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Report on the Meeting of the Expert Group on The World Economic Situation and Prospects (Project LINK)

Economic Assessment and Outlook Branch
Development Policy Analysis Division

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1. INTRODUCTION

The Spring 2001 meeting of the Expert Group on World Economic Situation and Prospects (Project LINK) was held at United Nations Headquarters, New York, from 9 to 11 April 2001. The Development Policy Analysis Division of the Department for Economic and Social Affairs (DESA) hosted the meeting. Over 60 participants from about 50 countries, as well as several representatives from international agencies and the United Nations Secretariat, attended the meeting. This report summarizes key issues discussed during the three days.

The agenda of the meeting covered three broad topics: (1) the global economic outlook, including the LINK global outlook as prepared by the Economic Assessment and Outlook Branch (EAOB) of the United Nations Secretariat, and the global outlook assessed by other international institutions; (2) the economic outlook for all regions of the global economy presented by LINK country participants and United Nations regional commissions; (3) other topics such as special issues in macroeconomic management, the terms of trade for developing countries, and exchange rate policy for developing countries and economies in transition.

The LINK *Global Economic Outlook*, with all the tabular supports, prepared by EAOB for the meeting, LINK *Country Reports* prepared by country participants, and other documents presented at the meeting are available on both the web sites of the United Nations (http://www.un.org/esa/analysis/link) and the Project LINK Research Centre at the Institute for Policy Analysis, University of Toronto (http://www.chass.utoronto.ca/link). The deliberations during the LINK meeting have since provided key elements of the background against which the United Nations Secretariat prepared part one of the *World Economic and Social Survey, 2001*.

Because of the rapidly growing apprehensions about the evolving sharp downturn in the world economy, the deliberations at the meeting attracted particular attention by the spoken and written press. A press conference was held on 10 April 2001 in which Nobel Laureate and Professor Lawrence Klein, Professor Peter Pauly, and Mr. Jozef M. van Brabant presented the summary of the LINK *Global Economic Outlook* and answered many questions. The event was well covered by many news agencies.

Mr. Ian Kinniburgh, Director of the Development Policy Analysis Division, delivered the opening statement on behalf of Mr. Nitin Desai, Under-Secretary-General for Economic and Social Affairs. First, he welcomed the participants to the meeting and expressed his appreciation to Nobel Laureate Professor Lawrence Klein, Professor Peter Pauly, and the other participants for the contributions they continue to make to the work of the United Nations. He then raised several questions about the current state of the world economy in the hope that the three-day meeting would provide thoughtful insights on these and related issues on which prospective work in the United Nations would necessarily have to focus. These included:

- What would be the major downside risks for the global economy, given the sharp slowdown in economic activity in the United States and economic stagnation in Japan?

- What would be the impact on developing countries and economies in transition, and what policies could these economies adopt in order to absorb the external shocks, such as declining exports and deteriorating external financing conditions?

- What would be the implication of the abrupt downturn led by the technology sector in major developed economies for the New Economy?

- Should we expect a rapid economic recovery and, if so, what would be its driving forces?

- What lessons could we derive from the seemingly greater volatility in global economic activity in recent years? More specifically, what would be the implications for the effectiveness of active monetary policy in many developed economies and for the choice of exchange rate regime in developing countries and economies in transition?

2. THE GLOBAL ECONOMIC OUTLOOK

Five international agencies presented their global economic outlook at the meeting: Mr. Jozef M. van Brabant on behalf of United Nations/Project LINK, Mr. Markus Haacker on behalf of the International Monetary Fund (IMF), Mr. Mick Riordan on behalf of the World Bank, Mr. Pete Richardson on behalf of the Organisation for Economic Co-operation and Development (OECD), and Mr. Ray Barrell on behalf of the National Institute of Economic and Social Research (NIESR). Three experts presented their outlook for international commodity markets: Mr. Matt Shane of the United States Department of Agriculture (USDA) discussed the outlook for agricultural commodities; Professor F. Gerard Adams of Northeastern University dealt with industrial raw materials; and Professor Robert Kaufmann of Boston University gave his perspective on oil markets.

While there were some small variations in the presentations on the global outlook, all agreed that a significant slowdown in the growth of gross world product (GWP) was taking place in early 2001. For example, while the LINK outlook predicted growth of 2.4 per cent for GWP, the World Bank expected a rate of 2.2 per cent. Most forecasts also expected a rebound in the pace of global economic activity in 2002. Many experts emphasized, however, that the global retrenchment that could be more prolonged and deeper than generally expected. Concerned about the current broadening and intensifying global economic downturn, most forecasters, as well as many other participants, called for more active economic policies to reverse the deteriorating trend promptly.

In their presentations, most global forecasters admitted that, although a moderation in global economic growth had been expected, the momentum of the downturn since the latter part of 2000 had been much stronger than they had earlier predicted. Their most recent forecasts marked therefore sharp downward revisions from the outlook depicted a half-year earlier, for example, at the fall LINK meeting in Oslo (October 2000). All forecasters agreed that an abrupt adjustment in United States manufacturing, particularly in sectors related to information and communication technology (ICT), had been the source of the current global setback.

In addressing the causes of the current global downturn, Mr. Van Brabant identified several major factors, though not all independent, that he believed were crucial. First, the tightening of monetary policy by central banks of major developed countries, especially the United States Federal Reserve (Fed), since late 1999 had directly triggered the plunge in technology stocks and induced the sharp decrease in the growth of ICT-related investment spending. The tightening policy was originally aimed at engineering a "soft landing." The outcome to date had proved, once again, that it is very difficult to bring about a "soft landing" for a real economy full of complex interrelations such as the rapid advance in technology, innovations in the financial sector, and increased global economic integration through trade and finance.

Second, he emphasized the negative effects of the precipitous sell-off in equity markets in many economies during 2000 and early 2001 on investment and consumption demand. He reminded the audience of the results of a downside scenario simulated by using the LINK modeling framework in the past for studying the effects of a collapse of stock markets in major economies. Though the current situation was eerily similar to what had earlier been simulated, the deceleration in investment spending was apparently even more pronounced.

