ESSAYS

PRIVATE CAPITAL FLOWS AS A SPRINGBOARD FOR WORLD BANK REFORM

DOUG IERLEY*

1. INTRODUCTION

Over the past ten years there has been a reversal in the relative importance of official development assistance ("ODA")¹ versus private capital flows for developing countries. Once the primary source of funds for these countries, ODA is now dwarfed by private flows, accounting for only eighteen percent of total net long-term resource flows in 1999.² Lauded as one of the most important changes to development finance in recent decades, the growth of private capital flows is unfortunately irrelevant for far too many developing countries that already confront decreased official aid flows.³ Compounding the problem of scarce official aid is the way in which existing funds are currently programmed. An analysis of World Bank assistance shows that the vast majority of the Interna-

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¹ ODA consists of grants and/or loans, the latter provided on a concessional basis, to qualifying developing countries according to the Development Assistance Committee in order to promote economic and social development. U.N. DEVELOPMENT PROGRAMME, HUMAN DEVELOPMENT REPORT 2000, at 280 (Bruce Ross-Larson ed., 2000). Official aid, as opposed to ODA, is provided to countries that do not qualify as recipients of ODA.

² See infra tbl. 1.

³ In 1999, for example, ten countries received seventy-seven percent of available private capital flows to middle and low-income countries. WORLD BANK, WORLD DEVELOPMENT INDICATORS 340 (2001).
tional Bank for Reconstruction and Development ("IBRD") lending goes to the countries that already receive the largest share of private capital flows.

This Essay briefly examines the relationship between private capital flows and the World Bank's program of IBRD lending in the context of the minimal financing available to developing countries. Section 2 will explore the phenomenon of private capital flows to developing countries, review which countries receive these funds, and raise questions regarding the impact of the flows. Section 3 will review the current status of ODA funding and recent thinking on the effectiveness of development aid. Section 4 will discuss the role of the World Bank in the provision of official assistance. It will compare IBRD lending and private capital flows over the past ten years. The results of this comparison will be used as a basis to suggest that IBRD be reformed in favor of lending to low-income countries, particularly given broader financial realities for these countries.

2. PRIVATE CAPITAL FLOWS

Whereas ODA represents assistance provided by governments to developing countries, private capital flows are funds from private actors seeking investment opportunities in markets throughout the world. While industrialized countries have attracted the lion's share of private capital flows, the proportion has shrunk as developing country markets have increasingly offered competitive returns on investment.4

Table 1: Net Private and Official Long-term Flows to Developing Countries 1990-1999 (in billions of U.S.$)5

<table>
<thead>
<tr>
<th>Year</th>
<th>Private</th>
<th>Official</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>42.6</td>
<td>55.9</td>
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<tr>
<td>1991</td>
<td>61.6</td>
<td>62.3</td>
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<td>1992</td>
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<td>1993</td>
<td>165.8</td>
<td>53.4</td>
</tr>
<tr>
<td>1994</td>
<td>174.5</td>
<td>45.9</td>
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<table>
<thead>
<tr>
<th>Year</th>
<th>Private</th>
<th>Official</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>203.3</td>
<td>53.9</td>
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<tr>
<td>1996</td>
<td>282.1</td>
<td>31.0</td>
</tr>
<tr>
<td>1997</td>
<td>303.9</td>
<td>39.9</td>
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<tr>
<td>1998</td>
<td>267.7</td>
<td>50.6</td>
</tr>
<tr>
<td>1999</td>
<td>238.7</td>
<td>52.0</td>
</tr>
</tbody>
</table>

4 Developed countries, however, still account for the majority of private capital inflows. Seventy-nine percent of foreign direct investment, for instance, goes to high-income countries. See WORLD BANK, supra note 3, at 342.

Private capital consists of private debt, which includes commercial bank lending and other private credits, and private non-debt, which includes foreign direct investment ("FDI") and portfolio investment.\(^6\) FDI involves the acquisition of more than ten percent of the equity of a company\(^7\) in one country by an investor in another country, where the investor intends to manage the acquired stake.\(^8\) Because FDI involves long-term investment in production facilities in which investors maintain some measure of control, during times of financial crisis those funds cannot be withdrawn with the speed and ease characteristic of portfolio investment. Portfolio investment encompasses equity securities, financial derivatives, and bonds, all of which are more easily liquidated or rationed in the context of volatile markets and represent the majority of funds involved in cases of capital flight.

A number of factors have contributed to the growth of private capital flows to developing markets. First, political and policy changes have played a significant role. The fall of the Soviet Union and the move toward market reform in many formerly planned economies expanded global investment opportunities considerably. The liberalization of international capital flows and the deregulation of domestic financial markets have accompanied many governments' willingness to reconsider development financing from financial markets.\(^9\) Until the 1980s, trade in financial assets had been held hostage to vestiges of the inter-war experience, at


\(^7\) Takatoshi Ito, Capital Flows to East Asia, in INTERNATIONAL CAPITAL FLOWS 111, 112 (Martin Feldstein ed., 1999).

\(^8\) WTO Secretariat, Trade and Foreign Direct Investment, PRESS/57, at 6 (Oct. 9, 1996).

