DEPARTMENT OF ECONOMIC AND SOCIAL AFFAIRS

AND

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

WORLD ECONOMIC SITUATION AND PROSPECTS 2000

UNITED NATIONS • NEW YORK 2000

As part of the Secretary-General's programme for reform which included proposals to improve the coherence of the work of the United Nations, it was decided that the Department of Economic and Social Affairs (DESA) and United Nations Conference on Trade and Development (UNCTAD) should produce a joint report on the world economic situation and prospects that would examine the performance of the world's economies and developments in the international economy.

This is the second joint report. By providing an overview of current macroeconomic developments and issues, it is intended to serve as a common point of reference for related work on such matters by the different United Nations entities in the economic and social area.

The present report is being issued without formal editing.

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CHAPTER I: GLOBAL OUTLOOK

MACROECONOMIC PERFORMANCE AND PROSPECTS, 1999-2000

Uneven recovery in 1999

At the beginning of 2000, the world economy was in better shape than a year previously, when the aftermath of the financial crises in Asia and the Russian Federation and the uncertainties relating to Brazil clouded the outlook. It is estimated that gross world product (GWP) expanded by 2.6 per cent in 1999 (see table I.1), a notable improvement over the 1.8 per cent of 1998 and 0.6 per cent higher than anticipated in mid-1999.[1]

Much of the improvement in 1999 stemmed from a faster and stronger recovery than foreseen in the Asian crisis countries, particularly the Republic of Korea, and an unexpected spurt of growth in Japan, in both cases largely as a result of reflationary policies. Contrary to earlier fears, the crisis in Brazil did not set off another round of exchange-rate and related adjustments. Although Brazil experienced a recession, with negative effects on neighbouring economies, the setback was less than expected. Similarly, instead of the anticipated further decline in output following the rouble devaluation in August 1998, the Russian Federation grew by 2 per cent in 1999. Meanwhile, growth in China slowed somewhat but remained above 7 per cent and West Asia suffered a further setback because a decline in output in the fuel importing countries outweighed the improvement in fuel exporting countries.

A critical factor underlying the global acceleration was the continued strong performance of North America, where the earlier widespread expectations of a substantial slowdown in the United States failed to materialize. Growth in Western Europe slowed but the outcome for the year and the region as a whole was broadly in line with expectations.

The economies in transition continued to perform poorly in 1999, but at widely differing growth rates; nearly a third did not raise per capita GDP levels. Following a decline in output in 1998, growth for the group in 1999 was about 0.6 per cent, better than expected in early 1999, largely on account of developments in the Russian Federation.

The developing economies as a group bore the brunt of the slowdown in 1998, when their rate of growth of gross domestic product (GDP) fell by more than four percentage points to only 1.3 per cent, implying a fall in their average level of per capita output. In 1999, this group registered the largest improvement in output with growth recovering to over 3 per cent. On a per capita basis, however, growth in output in the developing countries in 1999 was marginal and considerably less than in the developed economies. The developed countries increased their per capita output throughout the recent period of global financial and economic turbulence, with the annual increment in per capita output in the United States in each of the past four years exceeding the average annual per capita output in the lowest income countries. Overall, the developed countries were affected only marginally by the crises but most of the rest of the world suffered a setback. Even though the growth in developing and transition countries as a whole improved more than expected in 1999, the outcome remained far from satisfactory. By the end of the year, the developing countries had still not returned to the growth of over 5 per cent per year that had prevailed for some years prior to the crisis, nor made up the loss in per capita output in 1998.

More than one third of the developing countries (38 of the 95 regularly monitored) failed to raise their level of per capita output in 1999—roughly the same as in 1998 (37) (see table I.2). Only 19 economies registered per capita GDP growth in 1999 higher than 3 per cent, a threshold considered as a minimum to be sustained over time if poverty is to be reduced in a meaningful way. Because China and India were again among the rapidly growing, these 19 countries accounted for almost 60 per cent of the population of developing countries. East Asia was the only region where the number of countries with per capita GDP growth higher than 3 per cent increased in 1999. In Africa and Latin America, the number declined further.

The uneven distribution of growth across countries and country groups has resulted in major fiscal and current-account imbalances that will need to be reduced. As a result of the economic slowdown and the measures introduced to stimulate recovery, Japan and many developing

1 *World Economic and Social Survey, 1999* (United Nations publication, Sales No. E.99.II.C.1), table I.1.

Table I.1.
GROWTH OF WORLD OUTPUT AND TRADE, 1981-2000

Annual percentage change

	1981-1990	1991	1992	1993	1994	1995	1996	1997	1998	1999[a]	2000[b]
World output[c]	2.9	1.1	1.9	1.4	3.0	2.8	3.6	3.4	1.8	2.6	2.9
of which:											
Developed economies	2.9	1.1	1.8	0.9	2.8	2.3	3.2	3.0	2.0	2.5	2.4
Economies in transition	1.8	-7.9	-11.6	-4.7	-7.1	-0.6	-0.1	2.2	-0.8	0.6	2.4
Developing economies	2.3	2.9	4.8	5.2	5.6	5.0	5.7	5.4	1.3	3.2	4.9
World trade[d]	4.5	4.3	5.7	4.6	10.5	8.6	5.5	9.2	4.4	3.9	5.7
Memo items:											
World:											
Number of countries with rising per capita output	..	72	75	68	99	109	121	121	100	99	126
Number of countries in sample	..	127	144	145	145	145	145	145	145	145	145
Developing economies:											
Number of countries with rising per capita output	..	57	59	51	64	72	81	77	58	57	78
Number of countries in sample	..	93	95	95	95	95	95	95	95	95	95

Source: UN/DESA.

a Partly estimated.
b Forecast, based in part on Project LINK.
c Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 1995 prices and exchange rates.
d Average of the growth rates of the volume of exports and imports.

and transition economies confront sizeable fiscal deficits. At the same time, the income and relative price effects from the financial crises of 1997-1998 compressed import demand in many emerging economies, and the decline in international capital flows required many developing economies and a number of economies in transition to turn their trade balances into surplus. On the other hand, the price effects and shifts in capital flows were mostly favourable for the majority of developed economies, in particular the United States. As a result of these external developments and continued strong domestic demand, the trade deficit in the United States surged further to a record high of over $300 billion in 1999. These trade imbalances embody a continued negative net transfer of resources from developing and transition economies to developed countries—a contrast to the large positive transfers that characterized the earlier years of the 1990s.

As the recovery in the rest of the world broadens and if the pace of economic expansion in the United States moderates, trade imbalances should narrow. At the same time, improved growth should narrow fiscal deficits. However, given the size of the disequilibria, it would be desirable for these adjustments to be spread over a few years. In addition, the burden of external adjustment should be shared by surplus countries enjoying sustained growth so that the global process does not become contractionary and jeopardize economic growth and stability, particularly of poorer countries.

Improved short-term prospects for growth

The signs of strengthening and broadening of the recovery in the world economy identified in early 1999 have gained momentum. On present policies in major countries, the outlook is for a slight acceleration to almost 3 per cent growth of GWP in 2000 and a return to the pre-crisis pace of over 3 per cent in 2001.[2]

For developing countries, a return almost to the 5 per cent average growth of GDP recorded by the group in the earlier 1990s is forecast for the near-term (see table A.3).

2 The present outlook is based on monitoring by DESA and forecasts prepared in the context of Project LINK that were discussed at the November 1999 Project LINK meeting in Athens, Greece. Project LINK is an economic modeling network consisting of over 70 national research centres around the world, with shared headquarters at the University of Toronto and the United Nations Department of Economic and Social Affairs (DESA). The network meets twice a year to review the global outlook prepared by DESA and other national and international organizations. The programme of the November meeting and papers presented are available on DESA's website (http://www.un.org/esa/analysis/ddpa.htm).

Table I.2.
GROWTH OF PER CAPITA OUTPUT IN DEVELOPING COUNTRIES, BY REGION, 1997-2000

	Number of countries monitored	Decline in GDP per capita				Growth of GDP per capita exceeding 3 per cent			
		1997	1998	1999[a]	2000[b]	1997	1998	1999[a]	2000[b]
Frequency of high and low growth of per capita output (Number of countries)									
Developing countries *of which:*	95	18	37	38	17	35	23	20	33
Latin America	24	3	8	12	4	9	5	4	7
Africa	38	8	11	12	3	11	11	7	13
East and South Asia	18	3	9	3	1	12	6	8	11
Western Asia	15	4	9	11	9	3	1	1	2
Memo items:									
Least developed countries	40	8	13	14	12	10	8	6	9
Sub-Saharan Africa	31	5	8	9	3	9	8	6	10
Percentage of population									
Developing countries *of which:*	95	9.5	24.7	20.7	5.4	72.2	60.3	58.3	67.2
Latin America	24	3.1	55.1	65.0	9.0	38.2	22.6	4.9	31.7
Africa	38	22.3	39.6	27.7	7.7	27.6	22.6	11.0	28.6
East and South Asia	18	6.8	13.6	6.9	0.0	90.9	79.3	82.1	84.9
Western Asia	15	18.5	59.1	86.8	60.6	36.9	9.3	9.3	36.1
Memo items:									
Least developed countries	40	11.3	21.6	22.3	18.0	40.8	29.2	27.4	41.7
Sub-Saharan Africa	31	23.1	27.9	26.5	13.1	29.6	14.9	16.4	25.3

Source: UN/DESA, including population estimates and projections from United Nations, *World Population Prospects: The 1998 Revision* (United Nations publication, forthcoming.)

a Preliminary estimates.
b Forecast, based in part on Project LINK.

This growth is also anticipated to be better distributed among the major regions than in 1999. In contrast to its minor contraction in 1999, Latin America and the Caribbean will revert to positive growth, with a forecast rate of some 3½ per cent in 2000. Growth in Western Asia is anticipated to accelerate to almost 4 per cent in 2000, with a shift from contraction to over 4 per cent growth in the fuel importing countries in the region. Africa is forecast to achieve an average increase in GDP of over 4 per cent in 2000, thus returning to the faster pace of growth that began to emerge in the mid-1990s. The recovery in East and South Asia (excluding China) is expected to broaden but to accelerate only slightly—to almost 6 per cent—as growth in the recovering economies slows to more sustainable levels. China is expected to continue to decelerate marginally, but growth is nevertheless forecast to reach 7 per cent. Overall, 78 out of the 95 monitored developing countries are expected to achieve increases in per capita GDP in 2000—a marked improvement over the previous two years.

Growth in 2000 for the economies in transition, while higher than in 1999, is expected to be in the range of only 2 to 3 per cent, with the pace in the Russian Federation decelerating, in contrast to that of the Baltics and of Central Europe. The latter groups of countries should perform better in the near-term than in 1999, but will not return to the high growth that some of them achieved prior to the recent slump. The dispersion among the various countries of this group, especially North-eastern and Central Europe as contrasted with many CIS countries and South-eastern Europe, will continue to be marked. Nevertheless, most of these countries are expected to achieve an increase in per capita GDP in 2000.

The developed countries as a whole are forecast to continue to grow at close to 2½ per cent in 2000, but growth is expected to be more evenly spread among the

major regions than in 1999. The economies of Western Europe are expected to strengthen their recovery, while the pace of expansion in the United States is likely to moderate. Growth in Japan will continue to lag behind potential, in spite of massive injections of public funds aimed at encouraging private-sector consumption and investment.

International economic environment strengthens slowly

Despite the acceleration in the growth of world output, world trade volume in 1999 is estimated to have grown by only around 4 per cent, less than in 1998 (see table I.1). Trade was a weaker contributor to global economic expansion than in the past, with the ratio of the growth in trade to the growth in GWP of 1.5 being lower than the average of over 2 recorded since the early 1970s. As the recovery gained momentum, global trade gradually began to strengthen, albeit with a lag, in the second half of 1999. Faster growth in international trade is forecast for 2000, with world export volume expanding by about 6 per cent. This will bring the ratio of growth in trade volume to that of GWP back to the postwar average of about 2, but not to the higher levels observed earlier in the 1990s.

Reflecting the improvement in global economic growth, the deflationary pressures on international prices of commodities of the previous two years dissipated by late 1999. Oil prices rebounded from the lows observed in 1998 and early 1999, but prices for other commodities, except metals, on average continued to sag.

International financial markets stabilized as 1999 progressed and some degree of investor confidence in emerging markets returned. However, there was not a full recovery of financial flows to emerging market economies. This applies, in particular, to commercial-bank flows. Monetary conditions generally remained accommodative for most of the year, as the monetary authorities in many countries held interest rates down or lowered them, the latter especially in many developing countries and economies in transition. However, in some cases, notably in the United States, and later in Oceania and in Europe, monetary authorities began to change their policies towards more restrictive stances in the latter part of the year.

BENIGN INFLATION OUTLOOK

Except for the large economies in transition and a few other countries, the global economy has been subject to disinflation for the past few years. Inflation rates have been compressed to postwar lows. During the recent international financial crises, the large currency devaluations in many economies pushed up inflation rates only for a brief period, in contrast with earlier crises. The factors contributing to the successful control of global inflation have included cautious monetary policies, fiscal consolidation, and increased global competition. In a number of developed countries, low wage pressures and gains in productivity attributed largely to technological innovation have reduced not only inflation rates, but also inflationary expectations, breaking the potential for setting off a conventional inflationary spiral, at least in the near-term.

In a few economies, such as China and Japan, deflation rather than inflation has been a policy concern in the last two years. The main cause of deflation in these economies has been weak effective aggregate demand as a result of a shift in the behaviour of consumers and investors, due to cyclical and/or structural changes in the economy. Because deflation in these economies is more than a monetary phenomenon, the root of the problem cannot be addressed by monetary policy alone. Rather, authorities have to address the conditions needed for a revival in domestic aggregate demand. In many cases, this will require a combination of fiscal stimulus and structural reforms, such as state-enterprise restructuring in China and addressing the problems in the financial sector in Japan.

Inflation in the global economy is expected to continue to remain low in 2000. For most developed economies, where the average inflation rate fell to almost 1 per cent in 1999, a slight rise is expected because of higher oil prices, the recovery of other commodity prices and the wage pressures that may arise from tight labour markets in some countries if productivity gains cannot keep pace with real wage rises. Nevertheless, the rate of inflation in all of these countries in 2000 will likely remain under 3 per cent—within the inflation target range of many central banks of developed economies.[3] Japan is expected to continue to experience slight deflation, however. Elsewhere, further falls in inflation rates are likely, especially in countries with double-digit rates, such as the Russian Federation and other economies in transition, and several economies in Latin America.

Employment responds slowly

The world employment situation remains far from satisfactory in the majority of countries. The United States and a few other economies, including some in Europe (such as Denmark, Ireland, the Netherlands and Norway), have been able to achieve near-full employment.

3 The European Central Bank (ECB) has set a 2 per cent target as the upper range of the desirable pace of the harmonized inflation index. However, its policy also takes into account conditions other than the harmonized price index.

However, high rates of unemployment persist in much of the euro zone. Even though the zone's unemployment rate dropped below 10 per cent in late 1999 for the first time since December 1992, it is likely to remain unacceptably high until more encompassing labour-market reforms take effect. In Japan, unemployment has risen steadily during the recent years of slow growth and increased further in 1999, although, at less than 5 per cent, it remains lower than in most European countries.

Among the developing countries, there was a dramatic increase in unemployment in the crisis countries in 1997 and 1998, with correspondingly smaller consequences in countries less directly affected. Although economic recovery is under way, the consequences of the crisis in terms of unemployment, shifts from urban and formal sector employment to rural and informal sector job and heightened insecurity of employment persist. Similarly, the unemployment in the majority of the economies in transition remains very high and deteriorated in many of these countries in 1999. These reversals will take longer to be redressed, as will the setbacks to broader social objectives, such as the increase in poverty and the consequences of cuts in health and education expenditures resulting from fiscal austerity. The social costs of the crisis therefore persist, despite improving macroeconomic indicators.