Third, he mentioned that the ICT revolution, which had contributed to high growth of investment spending in many developed countries, as well as in some developing economies, might have entered into a consolidation stage. As a result of unsynchronized development in the ICT sector, where capacity building had gone far ahead of actual applications, and the failure of many new Internet-based businesses, profits in many ICT companies had declined or losses increased, leading to a sharp downward adjustment in capital spending and to writing off inventories. He warned that it remained to be seen how long the consolidation would last.

Fourth, the persistently high prices of oil during most of 2000 had been a drag on the global economy, creating greater uncertainty than prevailed in earlier years, as well as shifts in relative product and factor prices in oil-importing countries.

Finally, he also pointed out that, even if the above factors had not prevailed, the strong pace of economic expansion in many crisis-affected economies during 1999-2000, as they were recovering form the 1997-1998 international financial crisis, would not have been sustainable. Some moderation would therefore have come to the fore in any case. The economic downturn in the United States was just exacerbating this downward adjustment to a more sustainable pace of economic activity in these countries.

Other forecasters generally agreed with the causes of the downturn as assessed by Mr. Van Brabant. They supplemented the picture he had painted with a more detailed analysis of some of the causes underlying these factors. For example, Mr. Mick Riordan emphasized the correlation between consumer confidence and the Nasdaq stock index in the United States. He also recalled the ongoing global semiconductor cycle and the accumulation of inventory of ICT equipment during the current slowdown. Mr. Ray Barrell reported the results of a study, based on a forward-looking econometric model, of the effects of falling equity markets on economic activity. He emphasized that the decline in global stock markets had directly weakened consumer demand through wealth effects, raised equity risk premiums, and increased the user cost of capital, thus leading to depressed investment spending. He also commented on the contagion effects among the equity markets worldwide: the sell-off in equity, particularly in technology issues, occurred in almost all stock markets.

All global forecasters noted that, despite the general slowdown in almost every economy, the severity of the adjustment in the pace of economic activity varied markedly among countries and regions. In developed economies, besides a sharp deceleration in the pace of economic activity in the United States, these commentators expressed concern about the economic situation in Japan and the danger of the country's falling into recession. By contrast, they believed that the slowdown in many European economies would be relatively mild. Among developing economies, they expected the slowdown in several countries in Asia and Latin America to be more pronounced than elsewhere, because of the degree to which those economies are closely connected to the United States in particular. On the other hand, they all pointed out that China and India, the two largest developing countries, would weather the current global downturn and maintain solid growth for 2001. The slowdown for economies in transition was expected to be moderate.

Along with the outlook for a significantly slower pace of growth in global output, most global forecasters also depicted a gloomy prospect for world trade. There was broad consensus among these commentators that the growth of world trade, in terms of export volume, would be halved in 2001 as compared to the strong pace that prevailed in 2000, to about 5-6 per cent. While the sharp retrenchment in the import demand of the United States would be the direct cause, international trade of manufactured goods, especially ICT-related goods, would decelerate the most. As some of the forecasters pointed out, the growth of exports in several of the most dynamic Asian economies had already faltered from a rate above 20 per cent in early 2000 to almost zero in the beginning of 2001.

In discussions of the global forecasts, the meeting also analysed other aspects of the international economic environment in the current global slowdown, such as the prospects for international prices of commodities and the external financial conditions for developing countries and economies in transition. All forecasters noted the latest softening in the prices of many commodities, especially non-oil commodities. They also pointed out the strains built up in global capital markets, particularly the rise in risk premiums for international borrowings by developing countries and economies in transition.

In a panel discussion on commodity markets, Mr. Matt Shane, who focused on the prices of grains, believed that the latest recovery in the prices of grains from the three-year long decline since the 1997-1998 international financial crisis would continue, in spite of the current slowdown in the global economy. But he remarked that these prices were standing far below the levels prior to the Asian crisis. The buildup of global supplies and the expanding production potential in a number of countries, however, would keep agricultural prices under downward pressure in the next several years.

Professor F. Gerard Adams commented that prices of food commodities were much less affected by the world business cycle than by climatic and other crop-growing conditions in producer countries. He believed that the strength of the United States dollar relative to the currencies of the producing countries was an important consideration in determining incentives to produce, particularly for exporters of tropical products. A strong dollar tends to reduce dollar-denominated prices. Based on the current position of supply, demand, and inventory of particular crops, he predicted strengthening prices of maize, wheat, and rice in the near-term.

Professor Adams also presented his view on the prices of metals and industrial commodities. He stated that these prices were highly sensitive to manufacturing activity and had already begun to show the effect of the global economic slowdown. For example, demand contractions were already apparent for copper as a result of slowing production of automobiles, air conditioners, and electronic products, and the slowdown in construction. Despite slower demand, copper supply remained tight with low inventories, as production of refined copper in recent years had not kept up with growing global demand. Aluminium prices, on the other hand, were closely related to energy costs. As a result, they had remained near their recent highs, despite declining demand, particularly in the United States and Asia. He said that other industrial commodities would face some of the same prospects related to slowing global industrial activity. Prices for pulp, plywood, and rubber continued to find support in global markets.

In his forecast for world oil markets, Professor Robert Kaufmann predicted that, given little growth in oil demand due to the slowdown in the international economy combined with tight supply management by OPEC, oil prices would remain at the lower end of OPEC's target range of $22 to $28 per barrel for the rest of 2001. In his opinion, oil prices would be determined in the short run by changes in oil demand, Iraqi exports, and cohesion among OPEC members, other than Iraq, as well as some other main oil exporters. Iraq's varying compliance with United Nations sanctions, the erratic developments in Iraqi oil exports, and the uncertain future of the sanction regime foster huge uncertainty about Iraqi oil exports in 2001. This complicates the tasks of OPEC as it seeks to set and maintain quotas with a view to stabilizing prices within the above-cited target range. Also, following the reductions in OPEC production quotas in the first quarter of 2001, OPEC members now have more excess capacity, which raises the possibility of non-compliance with quotas.