\(^9\) Domestic policies in the recipient country were identified as playing an important role in motivating investment decisions. P. Chuhan et al., Equity and Bond Flows to Asia and Latin America: The Role of Global and Country Factors (World Bank, Policy Research Working Paper No. 1160, 1993), cited in Robert Lensink & Howard White, Does the Revival of International Private Capital Flows Mean the End of Aid?: An Analysis of Developing Countries' Access to Private Capital, 26 WORLD DEV. 1221 (1998). Investors may seek private equity, such as domestic demand for services, and those interested in bonds might look for "current account surpluses that suggest high capacity to repay international debt." Sylvia Maxfield, Understanding the Political Implications of Financial Internationalization in Emerging Market Countries, 26 WORLD DEV. 1201, 1203 (1998).
which time international speculation wreaked havoc on foreign exchange markets.\textsuperscript{10}

Second, economic conditions influence the direction and level of private capital flows. For starters, markets in some developing countries have been growing more rapidly than those in the industrialized world,\textsuperscript{11} making them an obvious choice for an investor. Economic conditions in the developed economies, such as low interest rates and recession, have pushed private capital toward developing markets.\textsuperscript{12} Easier access to global markets through technological innovation\textsuperscript{13} has facilitated these flows, lowering transaction costs and distances between financial actors. In the case of corporations considering direct investment in a developing country, low-wage labor, the availability and ease of extraction of natural resources, and opportunities to establish or expand market share significantly influence decision making.\textsuperscript{14}

For their part, private capital flows offer developing countries the opportunity to supplement domestic savings for purposes of high-priority project finance. Benefits extend beyond the availability of capital, though. FDI brings the recipient country better technology and management, while portfolio equity investments force local companies to become more transparent in order to participate in international capital markets.\textsuperscript{15} Greatly lowered inter-

\textsuperscript{10} Alberto Giovannini, Borrowing in International Capital Markets: Lessons from Experience, in PRIVATE CAPITAL FLOWS TO EMERGING MARKETS AFTER THE MEXICAN CRISIS 99, 100 (Guillermo A. Calvo et al. eds., 1996).

\textsuperscript{11} Pier-Luigi Gilibert & Alfred Steinherr, Private Capital Flows to Emerging Markets After the Mexican Crisis, in PRIVATE CAPITAL FLOWS TO EMERGING MARKETS AFTER THE MEXICAN CRISIS, supra note 10, at 115, 120.

\textsuperscript{12} Giovannini, supra note 10, at 100. In a study of portfolio flows, international interest rates have a more substantial impact than country creditworthiness. Eduardo Fernandez-Arias, The New Wave of Private Capital Inflows: Push or Pull?, 48 J. OF DEV. ECON. 389, 391 (1996); see also GUILLERMO A. CALVO ET AL., Capital Inflows and Real Exchange Rate Appreciation in Latin America: The Role of External Factors (Int'l Monetary Fund, Staff Paper No. 40, 1993) (showing that factors external to a country's economic situation often drive flows in and out of a country).


\textsuperscript{14} Guy Pfeffermann, Prospects for Increasing Foreign Direct Investment in Low-Income Countries, in EXTERNAL FINANCE FOR LOW-INCOME COUNTRIES 194, 195 (Zuhair Iqbal & Ravi Kanbur eds., 1997).

\textsuperscript{15} Martin Feldstein, Introduction to INTERNATIONAL CAPITAL FLOWS 1, 2 (Martin Feldstein ed., 1999).
national transaction costs are also a general result of capital liberalization.16

Surges in private capital, both inflows and outflows, are not a recent phenomenon. The first surge in private capital lasted from approximately 1870 to 1914 and represented funds channeled to European colonies in the developing world.17 The second wave accompanied the inter-war years, until the onset of the Great Depression, during which time bonds were utilized to help offset public sector deficits.18 The third surge took place as a result of the balance of payment surpluses of the oil-exporting countries in the 1970s. By the early 1980s, annual private capital flows to developing countries exceeded $100 billion.19 The onslaught of the Mexican debt crisis, caused by Mexico’s default on debt repayments, nearly brought private flows to a halt in 1982. By the 1990s, private capital flows had recovered, and a fourth wave peaked in 1997, reaching $303.9 billion.20

2.1. Fluctuations in Flows

While increasing over time, private capital flows have also proven extremely volatile.21 Crises in one country often have "spillover" effects across borders, causing capital flight from neighboring countries.22 The Asian financial crisis, attributable to the devaluation of the Thai baht, caused global private flows to developing countries to decrease by approximately $65 billion, or

17 World Bank, supra note 5, at 119 (citing background paper by Barry Eichengreen).
18 Id.
20 See supra tbl. 1.
21 "The issue area that most urgently requires new institutional innovation is supervision and regulation of capital markets." C. Fred Bergsten, Managing the World Economy of the Future, in MANAGING THE WORLD ECONOMY 341, 360 (Peter B. Kenen ed., 1994).
22 Capital flight has been defined as the concern of an owner of capital that the "value of [the] asset would be subject to discrete losses . . . [if] held domestically." S. Ibi Ajayi, An Analysis of External Debt and Capital Flight in the Heavily Indebted Poor Countries of Sub-Saharan Africa, in EXTERNAL FINANCE FOR LOW-INCOME COUNTRIES, supra note 14, at 77, 82.
one-fifth of total flows.23 The inflow of private capital to South Korea, Indonesia, Thailand, Malaysia, and the Philippines was $93 billion in 1995.24 Within two years private capital flows reversed in those same countries and transformed into a net outflow of $12 billion.25 The pattern is not new. After the Mexican debt crisis, the flood of private capital that followed recycled petrodollars into developing countries quickly dried up, turning private capital inflows negative.

The volatility of private capital flows, however, has been somewhat offset by changes in the structure of capital flows over the past ten years. In 1990, two-thirds of private capital flows consisted of commercial bank lending. By 2000, FDI constituted the largest source of private capital reaching developing countries.26 The significance of the change in the proportion of FDI (Table 2) lies in the fact that FDI itself is a more consistent source of funds for developing countries, maintaining a level of resilience, unlike other sources of private funds, despite financial crises.27 Although FDI grew more slowly in 1998 and 1999, it has continued to increase, while loans and portfolio investment have dropped sharply.

