (qualifying as ODA) while the latter is non-concessional. Both could, apparently, be said to be similar except for the different degree of concessionality. But in reality, their differences go beyond the degree of concessionality, as it can be seen in Figure 6, with the aggregate ODA-type flow rising steadily over the 1970-2000 period while the aggregate OOF-type flow is extremely volatile. The second type of IRT may not entail direct financial flows from donor governments to developing countries, and is merely directed to assisting businesses (with loans and/or subsidies) in the donor countries to help finance specified investments in aid recipient countries.

Another form of financial support is the export-related transactions (ERT). This can involve a direct financial flow to a developing country if it is in the form of official export credits. But no direct flow would be involved if the ERT is intended to support the donor country's private exporters, either via loans (to partially finance export credits extended by such private exporters to developing countries) or interest subsidies (to reduce the interest rate charged on private export credits). Broadly speaking, IRT and ERT are similar and an equal degree of underlying donor self-interest can be impugned in both cases, but potentially both can also provide advantages for the recipients' PSD.

Table 8 shows that official export credits to developing countries constituted the bulk of such finances during 1995-2000, followed by investment-related transactions with developing countries. The table also shows that donor countries differ in their preference of delivery instruments, and it appears that, even after allowing for differences in donor sizes, bigger donors use these more frequently than the smaller donors (see Jimoh 2002 for some econometric explanation of why different donors prefer different instruments). An interesting recent development is the attention now being focussed by bilateral donors on microfinance and microenterprises, as they now see this channel as a way of accomplishing the poverty reduction objective of the developing countries (see Nissanke 2002).

4.3 Multilateral official sources for PSD

There are many multilateral development banks and non-bank institutions that provide PSD assistance in one form or another. Many UN agencies (UNIDO, IFIAD, UNDP, UNESCO, etc.) provide technical support and grants, particularly for the development

of small-scale businesses and microenterprises (see Nissanke 2002 for details). Also, many multilateral development banks, particularly the World Bank Group, provide indirect support that aims at improving business environments in the developing countries through their adjustment lending (see Gibbon and Schulpen 2002). More importantly, they also provide direct financial and non-financial support. First, some banks have been established exclusively to provide financial supports for PSD, as in the case of the European Bank for Reconstruction and Development (EBRD) which assists 27 former communist countries in Europe and Central Asia to build market economies. Second, some other institutions, whose original mandate was to provide direct support to the public sector, have since diversified into establishing more or less autonomous affiliates charged with the provision of direct support for PSD. Thus, the World Bank Group (comprising originally only the International Bank for Reconstruction and Development, IBRD) established the International Finance Corporation (IFC) in 1956. IFC activities examined later in the paper, and in Mavrotas (2002). Another affiliate, the Multilateral Investment Guarantee Agency (MIGA), was created in 1988 to provide insurance cover to foreign investments in developing countries against political risks (risks of expropriation, transfer restrictions, breach of contract, wars, and civil disturbances) and to provide other investment and marketing services. The Inter-American Development Bank (IADB) followed the World Bank's footsteps by establishing the Inter-American Investment Corporation (IIC) in 1986, which was designed to perform similar roles as the IFC. But IADB went further in 1994 by establishing yet another affiliate, the Multilateral Investment Fund (MIF), that is specifically focussed on microfinance and microenterprise development. Third, other multilateral development banks, albeit without similar autonomous affiliates in their organizational structures, also provide direct financial support (i.e., without government guarantee) and non-financial assistance to enterprises in the countries of their domain, usually through some non-autonomous organizational units or departments. Generally, they also have specialized units for microfinance and microenterprises, as in the case of the ADF Microfinance Initiative for Africa (AMINA) unit of the African Development Bank. See Nissanke (2002) on AMINA and Gibbon and Schulpen (2002) for the list of multilateral development banks and their respective functions.

The IFC and EBRD are on the top in terms of recent financial flows (Table 7). But, in terms of geographical coverage, the IFC is the obvious leader—and, to a large extent, is also the prototype, pioneer and pacesetter. See Mavrotas (2002) for an evaluation of the specific activities and performance of IFC. For this leadership position of IFC, further analysis and discussion of multilateral support of PSD in this paper is based on the IFC as a complement to Mavrotas' (2002) study.

Figure 5 shows that the volumes of IFC financial support (both gross and net disbursements) to developing countries rose fairly steadily to a peak in the very early 1980s, declined for about 3 years before starting to rise very fast to attain an all-time pinnacle around 1990. This pinnacle was almost 'tested' again around 1998. As is further shown in Table 9, gross disbursements (in nominal US dollars) recorded an average annual growth of 11.6 per cent between 1970 and 2000, although the rate varies from one decade to the next, being the highest (17.6 per cent) in the 1970s, followed by 12 per cent in the 1980s, and finally just 3.8 per cent in the 1990s. Thus, the rate of increase in the tempo of IFC financing has been declining and the level of its finances more or less constant in 1990s, particularly in real terms.

Table 7
Selected bilateral and multilateral direct financial support for PSD, 1970-2000
(US$ million, annual average)

	Gross disbursements			Net disbursements		
	1970-80	1981-90	1991-2000	1970-80	1981-90	1991-2000
PSD multilateral development banks (biggest)						
IFC	183.7	704.3	1,439.0	119.8	369.8	600.3
EBRD *	na	na	1,634.7	na	na	800.7
Selected bilateral financial instruments						
ODA equity acquisition	26.0	94.4	157.7	24.2	82.6	116.3
OOF joint venture equity acquisition	367.1	528.2	376.1	214.7	65.0	-7.2
Total ODA and OOF equity acquisition	393.1	622.6	533.8	238.9	147.6	109.1

Notes: Statistics, except for EBRD, are for developing countries other than those in transition (Part II countries);
* indicates 1994-2000 average for gross and the 1992-2000 average for net disbursements for EBRD.

Source: OECD/DAC (online).

In terms of regional destinations, the bulk of financing has gone to the lower-middle income and especially upper-middle income country groups (based on DAC's classification). Only a negligible, declining proportion (4.1 per cent over 1970-2000) has been allocated to the least developed countries and a small proportion to other low-income countries (see Table 9). Geographically, North and Central America and, more specifically South America, have been major recipients, followed by the Far East and Oceania and Europe. Africa (north and south of Sahara), the Middle East and South and Central Asia have received relatively little.

What factors account for this distribution pattern? Prior to Mavrotas (2002), there have been no analytical assessments of IFC in the literature, which sought to provide some explanation. Here, we complement Mavrotas' effort. We observe that a number of developing IFC-member countries have never received financial support from the Corporation throughout the 1970-2000 period. Others have received support only occasionally, say, during 2 or 3 years. On the other hand, some countries (notably, Argentina, Brazil, Colombia, India, Indonesia, Kenya, Mexico, Philippines, Thailand, Turkey and Zimbabwe) have benefited from its financial support almost annually. It thus appears that some member countries are favoured by IFC while others are not. This raises the question of the factors that make a country an IFC favourite.