POLICY ISSUES

A panoply of factors has contributed to the current recovery in many crisis-affected economies. Pivotal have been accommodative global monetary conditions since the second half of 1998 and the reflationary policies adopted by the crisis-affected countries themselves. These stances were crucial in containing the international financial turmoil and in preventing the world economy from falling into a global deflationary spiral. There is now broad agreement among analysts that, if these policies had been embraced when the crisis began to unfold, the recession in these economies could have been less severe and the recovery could have started earlier.

With the global economy strengthening, monetary easing was reversed in late 1999 and this is likely to continue to be the direction of monetary policy in countries where domestic conditions are seen to pose a threat of inflation. At the same time, more and more economies are expected to adopt tighter fiscal policies in order to reduce the large budget imbalances that accumulated during the crisis as part of the eeofrt to expedite economic recovery.

Monetary-policy outlook

A global easing of monetary policy was led by the United States Federal Reserve with three consecutive cuts of interest rates in late 1998 and was followed by the ECB in early 1999. In the wake of these accommodative measures, many countries throughout the world reduced their policy interest rates in the course of the year. Many developing and transition economies, whose interest rates were pushed to extreme heights during the crisis, were able to lower their rates substantially, some to pre-crisis levels. In several cases, however, the reductions followed another sharp rise in rates that became necessary in early 1999.

The Federal Reserve raised interest rates three times in the second half of 1999, bringing its policy rates back to the levels in effect in mid-1998. Initially, only a few central banks, such as the Bank of England (BoE) and the monetary authority of Hong Kong Special Administrative Region of China (Hong Kong SAR), followed suit, although for varying reasons.[4] Subsequently, policy interest rates were raised by several central banks of developed countries, including the ECB which increased rates by 50 basis points, bringing them back to their level at the euro's inception in early 1999. Some other countries in Europe and Oceania also implemented one or more raises of between 25 and 50 basis points (see chapter III).

Central banks, especially in developed economies, have raised their rates further in the first few weeks of 2000. Several reasons are at play, notably the desire to move from an accommodative to a more neutral monetary policy stance. The latter owes much to the slight uptake in inflation and fears that tight labour markets, especially in the United States, and rising commodity prices worldwide may signal a strengthening of inflation. However, core inflation rates (that is, excluding the changes in prices for energy and foodstuffs) remain low.

The inflation outlook in the United States remains benign. Asset-price inflation and the tight labour market may increasingly pose, or be perceived as posing, as inflationary threat. However, there is no conclusive evidence that a pre-emptive monetary policy could control asset-price inflation without simultaneously slowing down the economy appreciably. Moreover, wage pressures, even in a tight labour market, should not emerge until productivity growth slackens. Nevertheless, the Fed eral Reserve may raise rates by another 50 points in the next six months, especially if more inflationary signs were to emerge in the domestic economy. Such further monetary tightening would not be helpful for many other countries where economic recovery remains in need of an accommodative monetary stance in both the United States and other major economies.

The ECB and the Bank of England are likely to maintain the policy stance inaugurated with the rise in rates in

[4] Hong Kong SAR did so because its currency is pegged to the U.S. dollar; in the United Kingdom, it was in part because of concerns about an asset-price bubble.

November 1999, and to raise interest rates for the euro area. In the baseline, the ECB is assumed to raise interest rates three times in 2000 by 15 to 20 basis points each time. However, the Bank of Japan, which has kept the overnight interest rate near zero since early 1999, is expected to remain accommodative.

Historically, when central banks in major developed economies tighten monetary policy, interest rates in emerging economies are also adjusted so that the differential continues to reflect perceived risk margins. However, even if interest rates in developed countries are increased as assumed, there is leeway for many emerging economies not to raise their rates immediately or even to lower them further.

A lowering or stabilization of interest rates in these economies would be desirable, as their nominal interest rates are still high, particularly compared with those in developed economies, and their real interest rates continue to be high by historical standards. The latter is also the case for many developed countries, given the levels of inflation that are expected. These worldwide high real interest rates indicate that monetary policy has not been as lax as nominal interest rates might suggest.

If inflation rates in some of these economies could be further reduced, nominal interest rates could be brought down. The leeway for, on the whole, a more accommodative monetary stance deserves to be especially carefully considered in developing countries that have recently moved from a fixed exchange-rate regime to a floating system. The latter should afford them greater independence in conducting their monetary policy, although it is unclear how these countries will define their monetary anchor under the new floating regime. This constitutes an important unresolved policy issue, including in the context of discussions about the usefulnesss of inflation-targeting in many emerging market economies. Nevertheless, with appropriate monetary policies, it seems unlikely that interest rates in these countries will have to follow every change in rates in the major countries, at least within a certain range.

Nevertheless, countries with a floating exchange-rate regime do not wish to submit their policies to fluctuating currencies without intervention. A depreciating currency, for example, has a potentially inflationary impact, so even countries with a floating exchange rate are concerned about the broad position of their currency relative to major currencies. When they face current-account deficits or fail to attract sufficient capital from abroad, they may have to adopt higher interest rates at home, or, reserves permitting, intervene in foreign currency markets.

In preparing the baseline forecasts for developing countries and economies in transition, it is assumed that the monetary authorities for economies with a fixed or rigid exchange-rate system follow the tightening in the relevant developed economy or economies, depending on their currency peg. For other developing economies, it is assumed that an accommodative monetary policy will be adopted to strengthen the recovery, at least through 2000, as nominal interest rates in many of them remain high.

Major fiscal policy features

In contrast to the trend of more globally correlated monetary policies across countries, largely due to increased international capital mobility, national fiscal policies are to some extent still independent.[5] The international financial crises of 1997-1999 left the world economy not only with large trade imbalances, but also large fiscal imbalances, especially in countries that experienced recession. Most developed economies, except Japan, have pursued a restrained fiscal policy, even during the international financial crises, and have improved their fiscal position considerably in the last few years, with some reversing a large budget deficit into a sizeable surplus. The outstanding case is the United States, which turned a deficit that had persisted for three decades into a surplus in 1998; the surplus for 1999 is estimated to have reached $140 billion. In Japan and the countries in crisis, however, measures to stimulate their economies out of recession resulted in a drastic deterioration in their fiscal positions: the budget deficit of Japan reached 10 per cent of GDP in 1999 and several Asian developing countries also reported high fiscal deficits relative to their income levels.

In view of the prevailing global economic environment, policy makers of most developed economies in Europe and North America are likely to adhere to a neutral to moderately relaxed fiscal policy for 2000. For Japan, after another fiscal injection announced in late 1999, but effective in early 2000, fiscal policy will be tightened in 2000.[6] Fiscal consolidation is also expected for most developing and transition economies in the future, albeit at varying points in time.

EXCHANGE RATES: FLEXIBLE VERSUS FIXED

Exchange-rate movements among the major currencies of the developed economies in the past few years have to some extent reflected the differentials in the recorded and expected paces of economic growth in these economies. The strength of the U.S. dollar vis-à-vis the yen, at least until late 1999, and against the euro, albeit with several short-lived reversals, has been in line with

5 In some cases, as in the European Union (EU) and especially the euro-zone countries, fiscal policy is subject to agreed-upon rules in the context of regional integration.

6 Additional net government spending of 5 trillion yen on social infrastructure, which is in line with Government policy as announced in November (see part III), is assumed in the baseline forecast.

the robust growth in the United States in comparison with the stagnation in Japan and the weak growth in Western Europe. But this is unlikely to continue for long. Whereas the U.S. dollar is anticipated to stay at the current exchange rate with the yen, it is expected to depreciate slightly against the euro by the end of 2000.

Currencies of many countries were devalued significantly against the U.S. dollar during the international financial crises. Most have stabilized since then. While some currencies (such as those of Indonesia, the Republic of Korea and Thailand and, most recently, Brazil) have appreciated somewhat from their lows, in both real and nominal terms, others (such as the currencies of the Russian Federation and South Africa) have been drifting around their new low parities.

As a result of the crises, two polarized exchange-rate systems are now prevalent in developing and transition economies. Several countries continue to adhere to a fixed exchange-rate system and are expected to hold on to it in the near-term, thus preserving the current nominal parity to the major pegging currencies. However, many of these countries adopted, or were forced by market pressures to adopt, a floating exchange-rate regime. These countries are likely to 'manage' their rates in line with expected international inflation differentials, so that a relatively stable real parity should prevail for the near-term. However, other factors, such as domestic policies and market sentiment, may drive the nominal exchange rates of these countries away from the assumed real parity.

Speculation about devaluation of the Chinese yuan has been rife. For the near-term, however, it would appear likely that the yuan will be kept at its current peg with the U.S. dollar. The real exchange rate of the yuan has fallen by about 8-10 per cent against the U.S. dollar during the past two years as a result of domestic deflation in China, so that the pressure for a further devaluation is now less than it was in the aftermath of the Asian financial crisis. Even if a devaluation were to be enacted, the ripple effects on other currencies, given the strong recovery under way in most of the crisis countries, will be much smaller than they would have been two years ago.

UNCERTAINTIES AND RISKS

The prevailing domestic and external imbalances accumulated in the wake of the disturbances provoked by the international financial crises in the last two years arose in part because the growth cycles among many economies have become significantly asynchronized. The increased fiscal deficits in Japan and in many emerging economies and the widening current-account deficit and the rapidly growing private-sector debt in the United States will need to be reduced. However, there also ought to be a parallel effort to compress the large current-account surpluses of such countries as China and some members of the EU. Otherwise, the desirable rebalancing of the current-account, fiscal and wealth positions will be brought about—as has traditionally been the case—as a result of efforts by the deficit countries alone; such efforts are inevitably contractionary in nature.

The outlook for the world economy therefore depends critically on how the imbalances are resolved. A gradual slowdown in the pace of economic growth in North America, accompanied by a strengthening of the economic recovery in Europe and by sustaining the recovery in Asia, would be highly desirable. Whether this scenario will in practice unfold depends in good measure on, at least implicit, national and international policy coordination in such areas as fiscal stances, monetary policy, trade and international finance.

Though prospects for the global economy in the aggregate are on the whole reassuring, there are potential risks and uncertainties that might lead to lower growth in the world economy.

First of all, working off the large current-account imbalances across countries and the fiscal imbalances in many countries may not evolve smoothly. Second, whereas an asynchronized world economy *can* be a dynamic and stabilizing force for sustaining the pace of global economic growth, large current-account imbalances may give rise to protectionism in certain countries, thereby inhibiting trade and weakening the prop to global aggregate demand needed to sustain the recovery. Third, continued economic recovery in a range of countries depends on progressing with further major structural reforms. Many have so far proved to be formidable in nearly all countries. Fourth, the rise in international integration, especially via international capital flows, and rapid technological innovation have posed new challenges to policy makers worldwide. The reform of the international financial system, which received a lot of attention at the height of the crisis, remains a piece of unfinished business. This leaves the global economic framework ill-prepared for coping with any similar crisis in the years ahead. The forecasts assume that there will be no such calamity, but most analysts accept that financial crises cannot be ruled out.

These downside risks and the likely consequences for the world economy may materialize via several channels. One scenario that has been widely analysed, including in earlier reviews of the global economic situation by the United Nations,[7] revolves around another crisis in world financial markets, but centred in developed countries such

[7] See, *World Economic and Social Survey 1999*, Box I.2.

as Europe and the United States rather than in developing or transition economies. Most analyses suggested that the effects of such an occurrence could be substantial.[8]

Increasingly, however, questions have been raised regarding, firstly, the relevance and probability of such a collapse in equity markets in the major developed economies, notably the United States, and, secondly, whether the wealth effects would be as significant as some suggest. A conclusive answer to these questions is difficult for several reasons. For one thing, there is no precedent for the recent changes in international economic linkages, notably through capital flows.[9] In addition, the sharp rise in the number of households now keeping some of their wealth in the form of shareholders' equity has in all likelihood modified household wealth behaviour.[10] Furthermore, the precise shape of the cycle, given the technological revolution and the way in which information technology in particular has been affecting productivity in non-traditional economic activities, has yet to be traced out.

Measured by price-earnings ratios, stock yields, or other traditional equity-valuation criteria, the United States stock market is *over*valued. An immediate return to the historical levels of these traditional indicators would imply a 20 to 40 per cent drop in the value of equity markets. However, some observers have argued that rapid innovation in information technology may have permanently lowered 'equity premiums', that is, the margin by which the expected rate of return on stocks exceeds the rate of interest on riskless assets. If this were to be borne out, the current valuation of the stock market in the United States would be *under*valued.[11] Between these polar cases, many other gauges for what might happen to asset prices can be readily applied.

Even if there is not an autonomous correction in equity markets, other financial vulnerabilities in the United States economy need to be borne in mind. Households and the corporate sector have been borrowing well beyond historical levels, leading to record private-sector debt. Household debt is now approximately 100 per cent of disposable income. Under these circumstances, a tightening of credit for the private sector is likely to lead to an unusually severe decline in business investment and contraction in household demand. At the same time, the widening current-account deficit of the United States has been sustained by large capital inflows, which could fall significantly if there were a sharp reversal in confidence in the United States economy. These would also slow economic growth and weaken the U.S. dollar, leading to reduced United States demand in the rest of the world. Importantly, these vulnerabilities are interrelated, with the result that any unforeseen shock could trigger a sequence of events in which all come into play and negatively reinforce each other.

Other uncertainties and downside risks include the possibility that the yen continues to appreciate considerably, in which case the current recovery in Japan could be in jeopardy. Alternatively, persistently high oil prices could rekindle inflation expectations, although a replay of the scenario that unfolded with the two oil-price leaps in the 1970s is unlikely (see Chapter II). Since post-crisis restructuring in many emerging economies has proved to be difficult and slow, recovery in these economies could be interrupted and the reform process stalled. Moreover, there are political uncertainties about the ability to reduce budget deficits in many countries. Failure to do so could induce another default crisis.

On the upside, it is possible that the reduction of the cited imbalances could have a smaller impact on the world economy than is forecast. For example, the economy of the United States could for some time continue to expand at the robust rate of the past several years, relying on further technological innovation to realize additional productivity gains. In this case, world economic growth could be up to 0.5 per cent higher than discussed above. Also, the recovery in Western Europe might turn out to be stronger than forecast. Particularly if this occurred with a better United States performance than anticipated, stronger growth in the global economy would become feasible.

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8 An earlier simulation based on the LINK modeling system showed that a 40 per cent decline in the value of equity markets in the United States and in a few major European economies, in combination with a credit crunch in corporate borrowing, would lead to a loss of 1.7 per cent of world GDP over two years. See *World Economic and Social Survey, 1999,* Box I.2.

9 Although the degree of international interdependence, both in trade and financial flows, from the late 1800s up to the First World War was probably larger than at present, it is not clear that this situation provides a pertinent precedent for the current policy discussion, given the many subsequent changes in the structure of the global economy, including the nature and extent of global interdependence.

10 Also the part of household wealth deriving from private residences has appreciated significantly. With any financial reversal, those prices too would be affected, in turn exerting a negative impact on household wealth behaviour.

11 For an argument along those lines, see James K. Glassman and Kevin A. Hassett, *DOW 36,000: the new strategy for profiting from the coming rise in the stock market* (New York: Random House, 1999).

CHAPTER II: INTERNATIONAL TRADE AND FINANCE

THE 1999 SLOWDOWN IN WORLD TRADE GROWTH

The slowdown in the growth of world trade of 1998 continued into 1999, with the annual increase in the volume of world merchandise trade falling from 4½ per cent in 1998 to less than 4 per cent in 1999 (see table I.1). This is substantially below the average rate of trade expansion from 1991 to 1997. Moreover, the ratio of trade growth to growth in gross world product (GWP) was far lower in 1999 than the average of 3 recorded for the period of the 1990s prior to the Asian crisis (see figure II.1). It was even below the historical average of 2 registered during the 1970s and 1980s. This points to the fact that the international financial crisis and the post-crisis adjustments affected international commerce more than domestic economic activity. World trade in 1999 was both a weaker contributor to world economic growth—and a weaker force for structural change—than it had been in the past.

The slackening in world trade growth in 1999 was brought about mainly by the slowdown in the growth of imports in developed economies, particularly in Western Europe. Import volume again contracted in Japan, albeit by less than in 1998 (see table A.4). Although North America could not maintain the pace of import growth of the previous two years, its imports continued to expand far more rapidly than those of other regions. By and large, governments in countries experiencing import surges were able to resist pressures to tighten trade barriers, although some developed and other countries increasingly resorted to anti-dumping and safeguard nitrons to reduce the impact of imports in certain sectors, particularly steel and textiles.