FDI’s staying power can be attributed to its responsiveness to long rather than short-term economic trends, dependence on labor and natural resources, neither of which are likely to suffer the immediate consequences of crisis, and ongoing opportunities for mergers and acquisitions in developing countries.28 FDI to developing countries is forecasted by the World Bank to increase during

23 WORLD BANK, supra note 5, at 36. The crisis in East Asia “had its roots in excessive private sector debt and weak financial and corporate institutions in the countries most affected, as well as abrupt changes in risk perceptions on the part of creditors.” WORLD BANK, supra note 5, at 120.
24 Symposium, supra note 13, at 242. While the outflow is a result of economic and political events, it is also a byproduct of “herd” behavior, where foreign and domestic investors seek to unload assets before they are severely depreciated. Mark Weisbrot, Exceptions and Conditions: Globalization for Whom?, 31 CORNELL INT’L L.J. 631, 648 (1998). For further analysis on investor behavior and contagion effects, see Graham Bird & Joseph P. Joyce, Remodeling the Multilateral Financial Institutions, 7 GLOBAL GOVERNANCE 75, 79 (2001).
25 Symposium, supra note 13, at 242.
26 WORLD BANK, supra note 5, at 35.
27 Id. at 134.
28 Id. at 42.
2000-2001 at approximately the same rate as respective rates of Gross Domestic Product ("GDP").

Table 2: Composition of Private Capital Flows to Developing Countries 1990-1999 (in billions of U.S.$)

<table>
<thead>
<tr>
<th>Year</th>
<th>FDI</th>
<th>Equity</th>
<th>Debt</th>
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</thead>
<tbody>
<tr>
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<td>24.1</td>
<td>2.8</td>
<td>15.7</td>
</tr>
<tr>
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<td>1992</td>
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<td>1993</td>
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<tr>
<td>1994</td>
<td>88.8</td>
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<td>50.5</td>
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<tr>
<td>1995</td>
<td>105.0</td>
<td>36.1</td>
<td>62.2</td>
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<tr>
<td>1996</td>
<td>130.8</td>
<td>49.2</td>
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</tr>
<tr>
<td>1998</td>
<td>170.9</td>
<td>15.6</td>
<td>81.2</td>
</tr>
<tr>
<td>1999</td>
<td>192.0</td>
<td>27.6</td>
<td>19.1</td>
</tr>
</tbody>
</table>

2.2. Countries Receiving Private Capital

In addition to overall volatility, private capital flows are unevenly distributed across developing countries, with Latin America and East Asia receiving the bulk of these flows. The ten largest recipients of private capital flows over the past ten years have been in Asia and Latin America. East Asia has drawn the majority of private capital flows due to several factors: political and macroeconomic stability, a welcoming environment for potential investors, and economic development as a principal object of policy-making by governments in the region. Funds flowing to Latin America followed the reform and modernization programs initially undertaken by Chile and Mexico, and subsequently by Colombia, Peru, Venezuela, Bolivia, Argentina, and Brazil.

Private capital has largely bypassed low-income countries and heavily indebted countries, particularly in sub-Saharan Africa. Middle-income countries received more than ninety percent of pri-

29 Id. at 46.
30 Id. at 36.
33 Lensink & White, supra note 9, at 1230-32.
Private capital flows to the developing world during the 1990s. In one study, forty of sixty-nine developing countries, for which data existed, faced sufficiently serious structural problems as to make the receipt of private capital flows unlikely. In the case of Africa, political instability and a poor macroeconomic environment have severely curtailed the interest of foreign investors. In 1997 and 1998, sub-Saharan Africa received $12.5 billion in private capital, of which South Africa and Nigeria accounted for sixty-seven percent. Disaggregating the flows to account for the relatively powerful economies of South Africa and Nigeria, the balance of sub-Saharan Africa received only $4.2 billion. Worldwide private flows during the same period exceeded $526 billion, of which East Asia and Pacific countries and Latin America received $377 billion. Although growth in sub-Saharan Africa is forecasted to be 3.8% by 2002 and highly indebted poor countries ("HIPC") debt restructuring packages should be prepared for more than twenty countries, a substantial increase in private capital flows to the region is unlikely. The situation in sub-Saharan Africa is representative generally of private flows to low-income countries. Although private capital flows to these countries increased from just $3.5 billion in 1990 to $15.2 billion in 1998, the proportion is tiny in com-

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35 Lensink & White, supra note 9, at 1232. Countries also face the problem in reverse, managing too much in the way of inflows. Capital inflows to Malaysia ranged from ten to twenty percent of GDP during the early to mid-1990s and exceeded ten percent in Thailand during the same period. Substantial inflows force up currency values, jeopardizing export industries, and widen current account imbalances. Zhang Shengman, Capital Flows to East Asia, in International Capital Flows, supra note 15, at 177, 179. Substantial capital inflows may overwhelm the ability of officials to regulate the economy and the capacity of the private sector to use the money. McKnight, supra note 16, at 862.
36 See generally Ajayi, supra note 22 (discussing capital flight in sub-Saharan Africa).
37 World Bank, supra note 34, at 171.
38 Calculated from World Bank data on aggregate net resources to developing countries. Id.
39 Id. The figures illustrate the view of one author that in lower income countries in Africa, "there is no private sector to speak of." Paul Mosley, The World Bank, "Global Keynesianism" and the Distribution of the Gains from Growth, 25 World Dev. 1949, 1953 (1997).
40 World Bank, supra note 34, at 171.
41 World Bank, supra note 5, at 11.
comparison to overall flows to developing countries.\textsuperscript{42} In 1998, developing countries received a total of $267.7 billion in private flows.\textsuperscript{43}