Professor Kaufmann emphasized that, seen in a longer-term perspective, the exhaustion of non-OPEC capacity combined with the resumption of economic growth in the world would imply a growing need for new sources of oil. However, he also argued that most of the proven oil reserves were in OPEC countries, but the resources and knowledge to invest and develop these fields were in the hands of non-OPEC oil companies. One key question in raising oil output is, therefore, whether OPEC nations will be disposed to allowing foreign investment to enter their economies. If not, there would be considerable upward risk to oil prices over the medium- to long-term.

A key issue in the presentation and discussion of the global outlook was the timing and the path of the global recovery from the current economic slowdown. In their baseline forecasts, most global forecasters had a recovery beginning in the second half of 2001. But all also agreed that there was considerable downside risk, which made an alternative downside scenario with a deeper and more protracted global economic slowdown not at all implausible. They generally expected that the rapid easing in macroeconomic policies in major developed countries since the beginning of 2001 could provide substantial support for stabilizing the economy and boosting domestic demand later in the year. All noted that macroeconomic policies had become more accommodative as many developed economies had recently reduced interest rates. Some had also adopted or proposed tax cuts. But all forecasters underlined that there remained more room for further policy easing if the economic downturn were to worsen.

Mr. Van Brabant had early on drawn the attention of the participants to some unusual features of the current business cycle in the United States, which might hold the prospect for an early recovery from the growth slowdown, and avoid a recession. Whereas earlier recessions in the United States, at least since World War II, had been consistently preceded by a surge in inflation, largely owing to wage pressures as labour markets tightened during the upswing, the current downturn had not been led by inflation. Instead, it was set off by a combination of declining corporate profits, tightening credit conditions, and decreasing investment spending. He warned that firms might take aggressive action to restore profits by shedding labour and inventory, and by cutting capital spending rapidly, thereby triggering a chain reaction: equity markets would decline further, more firms would cut spending, and more workers would be laid off. In this "vicious circle," the original slowdown in manufacturing would spread to the consumer sector, sending the economy into recession.

All forecasters agreed that the biggest downside risk for the global outlook was a deeper and more prolonged slowdown in the United States. A specific risk for the world economy would be a sharp reversal of the large trade and current account deficits of the United States. As illustrated by a simulated scenario presented by Mr. Van Brabant, the impact of the reversal on the global economy would be considerable.

During the discussion, many participants also expressed concerns about the potential for a chain reaction, as well as about the possibility of a large depreciation of the United States dollar, which usually accompanies a reversal of external deficits. In any case, the large imbalances across nations and the possibility of a crisis for the United States dollar were feeding major uncertainties regarding global economic prospects.

3. REGIONAL ECONOMIC OUTLOOK

Several sessions were devoted to the outlook for the various regions of the global economy. In presenting his views on the outlook for the *United States*, Professor Klein (University of Pennsylvania) emphasized his belief that the Federal Open Market Committee of the United States Fed had engineered the slowdown in the United States. When the pace of economic expansion of the United States was perceived to exceed its potential rate in 1999, the Fed raised interest rates several times with the purpose of bringing about a soft landing, that is, a return to an equilibrium pace of expansion of perhaps 3.5 per cent. In his view, this attempt had failed and he questioned whether monetary policy makers were still in control. He stated that, if the current monetary easing alone could not effectively arrest and reverse the slowdown, a combination of monetary policy and fiscal policy would do so.

He predicted no recession for the United States economy, but the pace of growth would be very low in the first half of 2001. He also commented in detail on many other macroeconomic issues, including the outlook for inflation, unemployment, trade balances, corporate profits, consumption, and investment. Most of his views were in line with the LINK *Global Economic Outlook*.

Many participants raised questions or made comments on Professor Klein's presentation. Some participants questioned the willingness of the Fed to cut interest rates further. Some commented on alternative recovery paths: instead of the V-shaped recovery that most speakers seemed to expect, the path could be U-shaped, meaning a more protracted and deeper recession than the quick turnaround from a growth slowdown in the baseline forecasts, or even L-shaped, meaning a shift to a path with sustained slow growth in the medium-term.

Some commentators argued that, because the returns on long-term government bonds did not follow and the spreads of corporate bonds did not shrink much when the Fed cut interest rates, the effectiveness of the Fed's monetary easing for investment might not be as large as expected. Others commented that a review of the recent monetary policy cycle in the United

States had shown the complexity of taking into account asset prices in determining the monetary policy stance. When the Fed raised interest rates in late 1999 and early 2000, policy makers were apparently aiming at lowering asset prices rather than controlling price inflation for conventional goods and services.

Professor Kanemi Ban (Osaka University, Japan) presented the outlook for the *Japanese economy*. He predicted that real GDP growth in Japan would slow down from 1.7 per cent in 2000 to 0.9 per cent in 2001, slightly higher than in the LINK *Global Economic Outlook*. He addressed several factors that, in his view, were dragging down the feasible pace of economic expansion in Japan: falling export demand, depressed domestic consumption and investment, declining asset prices over the last few quarters, and reduced public consumption and investment as fiscal balances need to be brought under control. He also explained the latest monetary policy changes in Japan to fight deflation. He mentioned that the current slowdown had highlighted the burden of bad loans, while the Government seemed hesitant to implement the painful measures necessary to tackle this problem, thus prolonging the situation.

Responding to a question of whether inflation-targeting would be helpful for Japan, Professor Ban pointed out that the Bank of Japan, given the state of deflation in the economy, could do little more than it had recently been enacting to stimulate growth and to reverse price deflation. As to the prospect of using fiscal measures to lift the Japanese economy out of its liquidity trap, the high public debt, in his view, rendered fiscal policy largely impotent.

André Dramais (European Commission) presented a summary of the economic outlook for *Western Europe*. He described the good economic performance in Europe in 2000, with GDP in the region growing by 3.4 per cent, the best in a decade. He expected growth to slow in 2001 to 2.75 per cent versus the 3.1 per cent that had been forecast last fall. Given the assumption that the slowdown in the United States would be V-shaped, he believed the impact on European economies would be limited: intra-trade in the euro zone would remain high, while trade to the United States represented only 2 per cent of GDP. His outlook for 2001 was predicated on strong domestic demand. While the rise in oil prices had meant a one-off cut in the purchasing power of consumers, consumption expenditure was supported by income growth due to higher employment, tax reforms, and labour-market adjustments. Real wage growth was moderate so far, and there would still be room for more increases due to the continued growth in productivity. Employment growth had accelerated to 1.7 per cent in 2000, and was expected to average 1.2 per cent in 2001 and 2002.