To attempt to answer the above question, we assume the IFC to be involved in a two-stage decision process. First, there is the decision as to which countries to operate in and, then, the decision on the allocation of financial support for each country that passed the first screening. To test this proposition, we adopt a special econometric test tailored to that type of situation.[7] Specifically, because the decision to invest in a country in a particular year is a binary factor, factors affecting the first stage of the Corporation's decision process are examined by fitting a probit equation to a panel of annual data (over 1970-2000) for IFC member countries (totalling about 90, mainly those with the 2000

7 See McGillivray and Oczkowski (1991) for the exposition and application and Akinkugbe (2002) for a similar application to foreign direct investors' allocation decision.

Table 8
Major instruments of bilateral official support for PDS in developing countries, 1995-2000
(US$ million, annual average)

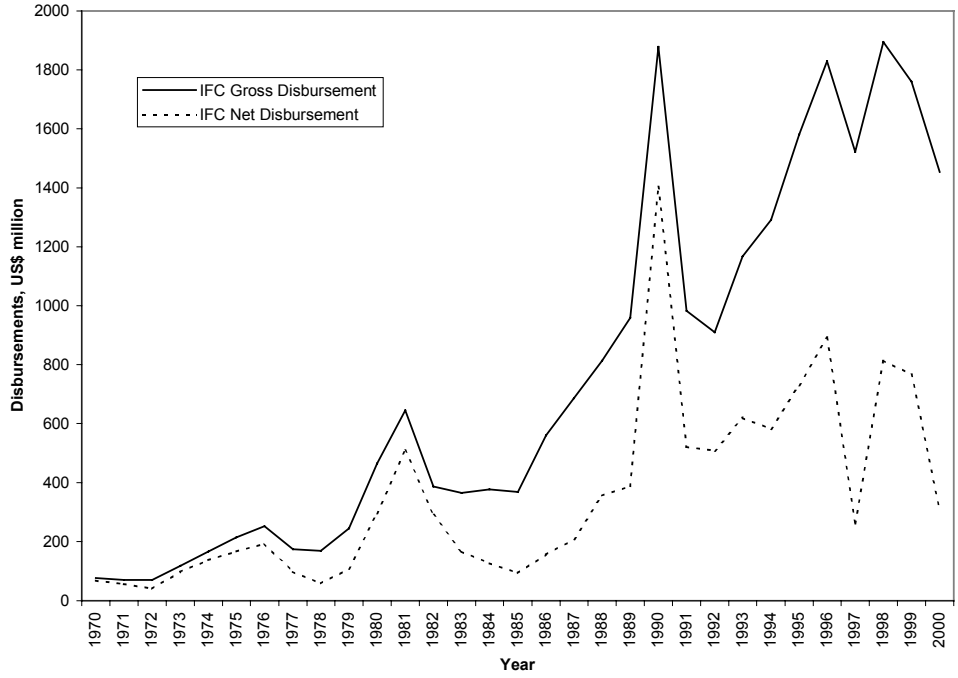
		Export-related transactions				Investment-related transactions							
							With developing countries				With residents		
								of which joint ventures (JV)					
	Equity acquisition	Total	Official export credits to developing countries	Loans to national private exports	Interest subsidies to national private exporters	Total	Total	Total	of which JV-loans	of which JV acquisition of equity	Total	Loans to national private investors	Subsidies to national private investors
Australia	–	110.6	110.6	–	–	–	–	–	–	–	–	–	–
Austria	–	93.7	93.7	–	–	–	–	–	–	–	–	–	–
Belgium	0.2	16.1	–	–	16.1	–	–	–	–	–	–	–	–
Canada	–	2,011.1	2,011.1	–	–	–	–	–	–	–	–	–	–
Denmark	27.5	182.0	113.4	17.4	–	10.4	9.0	8.5	8.5	–	17.4	17.4	
Finland	2.7	467.6	467.6	–	–	7.9	7.9	–	–	–	–	–	–
France	–	320.0	320.0	–	–	396.9	427.2	–	246.9	–	–	–	–
Germany	36.0	897.3	897.3	17.9	–	228.7	252.9	–	–	–	17.9	17.9	–
Greece	–	6.2	6.2	–	–	–	–	–	–	–	–	–	–
Ireland	–	–	–	–	–	–	–	–	–	–	–	–	–
Italy	–	373.5	1,107.9	14.1	96.6	32.2	43.4	43.4	29.8	13.6	11.7	14.1	–
Japan	88.2	2,029.4	837.2	–	–	7,644.3	–	–	5,614.2	–	–	–	–
Luxembourg	–	–	–	–	–	–	–	–		–	–	–	–
Netherlands	–	297.5	297.5	76.6	–	73.8	17.8	–	–	–	63.1	76.6	47.8
New Zealand	–	–	–	–	–	–	–	–		–	–	–	–
Norway	7.8	–	–	–	–	–	–	–		–	–	–	–
Portugal	–	–	–	20.8	–	103.2	115.4	93.2	93.2	–	14.1	20.8	7.1
Spain	–	3.2	3.2	–	–	–	–	–	–	–	–	–	–
Sweden	2.5	–	–	–	–	5.9	5.9	5.9	2.0	3.5	–	–	–
Switzerland	7.6	–	–	7.7	–	21.3	15.3	11.7	–	13.0	14.3	7.7	5.1
United Kingdom	133.7	36.1	27.8	–	44.4	202.3	173.5	178.1	156.8	23.2	–	–	–
United States	–	1,115.7	1,115.7	–	–	659.4	659.4	668.7	–	688.6	–	–	–

Notes: (a) Figures no not necessarily add up where they should. They should therefore be regarded as being only indicative.

(b) – means either zero value, or non-availability of statistics. Also, the average value is computed over only the years between 1995-2000 for which statistics actually exist. We did take the lack of statistics for a particular year to mean zero value.

Source: OECD/DAC (online).

Figure 5
IFC's gross and net disbursements, 1970-2000
(US$ million)



Source: OECD/DAC (online).

population exceeding one million). The binary dependent variable is whether or not a country receives IFC finance during each year. Testing the second stage of the decision process, on the other hand, consists of running OLS panel regression (using fixed-effect panel method) with the dependent variable now being the IFC financing received in relation to the recipient's GDP. Coverage is now limited to those data points with non-zero values for this dependent variable.

