LETTER FROM THE EDITOR

DEVELOPING countries have benefited from the opening up of financial markets around the world over the past several years. As cross-border capital flows surge, many developing countries are enjoying unprecedented access to portfolio and foreign direct investment as well as to the additional benefits that often accompany the latter, such as the transfer of advanced technologies and managerial expertise. And, with the debt crisis of the early 1980s behind them, many are also regaining access to voluntary bank lending.

But large capital inflows also carry certain risks for recipient countries. As demonstrated in the article by Nadeem Ul Haque, Donald Mathieson, and Sunil Sharma, among the most serious dangers are that capital inflows could fuel inflation and cause an unsustainable appreciation of the domestic currency. To design the types of policies that can protect countries against these potentially destabilizing effects, policymakers need to identify the forces driving the flows. Although this is easier said than done, the behavior of certain financial indicators may shed light on what is triggering capital inflows.

Another potential pitfall sometimes cited in connection with the liberalization of financial markets is that it may facilitate money laundering, which is undesirable not only because of its association with tax evasion and criminal activity but also because it distorts the economic data available to policymakers and therefore makes the conduct of monetary policy more difficult. But this does not warrant turning the clock back on financial reforms. As Peter Quirk points out in his article on money laundering, exchange controls are not the answer—in fact, they encourage the establishment of parallel markets. He demonstrates that anti-money laundering measures are compatible with financial liberalization and are needed urgently.

The liberalization of financial markets has not benefited all countries equally. A country's credit rating plays a critical role in determining whether it has access to private capital and at what cost. Nadeem Ul Haque, Donald Mathieson, and Nelson Mark explore the economic, political, and social variables that influence the credit ratings of three highly regarded rating agencies and suggest steps countries can take to rebuild their creditworthiness.

Claire Liuksila
Editor-in-Chief

Abbreviations used in this issue

ACDA	Arms Control and Disarmament Agency
BIS	Bank for International Settlements
BOO	Build-own-operate
BOT	Build-own-transfer
c.i.f.	Cost, insurance, and freight
CMEA	Council for Mutual Economic Assistance
EC	European Community
EIU	Economist Intelligence Unit
EU	European Union
FATA	Financial Action Task Force
FDI	Foreign direct investment
FSU	Former Soviet Union
GDP	Gross domestic product
GNP	Gross national product
IAS	International Audit Standards
IFC	International Finance Corporation
IISS	International Institute of Strategic Studies
IMF	International Monetary Fund
LIBOR	London interbank offer rate
OECD	Organization for Economic Cooperation and Development
SIPRI	Stockholm International Peace Research Institute
SSA	Social structures of accumulation
UFW	Unaccounted-for water
WDI	World Development Indicators
WEO	World Economic Outlook

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