Foreword

GLOBAL DEVELOPMENT FINANCE IS THE World Bank's annual review of global financial conditions facing developing countries. The current volume provides analysis and a statistical appendix. A separate volume contains detailed, standardized external debt statistics for 138 countries.

The background to this year's report is a difficult one. The global economy has been struggling to recover from a recession in 2001. Even though macroeconomic policies in the major economies have been very supportive, the recovery that has been underway for almost 18 months remains disappointingly anemic. A key hindrance to global recovery has been the financial imbalances that built during the expansion of the 1990s, and there has been a wide incidence of debt difficulties across both developed and developing countries. On top of this already challenging environment, current geopolitical uncertainties add an overlay of uncertainty for both financial markets and policymakers.

Against this difficult backdrop, developing countries are struggling to adjust to a major shift in the pattern of external financing that has been underway since the middle of 1998. Since that time, the flow of private sector *debt* finance to developing countries has plunged. At the same time, however, the flow of private sector *equity* finance—primarily foreign direct investment (FDI)—has remained remarkably robust. Countries that have adjusted in order to live with less debt and that have opened themselves to the flow of FDI funding have been the relatively strong performers in recent years. In turn, this solid economic performance has translated into tangible benefits in the area of poverty alleviation.

Creating the right conditions to benefit, rather than suffer, from the shifts in private-sector financing for developing countries is primarily the responsibility of developing countries. This means building conditions that both promote domestic productivity and investment, and attract FDI. And it has become all the more important for governments to run prudent debt-management policies, especially in nascent local-currency debt markets.

However, the high-income countries also have an important role to play if the pattern of international development finance in coming years is to be more stable than the volatile, growth-inhibiting one of recent years. With private capital flows low, raising the flow of official development assistance—as agreed to at the Monterrey Conference in 2001—is of key importance to the poorest countries. Moreover, the rich countries need to foster an open, competitive world-trading system, especially in goods such as textiles and agricultural products, in which developing countries have an obvious comparative advantage. Not only would this give countries that are under pressure to pay down debt the opportunity to generate the necessary export revenue (through export growth, rather than by relying on import compression), but it would also help create conditions fostering the continuation of a steady and significant flow of FDI to developing countries.

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