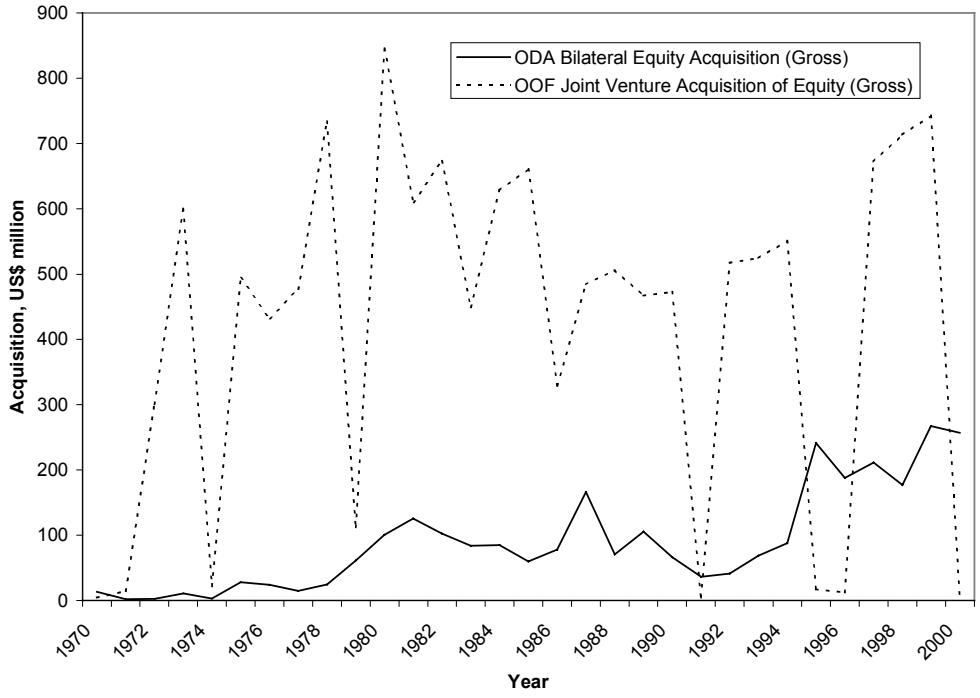
We tested for several possible explanatory variables assumed to be relevant in the first-stage decision process. One of these is the size of the country, alternatively measured by population and real GDP. We expect each of these to positively affect the chance of a country being an IFC favourite in a particular year. A high level of economic development (measured by the per capita income level), high level of industrialization (proxied by industry value added in relation to GDP), rate of economic (real GDP) growth, and rising phase of a business cycle (measured as described in Table 6) are also assumed to have a similar positive effect. On the other hand, the opposite effect is hypothesized to be induced by a high external debt burden (total external debt/GDP ratio) and the dominance of agriculture in the overall economic activities or agricultural value added/GDP ratio (as IFC rarely finances agriculture). Also posited to have a negative effect is the adverse domestic political performance (alternatively proxied by a high index of the lack of political rights; an index of the lack of civil liberties, and an index of the lack of political freedom, which is a combination of the first two).[8] We also included a trend variable. To test the second-stage decision process concerning the factors affecting the allocation amounts to the 'winners' of the screening process, we repeated the same explanatory variables listed above, plus an econometric term called

[8] The statistics are from the Freedom House (online).

'inverse Mills ratio', which seeks to account for some dependence of the second stage on the first (see McGillivray and Oczkowski 1991).

Based on the above specification, we estimated the equations with annual panel data over the 1970-2000 period and for about 90 developing countries. The results are presented in Table 10. The coefficients of all explanatory variables are statistically significant and have the expected signs in our first stage decision-making (or probit) equations, except for the coefficient of the share of industrial value added in GDP which (though with the expected sign) does not pass the statistical significance test. This evidence suggests that the chance of a country being allocated IFC financial support is enhanced by factors such as large size, a high level of per capita income, a high rate of economic growth, and a rising phase of the economic cycle. A country's prospects are also enhanced if it has a low external debt burden; if its total economic activities are not dominated by agriculture, as well as if its score in domestic political indicators is satisfactory. On the other hand, none of the factors tested for show expected and statistically significant effect in explaining the second-stage decision-making concerning how much to allocate to those countries that pass the first-stage screening test. Thus, unlike in the first-stage process for the selection of beneficiary countries, one can infer that the allocation of IFC financial support has not been consistently based on identifiable factors (or at least on the wide range of factors tested here). This is perhaps a reflection of the fact that the 'allocation' is mainly demand-driven by the potential beneficiary countries, instead of being at the discretion or initiative of the IFC.

Figure 6
Gross ODA and OOF acquisition of equity, 1970-2000
(US$ million)



Source: OECD/DAC (online).

Table 9
Level of development-based and geographical allocation of IFC gross disbursements, 1970-2000 (%)

	% of total				Avg annual nominal growth rate [a]			
	1970 to 1980	1981 to 1990	1991 to 2000	1970 to 2000	1970 to 1980	1980 to 1990	1990 to 2000	1970 to 2000
Level of development-based:								
Countries in transition	na	na	7.8	4.9	na	na	23.7	na
Developing countries	100.0	100.0	92.2	95.1	17.6	12.0	3.8	11.6
Least developed countries	5.8	4.3	3.8	4.1	29.9	7.1	16.7	11.5
Other low-income countries	11.0	16.5	24.4	20.9	5.8	14.2	-2.0	14.9
Lower-middle income countries	31.4	24.4	19.5	21.9	21.9	6.8	5.2	10.0
Upper-middle income countries	51.8	54.6	44.6	48.2	20.5	14.0	2.6	12.1
All	100.0	100.0	100.0	100.0	na	na	na	na
Geographical classification:								
Africa, north of Sahara	2.9	6.1	2.7	3.7	45.4	13.3	-0.8	14.0
Africa, south of Sahara	8.3	13.3	9.6	10.7	23.4	21.7	0.7	13.4
North and Central America	16.3	16.0	13.4	14.5	45.2	12.1	3.7	14.6
South America	26.1	32.1	31.6	31.3	14.8	12.8	2.1	12.0
Far East Asia and Oceania	16.0	8.1	17.2	14.2	7.4	9.6	9.0	10.5
South and Central Asia	3.7	8.3	13.7	11.1	12.9	10.9	0.7	19.0
Middle East	4.8	1.3	2.9	2.5	18.9	-23.7	29.0	8.0
Europe	21.9	14.9	9.0	12.0	15.4	13.8	3.1	6.9
All	100.0	100.0	100.0	100.0	18.3	11.8	2.9	11.3

Notes: na means not applicable;
[a] The annual growth rates were computed through the least squares method.

Source: OECD/DAC (online).