The International Monetary Fund ("IMF") has voiced "cautious optimism" in relation to the recovery of declines in overall flows in the wake of the financial crises in Brazil, Russia, and Asia between 1997 and 1999,\textsuperscript{44} with FDI remaining strong, recovery in portfolio flows, and increased repayment to banks.\textsuperscript{45} The World Bank projected private capital flows to developing countries to reach $220 to $230 billion in 2001, an improvement but still less than the peak reached in 1996-1997.\textsuperscript{46} FDI is projected to continue its modest growth, restrained somewhat by decreases in mergers and acquisitions.\textsuperscript{47}

For those countries that have been able to benefit from the availability of private funds,\textsuperscript{48} growth has not been without controversy. Rapid capital outflows in these countries reduce growth, erode the tax base,\textsuperscript{49} and have a pernicious impact on the poor\textsuperscript{50} and social development generally.\textsuperscript{51} The World Bank estimated that the number of persons living in poverty doubled in East Asia following the financial crisis, after two decades of decreases in the

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\textsuperscript{42} WORLD BANK, supra note 34, at 37.
\textsuperscript{43} WORLD BANK, supra note 5, at 36.
\textsuperscript{44} INTERNATIONAL MONETARY FUND, INTERNATIONAL CAPITAL MARKETS 44 (2000).
\textsuperscript{45} Id. at 76.
\textsuperscript{46} WORLD BANK, supra note 5, at 22.
\textsuperscript{47} Id. at 22-23.
\textsuperscript{48} Formerly, multinational entities represented the developing world's dependence on the industrialized countries and have been transformed into the "saviors" of development. DANI RODRIK, THE NEW GLOBAL ECONOMY AND DEVELOPING COUNTRIES: MAKING OPENNESS WORK 37 (Overseas Development Council Policy Essay No. 24, 1999).
\textsuperscript{49} See Manuel Pastor, Jr., Capital Flight from Latin America, 18 WORLD DEV. 1 (1990). As private wealth is put beyond the reach of government taxing power, land and labor are commonly substituted to make up the burden, which is likely to be regressive. Ajayi, supra note 22, at 84.
\textsuperscript{50} For a discussion concerning the difficulty for small economies to withstand the impact of substantial capital movements, see Ronnie C. Chan, Whither Global Capital Flow?, FAR E. ECON. REV., Nov. 5, 1998, at 33.
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number of persons living in absolute poverty. Developing countries seeking money in a competitive marketplace may have the effect of degrading workers’ rights and environmental protection.

Private capital flows have also grown, in part, as a result of its almost faddish popularity, rather than as a part of a coherent investment program. Despite a formulaic notion regarding the criteria to attract private capital, flows go to larger markets such that "low-income countries cannot expect much in the way of private flows even if they have good rule of law and sound economic policies." Claims as to the beneficial impact of FDI, such as technology transfer and labor training, are not necessarily borne out in fact. The link between growth and direct investment is also unclear. The presence of FDI, now by far the largest portion of private capital, may be a result of already existing strong growth figures, where private investment will seek out, rather than cause, profitable and productive economies. One study of FDI in developing countries concluded that the rationale that FDI is good for a country’s development is not upheld by data.

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54 John Williamson, Comment, in PRIVATE CAPITAL FLOWS TO EMERGING MARKETS AFTER THE MEXICAN CRISIS, supra note 10, at 112, 119. Also, “it must be recognized that despite the many benefits they bring, they can create problems by distorting economic realities.” Chan, supra note 50, at 33.
56 See generally Rodrik, supra note 48 (suggesting the same).
57 Barry Bosworth & Susan Collins, Capital Inflows, Investment, and Growth (Brookings Institution 1998), cited in Rodrik, supra note 48, at 37. Another commentator has noted, that

[s]everal emerging economies do indeed present excellent opportunities for efficient portfolio diversification because they combine ample national resources, skilled work forces, open trade policies, and the ability to benefit from technology transfers from nearby industrialized countries . . . . Not all emerging markets share these advantages equally, however, so that selectivity will still characterize such capital flows.

Gilibert & Steinherr, supra note 11, at 120.
Overall, there are three critical issues related to private capital flows in developing countries. First, low-income countries, as a group, have severely limited or no access to private capital. Second, for the handful of these countries that do receive some private capital, they remain particularly vulnerable to the impacts of capital flight and have yet to benefit from the increased stability linked to the growing proportion of FDI. Third, there are legitimate questions as to the basis upon which private capital is invested and its effectiveness. Although a deeper exploration of the latter point is beyond the scope of this Article, it has obvious implications for developing countries that belie the popularly held view that private investment is the saving grace for the developing world.

3. OFFICIAL DEVELOPMENT ASSISTANCE

In 1960, the United Nations ("U.N.") General Assembly endorsed a specific target for ODA of 1% of national incomes, based on a suggestion by the World Council of Churches in 1958. The target was subsequently decreased to 0.7% of Gross National Product ("GNP") in 1975. As of 1998, though, external aid to developing countries represented only 0.24% of the GDP of Development Assistance Countries ("DAC"), a slight increase over 1997. ODA has been declining generally since 1990, when the percent of combined GNP of the DAC allocated to ODA was 0.33%. The decline has been a result of changing domestic budget priorities, the decreasing strategic importance of aid following the end of the Cold War, and new questions as to the effectiveness of aid. Development assistance at the end of the decade was $3.5

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60 Id.

61 Id.

62 Id. One study has noted that global growth may help offset decreases in ODA. Specifically, economic growth would give current donors more money to spend on aid, middle income countries will reach developed country status and dispense aid of their own, and some low-income countries will experience sufficient improvement to allocate aid to other countries. Paul Collier, Redesigning the Aid Relationship (1999) (unpublished manuscript for Joint Conference of African Ministers of Finance and Ministers of Economic Planning), cited in A.A.G. Ali et al., Official Development Assistance to Africa: An Overview, 8 J. AFR. ECON. 504, 515-16 (1999).