In the transition economies, both export and import volumes fell in absolute terms due to large declines in the international trade of the Russian Federation and several other members of the CIS, especially the larger ones (see Chapter III).

Developing country import volume began to rise again in 1999, after the crisis-related contraction in 1998. In Latin America and the Caribbean, where the economic crisis hit with a lag, the volume of imports plummeted by an estimated 4½ per cent in 1999. In contrast, import volumes into East and South Asia (excluding China), which contracted 13½ per cent in 1998, increased 5½ per cent in 1999.[1] The volume of merchandise exports of developing countries rose 3½ per cent, a percentage point faster than in 1998; however, this average is made up of a beginning of recovery in Asian export growth and slower growth or a reduction in the quantity of exports shipped from all other main developing country regions.

A RECOVERY IN WORLD TRADE IN 2000

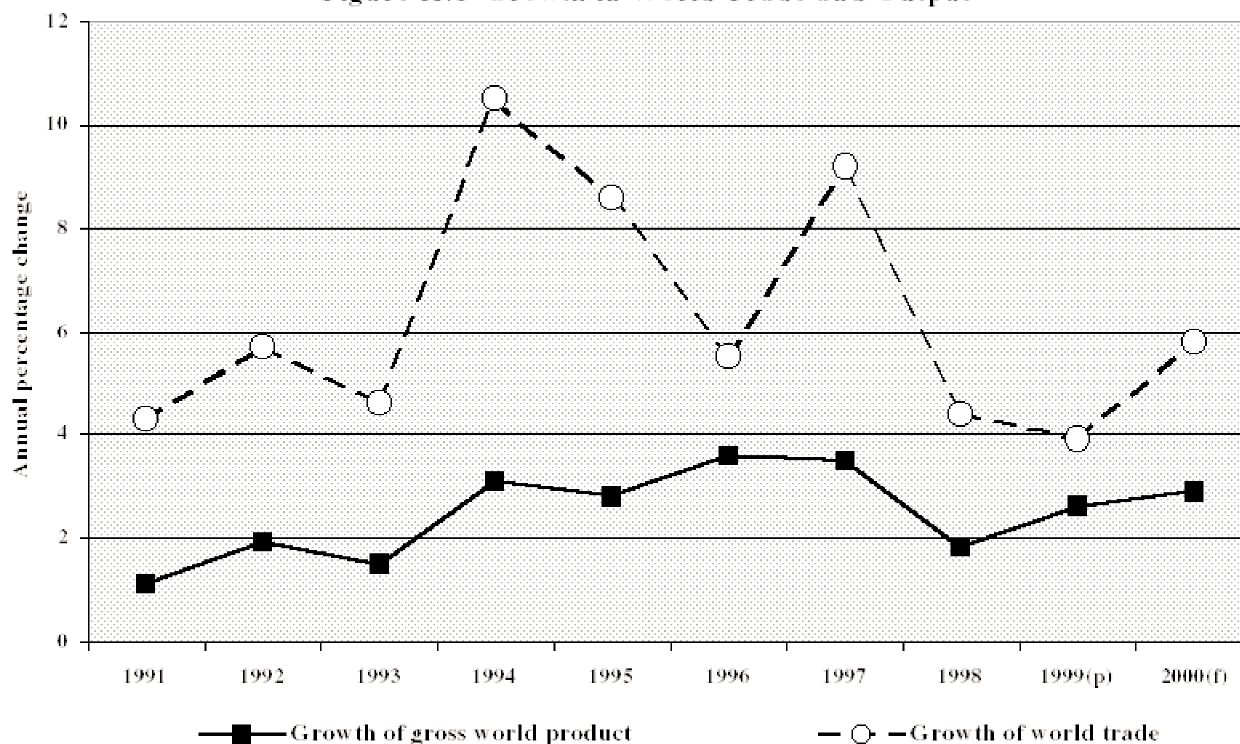
World trade in 1999 embodied the beginnings of a recovery that is expected to become more visible in 2000. Trade grew very slowly in the first half of 1999, with significant declines in some regions as many economies, especially in Asia and Latin America but also among the economies in transition, continued their post-crisis adjustment by cutting import demand. However, as the recovery process strengthened and more economies began to move towards positive growth, international trade began to rebound, rather strongly in the second half of 1999.

Continuing this momentum, world trade is expected to rise by 5¾ per cent in 2000. The improvement is expected to be spread among all major groups of countries and over all main categories of commodities, with total trade in some regions expanding more than 6½ per cent and world trade in manufactures growing more than 6 per cent.

The upturn in trade is expected to be particularly strong in Western Europe. Japan is forecast to register its first increase in import volume in two years but the expansion of its exports will be limited by the appreciation of the yen and the slowdown in the growth of imports expected in North America (see table A.4).

Among the transition economies, the strengthening economies—and thus imports—of Western Europe will boost Central and Eastern European exports. Strengthening global demand will help the Russian Federation and other CIS countries begin to reverse the export contraction of 1999.

[1] The large growth reported in China's import volume reflects, in part, the Government's efforts to curtail smuggling, causing more of China's trade to be reflected in the official data.

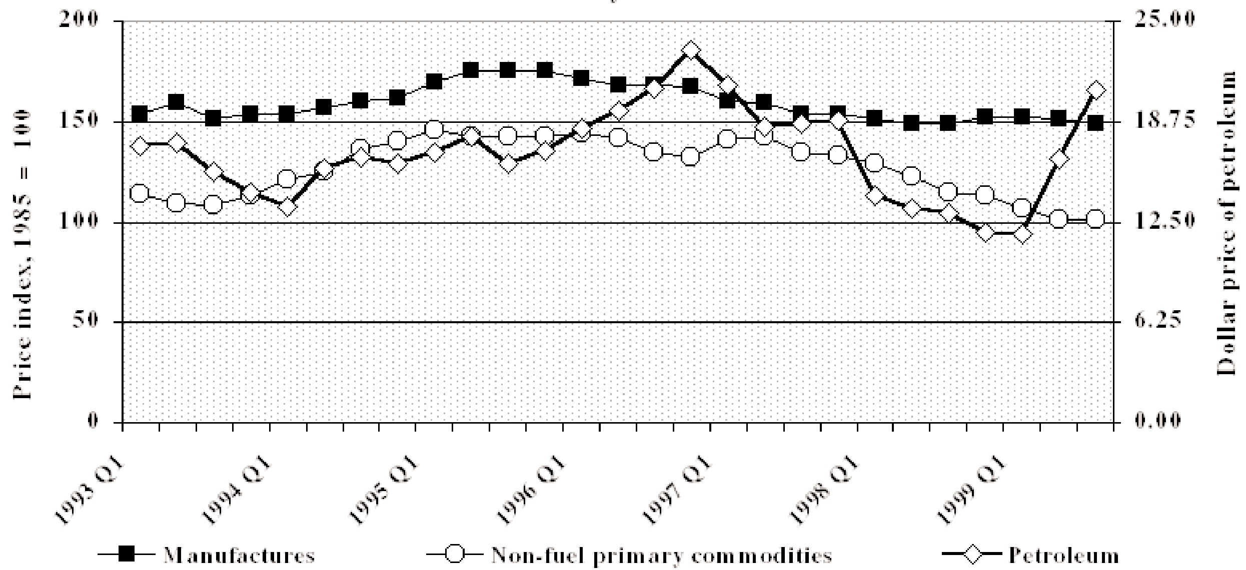


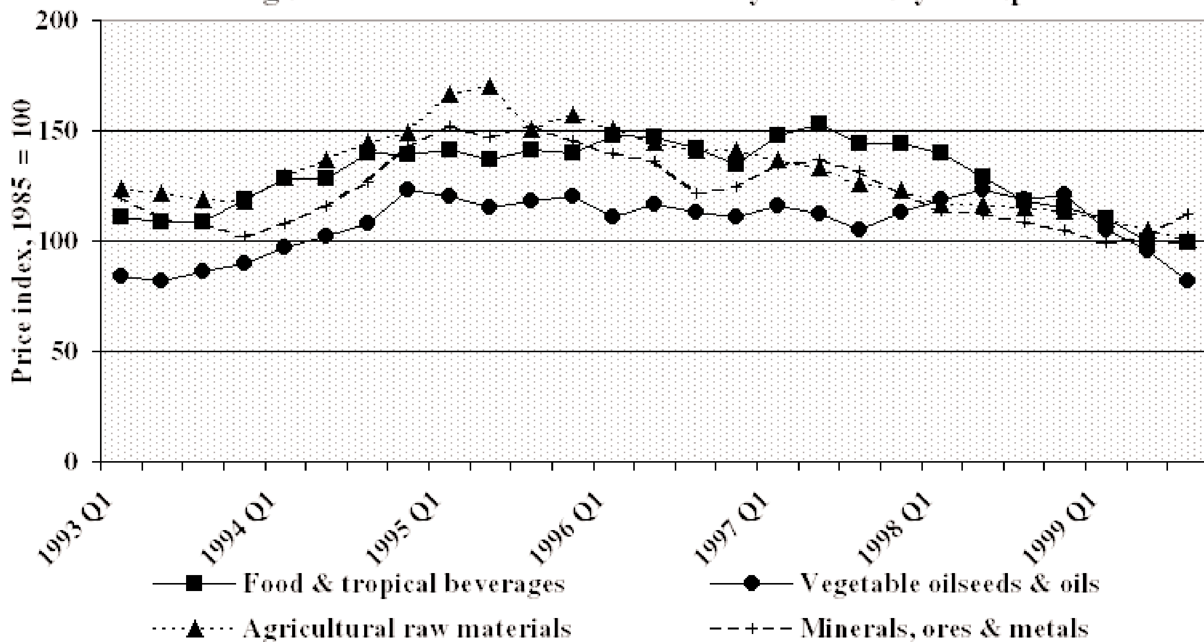
The pickup in trade of both primary commodities and manufactures will help raise exports from all developing country regions by more in 2000 than in 1999 and, with the exception of Africa, at a rate in excess of 4½ per cent for the year. The volume of imports is forecast to rise more rapidly as well, particularly in East and South Asia and Latin America, as recovery from the crisis continues. Faster overall growth in these two regions should contribute to accelerations in the expansion of exports from the developed countries, softening any slowdown in the United States economy and improving prospects elsewhere.

A TURNAROUND IN WORLD COMMODITY MARKETS

Prices of major primary commodities, expressed in U.S. dollars, dropped in 1998 to the lowest levels in many years (see figure II.2 and table A.5). Over the course of 1999, prices of many commodities, especially crude oil and related energy products, either stabilized or started to recover (see figure II.3). By the end of the year, some of these prices rose to levels not observed in the past three years, due in part to the recovery in global demand and, in the case of oil, to production constraints imposed by core oil-exporting countries. A rebound in the prices of some industrial metals and minerals, notably aluminium, nickel and phosphate rock, has also been under way, spurred in part by the substitution of relatively new industrial metals for traditional metals such as ordinary steel. Prices of agricultural commodities, on the other hand, did not experience any significant recovery and remained below their averages for 1998. This continued decline applied especially for many categories of foodstuffs and tropical beverages and for vegetable oilseeds and oils. In late 1999, the rate of price decline for many agricultural products slowed and, in the case of sugar and coffee, prices have risen. The more positive outlook for world economic growth in 2000 holds promise of some further improvement in prices and quantities of agricultural commodities sold on world markets. However, while some increase in world trade of these commodities is expected, only a weak recovery in prices is foreseen for 2000.

World oil markets remain in a sensitive state. OPEC countries suffered a large loss of revenue because of the fall in oil prices in 1998, and in 1999 they united in their efforts to stabilize volatile oil markets. Major oil-exporting countries have re-iterated their commitment to sustaining their coordinated supply cutbacks well into 2000. Given these considerations and the expected upturn in world economic activity, world oil demand is expected to exceed world oil supply in the near term. For this reason, the outlook is for another 9 per cent annual increase in 2000.





Nevertheless, future developments in world oil markets are particularly uncertain at this time, both with regard to oil prices and their impact on the world economy (see box II.1). Any sign that producers are not fully committed to maintaining agreed production cutbacks could precipitate a sharp decline in prices, which would adversely affect the more heavily populated and poorer oil-exporting countries. In this regard, an increase in output, especially after the second quarter of 2000 when world oil demand is expected to be at its low point between the winter heating season and the summer driving and cooling season in the major consuming countries, could lead to a sharp fall in prices. Some observers argue that recent price increases have become detached from supply and demand fundamentals. In this view, recent prices of over $25 a barrel for front-month

Box II.1: Oil Prices and their Effects on the Global Economy

Oil prices have risen strongly since late 1998, from about $10 to about $27 per barrel at end-1999 and further since then. This level of prices may persist for some time before additional supplies and demand adjustments bring downward pressure to bear. The question arises, then, whether the global economy may be exposed to another round of shocks such as those experienced in the 1970s, leading to another round of stagflation in many economies. A rise in the price of a major input produced by one group of countries and consumed overwhelmingly in another implies a substantial transfer of 'wealth' from the latter to the former, as it did from the early 1970s until the 1980s. While this is again taking place, the economic consequences of the current near-tripling of oil prices should be less deleterious for the global economy than they were in the 1970s.

For one thing, recent prices are not much higher than they were before the sharp price drop began in 1997. Moreover, the major transformations in the structure of world output mean that the cost of crude oil is now a much smaller share of aggregate output than in the 1970s. Developed countries have shifted towards less energy-intensive technologies for generating their value added and some have persisted in energy conservation, causing the energy intensity of value added to be about half of what it was in the 1970s. Estimates suggest that a sustained increase in oil prices of $10 (that is, if maintained for the year as a whole relative to the preceding year), would raise the inflation rate in developed countries by about half a per centage point while growth would decline by about one-quarter of a per centage point.

In marked contrast, many developing countries, especially the more dynamic ones, which are generally not resource rich, have forged their industrialization on intensive consumption of energy. These countries are therefore likely to be more affected by the rise in oil prices than developed countries. The precise impact on inflation and growth is unknown. However, on the basis of estimates for developed countries for the 1970s, a sustained rise in oil prices of $10 might reduce their growth and raise inflation rates by at least double the magnitudes cited above.

The effects of a rise in oil prices depend also on the behaviour of oil exporters, who stand to gain considerable export revenues due to favourable shifts in their terms of trade. Unlike the 1970s, when most of these countries were in surplus and had accumulated considerable foreign-exchange reserves, many have run fiscal and current-account deficits in recent years. They have also postponed expenditures on infrastructure investments and even on consumption. The foreign-exchange constraint in many of these countries, which has hampered their growth efforts, especially in 1998, will become less of a problem if oil prices stay at their current levels, or rise further. These countries are therefore more likely to spend their windfall export revenues than to stock up foreign-exchange reserves, which the international financial system would then need to recycle.

An additional reason for a more muted impact of a rise in oil prices is that there is little evidence to date of a generalized increase in commodity prices. Except for energy and some industrial minerals, commodity prices continue to be near their lows and only a modest recovery is expected in the years ahead.

However, there is one major danger stemming from a sharp rise in oil prices: 'headline' inflation rates would rise in many countries, including in the first instance the United States, especially if higher oil prices were to trigger wage demands that outpace gains in productivity. This might induce monetary authorities to enact pre-emptive increases in interest rates; these could push the United States economy towards a much lower growth path, possibly a recession. A precipitous decline in the pace of economic activity in the United States could, as examined earlier, have a major negative impact on the pace of global economic activity, as prevailing imbalances might be unwound in a disorderly manner.

Brent oil futures, a bell-weather contract traded on London's International Petroleum Exchange, may prove unsustainable. On the other hand, a prolonged period of high prices could threaten the nascent economic recoveries now underway in South-East Asia and weaken growth elsewhere. It could also undermine the resolve of OPEC countries to maintain the cutbacks and encourage exploration and drilling from non-OPEC suppliers.