He attributed the strong employment growth in the region to three factors. First, labour-market reforms had been successfully introduced and would continue to yield positive results in the near-term. Second, the structure of economic activity was shifting more and more towards services. Third, there were signs of labour shortages in some parts of the European Union, so firms were less likely to shed labour. The unemployment rate had dropped from 10.6 per cent in 1997 to 8.3 per cent in 2000. Despite the steady decline in unemployment, wage pressure had not yet become a problem. He believed that either the non-accelerating-inflation rate of unemployment (NAIRU) had declined or there was a measurement problem, or perhaps a problem with the NAIRU itself. Inflation was in the 0-2 per cent range for many countries, so inflation worries were minimal and core inflation was within the bounds.

He also reviewed the situation of public finance in 2000. The aggregate budget for the European Union had a surplus of 1.2 per cent of GDP. Overall, the objectives of the Stability and

Growth Pact had been achieved. In the euro area, there had been major improvements in small countries, but France, Germany, and Italy still had significant deficits.

Mr. Dramais concluded his presentation with a few comments on the potential problems associated with the introduction of euro notes and coins on 1 January 2002. He foresaw some effects on private consumption because people would be apprehensive about utilizing the new currency, but this would depress consumption only in the very short run. Another possibility would be a rise in inflation from converting national-currency prices with upward rounding. Finally, there could be an impact on the money supply: households might be encouraged to use credit cards, thus diminishing the demand for cash balances.

During the discussion, participants from countries within the region summarized their country-specific outlooks, and other participants raised questions and comments. Asked for more evidence for the change in productivity growth in Europe, Mr. Dramais replied that European data were substantially delayed, but there were some signs of a positive effect on productivity that could already be extracted from the data. In another comment, he suggested that the current economic slowdown in the United States would have different impacts on the various European Union members, if only because of these economies' trade dependence on and financial engagement with the United States vary considerably.

Professor Franjo Štiblar (University of Ljubljana, Slovenia) presented an overview of economic developments in *Central and Eastern Europe (CEE) and the Baltic states* in 2000 and early 2001. While all countries of the region registered positive growth in 2000, Professor Štiblar stressed that growth had primarily been export-led and had been highly dependent on import demand from the European Union. Growth in 2000 had also been accompanied by high inflation, mostly due to the increase in international oil prices. He also underlined that the transition towards functioning market economies in the region had not yet been completed, not even in the State of the region most advanced with its structural transformation and catch-up modernization. Continuing with the transition was facing a number of economic, political, and social obstacles.

He then briefly summarized developments in a number of individual countries, stressing the strong industrial performance of Hungary and the marked slowdown in domestic demand in Poland towards the end of 2000, and presented the main macroeconomic indicators of the region, as well as the state of affairs with the negotiations for accession to the European Union.

Among the main weaknesses of the region, he mentioned the lack of consensus in macroeconomic policies and difficulties in attaining fiscal consolidation. The outlook for these economies in 2001 was also clouded because of their strong dependence on economic performances in the European Union, which might be markedly less buoyant in 2001-2002 than in 2000. The ongoing slowdown of the United States economy, in his opinion, should not exert a direct impact on the CEE and the Baltic States since the share of overall trade of these countries conducted with the United States is very small.

Mr. Evgeniy Gavrilenkov (Higher School of Economics, Moscow) presented a summary of the economy of the Russian Federation. In his opinion, three factors had contributed to the strong economic performance of the Russian economy in 2000: the earlier devaluation of the rouble; increased subsidization of the economy by the energy sector; and adjustment between household and corporate incomes (reduction in wages and increased corporate profits), which stimulated rapid growth of investment. He posed some questions that he believed to be crucial for the country's future economic performance. He was particularly concerned about capital flight. If it continued, it would be hard to sustain the current pace of economic growth in the Russian Federation. He therefore considered what the authorities could do to encourage management to keep and utilize a larger proportion of corporate profits in the Russian Federation.

During the discussion, some commentators argued that, even if the share of trade with the United States in total trade is small, the economic slowdown in the United States might still affect the economies in transition because there are other channels of transmission, such as financial markets. Questions were raised, such as whether there was any indication for the Russian Federation that some of the "unofficial economy" became official in 2000 and, if so, how it would have affected measured GDP growth in 2000 and 2001. Mr. Gavrilenkov responded that there was no indication at all of a decreasing share of the "shadow economy," but that unofficially it was held that the share might have decreased from 25 per cent of GDP to 23.5 per cent in 2000. During the session, country participants from the region also summarized the country-specific situations, as documented in *LINK Country Reports*.

Mr. Are Forbord (UN/DESA) presented a summary of the economic outlook for *Africa*. He drew attention to three factors that had primarily driven economic performance of many African countries in 2000: weather conditions, international prices of commodities, and political stability within a country or a sub-region. Africa's GDP grew by 3 percent in 2000, only slightly higher than the rate of population growth in the continent. However, he expected some improvement in 2001. Oil-exporting countries in the region will continue to benefit from high prices of oil and agricultural production in several economies that experienced drought or floods in 2000 was expected to rebound. As a result, he expected GDP to grow by 4.3 per cent in 2001. He also reviewed macroeconomic policy stances and external financing conditions for the region. In concluding, he mentioned several downside risks for Africa, such as low-level tensions in many countries or sub-regions with spillover effects on neighbouring countries, the possibility of larger than expected decline in commodity prices due to weaker global demand, and adverse weather conditions.

Professor Sam Olofin (University of Ibadan, Nigeria) made some general comments on African developments and presented a summary of the Nigerian economy. For Nigeria, although the higher oil prices and increased oil production allowed for higher investment in the hydrocarbon sector and higher public spending, including for consumption purposes, loose fiscal policy had led to higher inflation. Nigeria's pace of economic growth was dampened by stagnation in the non-oil sectors of the economy and an acute shortage of refined petroleum products.