63 WORLD BANK, supra note 5, at 60.
billion less than at the start, a real cut of 30% in constant dollar terms.64 Aid flows now stand at their lowest level, as a share of GNP, since the 1950s.65

Currently, official finance is a higher percentage of external financial flows to sub-Saharan Africa than any other area in the world.66 A sample of thirty-four low-income countries in sub-Saharan Africa shows them receiving, on average, the equivalent of 21.2% of their respective GNP during the first five years of the 1990s, more than double the proportion of any other region.67 East Asia and sub-Saharan Africa received 51.7% of ODA in 1999.68 Nonetheless, in a number of countries across Africa, macroeconomic reform is taking place, and official aid provided in the near future will play a critical role in making more of Africa attractive to private investment.69 In a world of tightening aid budgets, a developing country's ability to attract private capital can be a critical factor in the provision of aid, where access to private flows might


If current trends continue, only one country will reach the $900 per capita income threshold for exiting LDC status in the next 50 years. Moreover, the LDCs will miss by a wide margin the 2015 human development targets of halving poverty, reducing child mortality by three-quarters, and achieving universal primary education.

OXFAM, supra note 64, at 1.

The low levels of official aid are not the only area in which the industrialized countries have been less than supportive of low-income countries. For example, in trade relations, "[f]or every $1 that Bangladesh receives from Canada in aid, it loses another $36 through trade restrictions. . . . For every $1 that Cambodia receives from the USA, trade restrictions cost the country another $4." Id. at 5.

67 WORLD BANK, supra note 5, at 65.
68 WORLD BANK, supra note 5, at 60. "[A]id . . . poorer countries focuses on the social programmes—mainly education, health, water supply and sanitation—and next on economic infrastructure, such as transport and energy projects. The mix changes as the country moves up the income scale, in line with the recipients' new socio-economic situation." Yasmin Ahmad, Development Aid: Snapshots of Recent Trends, OECD OBSERVER, Mar. 1999, at 46, 47.
69 Paul Collier, Aid 'Dependency': A Critique, 8 J. AFR. ECON. 528, 544 (1999).
make a country ineligible for official assistance. Absent recent donor budget restraints, official flows have tended to be counter-cyclical to private, non-FDI flows.

Separate from actual levels of aid flows, there has been a recent change in thinking about aid effectiveness. First, aid disbursed in a good policy environment helps attract private investment and acts as a catalyst for faster growth and improvements in social development. Unfortunately, aid has been as likely to go to countries with conducive policy environments as to those without. Second, aid should also be targeted appropriately. Countries that maintain sound macroeconomic policies and deliver public services should receive budget support. Countries that have established the policies, but have limited capacity to deliver services, should receive assistance aimed at improving public expenditure. However, Burnside and Dollar argue that there is no evidence that foreign aid actually encourages the adoption of sound macroeconomic policies.

70 Analytic factors have been suggested on the basis of which countries would be determined as able to function absent aid due to private flows. Lensink & White, supra note 9, at 1225. For example, Hernandez and Rudolph have identified countries that they consider to be “high private-capital recipients,” where the ratio between the “annual inflow of private capital and GDP exceeds two percent.” Leonardo Hernandez & Heinz Rudolph, Sustainability of Private Capital Flows to Developing Countries: Is a Generalized Reversal Likely? (World Bank, Policy Research Working Paper No. 1518, 1995), cited in Lensink & White, supra note 9, at 1225.

71 WORLD BANK, supra note 5, at 73.

72 The ability of aid to assist impoverished countries has been a controversial issue. “It remains the case that the measured ability of aid flows to trigger sustained growth in developing countries has been poor, and particularly poor in the poorest countries.” Paul Mosley, supra note 39, at 1951.

73 WORLD BANK, supra note 65, at 4. It has also been found that aid is neutral relative to development and is dependent for its effects on government policy. See Cecelia Lopez, Impact of External Aid on Latin America 1972-1992 (Tercer Mundo 1997) (original in Spanish), cited in WORLD BANK, supra note 65, at 37. In an address last year, former U.S. Treasury Secretary Lawrence Summers identified “national policies [for reform] in the developing countries” as a “basic reality” of the 21st century necessary to foster growth. Lawrence H. Summers, Development & Integration: A New Global Consensus, PRESIDENTS & PRIME MINISTERS, July-Aug. 2000, at 7.

74 WORLD BANK, supra note 65, at 4.

75 Id. at 5.

In Africa, official flows have promoted uneven growth. Dollar and Easterly found that recent strategies, including both “aid-financed investment” and “aid-induced policy reform,” have been failures. The study found that absent a domestic constituency for reform, foreign aid is unlikely to generate reform even when conditionality so stipulates. “Even when a country tries to implement economic policies to foster pro-poor growth and mount targeted poverty programs, inept or unresponsive governance institutions can nullify the impact.”

Poor performance on the part of receiving countries has diminished aid effectiveness but so has the pattern of foreign aid. Specifically, aid does not necessarily flow to countries which have chosen good policies. Alesina and Dollar found considerable evidence that aid disbursement is dictated by political and strategic considerations. Although countries that pursue democratic reform have been rewarded with a fifty percent increase in foreign aid, “[a]n inefficient, economically closed, managed non-democratic former colony politically friendly to its former colonizer, receives more foreign aid than another country with [sic] similar level of poverty, a superior policy stance, but without a past as a colony.” Dollar and Svensson found that nearly all adjustment loans disperse fully, even when policy conditions are not met.