Prices of industrial materials, especially metals, such as aluminium, copper and nickel, have also rebounded notably since the summer of 1999. The situation of oversupply in some of these materials in the past few years has come to an end, and, in response to increases in demand, world trade in industrial commodities has been growing faster than overall trade. With a continuing recovery of world industrial production, especially the strength and broadening of the recovery in the crisis countries of Asia and Japan, which have traditionally been large importers of these materials, the price rebound of these commodities is likely to be sustained into 2000. The gains in prices of industrial materials have spurred economic growth in countries that rely heavily on their sale. Over the longer-term, however, pressure on prices for minerals, ores and metals is likely to be constrained by cost-cutting measures, by advances in production capacity management and inventory control, and by conservation and efforts at recycling.

TURMOIL AND ADJUSTMENT IN NET EXTERNAL RESOURCE TRANSFERS

The international financial crises of 1997-1998 led not only to a slowdown in world trade growth, but also to a sharp and uneven shift in external balances across countries, as exports and imports of different groups of countries were affected in contrasting ways. The trade deficit in the United States, in particular, surged to record highs in 1998 and 1999, while most developing economies and some other countries, including a number of economies in transition, were forced by financial crises to turn their trade account into surplus and thereby transfer financial resources to the rest of the world.

While a full accounting would take account of trade in both goods and services, data on the latter are only available with a lag. However, the shift in external balances from 1997 to 1999 can be indicated by change in the merchandise trade balance, as merchandise still accounts for the bulk of international trade.[2] Before the financial turmoil created by the Asian and Russian financial crises, exports of the developed economies exceeded the value of their imports and this surplus embodied a net transfer of financial resources to the rest of the world. Under the impact of the financial crises, the merchandise trade surplus of these countries was progressively reduced (see table II.1) and became a trade deficit in 1999. The corresponding change on the part of the developing and transition economies was an increased aggregate trade surplus.

In the years immediately before the financial crises, the trade of developing countries expanded rapidly and a trade surplus often reflected success in expanding exports and sometimes fortuitous developments in trade prices. However, the growth of these countries' export earnings weakened in the years leading up to the crisis and trade surpluses were eroded or became deficits in a number of them. With the onset of crises and the termination of access to many forms of international financing, trade deficits had to shrink; this was achieved far more through import cutbacks than export expansion. The re-emergence of large trade surpluses in 1999 in developing countries was a sign of adjustment to economic crisis, rather than of economic strength.

Changes to export and import patterns and external balances caused by this period of turbulence were greatest in South and East Asia. In the years prior to the crises, these countries in the aggregate recorded a small trade surplus as the volume of their trade rose rapidly. When the Asian crisis engulfed the region in 1997, both exports and imports were negatively affected but the adjustment in imports was far greater than that of exports. Having increased at 8 per cent or more annually until then, Asian imports plummeted in volume terms by over 13 per cent in 1998. Exports on the other hand, increased by over 4 per cent, and played an important role in the recovery of production and, to some extent, employment. Continued access to the markets of developed countries facilitated this contribution of trade to recovery in Asia.

Latin America and the Caribbean also witnessed major shifts in trade balances associated with recent financial crises. Renewed capital flows to the region had allowed it to finance significant trade deficits in the 1990s, especially in 1997 when export receipts financed less than 90 per cent of imports. When external-financing conditions deteriorated sharply in 1998, the net resource transfer to the region was abruptly and substantially reduced. Combined with a slowing pace of export expansion and weak commodity prices, a reduced financial inflow of about $30 billion necessitated an even sharper reduction in the rate of import absorption. As a result, the volume of imports into the region declined markedly in 1999.

Unlike the sharp adjustments in other regions, African countries were able to sustain the growth of their import volume in 1998, despite a slowdown in their export growth. Between 1995 and 1997, the value of merchandise exports of African countries increased steadily and financed between 95 and 98 per cent of the value of their merchandise imports, which grew in volume about 6 per cent a year. However, the increase in their export volume slowed to only 1½ per cent in 1999. Import growth was maintained at a pace above that of exports, however, causing the trade balance of Africa to move towards wider deficits.

EXTERNAL FINANCING FOR EMERGING ECONOMIES REMAINS CONSTRAINED

As indicated in the foregoing discussion of trade balances, capital flows into emerging economies dropped sharply during the 1997-1998 crises. Although investor confidence was gradually restored after the Brazilian devaluation at the beginning of 1999, net private capital flows to emerging economies remained low. Corresponding to the net transfer of financial resources out of the developing countries, the net inflows to these countries of investment, credit and grants were smaller in aggregate than their net payment of interest and dividends.[3] Although data are available as of the time of

[2] Estimates for the total value of world merchandise exports exceed those for world merchandise imports in any year. Moreover, the size of the residual varies from year to year and has been unusually large in recent years. Any assessment of the impact of changes in the external balance of different groups of countries based on estimated changes in trade balances should therefore be interpreted with caution.

[3] Illustrating an extreme case, the negative net financial transfer of the Russian Federation rose as the trade surplus was increased both by the compression of imports resulting from adjustments to the crisis and the increase in export earnings owing to rising international commodity prices. At the same time, there was little improvement in the level of foreign-exchange reserves, as capital inflows were weak and capital flight continued.

Table II.1.
MERCHANDISE TRADE BALANCES, 1995-2000

Billions of dollars

	1995	1996	1997	1998	1999[a]	2000[b]
Developed market economies	117	140	135	42	-31	3
Economies in transition	8	5	-11	-9	5	4
Developing countries	-1	9	45	88	105	103
Latin America and the Caribbean	1	2	-11	-38	-9	-10
Africa	-18	-21	-3	-19	-16	-16
Western Asia	12	44	48	16	39	50
East and South Asia	2	16	-4	109	92	81
China	16	14	41	44	26	24

Source: UN/DESA, based on Project LINK.

a Provisional.
b Forecast.

writing for only some of the flows and for only part of the year, certain developments in 1999 can be discerned.

Private financial flows

In 1999, the composition of private financial flows to developing and transition economies shifted towards equity and away from credit flows. A major aspect of this change was the sharp decline in net lending, the result both of cutbacks in commercial bank credit and the slow recovery of bond issuance from the low level of late 1998. A number of major banks, especially from Japan, where major bank restructuring operations were underway, sought to reduce their exposure to emerging markets. At the same time, the demand by potential borrowers for external credit in developing and transition economies was weak, reflecting the weak state of domestic economies and thus investment.

Bank lending to Asia, which had already fallen sharply in 1998, fell further in 1999. The brunt of the reduction in lending to Latin America and transition economies took place in the latter year. Foreign bank claims on Brazil and the Russian Federation, for example, declined 16 per cent and 14 per cent, respectively, in the first half of 1999.

In addition, after a promising surge in the second quarter of 1999, emerging-market bond issuance weakened substantially. Several emerging-market economies, including Brazil, maintained or regained access to these markets, but others, such as the Russian Federation and Ukraine, were still excluded at the end of the year. Latin America accounted for the majority of new emerging-market bonds in the year, with substantial issues by Mexican and Argentine borrowers, while Brazilian issuance fell substantially below the 1998 level. Asian countries remained largely on the sidelines of this market and African countries continue to be marginal participants.

In marked contrast, net portfolio equity flows to developing and transition economies recovered sharply during the year, particularly to Asia, where stock values had fallen especially sharply. In Latin America, net outflows of portfolio equity were reversed. Reflecting renewed domestic as well as international investor activity, stock markets strengthened substantially in a number of emerging-market economies, notably in Eastern and Southern Asia, Latin America and in the Russian Federation.

As elaborated below, net flows of foreign direct investment (FDI), although moderating in the aftermath of the Russian and Brazilian crises, were much more stable than credit flows and constituted the overwhelming source of capital flows to various countries in 1999.

Official flows

Net official flows to developing and transition economies declined sharply in 1999, as the surge in disbursements of emergency financial assistance to countries impacted by the crisis subsided. Additionally, with financial stabilization and the beginning of economic recovery in a number of countries during the year, repayments of official loans rose substantially.

The most dramatic swing took place in net flows of the International Monetary Fund (IMF). The drop in Fund net lending in 1999 was exacerbated by the fact that some potentially large IMF disbursements to some countries have been delayed by differences over policy matters. The result was that, in the first nine months of 1999, IMF received net repayments from developing and transition economies totaling approximately $8.5 billion, compared to net lending of about $15 billion in the same period in

1998. Commitments of new lending during the first three quarters of 1999 declined also, but by far less, to $11 billion from $15 billion in the corresponding period of 1998, indicating that significant if somewhat smaller new drawings could be expected in the ensuing year.

Financing outlook

The large swings in the balance of payments of developing and transition economies since the mid-1990s have mainly reflected huge surges of private financial flows first into and then out of emerging-market economies. Investor interest in these countries began to reawaken in 1999, albeit mainly in the equity sector. Certain encouraging developments, however, could also be discerned in international bond markets, in particular in the trend of yields on emerging-market bonds through the year.

After exploding in the third quarter of 1998, yield spreads eased in major components of the emerging-economy bond market (see figure II.4).[4] The most encouraging developments were in the market for Asian bonds, where yields approached pre-crisis levels. Latin American yields also receded from their peaks, although they remained high even by that region's standards. The unresolved nature of the Russian situation, in contrast, ws reflected in the yield spread on that country's bonds, which, albeit reduced, still exceeded 30 percentage points.

The data on spreads also suggest that the world financial markets have become better able than during the depths of the crisis to make distinctions between different country situations. For example, the surge in Latin American yields in early 1999, associated with the Brazilian currency crisis, was only moderately reflected in Asian yields. Moreover, the increased Latin American yields in January and February 1999 were largely unwound by March and April.

This notwithstanding, emerging-market bonds were seen to have become more risky in 1999 in that the market was absorbing the changed views of the international official community on how to treat international bonds of countries in debt-servicing difficulty. Previously, the presumption had been that a country in debt difficulty would seek to renegotiate the debt servicing on its international bank loans and loans guaranteed or supplied by bilateral official institutions (mainly export-credit agencies of major economy countries). Negotiations with the multiple and dispersed holders of a bond issue were deemed to be

4 The interest yield on emerging-market bonds can be decomposed into a base interest rate for risk-free capital (usually the yield on United States Treasury bonds of equivalent maturity) and an additional element—the "spread"—that compensates bondholders for the higher risk of lending to these countries. Changes in the spread are taken to indicate changes in market sentiment about a country or group of countries.

Figure II.4. Yield Spreads on Emerging Market Bonds, 2 January 1998 to 31 December 1999

Source: Data of JP Morgan Company, New York.

difficult to organize, with the result that bond finance had been largely excluded from debt relief packages. Partly as a consequence, bond finance became increasingly popular and grew as a share of total debt. Because they became so important, bonds had to become subject to restructuring, along with all other debt.

Concern about the need to restructure bond financing in crisis situations was highlighted during 1999 by developments in Pakistan and Ecuador. In the former case, a January arrangement between Pakistan and the Paris Club of official creditors was made contingent, *inter alia*, on the successful renegotiation of Pakistan's Eurobond debt. This was unprecedented and led to an indirect form of restructuring wherein more than 90 per cent of the bondholders agreed to swap the bond in question for new bonds on which principal does not have to begin to be paid until 2002.

The developments in Ecuador also broke with convention. The economic situation in Ecuador had deteriorated severely owing to natural disaster, low commodity prices, a banking crisis and domestic controversies over policy reforms. At the end of September, Ecuador announced that it would not make nearly $45 million of interest payments due on a part of its "Brady" bonds (partially guaranteed bonds issued as part of the final resolution of the 1980s debt crisis). Lacking resources, the Government sought to cover the payment falling due by using an interest payment guarantee on the bonds in question that required approval of 25 per cent of the bondholders. However, a larger group of the bondholders decided instead to "accelerate" the bond, that is, to demand its immediate and full payment. This action sent the Government of Ecuador into formal default on the Brady bonds, which triggered cross-default clauses on other bonds and raised uncertainties about what other private international creditors of Ecuador might do. In effect, the Government had to renegotiate its entire private foreign debt.

Further similar disruptions could have adverse effects on other emerging-market bonds. Market prices might fall on other Brady bonds if the spectre were raised of bondholders pushing more debtors into formal default. At the same time, this experience shows that international bond purchasers are ultimately likely to seek a negotiated solution to a debt crisis, as had the bank creditors in the previous cycles of crisis, and that bonds are effectively renegotiable. This will make bond buyers more cautious in the future and raise the cost of access of emerging-market economies to international finance.

In the short run, the impact of these bond debt developments on emerging market debt is expected to be modest, especially set against the concerns that have already kept bond yields, as in Latin America, at exceptionally high levels. It is expected that equity flows—portfolio and FDI—will remain the largest component of external financing for developing and transition economies in 2000. As recovery gathers momentum and confidence grows over time, however, new financial surges could begin to build, in some cases as early as in 2000. Some countries may then find the robustness of their financial sectors again tested by high and volatile volumes of capital flows. This sets a premium on speedy and deep progress in financial reform programmes and in developing national and international policies and mechanisms for dealing with surges in capital flows.

RECENT TRENDS IN FOREIGN DIRECT INVESTMENT

In 1999, world foreign direct investment (FDI) inflows reached a record level of an estimated $827 billion, of

Table II.2.
FOREIGN DIRECT INVESTMENT (FDI), 1996-1999

Billions of dollars

	1996	1997	1998	1999[a]
Inflows	363	468	660	827
Outflows	382	479	648	..
Inward stock	3 048	3 336	4026	4853
Outward stock	3 146	3 419	4110	..
Cross-border M&As[b]	163	236	411	..

Source: UNCTAD, based on national sources and UNCTAD estimates.

a Preliminary estimates.
b Majority-held investments only.

which an estimated $198 billion were directed to developing countries (see table II.2). FDI flows grew by some 40 per cent in 1998 and some 25 per cent in 1999, among the highest growth rates attained since 1987. FDI is now the most important component of private capital flows to developing countries, having demonstrated remarkable resilience in the aftermath of the financial and economic crises.

FDI flows to developing countries increased by 15 per cent in 1999, after stagnating in 1998. Latin America and the Caribbean replaced developing Asia as the largest host developing region for FDI for the first time since 1986 (see table A.6). In Latin America, privatization was a major magnet, causing inflows to increase by about one-third over 1998. Of the estimated total of $97 billion, some $31 billion went to Brazil, which was the largest recipient in the region for the second consecutive year. Argentina also was a large recipient, with a significant increase in FDI in 1999 largely attributable to a single deal—the $17 billion acquisition of YPF SA by Repsol SA of Spain. Cross-border mergers and acquisitions (M&As) increased significantly in such countries as Chile, Ecuador and Peru, but decreased in Colombia and Venezuela. This is mirrored in FDI flows, which increased in the former countries but declined in the latter.

FDI flows to developing Asia (including West Asia) increased marginally in 1999 to an estimated $91 billion. China, the largest recipient of FDI flows among developing countries since 1992, received $40 billion, nearly 8 per cent less than in the previous year, partly because flows from crisis-affected countries in Asia declined. Flows to Singapore increased by 20 per cent to $8.7 billion. There was a substantial recovery in flows to Taiwan Province of China from $0.2 billion in 1998 to $2.4 billion in 1999. Among the five countries most affected by the financial crisis, FDI flows to Indonesia continued to be negative, declined in the Philippines (from $1.7 billion to $0.9 billion) and Thailand ($6.9 billion to $5.8 billion), but remained steady in Malaysia (about $3.7-3.8 billion). The Republic of Korea saw a 55 per cent jump to $8.5 billion, largely driven by M&As. The investment prospects for developing Asia remain bright in the light of the underlying economic determinants for FDI flows, the recovery of the regional economy, the widespread ongoing liberalization and restructuring efforts in the region, and the prospect of China's accession to the World Trade Organization.

Africa is estimated to have attracted $11 billion in inward investment in 1999, with large increases in Morocco (to $2 billion) and South Africa (to $1.3 billion).