Professor Jan van Heerden (University of Pretoria, South Africa) presented the outlook for South Africa. He attributed the stronger than anticipated recovery in 2000 to the stabilization and recovery of the emerging market economies in general, and the strong economic performance of many developed economies, which bolstered exports and investment. He expected the economy to grow above 3 per cent in 2001-2002. He also addressed structural changes in the South African economy, due to the greater degree of international openness and the continuing decline in the exchange rate. In his opinion, a significant constraint on the South African economy in the near-term would be unit labour costs, which are expected to increase by 7 per cent over the forecasting period, while there will be insufficient gains in labour productivity to warrant these raises.

Ms. Ofelia Templo (National Economic and Development Authority, the Philippines) and Mr. David Choi (UN/DESA) presented in a joint panel an overview of the economies of East and South Asia. The south-east Asian economies achieved higher GDP growth in 2000. Especially the countries most affected by the 1997-1998 crises (Indonesia, Malaysia, Philippines and Thailand) turned in their best performance since the crisis began in mid-1997.

Ms. Templo noted that the structure of growth in the region had become more balanced. While net exports initially led the recovery in the crisis-affected countries, domestic demand increasingly became an important source of growth in 2000. On the supply side, manufacturing led the initial recovery for such countries as the Republic of Korea, Malaysia and Thailand, but, as recovery advanced, services became an important source of growth. These countries also experienced further recovery of incomes lost during the crisis years.

She also addressed some weaknesses in the region. For example, there was an erosion of equity values in 2000, dragged down by concerns over domestic developments as well as global trends. Many countries in the region, such as Indonesia, the Philippines and Thailand, faced heightened political crises in 2000. In addition, fragile fiscal balances and the perceived slow pace of the bank and corporate restructuring were prominent in countries hit by the crisis.

Both speakers expected a notable moderation in the region's GDP growth, slowing to 4.0 per cent in 2001 compared to 7.0 per cent in 2000, primarily due to the economic stagnation in Japan and the sharp economic slowdown in the United States. The Republic of Korea and Malaysia would likely see the biggest drop in their feasible pace of growth, mainly because of their high dependence on the United States market, notably for ICT-related equipment. They expected that growth might accelerate in 2002, depending on the performance of the United States economy. They stressed that the spillover effects of the slowdown of the United States economy on the region should not be underestimated. Lower interest rates in the United States would provide scope for a more accommodating monetary policy in the region. Interest rates had already been lowered in the Republic of Korea, the Philippines and Thailand.

Other participants from the region also summarized their outlook for specific countries, as documented in *LINK Country Reports*.

Several questions and comments emerged during the discussion. One question concerned the impact of China's entry into the World Trade Organization (WTO) and whether this possibility had been factored into the outlook. In response, Mr. Wang Tongsan (Chinese Academy of Social Sciences, China) stated that he did not think it would have a serious influence on China's economy within the next three years. In the longer run, he noted, the effect would become larger. He emphasized that the impact would differ across regions and sectors: the coastal area would benefit more, while the middle and western regions of China would face difficulties; light industries would be able to export more, while the agriculture and telecommunication sectors would suffer some losses.

In addressing the question of how best to gauge the relative importance of external factors and domestic demand for the slowdown in the Asian region as a whole, Ms. Templo said that it was very difficult because of other complications, particularly political events, and the limited room for fiscal policy as a result of the recent financial crisis.

Asked about the possibility of a devaluation of China's renminbi, Mr. Wang responded that this possibility is almost nil at the moment because of large foreign reserves, persistent trade surpluses, and stable domestic inflation in China.

Messrs. Alfredo Calcagno (UN/ECLAC) and Santiago Guerreiro (UN/DESA) presented a summary of the economies of *Latin America and the Caribbean*. They stated that many countries in the region registered good performances in 2000, partly owing to favourable external conditions in the first half of the year. While countries in the north continued the strong performance of previous years, benefiting from strong import demand from the United States, others, including most of South America, experienced economic recovery from stagnation or recession following the 1997-1998 international financial crises. Especially Brazil, the largest economy of the region, registered a robust pace of growth. Argentina was an exception; its external sector continued to hamper a recovery as a result of growing external debt service, profit repatriation, and overvaluation of the currency. Also the fiscal adjustment measures adopted in 2000 had further depressed domestic demand in the country.

They also pointed out, however, that the region continued to face persistent external vulnerabilities, including worsening conditions of access to international capital markets since the latter part of 2000. The two speakers expected the outlook for the region to depend on the impact of the economic slowdown in the United States as GDP growth was anticipated to moderate. The most notable weakness was likely to stem from the sharp slowdown in the region's exports. They warned that large current account imbalances in some countries would continue to be of concern as external financing conditions remain tight.

Mr. Calcagno emphasized the role of the banking sector in the present economic conjuncture in Latin America. He reviewed the shift in bank lending, from a strong expansion in the early 1990s to increased volumes of non-performing loans and bank crises in the second half of the 1990s. Currently, the private sector was facing restrained credit availability, which in turn was hampering economic expansion.

During the discussion, participants from the region briefed the audience on their country-specific outlook. Mr. Eustaquio Reis (IPEA, Brazil) highlighted the credit boom in Brazil in 2000 in the context of a reduction of the reserve requirements of banks and easing of monetary policy. He also commented that the situation in Argentina had brought about a great deal of uncertainty. Especially the recent unilateral change in tariffs by Argentina posed a challenge to the future of Mercosur.

Asked to elaborate on the problems currently facing Mercosur, Mr. Reis pointed out that the trading bloc was affected by deep macroeconomic imbalances among its main partners and a lack of macroeconomic policy coordination. When the trading bloc was established in the early 1990s, Argentina had a stabilized economy, but Brazil's economy was in hyperinflation until 1994, when the *Plano Real* was launched. Argentina gained some competitiveness when the latter's implementation led to an overvaluation of Brazil's real. In the late 1990s, however, when Brazil devalued, abandoning part of the *Plano Real*, Argentina's peso became strongly overvalued. One of the consequences was the protracted recession in the country. Mr. Reis pointed out that Brazil would not provide a stable anchor for macroeconomic policies in Mercosur due to weak or non-existent credibility.