The determinants of aid do vary and encompass strategic considerations, political conditions in the recipient country, poverty, and colonial history. Nonetheless, U.N. voting patterns and a colonial past explain more of the distribution of aid than the institutions or policies of recipient countries. Donors were also faulted

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77 Id.
78 Id. at 568.
80 Alesina & Dollar, supra note 55, at 1.
81 Id.
83 Alesina & Dollar, supra note 55, at 5. Among the donor nations, Japan rewards developing countries with aid if they vote with Japan in the U.N. (more than France or the United States), the United States gives one-third of its aid to Israel and Egypt, and France and the U.K. give over half and three-quarters of their aid, respectively, to former colonies. Id. at 9, 13-16. For these countries in
in another study, where poor recipient capacity for monitoring and evaluating inflows of aid leads to donors taking a more invasive role in decisions regarding public expenditure, thereby weakening recipient capacity.\footnote{Ali et al., supra note 62, at 524.}

For developing countries, particularly those more dependent on ODA, overall developments related to aid are not encouraging. First, in both real dollar terms and as a percentage of GDP, ODA is decreasing, with no sign of an imminent reversal. Second, while it has become clear that an appropriate policy-making environment in recipient countries can help less overall aid go further, policies in aid-dispensing countries serve as variables which potentially offsets those gains. ODA falls far short of both need and the commitments made by the industrialized nations to the developing world.

4. THE WORLD BANK

The active role the World Bank plays in development today, largely taken for granted, was a less than certain possibility at its inception.\footnote{1 DEVESH KAPUR \textit{ET AL.,} \textit{THE WORLD BANK: ITS FIRST HALF CENTURY} 58 (1997).} The sister institutions, the World Bank and the IMF, were created as part of a new global monetary system that would prohibit the resurgence of the economic chaos of the 1930s, which contributed significantly to the start of World War II. Multilateral lending, like official development assistance, is of recent vintage. Although the international financial organizations have institutionalized multilateral lending, its origins lie in the specialized agencies of the U.N., premised on the fact that private capital markets could not provide the resources needed for postwar reconstruction.\footnote{DANI RODRIK, \textit{Why Is There Multilateral Lending?}, WORKING PAPER SERIES 1 (1995).}

The World Bank's core mission today is the promotion of economic growth and the eradication of poverty in the less developed countries.\footnote{Stiglitz, supra note 52, at 580.} To do so, it provides loans through the IBRD and, more recently, through loans at concessional rates and grants via

\footnote{\textit{Id.} at 23.}
the International Development Association ("IDA"). The World Bank channels only a portion of ODA flows, the balance of which is provided by governments on a bilateral basis. The provision of IBRD loans have been the World Bank's principal activity, through which funds are borrowed and lent to member governments at a rate slightly higher than the World Bank's borrowing rate but more favorable than the private sector rate. IBRD loans totaling $349 billion have been provided to middle-income countries and credit-worthy poorer countries since its establishment in 1945. IBRD lending in fiscal year 2000 was $10.9 billion, approximately half of the lending totals in each of 1998 and 1999, when financial crises in the Russian Federation, Thailand, the Republic of Korea, Indonesia, Argentina, and Brazil required funds to help stabilize those economies. The demand for IBRD lending in 2000 returned to more normal levels following the crises and has in fact dropped to seventy-one percent of average lending over the period 1992-1997.

The IDA was established in 1960, bringing to the World Bank concessional lending intended to meet the needs of economies too poor to service external borrowing and in need of support to create the structures necessary for development. The IDA works with

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88 Article I of the Articles of Agreement of the IDA states that its purposes "are to promote economic development, increase productivity and thus raise standards of living in the less-developed areas of the world . . . ." 1 IBRAHIM F.I. SHIHATA, THE WORLD BANK IN A CHANGING WORLD 391 (Franziska Tschofen & Antonio R. Parra eds., 1991).

89 Although beyond the scope of this Essay, the combination of readily available private capital and bilateral aid raises the question of the usefulness of multilateral aid in general. RODRIK, supra note 86, at 1. Rodrik has critiqued multilateral lending as valuable not because of the lending itself but due to the advantages that multilateral institutions have over bilateral ones. The benefits extend first to the conditionality that multilateral institutions are able to exercise because of their autonomy from governments. Second, multilateral institutions are in a better position to benefit from the "collective good" of information as to investing environments. Id. at 2. There is, though, "no independent economic rationale for multilateral lending per se." Id. at 31.


92 Id. (calculated from figures in the report).

93 KAPUR ET AL., supra note 85, at 1121. The establishment of the IDA was also a response to fears that concessional lending within the context of IBRD opera-
sixty countries, primarily in Africa and South Asia, which have low per capita rates of GDP. Loans are payable over a period up to forty years, double the most favorable terms available through IBRD, and at heavily reduced interest rates. Resources are based on replenishments from member governments, IBRD net income, and IDA's own resources. In fiscal year 2000, IDA lending totaled $4.4 billion, forty-seven percent of which was allocated to Africa. IDA has set fifty percent of annual lending as its target for support to Africa, reflecting the chronic poverty in the region. Twenty-seven percent of 2000 lending targeted South Asia. The IDA and co-financing from bilateral and multilateral donors are likely to be the only source of funds lending off disaster for the poorest countries.

The lack of private financial investment in low-income countries that makes IDA lending, and ODA generally, so critical, is more widely available in those countries that are recipients of IBRD lending and has had a substantial impact on demand for the lending. The dramatic increase in capital flows over the past ten years have caused World Bank lending and borrowing to stagnate overall, with middle-income countries, the principal beneficiaries of private capital, preferring equity financing at least in part due to the calamitous experience with debt instruments in the 1980s and 1990s.