Developed countries received an estimated $609 billion in FDI inflows in 1999, accounting for nearly three quarters of the world's total. The United States and the United Kingdom continue to lead the world in FDI flows, both outward and inward. The United Kingdom became the largest source of FDI in 1999, replacing the United States for the first time since 1988. These two countries also represent, for each other, the principal home as well as host country. Other developed countries recording high levels of FDI flows were France and Germany (both inflows and outflows), the Netherlands (inflows), Spain (outflows) and Sweden (inflows). Sweden became the second largest recipient country in the world for the first time. Total flows between the European Union and the United States increased significantly again in 1999, after doubling in 1998. FDI inflows to the European Union as a region were an estimated $269 billion, a 14 per cent increase over the previous year.

Economic restructuring in Japan has included a more liberal M&A regime that led to almost a quintupling of FDI inflows – from $3 billion in 1998 to an estimated $14 billion in 1999. Japanese outflows, also driven by M&As, declined marginally to an estimated $23 billion, but the decrease would have been larger if it were not for the acquisition of the international tobacco business of RJR Nabisco by Japan Tobacco for $7.8 billion.

The countries of Central and Eastern Europe maintained an inflow of about $20 billion in 1999. Poland, the Czech Republic and the Russian Federation were the main recipients. Flows to the Russian Federation rebounded after flows had been reduced to as low as $2 billion by the crisis in 1998.

As reflected above, the growth of FDI in recent years has been fuelled to a large extent by a boom in cross-border M&As. This phenomenon is increasingly important in the developing world and played a key role in reviving FDI flows in 1999. The value of M&As in 1999, at $1.1 trillion on an announcement basis, was some $450 billion higher than in 1998, itself an increase of $260 billion over 1997. In 1999, a number of large-scale cross-border M&As were announced. The acquisition of Mannesmann AG of Germany by Vodafone AirTouch PLC of the United Kingdom for nearly $200 billion, announced in 1999 but to be realized in 2000, is the largest M&A ever, far exceeding such previous large deals as the takeover of Amoco by BP for $55 billion and the acquisition of Chrysler by Daimler-Benz for $44.5 billion, both in 1998. Such cross-border M&As are the result of the increased competition brought about by liberalization and globalization and the special needs and conditions of particular industries which call for consolidation on a global scale, especially in developed countries. For example, overcapacity and low demand have prompted restructuring through M&As in such industries as automobiles and oil; in banking and pharmaceuticals, the strategic objective of sharing high investment costs in information technology and high research and development (R&D) expenditures is paramount. Achievement of such goals is facilitated by

the fact that most large M&As do not necessarily require cash or new funds, but take the form of a mutual exchange of stock.

Reflecting the growth of FDI, the ratio of FDI flows to gross fixed capital formation (GFCF) in developing countries increased from 7 per cent in 1997 to 11 per cent in 1998, reaching the average level prevalent in the developed countries. However, with M&As becoming a more important form of entry of TNCs into host markets, the rising ratio of FDI to gross fixed capital formation (GFCF) in recent years (figure 2) does not necessarily signify an increase in the foreign contribution to domestic investment in host countries, but rather a shift of ownership and management control over a country's production facilities to shareholders in a different country. This applies primarily to FDI in developed countries; in developing countries, M&As play a smaller (though rising) role as a mode of entry for TNCs. At the same time, capital is only one (and not necessarily the most important) component of FDI, and the greater participation of TNCs in host countries through M&As may result in increases in other resources and capabilities of host countries. If the total capital mobilized by TNCs is taken into account, the ratio of investment under the governance of TNCs to total investment in host countries is likely to be substantially higher, than the ratio of FDI to GFCF particularly in developed countries.

The world accumulated stock of FDI rose by about 20 per cent in 1999, reaching $4.9 trillion (see table II.2). Judging from data for such developed countries as Germany, Japan and the United States, the total value of the assets of foreign affiliates is some four to five times the value of the inward stock of FDI (UNCTAD, 1999).[5] In developing countries, however, this asset value is only slightly higher than FDI stock. This suggests that international production activity in developing countries relies much more on capital from parent firms than it does in developed countries. The global stock of total assets associated with international production is estimated at around $15 trillion in 1998. However, this figure does not capture international production that takes place in establishments under non-equity forms of TNC control. The size of, and stakes in, international production are much larger and extend wider than the assets owned by TNCs.

In 1998, with the stagnation of FDI flows to developing countries and a sizeable increase in flows to developed countries, the share of developing countries in world FDI flows declined to 26 per cent, from 37 per cent in the previous year. Even though FDI flows to developing countries rebounded in 1999, this share declined further. The share of Central and Eastern Europe also declined in 1998 and 1999. These reduced shares are largely the result of the exceptionally strong flows to the developed countries and the weakness of the Asia region. Their share of the least developed countries (LDCs) in world FDI flows remained less than one per cent during most of this period.

World FDI flows continue to be concentrated in a handful of home and host countries. The 10 largest *home* countries (in terms of outward FDI stock) accounted for four-fifths of the world's outward FDI flows in 1998; some 34 countries had FDI outflows of $1 billion or more, compared to 13 countries in 1985. On the host country side, the 10 largest (in terms of inward FDI stock) accounted for over 70 per cent of world FDI inflows in 1998. At the same time, 111 countries in 1998 recorded inflows of over $100 million, compared to 45 countries in 1985. Among developing host countries, the concentration of inflows rose in the 1990s: the five countries receiving most FDI over the past decade or so (China, Brazil, Mexico, Singapore and Indonesia, in order of inward FDI stock) accounted for 55 per cent of FDI inflows to all developing countries in 1998, compared to 41 per cent in 1990.

However, the concentration of FDI inflows and outflows does not provide a full picture of the significance of FDI for different countries. FDI flows need to be seen against the size of each economy to appreciate their importance in each case. If the size of host economies is taken into account, developing countries as a group received more FDI in relation to GDP than developed countries in 1997, with several developing regions receiving more FDI per dollar of GDP than any developed region. Moreover, the disparities among developing regions were considerably less than suggested by the distribution of world FDI inflows. Developing countries receive more FDI than might be expected on the basis of their incomes alone, reflecting the fact that FDI is attracted not only by market size but also by other factors, especially natural and human resources.

FDI outflows in relation to GDP from developed countries are higher than from developing countries, but the disparity is less than might be expected from the shares of the two groups in world FDI outflows. For some developing regions, such as South, East and South-East Asia, FDI outflows per $1,000 of GDP do not fall far short of the levels for developed countries in general, as well as for some individual major developed home countries. This suggests that, even at lower levels of development, many countries have firms that are sufficiently competitive to establish themselves abroad.

In contrast, the differences among regions in FDI inflows and outflows on a per capita basis are larger than for total inflows and outflows. In 1998, per capita FDI inflows to developing countries as a group were about

[5] *World Investment Report 1999: Foreign Direct Investment and the Challenge of Development,* United Nations publication, Sales No. E.99.II.D.3.

seven per cent of those for developed countries,[6] reflecting the fact that developing countries receive a smaller proportion of the world's FDI and yet account for the bulk of the world population. The same applies to outward FDI per capita.

The sectoral distribution of FDI has changed over the years, reflecting the competitive advantages of firms in host and home countries, the degree of liberalization in each industry and firm strategies in response to globalization in various industries. FDI data by sector and industry have limitations of country coverage as well as of disparities in industry classification among the reporting countries;[7] nevertheless, they throw light on various aspects of the sectoral and industrial patterns of international production and the trends emerging in those respects.

The most striking feature of the sectoral distribution of the stock of FDI is the decline, by half, of the share of the primary sector between 1988 and 1997, globally as well as in developed and developing countries (see figure II.5). The services sector experienced a corresponding increase, again in both developed and developing countries.[8] The share of manufacturing in total FDI remained stable and, in developing countries, is the most important sector.

The sub-sector accounting for the largest share of inward FDI stock is finance, followed by trade. The lead position of financial services (banks, insurance, securities and other financial companies) has not changed over the past decade. The finance sector was the largest recipient of FDI inflows both in 1988 and 1997 and its share of both inflows and inward stock has increased over this period. This is because TNCs need to be physically present in a market in order to provide financial services to that market, especially to service the international trade of foreign affiliates of TNCs in manufacturing and other services. More recently, the restructuring of the financial sector in developed countries through cross-border M&As has been a factor underlying its dominant position. Liberalization of the sector in developing countries has given further momentum to FDI in financial services.

Finance and trade are also the largest recipient sectors for FDI in developed countries. In outward FDI from developed countries (which accounts for some 90 per cent of world outward FDI stock), capital- or technology-intensive industries (such as chemicals, electrical machinery and motor vehicles) account for a large share of total manufacturing FDI, reflecting the global strategies of TNCs in those industries to benefit from technological development and from scale and scope economies through international production. Recent large M&As in motor vehicles and pharmaceuticals have intensified the concentration of FDI in these industries, in which partnership also plays an increasing role.

In developing countries, real estate and chemicals respectively are the two leading sub-sectors for inward FDI. The services sector has gained in importance principally at the expense of the primary sector. There was a significant decline in the share of and in total inward FDI stock in developing countries during the past decade, but it continues to be the most important sector.

THE INTERNATIONAL TRADING SYSTEM POST-SEATTLE: THE DEVELOPING COUNTRIES' PERSPECTIVE

The Seattle preparatory process revealed the extent of change within the World Trade Organization (WTO). It has lost the "rich man's club" image of its predecessor, GATT: of 135 WTO members, 97 are developing countries, including 29 least developed countries, and 16 of the 30 countries now in the process of accession are developing countries, including seven least developed countries. As of end-November 1999, more than half of the 249 proposals submitted in the preparatory process for the Seattle WTO Ministerial Conference, in more than 20 subject areas, came from developing countries (including proposals submitted jointly by developing and developed WTO members). The greatest number of proposals were in the following subject areas: agriculture - 46 proposals (18 from developing countries); services - 25 proposals (14 from developing countries); industrial products - 14 proposals (two from developing countries); TRIPS - 15 proposals (8 from developing countries); and 'new issues'[9]—37 proposals (11 from developing countries). This shift in balance created great expectations on the part of the developing countries for the Seattle process; these expectations were dashed both by the failure to launch a new round of multilateral trade negotiations and by the process which was used in an attempt to avoid this failure.[10]

6 In 1996 and 1997, this ratio was about 12 per cent.

7 The distribution is estimated on the basis of data for 38 countries that report inward FDI by industry and account for three-quarters of the world's inward FDI stock and data for 15 countries that report outward FDI by industry and account for some 90 per cent of the world's outward stock.

8 Services sector affiliates are established not only by service sector TNCs but also by TNCs in primary and manufacturing industries which often start international production by establishing trading affiliates. The importance of services activities for manufacturing TNCs is one factor contributing to the growth of FDI in services. (See UNCTAD, 1996. *World Investment Report 1996: Investment, Trade and International Policy Arrangements,* United Nations publication, Sales No. E.96.II.A.14.)

9 'New issues' include trade and investment; trade and competition policy; transparency in government procurement; trade facilitation; electronic commerce; and labour rights.

10 The negotiating process started with a set of open-ended consultations, in which all delegations could participate. When little progress was made, discussions shifted to smaller, exclusive groups (known at "Green Rooms") from which many delegations were excluded.

Figure II.5. Inward stock of foreign direct investment, by sector, 1988 and 1997

(a) World[a]

(b) Developed countries[b]

(c) Developing countries[c]

Source: UNCTAD, 1999.

a Not including Central and Eastern Europe.

b For 1988, data are based on inward stock in Australia, Austria, Canada, Germany, Iceland, Italy, Norway, Switzerland, United Kingdom and United States that accounted for 76 per cent of total inward stock in developed countries in 1988. For 1997, data are based on inward stock in Australia, Austria (1996), Canada, Denmark (1996), Finland, France (1996), Germany (1996), Iceland, Italy, Netherlands (1996), Norway, Switzerland, United Kingdom and United States. They accounted for 81 per cent of total inward stock in developed countries in 1997.

c For 1988, data are based on actual inward stock in Bolivia, Brazil, Colombia, Hong Kong, India, Indonesia (1992), Namibia (1990), Nigeria, Pakistan, Peru, Philippines, Republic of Korea, Singapore, Swaziland, Thailand and Venezuela, as well as inward stock on an approval basis in Bangladesh, Cambodia (1994), Lao People's Democratic Republic, Malaysia, Nepal, Sri Lanka, Taiwan Province of China and Viet Nam. They accounted for 53 per cent of total inward stock in developing countries in 1988. For 1997, data are based on actual inward stock in Brazil, Colombia, Hong Kong, India (1995), Namibia (1994), Nigeria (1992), Pakistan (1996), Peru, Philippines, Singapore (1996), Swaziland (1993), Thailand and Viet Nam (1996), as well as inward stock on an approval basis in Bangladesh, Cambodia, China, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar (1996), Nepal, Republic of Korea, Sri Lanka and Taiwan Province of China. They accounted for 67 per cent of total inward stock in developing countries in 1997.

Many WTO members had expressed their support for launching a new round of multilateral trade negotiations and the failure of Seattle has not fundamentally altered those countries' perception of the need for such a round. Despite the pressure exerted by NGO protests,[11] the main proximate cause for the failure was the substantive differences among major trading blocs, particularly as regards agriculture and anti-dumping.

A round of trade negotiations with a broad-based and balanced agenda to conclude within a three-year timeframe continues to be an objective of a number of developed and developing countries. The main argument for launching the new round has been to keep up the momentum of trade liberalization against potentially stronger protectionist pressures around the world, as well as to provide the opportunity for trade-offs that would facilitate concessions for different participants, including developing countries. Among the major trading countries, the European Union has been the main proponent of a "Millennium" Round and, since the Ministerial Conference, has been calling for an early start on relaunching the negotiations. The United States, on the other hand, has been hindered from taking major initiatives by the failure to obtain "fast track" authority (or even legislation setting out negotiating objectives) and has thus tailored its proposals to conform to its residual negotiating authority.

In contrast, some developing countries consider that WTO work should concentrate on the full implementation of the Uruguay Round and its "built-in agenda" which foresaw new negotiations on agriculture and trade in services, and reviews of several Multilateral Trade Agreements (MTAs) which could give rise to negotiations. These countries have indicated that there was no consensus on structuring the future WTO work programme as another "round". Other matters of priority for many developing countries include the implementation of special and differential treatment in their favour as envisaged in various WTO agreements, and correction of imbalances in several WTO Agreements, including on Subsidies and Countervailing Measures, Anti-Dumping, TRIPS and TRIMS, all of which have major implications for development policies and/or the export interests of developing countries.

In particular, in the view of developing countries, multilateral negotiations should seek substantial liberalization of trade in a balanced manner covering all products, services sectors and modes of supply of export interest to developing countries. In this view, there should be "umbrella" negotiating groups which would conduct overviews of the progress in specific areas toward these general goals. For example, such a negotiating group on the transfer of technology has been suggested; this would propose approaches to negotiations in various areas that would correct the current trend toward reduced access to technology for developing country firms arising primarily from the privatization of R&D in the developed countries.[12]

The preparatory process for the Seattle Ministerial Conference undertaken in the WTO General Council from September 1998, centered on issues and proposals relating to: (a) the implementation of the WTO Agreements; (b) already mandated negotiations on agriculture and services and the "built-in agenda" in other areas; (c) the follow-up to the High-Level Meeting on Least Developed Countries in 1997; (d) other possible work on the basis of the programme initiated at the Singapore Ministerial Conference, such as "new issues"; and (e) other matters concerning multilateral trade relations of WTO members. There was also an expectation that some decisions or agreements could be reached at Seattle (the so-called "deliverables"). These included ministerial decisions regarding: (a) duty-free access for products exported by the least developed countries; (b) the coherence of global economic policy-making, i.e., coordination of activities among the WTO, the Bretton Woods institutions, UNCTAD, UNDP and other international organizations; (c) transparency in government procurement; and (d) decisions with respect to matters where outstanding deadlines have not been met (see 'Implementation' below) or where decisions were awaited, e.g. the extension of the moratorium on non-violation cases under the TRIPS Agreement. African countries also set out a list of issues on which they considered that decisions should be taken.