Mr. Alfredo Coutiño (CIEMEX-WEFA) confirmed that Mexico's fiscal deficit in 2000 had been around 4 per cent of GDP, much higher than estimated earlier. He also stressed the dependence of the Mexican economy on exports to the United States, which accounted for 85 per cent of Mexico's total exports. Luis Garcia (Universidad Javeriana, Colombia) pointed out that unemployment in Colombia remained at the highest level in history. He commented that economic policy during the last decade was chiefly oriented towards the reduction of the inflation rate through the application of restrictive monetary policy, leading to an overvaluation of the currency, which in turn depressed domestic economic activity.

4. OTHER ECONOMIC ISSUES

Three sessions on special topics were held. The first was organized around a paper presented by Mr. George Zanias (KEPE, Greece) on the "Terms of trade and developing countries." The study, which was based on an econometric analysis of commodity prices and the net barter terms of trade of developing countries for the period 1900-1995, confirmed that commodity prices and the net barter terms of trade declined continuously during the twentieth century. The findings in this study differ from others, however, by the observation (confirmed by the appropriate econometric tests) that the decline in the net barter terms of trade occurred because of two sharp structural breaks in the series rather than on account of a secular negative trend (for all but one commodity group). The structural breaks occurred in 1920 and 1984 for the aggregate commodity price series and for the prices of food commodities. For metals, only the 1920 structural break could be observed (without a negative trend decline). Agricultural raw materials, however, suffered from the two structural breaks in addition to a trend decline.

The explanation for the structural breaks was that overinvestment occurred in the booming commodity sectors, most likely in the absence of adequate investment alternatives in other sectors of the economy. Outward shifts in the supply curve, with an unchanged demand structure, caused the structural shifts in the evolution of prices and terms of trade that were observed and confirmed by the statistical tests. The role of synthetics as substitutes for higher-cost primary commodities and the displacement of high-cost producers through technological innovations during periods that roughly coincided with the structural breaks were additional reasons for the structural shifts. The absence of the 1984 structural break for metals was explained by "market controls" exercised by large transnational producers who can directly influence prices. Other findings of the study indicated significant increases in the income terms of trade and purchasing power of exports after 1980. This was attributed to the growing share of exports of manufactured goods, which benefited only a few developing countries.

During the discussions, a question was raised regarding the validity and appropriateness of some of the econometric methods used in the study. It was pointed out that the appropriate statistical tests required large critical values to confirm the existence of structural breaks. Others questions were raised about the validity of the econometric methods (Phillips-Peron tests) that were used in the study to test for structural breaks. There was also a discussion of the proper interpretation of the results, especially the need to provide economic explanations for the econometric estimates.

Mr. John Williamson (Institute for International Economics, Washington, DC) was invited to speak on "Exchange rate policy: the post-conventional wisdom." He stated that the first element of BBC (basket, band, and crawl) principles implied that countries with diversified trade would do better if they pegged their national currency to a basket of currencies rather than to a single currency. He argued that there would be advantages for East Asian currencies to peg to a common basket of the three major world currencies (United States dollar, euro and yen) to define their parities and the bands defining their intervention policies. Use of a currency basket in lieu of a peg to a single currency, chiefly the United States dollar, would tend to stabilize the effective exchange rates of these countries, even in the presence of capricious variations as a result of movements in third currency exchange rates, notably the gyrations between the yen and the United States dollar.

He claimed that the economies involved in the 1997-1998 Asian crisis would have lost little in terms of stabilizing their effective exchanges rates by using a common basket rather than adopting different baskets based on their individual trade patterns. The common peg would offer the important benefit of ensuring that their reciprocal exchange rates would not become destabilized by shocks to the exchange rates among the United States dollar, euro, and yen. This would avoid the possibility of inadvertent competitive devaluation, or the suspicion of deliberate competitive devaluation, as a result of different pegging policies.

He saw no reason why individual economies could not continue to pursue different exchange rate policies if circumstances warranted it. But the adoption of a basket peg should not be generalized. Chile and Israel, for example, had both chosen to peg to a basket, while Colombia pegged to the dollar. This, in his opinion, would be perfectly rational given the differences in their pattern of trade: trade of Colombia is overwhelming with the United States, and the trade of other countries, such as Chile and Israel, was far more diversified. In his opinion, the United States dollar seemed to be a natural peg for all those Latin American countries that border the Caribbean, and even for countries farther south. He said that one could question the wisdom of dollarization in Ecuador, and regarded Argentine's intention to adhere permanently to its present currency board based on the United States dollar as unsound.

The second element of the BBC formula was a wide band. One purpose of this was to make sure that the authorities did not get into the no-win situation of trying to defend a disequilibrium exchange rate, given that no one knows how to estimate equilibrium exchange rates with any precision. A second purpose was to permit the parity to be adjusted, keeping it in line with fundamentals, without provoking expectations of discrete exchange rate changes that might destabilize the markets. A third purpose was to give some scope for an independent monetary policy, to be used for anticyclical purposes when a country finds its economic cycle is not synchronized with the rest of the world. A fourth purpose was to help a country cope with strong but temporary capital inflows.

The final element of the BBC formula was the crawl. This was most often used with a view to neutralizing differences in inflation across nations. It could also be used to compress inflation over time, as had been done by Israel, although this could risk undermining competitiveness if pursued too dogmatically, as happened in the Russian Federation. A crawl could also be adjusted in a rapidly modernizing economy in order to facilitate adjustment to the real appreciation that such an economy requires over time to maintain equilibrium. Finally, the rate of crawl could be changed, or occasional small parity adjustments can be superimposed on the regular crawl, in order to facilitate the needed real adjustment.