Table 10
Econometric results of identifying factors affecting IFC's allocation of financial support across countries, 1970-2000

	Probit equation results			Corresponding panel OLS equation results		
Trend	0.026	0.017	0.018	0.000	0.0001	0.00002
	(7.5)	(4.8)	(5.3)	(0.3)	(1.9)	(0.8)
GDP per capita (log, 1995 US$)	–	0.171	–	–	-0.001	–
		(4.9)			(-2.4)	
Total real GDP (log, 1995 US$)	–	–	0.33	–	–	-0.001
			(18.8)			(-2.3)
Total population (log)	–	0.35	–	–	-0.002	–
		(17.6)			(-1.2)	
External debt/GDP ratio	-0.106	–	–	0.0001	–	–
	(-2.8)			(1.3)		
Real GDP growth	–	1.10	1.13		-0.0002	-0.001
		(2.2)	(2.3)		(0.1)	(-1.0)
Rising phase of economic cycle	1.033	–	–	0.0001	–	–
	(3.4)			(0.1)		
Industry value added/GDP ratio	–	0.108			0.003	–
		(0.3)			(2.0)	
Agriculture value added/GDP ratio	-1.39	–	–	0.0002	–	–
	(-6.4)			(0.1)		
Index of lack of political freedom	-0.027	–	–	-0.000	–	–
	(-3.0)			(-0.1)		
Index of lack of political rights	–	-0.10	–	–	-0.0001	–
		(-5.8)			(-0.6)	
Index of lack of civil liberty	–		-0.06	–	–	0.00002
			(-3.1)			(0.3)
Statistical inverse Mills ratio	–	–	–	0.0004	0.001	-0.001
				(0.2)	(0.6)	(-0.6)
Adjusted R^2	–	–	–	0.255	0.254	0.250
Log likelihood	-1,480.7	-1,337.3	-1,343.9	–	–	–
Number of cases correct	1,421	1,606	1,582	–	–	–
Number of observations	2,279	2,312	2,323	1,057	1,055	1,067

Notes: (a) The dependent variable is gross disbursement of IFC financial support in relation to recipient's GDP;
(b) See Table 3 for reporting and interpretation of t-values as well as for the econometric techniques of deriving the estimates.

5 Private flows to multilateral institutions

Both in the past and the present, multilateral institutions raise funds from the private markets in developed countries. These funds are used to augment the other sources in financing their resource transfers to the developing countries, and the bulk of private-market funds are obtained through the issue of new securities. Available statistics do not identify the specific institutions issuing debt instruments, but they are most likely to be the multilateral development banks.

This channel, however, is declining in importance. As is shown in Table 11, while the annual average of new issues increased between 1979-89 from US$ 9.12 billion to US$ 11.88 billion for the period 1990-2000, reflows (i.e. repayment by multilateral institutions of maturing debts) outweighed new issues in the latter period. The result is a net flow to multilateral institutions from private investors to the tune of US$ 3.42 billion per annum during the first period and a net (reverse) flow of US$ 2.10 billion per annum from the multilateral institutions during the second period.

We posit interest rates to be one of the major factors that could account for the private investors' holdings of securities issued by multilateral institutions (and, hence, partly explains the observed trend). A high domestic interest rate is likely to reduce relative

Table 11
Private flows to the multilateral development banks, 1979-2000
(US$ billion, annual average)

	Gross disbursements		Net disbursements	
	1979-89	1990-2000	1979-89	1990-2000
	9.12	11.88	3.42	-2.10

Source: OECD/DAC (online).

Table 12
Factors affecting private investment in securities issued by multilateral institutions

Trend	0.0003	-0.0001
	(1.9)	(-2.3)
Interest rate in the country	-0.0003	-0.0003
	(-4.6)	(-4.5)
Interest rate in all other developed countries combined	0.0005	0.0005
	(3.8)	(4.1)
Real per capita income in the country (log, 1995 US$ value)	0.0068	–
	(2.1)	
Real per capita income in all other developed countries combined (log, 1995 US$ value)	-0.0209	–
	(-3.5)	
Rising phase of economic cycle in the country	–	-0.0065
		(-1.7)
Rising phase of economic cycle in all other developed countries combined	–	-0.0183
		(-3.0)
Adjusted R^2	0.358	0.327
Number of observations	159	159

Notes: (a) The dependent variable is net private investment in the securities of multilateral institutions in relation to the GDP of the investors' country;

(b) See Table 3 for reporting and interpretation of t-values as well as for the econometric techniques of deriving the estimates.

attractiveness of these multilateral securities while the foreign interest rate (computed as size-weighted average interest rate of remaining developed countries, other than the one in question)—which is indicative of the rate of interest on the securities of the multilaterals—is likely to have the opposite effect. A high level of per capita income in the investor country is also posited to affect the volume of these securities since this indicator signifies high savings and investible resources. On the other hand, a high level of per capita income in the other developed countries combined is expected to have the opposite effect, since these other countries are, in effect, alternative outlets for the investor. Alternatively, for broadly similar reasons, we expect the rising phase of domestic economic cycle to have a positive effect on holding of multilateral securities.

We ran panel regressions based on annual data for most of the DAC member countries over the 1979-2000 period, to test the above factors. We also included a trend variable. The dependent variable is the net private investment in the multilateral securities in relation to investor's GDP. The results are reported in Table 12, which shows that the coefficient of rising phase of domestic economic cycle has the unexpected negative sign which, however, hardly passes statistical significance test. The coefficients in the other cases have the expected sign and all are significant. This evidence supports our hypothesis above, except for the effect of the domestic economic cycle.

6 Private commercial flows: foreign direct investment and portfolio capital flows

6.1 Concepts of foreign direct investments and portfolio capital flows

Unlike the multilateral private flows discussed earlier, private investments, although also characterized by commercial or profit motives, are bilateral in nature. A major component of these bilateral private flows is the foreign direct investments (FDI), comprising (according to DAC's definition)[9] net financing by an entity in a developed country 'which has the objective of obtaining or retaining a lasting interest in an entity resident in an aid recipient (developing) country'. Lasting interest, in turn, is defined as:

> … a long-term relationship where the direct investor has a significant influence on the management of the enterprise, reflected by ownership of at least ten per cent of the shares of the enterprises, or the equivalent in voting power or other means of control.

The other component is portfolio capital flows (PCF), which is a concept of cross-border capital flows that seems to have no precise meaning. According to a survey of PCF definitions by Wilkins (1999: Box 1):

> … a range of definitions became apparent. The broadest usage included all investments going to a host country that were not classified as FDI, including short- as well as long-term capital movements … Many authors include, as I do in this paper, only long-term investments other than FDI … Others include only securitized investments (bonds and stock), once more excluding FDI, but now excluding long-term bank

9 DAC Statistical Reporting Directives (online).

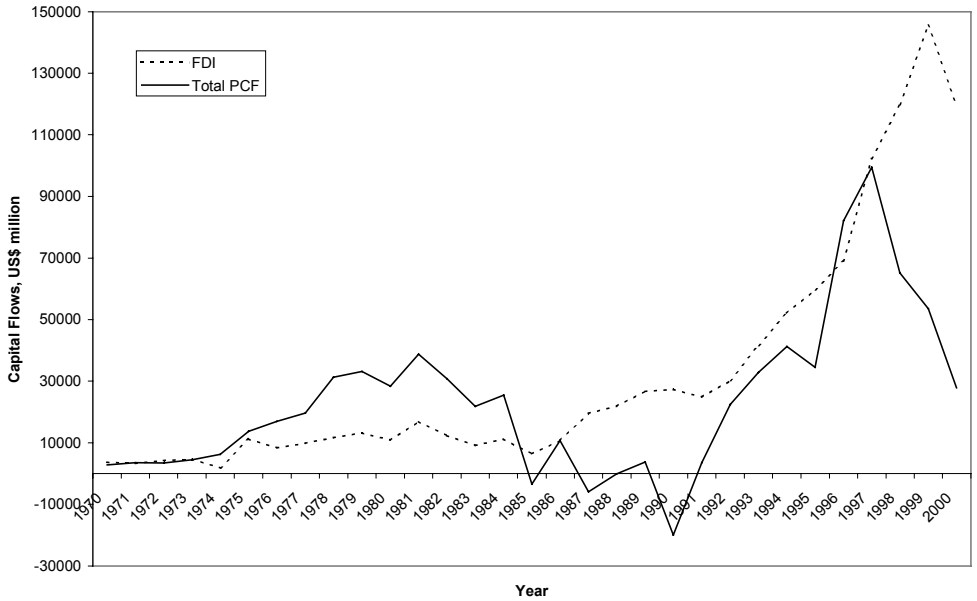
> lending as well … Some sources classify as FPI (foreign portfolio investment) only equity investments that are not FDI ….