Developing countries are of the view that any Ministerial declaration eventually launching the new negotiations should contain a statement of the 'problematique' facing developing countries - a 'diagnosis' of the overall problem which the negotiations should seek to correct. Otherwise, in their view, the negotiations would be conducted on the assumption that liberalization of world trade, and the tightening and extension of multilateral trade disciplines into new areas, was an end in itself, rather than a means to achieving the more rapid development of developing countries.

The state of implementation of many provisions

[11] The 30,000-40,000 street demonstrators outside the conference building included a variety of very different groups: (a) over 20,000 members of labour unions demanded the enforcement of minimum labour standards in countries supplying the United States, and the maintenance of US defences against dumped and subsidised imports; (b) environmental activists protested against WTO rulings relating to dolphins and sea turtles, imports of beef from hormone-fed cattle, and regulatory action against genetically modified (GM) foods; (c) a broad coalition of NGOs condemned the WTO as an instrument that served the interests of multinational corporations and globalisation; most supported calls for labour standards and many saw trade liberalisation as damaging to social and political goals; (d) other groups accused the WTO of overriding US laws, preventing state and local governments from applying secondary boycotts in protest against human rights abuses in China and Myanmar, denying anti-AIDs drugs to African countries, and forcing inappropriate policies on developing countries.

[12] See Carlos M. Correa, "Technology Transfer in the WTO Agreements", UNCTAD August 1999

intended to provide for special and differential treatment for the developing countries ('S&D' provisions) is a source of deep concern to many developing countries. In many cases, this is because such provisions are phrased in vague, "best endeavour" language. Developing countries would like all S&D provisions translated into concrete benefits for them and would like the concept of special and differential treatment to be reconfirmed and adapted to the realities of globalization, as well as to their own development policies, so as to ensure enhanced coherence between trade and development policies. They believe such treatment should take into account the changing methods by which international trade is conducted and should attempt to correct the handicaps faced by developing country firms in competing in such trade by modifying the multilateral trade agreements (MTAs) where necessary. In doing so, all relevant provisions of the MTAs would need to be reviewed, the objective being to reach agreements on these issues at an early stage of negotiations.

Many developing countries are having difficulty in complying fully with their obligations under the Uruguay Round agreements before the expiry of the transitional periods. They therefore consider that the transitional periods should be extended for a length of time that would reflect the availability to developing countries of the necessary financial resources and human capacities to implement these agreements. In this view, if new negotiations are launched, they should include a "peace clause" so that developing countries could not be challenged under the dispute settlement mechanisms while the negotiations were in progress. This would preempt a situation in which developing countries would find themselves negotiating under the duress of frequent resort to the dispute settlement mechanism against them. Developing countries believe that, as in previous negotiations, a "standstill" clause should apply, and that such standstill should refer to all market access conditions, including the Generalized System of Preferences (GSP) and other preferential agreements. They are also of the view that developed countries should make a clear indication when the negotiations are launched that they are committed to meaningful trade liberalization in areas of interest to developing countries, including tariffs, agricultural subsidies and anti-dumping measures.

Developing countries consider that, as a general principle governing negotiations, they should be given credit for autonomous trade liberalization measures and that the binding of liberalization undertaken since 1 January 1995 should be recognized as a concession on their part. In their view, this principle, articulated in GATS Article XIX:3, should apply across-the-board.

Experience with the implementation of the Uruguay Round agreements has demonstrated that the administrative and other costs of implementing Multilateral Trade Agreements at the national level should be an integral part of negotiations, both to ensure that developing countries are able to implement the agreements and exercise their rights and to identify the amount of assistance that should be provided by the international community to support them.

Developing countries consider that there should be a reconfirmation of the commitment to devote special attention to the problems faced by the least developed countries (LDCs) and the adoption of measures to prevent their marginalisation in world trade. In their view, the launching of the negotiations should result in a decision to establish schedules under GATT Article II to extend bound, duty-free and quota-free treatment in favour of the LDCs by developed countries and by other developing countries in a position to do so; this should be accompanied by flexibility in the rules of origin to enable LDCs to benefit effectively. The specific problems of small vulnerable developing economies were recognized in the 1998 Geneva Ministerial Declaration. Developing countries consider that these should be addressed by identifying the specific concerns of these countries under the various MTAs and formulating proposals for action.

There are a number of areas where the deadline for action set in the Uruguay Round Agreements have not been met. These include, *inter alia*, the negotiation of an arrangement to limit export credits in agriculture, a GATS emergency safeguard clause and the completion of negotiations on rules of origin and anti-circumvention measures. These will have to be addressed by the WTO's governing body in preparing for the eventual launch of negotiations.

Developing countries see the most urgent objective in new negotiations as being to address implementation issues.[13] As part of these issues, they consider that, where S&D treatment has been expressed in terms of best endeavour clauses, there will be a need, before the negotiations are launched, to assess the extent to which the expected benefits have materialized. These clauses include the provisions of Article IV of GATS, the transfer of technology provisions of the TRIPS and SPS Agreements, Decisions on Measures in Favour of Least Developed Countries and Net Food-Importing Developing Countries and practically all provisions in the WTO Agreements related to technical assistance. The launching process might need to take separate decisions aimed at ensuring the effective operation of these provisions.

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13 These include issues related to the agreements on agriculture, services, anti-dumping, subsidies, sanitary and phytosanitary measures (SPS), technical barriers to trade (TBT), textiles and clothing, trade-related investment measures (TRIMs), trade-related aspects of intellectual property rights (TRIPS), customs valuation, rules of origin, balance of payments provisions, and special and differential treatment.

Another issue relates to the so-called "deliverables", i.e. those agreements which could be undertaken at the launching process itself. Countries have different proposals regarding such deliverables in this respect. The United States appears to attach very high priority to "deliverables", arguing that the biennial Ministerial Conferences should produce concrete results (e.g., ITA at Singapore in 1996, the moratorium on duties on electronic commerce in Geneva in 1998). The United States attaches particular importance to an extension of the moratorium on duties on electronic commerce, agreement on transparency in government procurement, a commitment to pursue the objective of zero duties in the APEC accelerated tariff liberalization (ATL) list, the expansion of the country coverage of the ITA (ITA II), increased technical assistance for developing countries for their implementation of the WTO Agreements, and provision for increased transparency of WTO operations. The EU supports certain of these views with qualifications, but a key deliverable for the EU is a decision to provide duty free treatment to LDCs' exports, as well as endorsement by the heads of international organizations of capacity building for developing countries. From a developing country perspective, most deliverables are closely linked with implementation issues, while least developed countries insist that the long-promised duty-free and quota-free treatment of their exports be among the deliverables.

CHAPTER III: REGIONAL DEVELOPMENT AND OUTLOOK

Growth of the world economy in 1999 was, on average, better than anticipated. None the less, it was also characterized by diverse outcomes across regions and countries. As economic recovery becomes more sustainable and economic prospects for a larger number of countries improve, growth is expected to be more evenly distributed in 2000 and the major imbalances in the world economy will be reduced.

DEVELOPED ECONOMIES

The developed economies grew by 2.5 per cent in 1999, well above the 1.8 per cent earlier anticipated. The main factor behind this improved growth was the better-than-expected performance of Japan. The economies of North America maintained their prolonged economic expansion with robust growth during the year. The economic slowdown in Western Europe in early 1999 was brief, although more protracted than earlier expected in Germany and Italy.

The prospects for 2000 for the developed countries as a group are positive. GDP growth will reflect a combination of slowing, but still strong, expansion in the United States, an acceleration of growth in Western Europe, and a more self-sustained recovery in Japan.

North America: durable economic expansion?

The developed economies of North America continued to expand rapidly in 1999, with the combined output of the United States and Canada increasing by nearly 4 per cent for the year. While the United States seems unlikely to be able to maintain its rapid growth, especially given the tight labour market, Canada still has some slack in capacity. A moderation of growth is expected in 2000, with both countries growing by about 3 per cent (see table A.1).

The strength and duration of the current economic expansion in the United States have surprised many economists and policy makers. Private consumption expenditure has been the driving force behind the expansion, fueled by real wage gains, high consumer confidence, and a sharp appreciation in equity markets. Strong business investment, particularly in information-processing equipment, has been another important factor. It has not only added to effective demand, but also contributed to rapid capacity creation and a rise in productivity.

However, these recent high rates of growth may not be sustainable. First, the labour market is very tight, as the unemployment rate has fallen to just above 4 per cent, the lowest in decades. Second, the current-account deficit reached a record high of more than $300 billion in 1999. Third, valuations in equity markets have risen much more than seems justified by economic fundamentals and are at levels that are exceptionally high by traditional benchmarks. Fourth, households have used large capital gains from equity and property markets for spending needs; the household propensity to save out of current income has declined to near zero and both consumers and the corporate sector have been borrowing well beyond historical levels, leading to record private-sector debt. These developments, among others, indicate that the pace of economic growth in the United States is close to, or already beyond, the potential warranted by its resource constraints and the need to maintain external balance. The challenge before policy makers is to avoid an immediate and sharp downturn in economic activity as the economy adjusts.

Inflation in the United States remains benign, with consumer prices rising at 2 per cent in 1999 despite the tight labour market and higher oil prices. Many factors contributed to this positive outcome, including vigilant monetary policy, disciplined fiscal actions, lower international prices, increased global competition, and higher productivity. However, the Federal Reserve has adopted a pre-emptive tightening of monetary policy, raising interest rates four times since the summer of 1999.

The conduct of monetary policy has become more complex as new factors pose additional challenges for the monetary authorities. First, the increased financial linkages in the world economy, including the problems of instability and contagion that became particularly acute during the past two years, have increased the impact of the Federal Reserve's policy on the rest of the world. Second, rapid technological innovation has made it difficult to assess the rise in productivity and to estimate the possible change in the non-inflationary potential rate of growth for the economy. Finally, the surge in the value of equity markets may have increased their impact on the real economy via the so-called wealth effects, thus requir-

ing the Federal Reserve to be concerned about developments in asset markets as well.

Fiscal policy in the United States has generally remained restrained, with government spending rising slower than GDP and government revenue. As a result, the surplus in government accounts is expected to reach $140 billion in 1999, up from $58 billion in 1998. The current debate on how to use the budget surplus is not expected to lead to any significant policy change in the short run. Large federal surpluses, over $100 billion per year, are expected to continue for the next few years.

There are several downside risks to the future growth prospects of the United States economy, as examined in chapter I. There are also optimistic views, reflected in the "new economy", that technological innovation and globalization may have permanently lifted the long-run rate of growth of productivity for the economy and that continued expansion of the "new" economy, i.e., the technology-related sectors, could offset, if not eliminate, any cyclical downturn in traditional economic sectors.

The economy of Canada also grew at above 3.5 per cent in 1999, but with variations in performance in the components of GDP. While consumption and government expenditure grew moderately, investment and inventory accumulation rose at a more robust pace, in contrast to weak real export growth. A rebound in exports and continued strength in machinery and equipment investment are expected to support growth in 2000.

The Canadian central bank, like its U.S. counterpart, also begain to increase interest rates in late 1999, but inflation continues to be low and the low rate observed in 1999 is likely to be sustained into the immediate future. Inflationary pressures could build as spare capacity is used up and the price of commodities exported by Canada strengthens in international markets. Interest rates in 2000 will be higher than in 1999, not only to contain inflationary pressures, but also to narrow the interest-rate spread relative to the United States.

Asia and the Pacific: a fragile economic recovery in Japan

The Japanese economy is finally recovering gradually, although the banking and corporate sectors remain fragile. After five consecutive quarters of decline, GDP rebounded in the first half of 1999, but reversed in the third quarter. For the year as a whole, GDP is estimated to have grown by just under 1 per cent, reversing a contraction of 2.8 per cent in 1998. The near-term economic outlook is still cautious, with a forecast of about 1 per cent in economic growth for 2000.

Government expenditure and net exports have been the most dynamic components of demand. Private consumption has remained weak and the level of consumer spending is still lower than a few years ago. Inventory adjustment has also taken place and industrial production has started to increase with a positive impact on corporate profits. In contrast, business investment has continued its downturn due to corporate restructuring. Despite the recent improvement in business sentiment, investment is expected to decline through early 2000 as firms continue to scale back on widespread excess capacity.

Various policy measures have played important roles in stimulating the economy. The Bank of Japan has held the overnight interest rate close to zero since early 1999 to promote recovery. Moreover, the Government has extended credit lines, particularly to small- and medium-sized firms, in order to further relax tight credit conditions. While private financial institutions remain cautious, credit conditions have eased somewhat. The accommodative monetary policy is expected to continue in 2000.

Fiscal policy has been crucial in stimulating the Japanese economy directly. There was a massive fiscal injection in the first quarter of 1999, but spending slowed down in the second quarter. In order to obtain a full-fledged recovery, the Government unveiled a new, but long-awaited, stimulus package in November 1999. The package totals 18 trillion yen ($ 170 billion), and includes large increases in spending on infrastructure projects and loans for small and medium-sized enterprises, as well as financing measures for housing, job creation and employment stability. It is estimated that the direct expansionary effects of the 6.8 trillion yen ($65 billion) infrastructure spending would boost GDP, which otherwise would have declined by 1.5 per cent in 2000.

Despite the Government's stimulus, employment and income conditions continued to deteriorate. By the end of 1999, the unemployment rate was nearly 5 per cent, the highest level in the postwar period, while the ratio of job offers to applicants stayed at the lowest level in decades. Incomes are still falling as wages and compensation of employees continue on a declining trend. Moreover, since corporate restructuring is continuing, employment and incomes are not expected to recover soon. A resumption of normal bank lending through the implementation of bank reforms will be crucial to a revival of business investment to an increase in the demand for labour, but this is not expected to be attainable in the short run.

Other factors may compromise the growth prospects of the Japanese economy. Among them, the sharp appreciation of the yen during the second half of 1999 may adversely affect exports and the recovery. To date, however, the negative price effect of the stronger yen has been more than offset by the positive income effect from the upturn in demand in Asia, Europe and the United States and by the transnational industrial linkages between parent firms in Japan and their overseas subsidiaries.

The fiscal deficit for 1999 reached almost 10 per cent of GDP (excluding social security), tax revenues are falling, and it is estimated that 40 per cent of the budget in 2000 will have to be covered by bond sales at a time when government debt levels are already at record highs. The additional bond issuance of about 7 trillion yen required to finance the package will push Japan's debt to 120 per cent of GDP, among the highest for developed economies. These considerations make it difficult to increase the fiscal stimulus further.

Like Japan, New Zealand suffered a recession in 1998 and is recovering. The economy bounced back strongly in the second half of 1999, supported by a rebound in exports, a turnaround in consumption, and a strong pick-up in agricultural production. The Australian economy, on the other hand, is in a situation similar to that of the United States: robust growth accompanied by stable low inflation. Having weathered the Asian financial crisis remarkably well, the economy registered its eighth year of expansion in 1999. Private-consumption expenditure, supported in turn by employment gains, low interest rates, and rising consumer confidence, is the main factor underlying growth in the economy. Construction projects related to the Olympics in 2000 have also contributed to growth. The housing sector and equity markets have remained buoyant. However, the growth of business investment, after a long expansion, has begun to wane recently. Because the stimulus related to the Olympics will fade, the economy is expected to slowdown in 2000 (see table A.1).

Both Australia and New Zealand experienced—albeit for different reasons—current-account deficits of at least 6 per cent of GDP in 1999. The deterioration in the terms of trade was the main cause of New Zealand's widening external deficit, but also sluggish export growth played a role in early 1999. In the case of Australia, the current-account deficit reflects a lower domestic saving rate, which is a key policy concern.

Australia and New Zealand share some downside risks and uncertainties First, low saving ratios and widening current-account deficits are major risks to the current outlook. Second, the strength of recovery in Asian economies and the continued buoyancy of the United States economy are crucial for both economies, but especially for New Zealand.

Western Europe: economic growth picks up

The economies in Western Europe strengthened during the year, as the effects of the slowdown induced by the world financial crisis dissipated. The slowdown in world demand, which had hit particularly hard in the fourth quarter of 1998 and lasted through the first quarter of 1999, resulted in a substantial drop in the region's exports. Manufacturing suffered badly due to the dependence on exports, and the strong investment growth seen in 1998 slowed. None the less, economic activity picked up from about the second quarter and prospects for the near future are positive (see table A.1).