During the discussion, a question was raised regarding the optimal exchange rate policy for East Asia, where countries were competing with each other in global export markets. The speaker felt that this area (excluding Japan) should have a tight exchange rate peg among the region's economies. A second question was raised about the speaker's view on open capital account. Questions were also raised regarding the prospects for exchange rate developments in different regions, including the strength of the United States dollar, real appreciation of currencies in Eastern European countries and their entry into the Exchange Rate Mechanism (ERM) in preparation for joining the monetary union, and the common currency area for Central America. After presenting his views on these issues, the speaker, by way of conclusion, argued that a floating exchange rate regime would not prevent a country from a currency crisis.

Mr. Ray Barrell presented a paper entitled, "Macroeconomic management in the European Union," in which he discussed various aspects of the new macroeconomic policy framework in the European Union and the institutions empowered to carry it out, and linked this to the various dimensions of economic convergence. He stressed that the concept of macroeconomic management also included maximizing full employment output.

The growth rate in the EU had recently approached that of United States, but it was not clear whether this represented convergence. Mr. Barrell looked at three different measures of convergence. First, GDP per capita at purchasing power parities (PPPs) had stopped converging with that of the United States, but this was perfectly compatible with the notion of conditional convergence from growth theory. Second, GDP per employed person showed more convergence, but it had either slowed or stopped in recent years. Finally, GDP per working hour showed that by the late 1990s convergence had taken place. To understand the relation between the three measures, he suggested that one could decompose GDP per capita into the participation rate multiplied by the employment rate, multiplied by output per employee hour, and multiplied by the evolution of hours. Labour force participation was much lower in the European Union than in the United States, meaning that output in the latter exceeds the former's on account of longer working hours, which were either enforced or allowed, while in the European Union they were not allowed.

He also looked at the issue from an historical perspective, and believed that the period 1950-1973 was characterized by rapid convergence within the present European Union and vis-à-vis the United States. He noted that, in the subsequent period until the present, the convergence was far less monotonic. Divergence had decreased for a while but rose again in the 1990s. He thought this could be the result of increasing specialization across regions. It could also stem from macroeconomic problems. The question of whether the single market programme implied convergence or divergence had not yet been resolved.

The speaker then discussed the building of new institutions, and questioned whether they had slowed convergence. The very strong drive for Economic and Monetary Union (EMU) in Europe had important macroeconomic effects. There were two groups of issues: monetary and fiscal. He first reviewed ERM, which started in 1978. Behind the adoption of this system was the desire for a common inflation rate and common economic policy. There was also a political rationale, namely the aspiration of fostering a more integrated European Union. He also reviewed fiscal targets that were part of the Maastricht agreement, now supplemented with the

Stability and Growth Pact, which constrains fiscal policy through the threat of fines. It includes targets for balance over the medium run and surpluses in boom years.

In reviewing monetary policy, the speaker described the two pillar monetary policy strategy of the European Central Bank (ECB): a target range for inflation from zero to 2 per cent in the medium-term and a reference growth rate for money of 4.5 per cent in the long-term. The speaker noted that, generally speaking, an observed inflation rate of 1 per cent was consistent with price stability in a modern economy, when quality changes are taken into account. But for the catching-up countries, inflation of greater than 1 per cent was possible due to the Balassa-Samuelson effect, and this could add up to 0.5 per cent to the European Union target, so that the resulting central target was 1.5 per cent.

The speaker then discussed the credibility of the new institutions. For monetary policy, it was possible to look at French index-linked bonds to assess the rate of inflation expected by the market. This was currently estimated to be 1.5 per cent, so monetary policy was credible. However the fiscal side of policy credibility was far less solid.

The speaker noted that there were a number of different institutions that have responsibility for surveillance and coordination of the macroeconomic policy mix, and focused on the roles of the Council of Ministers of the European Union and the European Commission. The Council is the community's legislative body and, among other things, has responsibility for the exchange rate. This would clearly be an area where the Council of Ministers and the ECB needed to coordinate. Recently the ECB had undertaken a currency market intervention in coordination with other central banks, and the Council of Ministers endorsed these decisions. While the remit of the ECB is price stability, it could rightly be concerned about exchange rate movements that compromise price stability. The Commission was the executive body of the European Union and had the right of initiative but not of approval. Both the Commission and the Council are involved in the formulation of the broad economic policy guidelines that play a key role in both macroeconomic and structural policy making.

Mr. Barrell stated that, since membership in the EU placed constraints on both fiscal and monetary policy, structural policies had become an important element of individual policy, in particular labour market reforms. Labour market policies were coordinated at the community level through the four pillars under the National Action Plans: improving employability, developing entrepreneurship, encouraging adaptability of businesses and employees, and strengthening equal opportunities for men and women.

He summed up his presentation by noting that the institutions needed more reform. The ECB needed to be clearer on strategy and fiscal policy needed further reform. Fiscal policy would probably be too tight in the next few years due to the Stability and Growth Pact. He had found that a 1 per cent deficit target would allow sufficient room for automatic stabilizers to work, but that zero per cent would be too strict. The current discussion concerned allowing government investment to be financed by borrowing. The golden rule stated that governments could only borrow to finance public investment. Public investment was important because it affected long-term growth potential. Finally, labour-market reforms needed go further, but not necessarily in the direction of the OECD recommendations.

Annex 1

Agenda

Monday, 9 April

10:00 **Opening Address**

Ian Kinniburgh
Department of Economic and Social Affairs, United Nations

10:30-1:00 **Global Outlook**
Chair : Lawrence Klein

United Nations Project LINK
Jozef van Brabant, United Nations, New York

The International Monetary Fund
Markus Haacker, IMF, Washington

The World Bank
Mick Riordan, The World Bank, Washington

The OECD
Pete Richardson, OECD, Paris

The National Institute of Economic and Social Research
Ray Barrell , NIESR, London

2:30-4:30 **Global Outlook (cont.)**
Chair : Bert Hickman

4:30-5:30 **Review of Commodity Markets**
Chair : Bert Hickman

Agricultural commodities
Matt Shane, USDA, Washington
Industrial raw materials
F. Gerard Adams
Oil
Robert Kaufmann, Boston University, Boston

General Discussion

Tuesday, 10 April

10:00-12:00 **Regional Economic Outlook : North America and Japan**
Chair : Stephen Hall