Middle-income countries have also been attracted to the less onerous compliance requirements and diminished scrutiny implied by private market financing, decreasing administrative, financial, and political costs. The result has been the erosion of the World Bank's position by the market, ironically a sign of success in the World Bank's efforts to offset capital market imperfections. Overall, increases in IBRD lending have been short-lived and for

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94 Gilbert & Vines, supra note 90, at 12.
95 Id.
96 WORLD BANK, supra note 91, at 10.
97 Mosley, supra note 39, at 1953.
98 KAPUR ET AL., supra note 85, at 1112-13.
99 Mosley, supra note 39, at 1952.
the sole purpose of responding to calls to offset destabilizing forces in private capital markets during financial crises.\textsuperscript{100} The larger trend of stagnation in IBRD lending posits an important question as to its relevancy and legitimacy when private capital is available.\textsuperscript{101}

Table 3: Percent of IBRD Lending to the Ten Largest Recipients of Private Capital Flows 1990-1999\textsuperscript{102}

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>41%</td>
</tr>
<tr>
<td>1991</td>
<td>45%</td>
</tr>
<tr>
<td>1992</td>
<td>46%</td>
</tr>
<tr>
<td>1993</td>
<td>53%</td>
</tr>
<tr>
<td>1994</td>
<td>49%</td>
</tr>
<tr>
<td>1995</td>
<td>52%</td>
</tr>
<tr>
<td>1996</td>
<td>51%</td>
</tr>
<tr>
<td>1997</td>
<td>59%</td>
</tr>
<tr>
<td>1998</td>
<td>71%</td>
</tr>
<tr>
<td>1999</td>
<td>51%</td>
</tr>
<tr>
<td>Average</td>
<td>52%</td>
</tr>
</tbody>
</table>

\textsuperscript{100} The IMF may be the most obvious candidate to provide emergency assistance to offset financial crises caused by volatile capital flows, given its stabilizing role in monetary systems. The IMF could act to "coordinate the activities of other official agencies while encouraging private lenders to take a tractable approach toward debt restructuring. The IMF also plays a valuable role in providing assistance to countries when private funds are not available." Joseph Joyce, \textit{The IMF and Global Financial Crises}, \textit{Challenge}, July/Aug. 2000, at 102.

\textsuperscript{101} Questions as to the effectiveness and results of World Bank lending are not new. The World Bank has "for decades, financed governments . . . whose policies have been antithetical to growth and have been responsible for poor people's misery in the first place." Ian Vasquez, \textit{The Role of Multi-lateral Institutions in African Development}, 30 \textit{Law & Pol'y Int'l Bus.} 703 (1999). The criticism has also been made that World Bank lending is premised on the input of experts who are "completely out of touch with the local African reality," leading to a situation in which development planning for Africa takes shape in Washington, D.C. George B.N. Ayittey, \textit{How the Multilateral Institutions Compounded Africa's Economic Crisis}, 30 \textit{Law & Pol'y Int'l Bus.} 585 (1999). Already by 1989, the number of expatriate consultants employed by the Bank to work on economic difficulties in Africa exceeded 80,000, costing over U.S. $1 billion per year. \textit{Id.} at 587. Since World Bank and IMF structural adjustments were instituted in the 1980s in Latin America, the region has had a growth rate of approximately zero and has become disillusioned with democratic reform. Weisbrot, \textit{supra} note 24, at 634. For an evaluation of structural adjustment, see \textit{Jayati Datta-Mitra, Fiscal Management in Adjustment Lending} (1997).

\textsuperscript{102} Based on data from \textit{infra} apps. I & II.
Instructively, paragraph ii of the Articles of Agreement of the IBRD states that one purpose of the IBRD is “[t]o promote private foreign investment . . . and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources.” Table 3 indicates quite clearly that over the past ten years, IBRD loans are increasingly being made available to countries which already have access to private market capital and account for the receipt of over three-quarters of all flows, on average. In 1990, an already substantial forty-one percent of IBRD’s loan portfolio went to the ten largest recipients of private capital flows. By 1998, the proportion rose to an alarming seventy-one percent, decreasing to fifty-one percent in 1999. These figures, though, only represent an analysis of IBRD’s lending schemes relative to the ten largest recipients of private capital flows. Reviewing all of IBRD’s lending each year relative to all recipients of private capital flows increases the proportions.

Should World Bank lending be reformed such that funds previously available to countries receiving massive levels of private capital are re-channeled to low-income countries? The answer is a resounding yes, and it is here that earlier conclusions reinforce the need for change for which empirical evidence is already so strong. Despite the increase in FDI as a mitigating factor against volatile private capital flows, there is no sign private funds will reach low-income countries anytime soon. ODA flows are likely to remain stagnant or decrease based on analyses of the past ten years of contributions, including IDA replenishments. With the shrinking pot of official assistance and the variables of both recipient and donor country policies potentially undermining the effectiveness of

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103 SHIHATA, supra note 88, at 345.

104 Despite the stabilizing influence of FDI, improvements in the international financial architecture, and improved regulatory frameworks, the World Bank forecasts continued high volatility and frequent crises, citing “marginally creditworthy borrowers and volatility in risk assessments,” “herding and contagion,” “systemic risks and moral hazard,” and “financial innovations” (which promote speculation). WORLD BANK, supra note 5, at 134. Previous surges in capital flows “were punctuated by currency and financial instability in the capital receiving countries, and eventually ended in global political or economic crisis.” Id. at 119.
aid, the need to spend available funds judiciously and effectively is even more urgent.

5. Conclusion

The challenge is not to simply cut off the countries that are simultaneously receiving private capital and IBRD lending but rather to identify those countries that consistently receive private capital and those which receive it sporadically. Lending should then be shifted away from the former to low-income countries that create policies conducive to sustainable development. To the extent that low-income countries face a shortcoming in external finance for development projects from private sources, or support for poverty alleviation, the World Bank should be there to lend greater assistance. Given stagnant lending levels over the past ten years, interrupted only by crisis lending in 1998-1999, there is already ample reason to review World Bank programming.