Within the context of this paper, we adopted the specific PCF concept also applied by Wilkins, which is 'only long-term investments other than FDI'.

The FDI and PCF combined constitute what is conventionally referred to as total private capital flows. The trend in the volumes of total net private capital flows from the developed to the developing countries was already shown in Figure 2 and described in subsection 2.2.[10] The corresponding patterns for FDI and PCF are shown in Figure 7. As can be seen, prior to the early 1990s, FDI showed a more or less steady upward trend, after which it made drastic jump to attain an all-time peak in 1998. It has since declined from that pinnacle in 1999 and 2000. Net PCF, on the other hand, has been more volatile. It rose steadily from the very low pre-1975 level to an initial peak in the early 1980s. Thereafter, it declined until around 1985 when it dipped into the negative side, where it remained for most of the pre-1991 period. After 1991, the volume rose rapidly, first into the positive territory and, then, to an all-time crest in 1997. Following the East Asian financial crisis of 1997, it fell again and, by 2000, was already below the aforementioned initial peak attained in early 1980s.

Table 13 shows the destinations of both total and components of net private capital flows over 1995-2000, analysed according to the level of per capita income, while Table 14 shows the regional classification of the target countries. Figure 8 gives a graphic perspective of the trend for the different PCF components. For the source-country analysis of the flows and the size relative to GDP of both the source and destination countries, see Odedokun (2003).

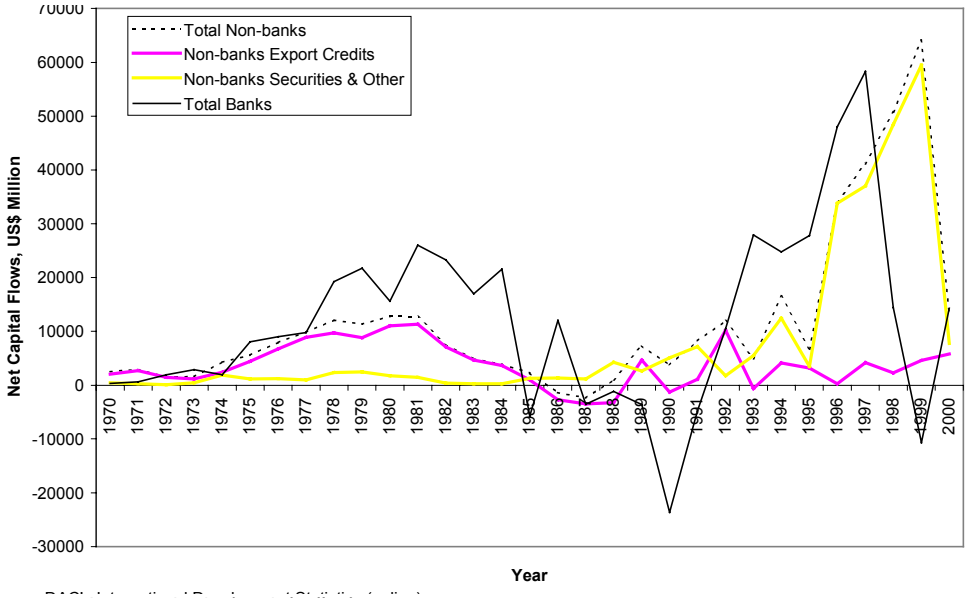
Figure 7
Trends in foreign direct investment and portfolio capital flows from DAC member countries to other countries, 1970-2000
(US$ million)



Source: OECD/DAC (online).

[10] Although NGO grants are included in the private capital flows discussed in section 2, the inclusion hardly makes a difference.

Figure 8
Trends in different components of net portfolio capital flows from DAC members to other countries, 1970-2000
(US$ million)



Source: OECD/DAC (online).

In this section, the capital flows are limited to those from the 22 DAC member countries to the rest of the world, collectively labelled the 'developing countries', which sometimes includes countries in transition. Flows between developing countries as well as between developed countries, are ignored, as they are not relevant to our present objective. Thus, statistics may not be comparable to those relating to total net outflows from each developed country or to total receipts for each developing country (or group of developing countries).

6.2 Foreign direct investments (FDI)

FDI, when compared to portfolio capital, is a relatively stable and less volatile form of private capital flows. In principle, FDI also has the attraction of embodying entrepreneurship and technology, which should make it more growth-friendly to the host economies.

The trend in aggregate net FDI flows from developed to developing countries over 1970-2000 is depicted in Figure 7 (see also Akinkugbe 2003 and Odedokun 2003). Its distribution according to the various income level-based and regional breakdown of destination countries for the 6-year period 1995-2000 is given in Tables 13 and 14. Geographically, in relation to the recipients' GDP, North and Central America received the largest share, accounting for 4.4 per cent of the region's GDP. Following at a distance is South America, with 2 per cent. South and Central Asia received the least, 0.3 per cent of the region's GDP, with Africa next (0.61 per cent of GDP for north of Sahara, and 1.07 per cent for south of Sahara).

But a more interesting characteristic is the wide disparity that exists in FDI-GDP ratio between countries at different level of development. As is shown in Table 13, FDI in relation to GDP varies more or less directly according to the level of development (per

capita income). Thus, while net FDI flows on the part of the least developed countries were equivalent to only 0.56 per cent of their GDP, and a mere 0.51 per cent for other low-income countries, corresponding figures for the lower-middle income, upper-middle income and high-income developing countries were 1 per cent, 1.6 per cent and 0.83 per cent of their respective GDPs. The transition economies (also high-income) received the highest share, 2.32 per cent of GDP. Furthermore, it is generally recognized that even the minimal FDI amount received by the least developed and other low-income countries constitutes a flow mainly to their extractive industries.