The U.S. Outlook
Lawrence R. Klein, University of Pennsylvania, Philadelphia

The Outlook for the Japanese Economy
Kanemi Ban, Osaka University, Osaka

General Discussion
LINK National Representatives

12:00-1:00 **Regional Outlook : Transition Economies and Africa**
Chair : Stephen Hall

Russia : Summary
Evgeny Gavrilenkov, Higher School of Economics, Moscow

Africa : Summary
Are Forbord, United Nations, New York
Sam Olofin, University of Ibadan, Nigeria

General Discussion
LINK National Representatives

2:30-4:30 **Regional Economic Outlook : Europe**
Chair : Delia Nilles

Europe : Summary
Andre Dramais, Commission of the EU, Brussels

Macroeconomic Management in the EU
Ray Barrell, NIESR, London

General Discussion
LINK National Representatives

4:30-5:30 **Developing Countries Outlook**
Chair : Delia Nilles

Terms of Trade and Developing Countries
George Zanias, KEPE, Athens

General Discussion
LINK National Representatives

<u>Wednesday, 11 April</u>

10:00-11:30 **Regional Outlook : Latin America**
Chair : Hans Timmer

Latin America : Summary
Alfredo Calcagno , ECLAC, Santiago
Santiago Guerreiro, United Nations, New York

General Discussion
LINK National Representatives

11:30-1:00 **Exchange Rate Policy**
Chair : Hans Timmer

Exchange Rate Policy : The Cost of Conventional Wisdom
John Williamson, IIE, Washington

General Discussion

2:30;4:00 **Regional Outlook : Asia**
Chair : Peter Pauly

Panel Discussion on Asian Economies
David Choi, United Nations, New York
Ofelia Templo, NEDA, Manila
Wang Tongsan, Academy of Social Sciences, Beijing

General Discussion

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Annex 3

LIST OF FORECAST PAPERS

Sl. No.	COUNTRY	AUTHOR
1	AUSTRIA	Andrea Weber
2	BANGLADESH	Salahuddin Ahmad
3	BELGIUM	Simon Erlich
4	BRAZIL	E.J. Reis
5	CHINA	Tao Liping
6	CROATIA	Andrea Mervar
7	DENMARK	Henrik Olesen
8	GERMANY	Gyorgy Barabas
9	GREECE	S. Balfoussias
10	HONG KONG	Chou Win Lin
11	INDIA	V.N. Pandit
12	IRELAND	Terry Quinn
13	ITALY	L. Vincenzi
14	JAPAN	Kanemi Ban
15	MEXICO	Alfredo Coutino
16	NIGERIA	Sam Olofin
17	NORWAY	Robin Choudury
18	OXFORD	Erik Britton
19	PAKISTAN	A.H. Khan
20	PHILIPPINES	Jon Principe
21	POLAND	W. Welfe
22	ROMANIA	C. Ciupagea
23	SINGAPORE	Toh Mun Heng
24	SLOVAK	Michal Olexa
25	SPAIN	Julian Perez
26	SWITZERLAND	
27	TAIWAN	Lin Henry
28	TOGO	Kodjo Evlo
29	TURKEY	S. Ozmucur
30	VENEZUELA	Jose Barcia
31	VIETNAM	Tran Kim Chung

Annex 4

LIST OF COUNTRY REPORTS

Sl. No.	COUNTRY	AUTHOR
1	AUSTRALIA	Peter Brain
2	AUSTRIA	Andrea Weber
3	BELGIUM	Simon Erlich
4	BULGARIA	G. Minassian
5	CHINA	Y Z Liping Tao
6	COLOMBIA	
7	COSTA RICA	Juan Vargas
8	CROATIA	Andrea Mervar
9	DENMARK	Henrik C. Olesen
10	GERMANY	Elke Schäfer-Jäckel
11	GREECE	Stella Balfoussias
12	HUNGARY	Andras Simon
13	INDIA	V.N. Pandit
14	IRELAND	Terry Quinn
15	ITALY	Lorena Vincenzi
16	JAPAN	Kanemi Ban
17	MALAYSIA	Muthi Samudram
18	MEXICO	Alfredo Coutiño
19	NIGERIA	S.Olofin
20	NORWAY	R. Choudhury and M. Rolland
21	PAKISTAN	Ashfaque Khan
22	POLAN	Wadysaw Welfe
23	ROMANIA	C. Ciupagea
24	RUSSIA	E. Gavrilenkov
25	SLOVAK REPUBLIC	M. Olexa and J. Haluska
26	SLOVENIA	F. Stilbar and J. Mencinger
27	SOUTH AFRICA	Jan van Heerde
28	SPAIN	M. Luna, R. Mahia and J. Perez
29	SWEDEN	Patrik Eriksson
30	SWITZERLAND	Delia Nilles
31	TAIWAN	Jin-Lung Henry Lin
32	TOGO	Kodjo Evlo
33	UNITED KINGDOM	Erik Britton

Annex 5

List of other papers presented

Document:

Latin America Outlook provided by ECLCA

NISER World Economic Outlook presented by Ray Barrell (Slideshow)

Results from the Current Quarter Model of the U.S. Economy by Lawrence R. Klein

World Oil Market Forecast by Robert K. Kaufmann (Slideshow)

USDA Agricultural Baseline Projection presented by Mathew Shane (Slideshow)

Commodity Prices: Current Perspective presented by F. Gerard Adams (Charts)

"Exchange Rate Policy: The Cost of Conventional Widsom" by John Williamson

"Macroeconomic Management in the EU" presented by Ray Barrell

Background Materials:

Articles:

Contributions of Input-Output Analysis to the Understanding of Technological Changes: The Information Sector in the United States" by Lawrence R Klein, Vijaya Duggal and Cynthia Saltzman

International Macroeconomic Situation:

Key Indicators for Three Major Economic Bodies

Recent GDP Figures for Some Asian Countries

International Trade Situation :

Short-term Development of International Trade for Selected Major Traders

Mid-term Development of International Trade

Oil Market Situation and Energy Information

Non-Energy Commodities Price Information