The recovery of growth in the region has been supported by a strong rebound in exports, while consumption expenditure remained robust, inventory destocking ended, and investment picked up with the revival in manufacturing activity. Domestic demand, absent some cooling in the second quarter, remained strong throughout the rest of the year. Positive readings from recent consumer surveys suggest that this trend will persist into 2000. Steady employment growth, moderate wage gains, and low inflation should maintain growth in purchasing power, while high levels of consumer confidence argue for stable saving rates.

Exports started to expand in the second quarter as external demand strengthened. The increased competitiveness resulting from the substantial depreciation of the euro was also an important factor underlying the recovery of exports. Additionally, the adoption of a single currency has had a positive impact on growth. The elimination of exchange risk between member states has resulted in substantial cross-border merger and acquisition activity, propelled by the increase in competitive pressures. Moreover, companies have gained access to a much wider source of funds by issuing euro-denominated bonds.

Policy makers and commentators have raised questions regarding the appropriate exchange rate of the euro relative to the dollar. The euro started strongly with an early high in January of $1.19 but weakened significantly during the year, even briefly sliding below parity in early December. It is been argued that the sustained depreciation of the currency during the first half of the year was mostly a matter of the relative cyclical position of the euro-zone economies vis-à-vis the United States, as well as unfavourable yield differentials. However, early doubts whether ECB's policy decisions would be immune from political pressure may also have played a role. Later in the year, volatility reflected market uncertainties concerning the timing of the reversal of these fundamentals. None the less, there were also signs of confidence in the new currency, as euro-denominated bond issuances were substantial. The euro is therefore expected to strengthen in the medium term as euro-zone growth picks up relative to that in the United States and interest differentials narrow further. The British pound has remained strong, in contrast to expectations, but is relatively high historically and is expected to weaken in the medium term.

Individual country performance has been rather uneven across the region partly due to differential impacts of the world crisis and the fact that some countries were at a more advanced stage of the business cycle than oth-

ers. However, the relative strengths of domestic demand and external competitiveness of countries have also been affected by the continuing effects of the policies undertaken to enter the new monetary union, including the fiscal-austerity measures; the fixing of nominal exchange-rate parities; and the convergence of nominal interest rates. The major surprise was the mixed performances of the large economies, with France and the United Kingdom growing much more strongly than previously anticipated. On the other hand, Germany and Italy were much weaker. However, these two countries should benefit the most as exports pick up and economic growth accelerates in the Asian countries.

Diversity of growth performances in Western Europe also resulted from the continuing process of real convergence within the euro area, with some countries catching up to average levels of productivity and per capita income. These countries, including Finland, Greece, Portugal and Spain, are estimated to have grown by more than 3 per cent in 1999, with Ireland growing at more than 8 per cent.

The labour market in Western Europe continues to improve, but slowly and unevenly across the region and over the course of 1999. In the euro area, employment growth decelerated in the first half of 1999, probably caused by lagged effects from the economic slowdown. In the United Kingdom, employment stagnated in the first quarter but grew thereafter. For 1999 as a whole, growth of employment for Western Europe was similar to the rates experienced in 1998. Some acceleration is likely in 2000. The unemployment rate in the EU dropped below 10 per cent in 1999, for the first time since 1992 (see table A.4); some further declines are expected for 2000. However, no dramatic improvement is envisaged as it is generally agreed that the majority of unemployment is structural in nature.

Inflation in Western Europe began to pick up in the second quarter of 1999, due to the strong rise in oil prices and some non-oil commodity prices. The depreciation of the euro against the dollar in the first half of 1999 has also been a factor in the euro zone. The effect of these developments was most notable in the turnaround in industrial producer prices, which had seen continuous declines since 1998, but exhibited increases in the last few months. The threat of deflation appears over, but concerns over the inflationary potential from higher economic growth, coupled with rising commodity prices, have emerged. As yet, there are no signs of an acceleration in prices, in part due to the continuing downward pressure exerted by deregulation and increased competition, and the process of price harmonization across the new currency area. In addition, wage growth in most countries has remained moderate.

Notwithstanding the above, there are some concerns of overheating in some of the fast-growing economies, with a number of countries expected to register rates of inflation above 2 per cent. In the cyclically advanced countries, fiscal austerity may be appropriate to control inflation. In Denmark, for example, tight fiscal policy initiated in the second half of 1998 slowed activity significantly in 1999 and is expected to bring inflation back to almost 2 per cent in 2000. The very high rates of growth in some of the catching-up countries may indicate the need for some policy action.

With the strengthening of the recovery across Western Europe, monetary policy stances have changed after the substantial loosening that took place during the first half of the year. In the United Kingdom, the surprising rebound of the economy, especially the acceleration of housing prices feeding through into consumption, led the Bank of England to raise its repurchase rate twice since September, bringing it to 5.5 per cent. The ECB followed suit soon thereafter, raising rates by 50 basis points at its November meeting, citing high monetary growth providing ample liquidity in the system, the general improvement in the economic environment, and the end of the downside risks to price stability as the reasons for action. In both cases, the monetary authorities acknowledged that there were few immediate risks of breaching their respective inflationary targets, but that there were concerns over the medium-term. In the case of the ECB, the move can be seen as bringing rates back to their pre-crisis levels. Further moderate tightening can be expected over the next few years as the ECB reverts to a more neutral stance.

Fiscal policy has generally been neutral to mildly expansionary over 1999. However, low interest rates and more rapid growth have improved budget positions. On the other hand, progress on reducing structural budget deficits has been slow. Most countries have struggled to enact more comprehensive reforms or have postponed them.

Risks to the present outlook are mostly on the upside. Both consumption and investment could turn out stronger than anticipated, given the favourable monetary environment and potential for strong export growth. Also, stronger employment growth is possible, which would raise incomes and fuel consumption expenditure. These may exacerbate price risks, especially if higher wage increases were to materialize. A major unknown is how the monetary union will affect the dynamics of the wage-bargaining process in key countries. Finally, the possibility of policy mistakes should not be overlooked, especially given the new institutional environment. A single central bank must now manage a new entity, the euro zone, composed of 11 different economies, some experiencing markedly different economic conditions. Furthermore, policy decisions are to be made on the basis of aggregate

data, such as money supply, that do not have a solid track record and whose dynamics may well be subject to structural shifts and instability. A great deal of learning both by market participants and policy makers will be going on for the foreseeable future with attendant risks.

ECONOMIES IN TRANSITION

The economies in transition on the whole continue to perform poorly and very unevenly, although some marginal improvements in outlook have recently come to the fore. Growth, for group as a whole, was about 0.6 per cent in 1999 and is expected to accelerate in 2000 (see table A.2). The dispersion among the various countries of this group continues to be marked, however, with a deceleration anticipated for the Russian Federation, an upturn for the Baltics and Central Europe, and a continuation of the sluggish performance in south-eastern Europe.

Central and Eastern Europe: challenges of growth

The economic performance of countries in Central and Eastern Europe during the first half of 1999 was disappointing. In Central Europe, output and exports grew very slowly while it declined in most economies of South-eastern Europe. With the exception of Hungary, industrial output declined in the first half of the year throughout the group. However, signs of a reversal of this trend, particularly in the Czech Republic, Hungary and Poland, emerged in the latter part of the year. With an improving external economic environment, economic growth is expected to accelerate in the region and reach about 3.5 per cent in 2000, but with wide variations along a positive trend (see table A.2).

Among the principal reasons for the slowdown in 1999 were weakened global demand and the aftermath of the external shocks incurred in 1998. Slow growth in Western Europe and the loss of the Russian market after the devaluation of the rouble in August 1998 had a substantial impact on the region, owing to these countries' limited policy options, domestically as well as by way of reorienting their trade. Despite curbs in imports and temporary depreciation of real exchange rates for some economies, external balances deteriorated owing to the fall in exports in 1999 (see chapter II). The depreciation of the exchange rate and the temporary gains in terms of trade early in the year did not exert a favourable impetus.

The conflict in Kosovo also affected the region, especially countries of south-eastern Europe, by disrupting trade, by contracting tourism revenues, by delaying foreign direct and portfolio investment and structural reforms, as well as by increasing the cost of borrowing in international capital markets. The economic consequences of the conflict for these countries varied, but were substantial.

In addition to external shocks, weaker domestic demand also played a crucial role in the economic downturn. Tight fiscal and monetary policies were implemented to prevent an overheating of the economy of some countries, which the high current-account deficits recorded in 1998 could have set off. Poland, for instance, forced the economy to "cool down" after the rate of growth of domestic absorption in 1998 exceeded the rate of output growth by almost 4 per cent. Many countries tightened fiscal policy because of low revenues resulting from weak growth. Due to an acute twin-deficit problem, both Romania and Slovakia enacted austerity measures aiming at lowering expenditures and increasing revenues. Finally, structural problems in some countries, the deteriorated financial situation of enterprises, and further delays in the implementation of reforms (particularly in the Czech Republic and Slovakia) contributed to the region's poor economic outcome.

Inflation continued to fall in most of Central and Eastern Europe in 1999 (see table A.2). Nevertheless, inflation remained high in Romania due to a combination of lax income policies with declining output as well as to the monopolistic behaviour in public-service firms. Inflation also accelerated in Yugoslavia due to a relaxation of price controls in view of shortages incurred during and in the aftermath of the Kosovo conflict.

Deceleration of inflation should have created a more favourable investment environment, yet the region failed to benefit. Although interest rates were cut and monetary conditions gradually relaxed during the first half of 1999 in the Czech Republic, Hungary and Poland, real interest rates remained high, thus dampening investment in particular. With the rise in commodity prices, especially fuels, inflation began to pick up in the third quarter of 1999 in most of the region, thus inhibiting a further decline in interest rates. Hungary had to revise its inflation forecast upwards, while Poland raised interest rates in September as a pre-emptive measure to curb inflationary pressures.

Employment fell in 1999. Labour markets were affected by the fall of exports and, in Bulgaria, Czech Republic, Romania and Slovakia, by austerity measures and the restructuring of loss-making enterprises. The Kosovo conflict imposed a toll on labour markets in the Balkan countries, particularly in Yugoslavia.

For the most advanced economies of the region, one of the main policy goals for the near-term is the resumption of faster rates of growth. This, however, depends on the particular characteristics of the economies of the region. For Poland, for example, due to the relatively large size of its economy, the promotion of domestic demand provides the salient path to return to faster rates of growth, though

a solid export performance would be welcome too. To accomplish this uplift in domestic demand, the business environment in the country needs to be enhanced, including through privatization of the remaining large state-owned enterprises and by lowering the fiscal burden. Abatement of the tax burden, in turn, requires the adoption of welfare reforms. Accordingly, a tax reform is expected to be launched in 2000.

For the other more advanced economies of Central Europe, especially the Czech Republic, Hungary, Slovakia and Slovenia, the external sector is very important, and these economies are expected to benefit from the upturn in Western Europe as the Czech Republic and Hungary already experienced in part during the latter part of 1999. To bolster export revenues and gradually make room for wage drift, policy in these countries needs to gear export-promoting efforts towards knowledge-based economic activities (for which present investment-allocation strategies remain determinant.) Other necessary measures include further structural reforms, such as the introduction of new tax codes to foster private and foreign investment, enterprise restructuring to stimulate productivity, better enforcement of corporate governance, and improved control of inflation and of the current account.

The situation is more complex for the other economies of the region. Bulgaria and Romania, with a wide range of problems in many economic sectors and at the enterprise level, are expected to experience a recovery and a return to positive growth, respectively, in 2000. However, near-term growth prospects in these countries depend on the reopening of traditional transport routes to Western Europe which have been encumbered or altogether blocked due to the military confrontation over Kosovo and disagreements on Kosovo's future. Delays in reconstruction efforts may discourage FDI flows into Bulgaria, for instance, thus potentially hampering the implementation of its policies towards the establishment of market institutions.

For Albania and the successor States of the former Yugoslavia (except Slovenia), growth prospects depend strongly on the commitment of Western Europe to assist these countries in overcoming the economic fallout of the Kosovo conflict and guiding them onto a feasible modernization path. The total estimated cost of reconstruction of the region alone is on the order of $100 billion. Despite support by the international community, the pace of reconstruction has been slower than anticipated.

Economic prospects of several countries in the region are also influenced by the outcome of negotiations to join the EU. Among the proposed changes in the EU's strategy towards enlargement, as approved by the Helsinki European Council (10-11 December 1999), three are pivotal. One is that the distinction between slow- and fast-track negotiations will be abolished so that all 10 candidates from the eastern part of Europe will henceforth be actively negotiating for accession. Another is that the EU has committed itself to reforming its institutions in the course of 2000 to make enlargement possible and that it will reinforce its strategy towards the candidates. Finally, the EU is formulating a strategic approach to assisting the countries of south-eastern Europe as well as the Russian Federation and Ukraine. If implemented, these and other measures may in due course exert a positive impact on growth prospects for Central and Eastern Europe and provide incentives for the other south-eastern European countries to develop or improve their democratic institutions and market economies. However, many sensitive issues remain to be resolved before major changes will materialize.

The outlook for the region in 2000, therefore, carries two sources of uncertainties. One is internal and primarily associated with the social costs of the further needed structural reforms. The other is external and hinges on negative changes in the global outlook. Both for the most advanced States in terms of their structural transformation and for economies currently undergoing meaningful structural change, the high cost and low expected benefits in the short run of structural reforms may weaken the determination of policy makers to proceed with such incisive changes, especially when elections are scheduled, as in 2000-2001.

Commonwealth of Independent States: can the Russian recovery be maintained?

The twelve members of the Commonwealth of Independent Statues (CIS) are estimated to have grown by 1.6 per cent in 1999, which is better than had been anticipated earlier in 1999. However, as in preceding years, wide variations prevailed among various countries. The outlook for economic recovery in the laggard countries and for sustaining the recovery elsewhere remains subject to a number of conditions, many of which are outside the policy control of the domestic authorities. Growth is likely to return to most of the CIS countries in the near term, Moldova being a notable exception (see table A.2). Growth in 2000 should on average be around, or perhaps slightly below, that estimated for 1999.

Among the core conditions that delimited the environment for economic performance in 1999 three rank supreme: (1) the economic situation in the Russia Federation, (2) the recovery in energy and some other commodity prices, and (3) the determination of policy makers to pursue policies conducive to undertaking structural reforms and holding on to appropriate macroeconomic-policy stances. But even countries, such as Kyrgyzstan, that continued to progress with structural reforms and adhered to an appropriate macroeconomic-

policy environment, had to come to grips with the other elements of the policy environment, which tended to dominate in circumscribing the room for policy manoeuvre, hence for growth.

The Russian economy in 1999 performed much better than had been expected in the aftermath of the 1998 financial crisis. Driven by import substitution due to the substantial rouble depreciation in 1998, consumers shifted their shrunken demand to domestic products. So did domestic producers, albeit with some lag. As a result, industrial production began to reverse course in the second quarter of 1999. Monetary policy remained generally tight so that inflation fell markedly, thus underpinning a fairly stable exchange rate, which was also bolstered by unexpected gains on account of fuel exports. Fiscal revenues rose much faster than had been anticipated, in part because of higher revenues from oil exports, providing welcome room for policy manoeuvre. Public-sector arrears for wages and transfer payments could therefore be markedly reduced in the course of the year, which in turn propped up consumer demand to some degree. But levels of unemployment remain appallingly high in the Russian Federation, as in many other CIS countries. The upturn in economic activity has thus far not created jobs and the absence of incisive enterprise restructuring leaves ample room for continuing growth without adding to the demand for new workers.

Performance in the other CIS members in 1999 remained affected by the economic fortunes of the Russian Federation, given the magnitude of the slump in that country's trade, including with the CIS economies, and the lagged effect of the economic recovery on its import demand. The convulsions in the Russian economy after August 1998 set off a chain reaction, leading to a cumulative contractionary effect in many other CIS countries. This was due in no small measure to the magnitude of the slump during the first quarter of 1999 in the three largest economies (Kazakhstan, the Russian Federation and Ukraine), which account for over 90 per cent of the group's output. The ripple effects were especially pronounced in the neighbouring economies such as Belarus, Kyrgyzstan and Moldova.

