Foreword

NEVER BEFORE HAVE DEVELOPED and developing countries shared such a strong interest in ensuring the stable growth of international capital flows. Both South and North stand to benefit from the recovery now under way in the global economy, which coincides with a rebound in financial flows to developing countries. The key question for policymakers is how to channel these gains into investments that promote development and sustainable poverty reduction.

The external environment for developing countries improved in 2003 as global growth gained momentum and as private capital flows recovered from the subdued levels of the past five years. The recovery in private flows was encouraged by expansionary monetary policies in the advanced economies and structural improvements in the developing world. There are, however, important risks that need to be addressed. High-income countries need to adjust toward a more balanced pattern of economic growth and more sustainable financing of current account imbalances. The U.S. current account deficit is now more than 5 percent of gross domestic product, and its financing has important implications for the sustainability of the global economic recovery. The nature and timing of the necessary adjustments will depend on several factors, including how fast economic activity picks up in the rest of the world—particularly in the Euro area—and the success of policymakers in facilitating orderly adjustments in exchange rates. Should the resolution of imbalances in the advanced economies eventually require an abrupt adjustment in international financial markets, including a sharp increase in interest rates, the flow of capital to developing countries might be adversely affected.

Structural measures to promote stability should continue to be pursued, including lengthening the maturity and depth of markets for emerging-market bonds, enhanced transparency and adherence to standards and codes, and the inclusion of collective action clauses in international bond covenants. It will be important for governments in developing countries to maintain prudent macroeconomic policies and to persevere with reforms designed to consolidate the improvement in credit quality. Maintaining the confidence of investors and creditors, particularly in the face of political uncertainties linked to forthcoming elections in several countries, will be important, as will be avoiding an accumulation of excessive, especially short-term, debt. Pursuing these measures will reduce their vulnerability to adverse financial shocks.

To maximize the development impact of these cyclical gains, capital flows should be channeled into areas where they can lay the foundation for long-term economic growth, international competitiveness, and the expansion of trade. Increased investment in infrastructure stands out as an urgent need, with more than a billion people lacking access to safe drinking water, 2.4 billion without adequate sanitation, and 1.4 billion without access to power. Promoting new capital investment in infrastructure requires promoting balanced public-private partnerships, with appropriate risk distribution. International financial institutions can support this process by creating the conditions under which unmet needs can be converted into investment opportunities that are attractive to global capital markets.

Access to capital flows must be broadened. With the exception of trade finance, private capital flows remain heavily concentrated in a few countries and regions. In 2003, just ten countries accounted for 69 percent of foreign direct investment in the developing world, while only five accounted for 60 percent of total bond issuance.

Official development assistance is still an important source of external finance for many countries. But, as private capital flows have rebounded, official aid flows have risen only slightly and remain below the levels needed to achieve the Millennium Development Goals. To meet the goals, along with the expectations raised by the launching of the World Trade Organization (WTO) Doha

Development Round in 2001, donor countries must deliver on their pledges to increase aid and reduce debt owed by the poorest countries, and lower agricultural subsidies and trade barriers. The failure to reach agreement at the Cancún WTO talks in September 2003 makes finding additional sources of finance for these countries especially urgent within the context of broader efforts by the international community to shape coherent and mutually reinforcing aid and trade policies.

Global Development Finance is the World Bank's annual review of the external financial conditions facing developing countries. The current volume provides analysis and summary tables on selected macroeconomic indicators and financial flows. A separate volume contains detailed, standardized external debt statistics for 136 countries. More information on the analysis, including additional material, sources, background papers, and a platform for interactive dialogue on the key issues can be found at www.worldbank.org/prospects.

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