This change in priorities for World Bank lending is a realistic and practical step in the context of international efforts to promote growth and reduce poverty. Ideally, it will be accompanied by a sober discussion on the availability and impact of private capital for the poorest developing countries and a serious commitment on the part of the international community to fulfilling its financial commitments to the developing world.

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105 The World Bank has stated there are grounds for thinking that the use of available funds may become more effective as greater percentages of existing assistance are provided to countries with good policies. WORLD BANK, supra note 5, at 61.
### Table 4: Top Ten Developing Country and Emerging Market Recipients of Net Private Capital Flows 1990-1999 (in millions of U.S.$)\textsuperscript{106}

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<tbody>
<tr>
<td>Mexico</td>
<td>8,293</td>
<td>8,107</td>
<td>8,023</td>
<td>12,150</td>
<td>21,299</td>
<td>39,550</td>
<td>21,253</td>
<td>21,214</td>
<td>16,214</td>
<td>14,392</td>
</tr>
<tr>
<td>China</td>
<td>8,107</td>
<td>8,023</td>
<td>8,293</td>
<td>12,150</td>
<td>21,299</td>
<td>39,550</td>
<td>21,253</td>
<td>21,214</td>
<td>16,214</td>
<td>14,392</td>
</tr>
<tr>
<td>Russia</td>
<td>5,552</td>
<td>4,399</td>
<td>4,159</td>
<td>3,607</td>
<td>12,874</td>
<td>19,987</td>
<td>15,937</td>
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<td>Brazil</td>
<td>5,552</td>
<td>4,399</td>
<td>4,159</td>
<td>3,607</td>
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<td>8,023</td>
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<td>15,937</td>
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<td>21,214</td>
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<td>19,987</td>
<td>15,937</td>
<td>15,937</td>
<td>15,937</td>
<td>15,937</td>
</tr>
</tbody>
</table>

\textsuperscript{106} World Bank, "Net Private Capital Flows," in World Development Indicators (World Bank CD-ROM, current through 1998); WORLD BANK, supra note 3, at 340-42.
### APPENDIX II

**Table 5: IBRD Lending to the Top Ten Recipients of Private Capital 1990-1999 (in millions of U.S.$)**

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<th></th>
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</thead>
<tbody>
<tr>
<td><strong>Mexico</strong></td>
<td>2,608</td>
<td>Mexico</td>
<td>1,882</td>
<td>China</td>
<td>1,578</td>
<td>China</td>
<td>2,155</td>
<td>China</td>
<td>2,145</td>
<td>China</td>
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<tr>
<td><strong>Russia</strong></td>
<td>0</td>
<td>Russia</td>
<td>0</td>
<td>Brazil</td>
<td>0</td>
<td>Brazil</td>
<td>1,154</td>
<td>Brazil</td>
<td>552</td>
<td>Brazil</td>
</tr>
<tr>
<td><strong>Indon.</strong></td>
<td>1,633</td>
<td>Indon.</td>
<td>0</td>
<td>Korea</td>
<td>0</td>
<td>Korea</td>
<td>1,590</td>
<td>Korea</td>
<td>2,322</td>
<td>India</td>
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<tr>
<td><strong>Chile</strong></td>
<td>354</td>
<td>Chile</td>
<td>1,708</td>
<td>Brazil</td>
<td>875</td>
<td>Brazil</td>
<td>1,618</td>
<td>Brazil</td>
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<tr>
<td><strong>India</strong></td>
<td>1,108</td>
<td>India</td>
<td>860</td>
<td>Argen.</td>
<td>1,538</td>
<td>Argen.</td>
<td>1,145</td>
<td>Argen.</td>
<td>2,642</td>
<td>Argen.</td>
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<tr>
<td><strong>Turkey</strong></td>
<td>326</td>
<td>Turkey</td>
<td>250</td>
<td>Argentina</td>
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<td>Argentina</td>
<td>312</td>
<td>Argentina</td>
<td>0</td>
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<tr>
<td><strong>Czech.</strong></td>
<td>111</td>
<td>Czech.</td>
<td>272</td>
<td>Thailand</td>
<td>30</td>
<td>Thailand</td>
<td>94</td>
<td>Thailand</td>
<td>284</td>
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<tr>
<td><strong>Peru</strong></td>
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<td>Peru</td>
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<td>Argentina</td>
<td>516</td>
<td>Argentina</td>
<td>1,235</td>
<td>Argentina</td>
<td>38</td>
<td>Argentina</td>
</tr>
<tr>
<td><strong>Colom.</strong></td>
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<td>Colom.</td>
<td>312</td>
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<td>Turkey</td>
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<td>Korea</td>
<td>5,000</td>
<td>Korea</td>
<td>528</td>
<td>Korea</td>
</tr>
</tbody>
</table>

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107 Based on figures taken from World Bank Annual Reports, 1990-1999.

https://scholarship.law.upenn.edu/jil/vol23/iss1/1
Table 6: Total IBRD Lending Per Year (in millions of U.S.$)\textsuperscript{108}

<table>
<thead>
<tr>
<th>Year</th>
<th>IBRD Lending</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>15,179</td>
</tr>
<tr>
<td>1991</td>
<td>16,392</td>
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<tr>
<td>1992</td>
<td>15,156</td>
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<tr>
<td>1993</td>
<td>16,945</td>
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<tr>
<td>1994</td>
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<td>1995</td>
<td>16,853</td>
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<tr>
<td>1998</td>
<td>21,086</td>
</tr>
<tr>
<td>1999</td>
<td>22,182</td>
</tr>
</tbody>
</table>

\textsuperscript{108} Id.