The lopsided distribution of FDI has intrigued analysts and worried development policymakers and donors (see Swedish Foreign Affairs Ministry 2002, online). This has prompted many studies in a attempt to explain the FDI flow. Some of these studies simply adopt the case study method while others, in turn, are micro-oriented in approach, seeking to identify the factors that make a particular multinational locate in a specific country or another. Others are macroeconomic in approach, in which factors affecting the aggregate flows of FDI from a particular country (or group of countries) to another country (or group of countries) are reviewed. Several factors have been identified in these studies as the determinants of FDI flows. These include macroeconomic environmental factors in the developing countries, recipient-specific institutional and political variables, and circumstances prevailing in the rest of the world (particularly with regard to actual and potential source countries)—what are popularly known as 'push' factors in the literature (see Odedokun 2003 for a review). But the above approaches are not suitable for shedding adequate light on the immediate problem as to why FDI does not flow to certain countries, specifically the low-income ones that have no extractive or mining industry enclaves. Literally speaking in the last decade or so, some countries have never recorded FDI flows. What is therefore needed, is finding a substitution for the micro-oriented and macroeconomic method which would identify the reasons as to why some countries have been favoured with FDI flows while others receive nothing. One such approach is reported by Akinkugbe (2003), who is able to identify a few factors, including the level of per capita income and degree of economic openness, which may mutually produce results that deprive some developing countries of FDI receipts.

6.3 Portfolio capital flows (PCF)

In Figure 8, the movements during 1970-2000 of the different categories of PCF are shown. Commercial bank sources constituted the largest group between 1974 and 1984 and, again, after 1992. Non-bank sources were also sizeable during the 1974-84 period (mainly due to export credits) and became the largest source after the mid-1990s. Following the Asian financial crises, bank sources pummelled in the 1997-99 period—this time, solely because of securitized debt flows, as export credits have since become almost negligible (but rose somewhat in 2000) while non-bank sources also nose-dived in 1999 and 2000.

Table 13 shows that the total volume of net PCF—amounting, on an annual average, to US$ 59.2 billion and accounting for only 0.89 per cent of the recipients' GDP—was barely more than half of FDI volume for the 1995-2000 period. The bulk of PCF (annual average of US$ 35.48 billion) was from non-bank sources, mainly in the form of securitized and related flows (US$ 31.66 billion), as opposed to export credit sources. The remaining US$ 23.74 billion was from commercial banking sources (again, mainly

from non-export credit sources). Net export credits from bank and non-bank sources which were relatively important in the 1974-84 decade (see Figure 8) now accounted for a negligible fraction of net PCF during the middle and latter part of the 1990s.

The net PCF earmarked for the poorer developing countries—and for the other low-income country group in particular—was disproportionately lower compared to the already limited volume of net FDI these countries received. The high-income group fared better; their share of PCF was substantially more than that of FDI. Also, countries in transition performed better than average in comparison to the FDI they received. Despite the negligible volume of export credits mentioned above, it still constituted a sizeable portion of the total PCF to the least developed countries, and over 50 per cent of even that volume going to the other low-income country group. Export credits to the upper-middle income and high-income groups as well as countries in transition accounted for a negligible fraction of their total net PCF receipts. Concerning the relative volume of commercial bank PCF in total, countries in transition received much lower than average for other group of countries while the other low-income group of countries even suffered a net outflow. On the other hand, the lower-middle income and the least developed groups of countries received net PCF from banks than from non-bank sources. Developing countries (excluding countries in transition) as a whole received equal amounts of net PCF from banks and non-banks.

Table 13
Destination of private capital flows:
Level of income-based destination classification
1995-2000 (annual average)

	Least developed	Other low-income	Lower-middle income	Upper-middle income	High income	All developing	Part II (Transition)	Total
	Amounts in US$ billion, current values							
Total private flows	1.15	9.88	13.94	51.38	0.90	110.33	52.72	163.05
FDI	0.77	8.44	9.78	32.44	0.19	72.31	30.33	102.64
Portfolio capital:								
Total	0.44	1.57	4.52	19.01	0.72	38.66	20.57	59.22
Banks	0.31	-0.21	2.78	8.68	0.35	19.38	4.36	23.74
of which banks' net export credit	-0.01	0.02	-0.14	0.17	0.02	0.11	-0.05	0.06
Non-banks	0.13	1.78	1.74	10.34	0.37	19.28	16.20	35.48
of which non-bank's net export credits	0.11	0.78	0.50	0.99	-0.01	3.21	0.18	3.39
of which non-banks' securities & others	0.11	0.67	1.15	9.21	0.38	15.58	16.08	31.66
	% of GDP (1995-2000)							
Total private flows	0.83	0.60	1.43	2.53	4.04	2.05	4.03	2.44
FDI	0.56	0.51	1.00	1.60	0.83	1.34	2.32	1.54
Portfolio capital:								
Total	0.31	0.10	0.46	0.94	3.21	0.72	1.57	0.89
Banks	0.22	-0.01	0.28	0.43	1.55	0.36	0.33	0.36
of which banks' net export credit	0.00	0.00	-0.01	0.01	0.09	0.00	0.00	0.00
Non-banks	0.09	0.11	0.18	0.51	1.67	0.36	1.24	0.53
of which non-bank's net export credits	0.08	0.05	0.05	0.05	-0.04	0.06	0.01	0.05
of which non-banks' securities & others	0.08	0.04	0.12	0.45	1.70	0.29	1.23	0.47

Source: Computed from OECD/DAC (online).

Table 14
Destination of private capital flows, 1995-2000: regional/geographical destination classification[a]
(annual average)

	Africa: north of Sahara	Africa: south of Sahara	North & Central America	South America	Far East, Asia & Oceania	South & Central Asia	Middle East	Europe
	Amounts in US$ billion, current values							
Total private flows	-0.10	3.65	36.65	38.24	41.74	2.79	7.14	4.51
FDI	1.08	3.21	21.54	26.53	24.24	1.75	2.12	1.86
Portfolio capital:								
Total	-0.84	0.60	15.12	11.79	17.52	1.06	5.02	2.66
Banks	-0.52	0.88	5.70	6.65	4.24	0.43	2.30	0.60
of which banks' net export credit	-0.12	-0.03	0.07	0.09	-0.06	0.08	0.11	-0.11
Non-banks	-0.33	-0.28	9.42	5.14	13.28	0.63	2.72	2.06
of which non-bank's net export credits	-0.11	0.11	0.26	-0.05	2.00	0.13	0.56	0.36
of which non-banks' securities & others	-0.22	-0.32	9.51	5.14	10.63	0.44	2.03	1.60
	% of GDP (1995-2000)							
Total private flows	-0.06	1.21	7.49	2.89	1.76	0.48	1.50	1.78
FDI	0.61	1.07	4.40	2.00	1.02	0.30	0.45	0.73
Portfolio capital:								
Total	-0.48	0.20	3.09	0.89	0.74	0.18	1.06	1.05
Banks	-0.29	0.29	1.16	0.50	0.18	0.07	0.48	0.24
of which banks' net export credit	-0.07	-0.01	0.01	0.01	0.00	0.01	0.02	-0.04
Non-banks	-0.19	-0.09	1.92	0.39	0.56	0.11	0.67	0.81
of which non-bank's net export credits	-0.06	0.04	0.05	0.00	0.08	0.02	0.14	0.14
of which non-banks' securities & others	-0.12	-0.11	1.94	0.39	0.45	0.08	0.43	0.63

Note: [a] Transition countries excluded.

Source: Computed from OECD/DAC (online).

Concerning the geographical distribution of the net PCF, Table 14 shows that North and Central America received, by far, the highest share in relation to the recipients' GDP, or 3.09 per cent of its GDP. The region was followed by the Middle East and Europe, each receiving slightly below 1.1 per cent of GDP. By contrast, South and Central Asia and Africa (south of Sahara) received just about 0.2 per cent of GDP while the African region north of Sahara suffered a net outflow of every component of PCF.

What factors could have accounted for the above trends and distribution of net PCF? Some answers can be found in the literature on the subject. After each financial crisis episode (Mexico in 1984-85 and East Asia in 1997-98), a plethora of studies have sprung up, trying to provide explanations to the reverse PCF that characterized the episodes (see Odedokun 2003 for a review of these). Some explanations emanating from these studies have to do with a limited and narrow range of indicators of rates of return and risk considerations. But most of the studies adopted essentially *ad hoc* approaches, invented for the particular financial crisis under consideration, with limited application to some earlier episodes. Thus, Odedokun (2003) introduces a study which adopts a different approach to analysing past episodes of financial crises with a more general and enduring applicability as its objective.

6 Reverse net flows from developing to DAC member countries

On the whole, it should be noted that not all types of net financial flows move from developed to the developing countries. Some finances on a net basis actually flow in the

opposite direction to the developed countries, and one important category—the cross-border bank transactions connected with international banking—is examined here. Cross-border transactions serve as a vehicle for draining resources from the developing countries, and can be regarded as a vehicle for capital flight (see Hermes *et al.* 2002).

A widely known source of published information on cross-border transactions with international banks used to be the IMF's *International Financial Statistics, IFS* (World Tables). But the most recent of these statistics are for year-end 1994 which were last published in the 1995 IFS issues. Table 15 has been prepared using the 1995 IFS statistics.

First, non-bank residents of developing countries lodge cross-border deposits with banks located either directly in the developed countries or indirectly, as in the case of offshore banking centres, notwithstanding that most of these are legally sited in the developing countries. Table 15 shows that the deposit volume is enormous and has also been growing rapidly over the period for which statistics are published.[11] While it is remarkable that the stock of gross deposits (about US$ 1.6 trillion at end-1994) from the developed countries greatly exceeds that of developing countries (US$ 588 billion at end-1994), this is because of the enormous wealth of the former and, in any case, as discussed next, gross deposits are being re-cycled to the same developed countries.

Of course, the non-bank residents in developing countries also obtain credits from these international banks, thereby moderating the net outflows somewhat. After netting out such cross-border lending to non-bank borrowers resident in the developing countries, we arrive at the item labelled 'net deposits by residence of depositors' in Table 15. Despite this adjustment, Table 15 still shows that the resource outflows from developing countries remained enormous, and that the countries subsequently 'lost' US$ 125.8 billion over the 1984-94 period. Although the flow of gross deposits over the 1984-94 period from the developed countries to the international banks was substantial, over the same period there was actually a huge reverse net flow from the banks to the developed countries, amounting to US$ 875 billion. This reflects the fact that gross deposits received by the banks from the developed countries, together with the bulk of what they received from the developing countries, were being lent to non-bank borrowers resident in developed countries. Only a small portion of gross deposits from the developing countries eventually found their way back to the original source, i.e., developing countries.

For a more complete picture, we also took cognisance of, and made adjustment for, the fact that international banks not only received deposits from, but also lent to, the banks (as opposed to non-banks discussed so far) resident in developed and developing countries. The resulting net deposits[12] of the banks in these two country groups is consolidated with the non-bank net deposits discussed earlier, giving us the line 'net deposits and liabilities by residence of depositor and borrowing bank' in Table 15. Again, the enormity of resource flows from the developed to the developing countries is

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11 See Table 15, the row titled: Cross-border Bank Deposits of Non-banks by Residence of Depositors, from page 7xr d of the IFS World Tables.

12 This is arrived at by subtracting cross-border inter-bank liabilities by residence of borrowing bank or page 8ya d of IFS World Tables from cross-border inter-bank claims by residence of lending bank or page 8ya d of IFS World Tables.

not reduced by this adjustment. What the adjustment highlights more clearly is the role of the offshore banking centres (e.g., Bahamas, Bahrain, Barbados, Bermuda, Cayman Islands and Singapore) as the pipeline through which resources are being mopped up from the developing to the developed countries. While the 1984-94 overall net resource flow from the developing countries was US$ 134.4 billion, the major offshore banking centres alone accounted for US$ 190.7 billion, more than the total, suggesting that international banks (other than offshore centres) probably even recorded some net resource flows to the developing countries. Given that the total bilateral ODA net flow over the same 10-year period was US$ 345.8 billion, this conservatively estimated net resource flow (US$ 134.4 or about 40 per cent of bilateral ODA) through the offshore banks is, without a doubt, substantial.

The regional distribution shows that the bulk of net resource flows to the international banks originated from Latin America. This is in line with the finding reported by Hermes *et al.* (2002) in their study of capital flight (a rather nebulous concept) of which a specific and special form is the cross-border banking transactions being discussed here.

A question that naturally arises from Table 15 is the reasons for the observed resource movements and the motives of non-bank economic agents for patronizing international banks, particularly offshore banking centres. The answer depends on whether the agents are residents of a developed or a developing country. Developed country residents are likely to patronize banks on the basis of return-risk investment considerations. Money laundering for tax evasion purposes could also be a major reason, particularly with deposits to offshore banking centres. While similar reasons could also apply to non-bank residents of developing countries, other motives are likely to loom larger, such as the urge to put their mostly illegally acquired wealth in safe havens beyond the reach of national laws. While illegality and money laundering could arise from transactions in narcotics, the bulk is likely to be corruption-related. This could also partly explain the increasing importance of the offshore banking centres, given the recent clamour for anti-secrecy banking laws in traditional safe havens for illegally acquired wealth (in countries like Switzerland and the UK), making these less preferred and less secure.

These outward flows of resources from developing countries are a major component of capital flight, as it is known within the context of development policy circles. As discussed in detail by Hermes *et al.* (2002), some capital-flight researchers use similar statistics to what we present above as their own measure of capital flight. But, as also discussed by Hermes *et al.*, capital flight can encompass more than the just outward movement of corrupt enrichment or illegally procured wealth. Legitimately acquired wealth can also give rise to capital flight (just as it can be a component of developing country residents' deposits with international banks, including offshore centres). Also, not all capital flight (regardless of whether legitimately or ill-gotten wealth) involved in cross-border movements has to be lodged in foreign banks, as it can be used to buy other financial assets (e.g., stocks, bonds, etc.) and non-financial assets (real estate abroad). In the absence of statistics on the uses of cross-border resource flows among various foreign assets categories, capital flight continues to be based on rough estimates, as surveyed by Hermes *et al.* (2002) and so does the measurement of cross-border transfers of ill-gotten resources, as we have done here. The various factors affecting capital flight are reviewed comprehensively by Hermes *et al*., and most would be

applicable in explaining the observed distribution and trends in cross-border banking transactions in Table 15.

Table 15
Cross-border banking activities as a vehicle for net private financial outflows
from developing countries, 1984-94
(US$ billion)

		Developing countries						
	Developed countries	All	Major offshore banking centres	Africa	Asia	Europe	Middle East	Western hemisphere
Increase (flow) between 1984-94								
Cross-border bank deposits of non-banks by residence of depositor [a]	1,157.6	288.0	105.7	22.7	44.7	17.3	25.7	141.4
Net deposits by residence of depositor [a]	-875.1	125.8	9.7	23.5	-23.5	-5.2	15.8	101.5
Net deposits and liabilities by residence of depositor and borrowing bank	-834.7	134.4	190.7	9.8	107.3	-35.4	-7.8	44.7
End-1984 stock value								
Cross-border bank deposits of non-banks by residence of depositor [a]	487.2	300.2	59.6	13.5	31.0	3.6	65.4	130.5
Net deposits by residence of depositor [a]	53.5	-44.4	25.2	-36.6	-42.7	-13.1	37.0	-111.9
Net deposits and liabilities by residence of depositor and borrowing bank	77.4	-36.3	51.6	-31.1	-46.0	2.5	-34.0	-48.5
End-1994 stock value								
Cross-border bank deposits of non-banks by residence of depositor [a]	1,644.8	588.2	165.3	36.2	75.7	20.9	91.2	272.0
Net deposits by residence of depositor [a]	-821.5	81.4	34.9	-13.1	-66.2	-18.3	52.8	-10.4
Net deposits and liabilities by residence of depositor and borrowing bank	-757.2	98.2	242.3	-21.3	61.4	-32.9	-41.8	-3.8

Notes [a] There were unallocated portions (in the data source) of global cross-border bank deposits (by residence of depositors) of non-banks and cross-border bank credits received (by residence of recipients) because the residences of the non-bank transactors could not be determined. We prorated these on the basis of the share of each region from the allocated portions. By this, the regional shares now add up to the global volumes.

Source: IMF (1995).

7 Short-term and net liquid resource flows from developing to developed countries

We do not have access to statistics on short-term private capital flows (i.e., those with maturity of no more than a year). The combined private and non-private sources that are published (e.g., in the World Bank sources) do not tell much, particularly as interest arrears on long-term debts are included. Thus we are unable to infer much on the trends and magnitudes for short-term capital flows, but we do not believe that these differ markedly from the portfolio capital flows (PCF) discussed earlier, because maturity is the only distinguishing element between short-term capital flows and PCFs.

But, in addition to conventional short-term capital flows, there is also the cross-border flow of liquid capital, including cross-border holding of currencies (of other nationalities). While we have no statistics to determine as to whether there is a net outflow of conventional short-term capital from developing countries, available evidence suggests that a net flow of liquid capital exists from the developing countries to the developed. The flow of international reserve assets[13] is an example of these. According to the IFS (World Tables), total reserves (gold excluded) held by all developing countries at the end of 1970, 1980, 1990, and 2000 were 17, 135, 241 and 850 billion SDRs, respectively. This suggests that the net resource flows on the account of (non-gold) foreign reserve movements during the 1970s, the 1980s, and the 1990s amounted to about 118, 106 and 609 billion SDRs, respectively, totalling 833 billion SDRs over the three decades.

Our main concern here, however, is the financial flows directly affecting the private sector in the developing countries. Foreign reserve movements directly impact on the public sector through central banks, except for the portion held by the commercial banking system that directly affects the availability of cross-border funds to the private sector. But in addition to the portion of commercial bank foreign reserves, the private sector also holds portfolios of foreign currencies and other liquid assets (i.e., liabilities of developed countries) outside the banking systems. The official sector maintains foreign reserves for transactions and precautionary reasons, but so does the private sector, with the only difference that there are no statistics on the volumes held by the private sector. In almost every urban centre, parallel and informal (at times, illegal) foreign exchange markets exist for transactions in major currencies, especially the US dollar, followed by the British pound, European Union Euro and Japanese yen. Across all developing countries, the equivalent of trillions of US dollars is likely to be involved in such holding of foreign liquid assets. A small annual percentage accretion to this huge stock of foreign currency translates to substantial net resource flows from the developing countries. This situation is further compounded by the macroeconomic problems many developing countries are experiencing, causing domestic residents to lose confidence in their national currencies, thereby effecting most of their exchanges through, and holding much of their wealth in, the so-called 'hard currencies'. Studies on currency substitutions and the so-called dollarization have identified a number of factors responsible for this phenomenon (e.g., see Mulligan and Nijsse 2001 for studies on transition economies; Dontsi 2001 for African economies; and Mourmouras and Russell 2000 for some theoretical exposition).[14] We do not have statistics with respect to all of these, but casual empiricism leads us to believe that the amounts involved are enormous.

7 Summary and conclusion

[13] Here we imply items other than gold and relatively small items like the IMF's special drawing rights (SDRs), whose value is a little above one US dollar.

[14] Some use currency substitution and dollarization interchangeably while others (e.g., Alami 2002) defines currency substitution as holding foreign money as a medium of exchange and dollarization as holding foreign money as a store of value.

The paper has presented a comprehensive survey of the 'shopping list' of sources of external finance that are directly channelled to the business sector of the developing countries. Generally, our survey and statistical analysis cover the 1970-2000 period. The distribution of foreign sources according to different income-based and geographical classifications of the developing countries were reviewed. We examined the aggregate net resource flows in the form of saving-investment gap and current account surplus in the developed country balance-of-payments. We also examined the institutionalized component of this aggregate, which encompasses both official and private flows. In addition, we discussed the different components of private flows, including unrequited private transfers (grants by NGOs and worker remittances) and commercial capital flows (private flows to multilateral institutions and bilateral private capital flows in the form of foreign direct investments and portfolio capital flows) to developing countries. Official foreign flows for business sector development were also examined and the recent pre-occupation with assistance to microfinance and microenterprises in the developing countries to promote poverty reduction and gender balance in the recipient countries was highlighted. These official sources are bilateral flows and multilateral flows, including those from the International Finance Corporation. Those items that by their nature are inherently net outflows from the developing countries were not omitted. These include the cross-border international banking transactions by residents of developing countries that often give rise to capital flight. Also included are the foreign currency and other liquid liabilities of developed countries, whose holding by the residents of developing countries seems to have been ever-increasing over the years.

While most of these components have been discussed and analysed in various contributions within current research project, questions and issues still remain. Also, some have hardly been examined at all in any previous study. Within the limit of available space, we attempted to address each issue. Where feasible, we also reported our own studies that seek to explain the trends over the years and distribution across countries. As mentioned earlier, not all the types of movement of funds involve net resource flows to developing countries. A number of these actually are inherently a form of resource outflows from the third world to developed countries. Whether there has been a net resource flow on balance to or from developing countries over the years is difficult to ascertain. Only the increased availability of requisite statistics in the future will permit a more categorical assertion in this regard.

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