Worst affected was Moldova, where industrial production fell by almost 30 per cent in the first half of 1999 and GDP declined by some 9 per cent for the year as a whole, the sharpest fall in the CIS region. However, thanks to disciplined policies by the authorities, IMF resumed its lending thus alleviating the external constraint and debt-servicing problems. In contrast, Belarus continued monetary and credit expansion and failed to implement long-delayed structural reforms. Inflation probably surpassed 200 per cent at end-1999 and GDP growth sharply decelerated, yielding around zero for the year as a whole.

However, the sharp negative impact of the Russian crisis on CIS economies peaked in early 1999 and gradually eased the downward pressures on the economic-policy environment elsewhere in the CIS. The economic slump in most of the rest of the CIS bottomed out around the middle of 1999 with the arrest of the fall in industrial production in the Russian Federation around the end of the first quarter and the easing of conditions of some other countries, including Kazakhstan and Ukraine, that began to benefit from substantial currency depreciations. Thereafter, a gradual recovery started in most countries of the region.

Ukraine reversed output contraction in the second quarter of 1999 as the industrial sector rebounded, helped by the sizeable real depreciation of hryvnya, but for the year as a whole the economy shrank by 1 per cent. The recovery in Kazakhstan began somewhat later during the third quarter, but overall growth for the year was a meagre 0.3 per cent. However, the sharp devaluations exerted upward pressure on inflation, which rose during the year. Domestic interest rates remained high in all countries with negative consequences for money markets and investment.

In several of the CIS countries of the Caucasus and Central Asia, which are non-fuel commodity exporters, weak commodity prices compounded the economic-policy environment, despite a relatively good agricultural performance in some countries. As the budgets of most countries are heavily dependent on export revenues, fiscal balances worsened, thus severely limiting the policy options available to domestic policy makers and prompting additional painful adjustment measures that cumulatively exerted downward pressure on the sustainable pace of economic activity. However, the economic situation has been slowly improving in these countries. Only Uzbekistan has thus far been left out of the incipient regional recovery, in spite of the country's natural resources. Its half-hearted approach to transition to a market economy is considered the principal culprit.

Oil exporters, on the other hand, have benefited from higher oil prices and progress in firming up or the inception of implementation of plans for major oil and gas pipelines, all of which are important for bolstering expectations and policy credibility. Meanwhile, Armenia and Georgia, which do not possess large natural resources, managed record substantial economic growth, single-digit inflation, and reduced current-account imbalances financed via official borrowing. The latter was made possible, of course, because of their strong reform commitment, which in turn helped them to weather the adversities discussed above.

As noted, the situation in the largest economies of the group remains precarious and growth prospects for the region as a whole depends much on the sustainability of the Russian recovery. On present policy stances and growth conditions, there does not appear to be sufficient

strength in the largest economies to help pull the other CIS economies out of relative stagnation. Structural reforms in the larger countries have been lagging and the outlook for a quick reversal in policy makers' sentiment is not very encouraging. Electoral concerns in several countries are likely to impinge upon short-term macroeconomic-policy stances as well.

It is still not clear whether the Russian Federation can maintain its recovery. Domestic demand is still very weak, with real disposable income, retail sales and personal consumption one fifth lower than their levels in 1998. Investment is still falling and uncertainty associated with the upcoming elections does not bode well for the immediate future. Whereas tax collection improved during 1999, much of it remains subject to ad hoc negotiations, especially with just a few large companies. Given the electoral environment and the military conflict in Chechnya, it is uncertain whether expenditure discipline can be enforced. Additionally, the rouble has been appreciating lately, thus gradually hollowing out the competitive margin for domestic producers afforded by the August 1998 devaluation. The scope for import substitution will soon be exhausted and commodity exports will hit supply bottlenecks. The absence of other policy measures, including structural reforms aiming at more solid productivity gains, compound the problem. As a result, Russian GDP growth is expected to slow down in 2000.

The outlook for Ukraine, the second largest CIS economy, remains subdued. There are considerable uncertainties over the pace, character and sequencing of structural reforms. Whether the authorities will exert sufficient discipline to ensure continuation of the macroeconomic stability remains to be seen. At year-end 1999 the currency continued to be under severe pressure. Any worsening of the budget deficit will exert further downward pressure on the exchange rate and foment inflation. Ukraine is also facing a possible default in early 2000 due to the debt-service hump on its recent Eurobond placements.

Such a scenario for the larger economies of the group provides only a moderately improved trading environment in 2000 for the other CIS countries However, the expected further firming of commodity prices and the improved regional environment in the near-term will benefit the Central Asian CIS countries in particular. If the agreements signed at the end of 1999 on constructing a major oil pipeline and building in parallel a gas pipeline come to fruition, foreign investment inflows should provide a major impetus to economic activity in the subregion. This would be particularly beneficial to Azerbaijan, Kazakhstan and Turkmenistan, but with spillovers into the regional economy. This might be especially important for Georgia, as it stands to benefit from transit revenues as well as from the more indirect spillover effects, including foreign-investor confidence.

Baltic countries: recovering from the Russian crisis

Economic performance of the Baltic States in late 1998 and early 1999 was markedly affected by events in the Russian Federation, leading to a severe contraction in industrial production and to low to negative growth in aggregate performances. However, all three countries have been recovering strongly since the second half of 1999. Estonia was the first to do so in the summer of 1999, paced by exports to the recovering EU markets, with Latvia following in the third quarter and Lithuania by year-end. None the less, GDP is expected to have declined by 1.2 per cent in 1999 for the region as a whole.

Current-account imbalances were a major source of policy concern in recent years as a result of weakening domestic demand and lower imports. Significant improvements of current accounts were booked in 1999 in these countries. Inflation declined further (see table A.2); and producer price inflation was negative in the final months of 1999. The latter in particular benefited exports, especially given the rigid exchange-rate arrangements these countries maintain. However, the depressed economic activity adversely affected government-budget balances. All three countries were cutting back expenditures in order to defend the credibility of their exchange-rate regimes. Latvia in particular resorted to monetary policy to defend the currency peg, but high interest rates discouraged consumer demand and investment. A credibility problem arose also for Lithuania's currency, the litas, owing to uncertainties about the future of the currency-board arrangements, which were removed in late 1999.

The anticipated recovery in Western Europe, the main trading partner of Baltic countries; reduced exposure of these countries to Russia; the relatively high resilience of the economies, owing to their structural reforms and firm macroeconomic-policy stances; and their improved prospects for membership in the EU in the medium run, all suggest that the incipient recovery in the region will strengthen in 2000. The region's output is expected to rise by 2.7 per cent, inflation to remain low, and current accounts to be moderately high but largely financed by strong FDI inflows. This is a moderately encouraging outlook, although GDP growth is well below the 4 to 7 per cent the region recorded in 1996-1998.

DEVELOPING ECONOMIES

Developing countries are estimated to have grown by about 3 per cent in 1999, a remarkable improvement over the 1998 performance but yet well below the rates of growth observed earlier in the decade. Growth returned to most of the Asian crisis-hit economies faster and stronger than anticipated due to successful reflationary

policies and strengthening external demand. The most populous countries in Asia, China and India, continued to record respectable rates of growth although the pace of growth seems to be slowing down in the former economy. Meanwhile, Latin America exhibited a dismal performance with most economies in South America experiencing a recession during the year. GDP growth was anaemic in western Asia, while in Africa growth increased only marginally (see table A.3). Prospects for the near-term are positive as growth is expected to return to Latin America and accelerate elsewhere. It is forecast that developing countries will grow by almost 5 per cent on average in 2000 as recovery is sustained and external demand continues to strengthen.

Africa: growth decline comes to an end

Africa grew by 3 per cent in 1999. This was a negligible improvement over the 2.8 per cent growth in 1998, but signaled an end to two consecutive years of decline. The turnaround was largely attributable to growth in export earnings of the region's oil exporting countries as a result of the increase in oil prices. A recovery in demand for some non-oil commodity exports in Asia and Europe improved export earnings of other countries, even though prices for some commodities remained weak or declined further. Strong macroeconomic policies and favourable domestic factors, notably, increased agricultural output in the majority of countries, also contributed to Africa's improved growth performance in 1999.

The combined GDP of oil-exporting countries increased by a full percentage point to 4 per cent (see table A.3). This outcome is even more remarkable since voluntary production and export restraints under OPEC agreements lowered crude petroleum output and the volume of exports in Algeria, Libya and Nigeria after new quotas came into effect on 1 April 1999. Libya's economic prospects improved significantly with the increase in oil revenues, the suspension of United Nations economic sanctions in April 1999 and the resumption of trade and investment ties with trading partners in Europe and Africa. On the other hand, increased oil revenues in Angola—which were also due to significant increases in output—benefited the economy only marginally because of the intensification of the civil war in 1999.

In Nigeria, frequent power supply disruptions, fuel shortages and civil unrest in oil-producing regions also reduced oil output. Accordingly, one of the policy initiatives adopted by the new civilian administration in Nigeria aimed at eliminating structural bottlenecks such as persistent power failures and fuel shortages that have crippled the economy. Additionally, the new administration unveiled a comprehensive set of policy proposals that emphasize a more prominent role for the private sector in the economic development of the country. The immediate concern of the new Government, however, was the introduction of reform policies aimed at combating corruption and mismanagement in the public sector, the armed forces and the oil industry.

While the recovery of oil prices strengthened government revenues in oil-exporting countries, Algeria and Egypt maintained existing policies of fiscal restraint that were consistent with ongoing reforms and economic liberalization policies. Libya, on the other hand, embarked on an expansionary fiscal policy after the suspension of sanctions. Increased government expenditures were concentrated on large-scale infrastructure projects and the acquisition of a wide range of goods and services that were unobtainable while the sanctions were in effect.

Growth, on average, in the non-oil exporting countries was slightly below the 1998 rate. The South African economy—the largest in the region—regained its growth momentum after a brief period of decline caused by the turbulence of the Asian financial crisis. Exports recovered with the strengthening of world demand. Capital flight and disinvestment, depletion of the country's gold and foreign-exchange reserves, currency depreciation, high domestic interest rates and escalating inflation observed in the early months of 1999 were halted and reversed as international investors responded to the sound macroeconomic management followed in the country. The newly elected Government implemented tight monetary and fiscal policies. By September 1999, the monthly rate of inflation in South Africa had dropped to its lowest level in over three decades. The new government also reconfirmed previous commitment to the macroeconomic strategy for growth, employment and redistribution (GEAR) introduced by the previous administration. The GEAR strategy emphasizes employment creation in the formal economy through strong, private-sector growth, as well as a commitment to fiscal discipline by the central government. South Africa's improved performance is important for the smaller economies of the region with which it has extensive economic linkages.

Increased domestic and foreign investment also contributed to GDP growth in several other countries that have made significant progress in maintaining stable money-supply growth, low inflation and manageable fiscal deficits. Privatization and market liberalization policies have opened up opportunities for strong private sector growth in many of those countries. Economic policies and structural adjustment programmes in some countries have also featured the necessary institutional and financial sector reforms—including extensive revisions of investment codes and other legal frameworks—to improve the investment climate and the confidence of both domestic and foreign investors.

Agricultural output increased in most countries as a

result of improved weather and growing conditions, in marked contrast to the two previous years, and provided the main stimulus to GDP growth. Agriculture-related services and manufacturing sectors expanded accordingly. However, in Ethiopia, Mauritius, Morocco and several other countries drought led to a decline in agricultural output and food shortages and had a negative impact on growth.

Continuing armed conflicts took a toll on economic activity in Africa and contributed to poor performance in Angola, Eritrea, Ethiopia, Somalia, Sudan and other countries. The border war between Eritrea and Ethiopia has caused the diversion of significant amounts of scarce foreign exchange and government revenue for war-related expenditures. The civil war in the Democratic Republic of the Congo abated during the year, but slow progress in the implementation of a cease-fire agreement since July 1999 delayed that country's resumption of normal economic activities. Post-conflict reconstruction efforts in Liberia and Sierra Leone made progress with only limited setbacks in 1999.

The average rate of inflation in Africa increased to 14 per cent in 1999 from 11 per cent in 1998, both averages being driven up by hyperinflation in Angola and the Democratic Republic of the Congo. Inflation increased to double-digit rates in Ghana, Libya, Malawi, Nigeria, Sudan, Tanzania, Zambia and Zimbabwe under localized conditions of supply shortages of food and other commodities, higher fuel-import costs, large fiscal deficits, high rates of money-supply growth or currency depreciation. Elsewhere, consumer price inflation was subdued because of lower food prices, stable money-supply growth, fiscal prudence and stable exchange rates.

GDP growth is expected to accelerate further in 2000 to match or exceed the 4.6 per cent growth attained in 1996, which was the previous peak of the decade. This more encouraging outlook hinges on oil prices remaining at high levels and some strengthening in the international prices of non-oil commodities as global demand for Africa's exports improves further. Growth in the value of exports is expected to accelerate to 11.5 per cent in 2000, which would provide a firm basis for sustained growth in other sectors.

East Asia: recovery stronger than anticipated

East Asia began to show signs of recovery during the first half of 1999 and strengthened further in the second half of the year. Aggregate GDP for the region (excluding China) is estimated to have grown by 5.5 per cent in 1999. All economies that had fallen into recession during 1998 resumed growth in 1999. Other countries in the region, which had been less severely affected by the crisis, performed relatively well. China experienced some slowdown but still attained growth of 7.1 per cent in 1999 (see table A.3).

Recovery in the four crisis-hit Asian emerging economies (Indonesia, Malaysia, Republic of Korea and Thailand) has been stronger than anticipated. Expansionary macroeconomic policies, financial restructuring and an improving external environment have supported the recovery. Among these economies, the performance of the Republic of Korea has been outstanding as the GDP grew by 9.8 per cent and 12.3 per cent, respectively, during the second and third quarters of 1999 (year over year). Even Indonesia, which had been experiencing difficulties and delays in the implementation of structural reforms, exhibited some growth during the year, contradicting earlier expectations of future decline.

In most crisis-hit countries, the recovery, however, has not been broad-based. Private consumption, despite high unemployment and lower real wages, began to pick up in response to policy stimuli and improved consumer confidence. As domestic demand recovered, regional trade links were reactivated and exports expanded. The continued demand expansion in the United States, the recovery in Japan and Europe, and the overall increase in the world demand for electronics (related to Y2K compliance) were also relevant factors underlying the recovery of exports. Except for the Republic of Korea, business investment continued to decline—albeit at a slower pace—due to excess capacity, cautious bank lending, and weak business confidence. On the supply side, industrial output, particularly manufacturing, has increased rapidly in recent months and led the recovery. The service sector has improved as well. In Indonesia, on the other hand, industrial output growth was rather weak, while exports still appear to be impeded by the lack of export financing.

An upturn in both domestic demand and exports supported recovery in other economies of the region as in the case of Hong Kong Special Administrative Region (SAR) and Singapore. In the Philippines, as in Indonesia, agricultural output recovered strongly with the return of normal weather from the 1998 setback but industrial output was weak. In spite of the mid-year earthquake, the economy of Taiwan Province of China remained strong in part because its manufacturing regions escaped the epicenter of the earthquake and because vigorous reconstruction efforts contributed to sustain economic activity.

As several Asian emerging economies came out of recession, China faced a deterioration of its economic situation in the first half of 1999. Exports dropped by about 10 per cent from the same period of 1998 and domestic demand stagnated. The reform of state-owned enterprises (SOEs) continued to be a major challenge for policy makers as the number of laid-off workers soared, thus contributing to depressing consumption, feeding into a deflationary process and slowing growth. Since mid-1999, however, increasing signs of improvement, including a significant turnaround of exports, have appeared.

Industrial production also increased as investment expanded at a strong pace, supported by increased government spending on infrastructure.

Reflecting the recovery in production and job-creation programmes, the unemployment fell in some East Asian countries but it is still well above the pre-crisis level. In the case of the Republic of Korea, for instance, the unemployment rate fell from a peak of 8.7 per cent in February 1999 to 4.6 per cent in August 1999, while it was 2.5 per cent in the second quarter of 1997. In other countries, however, the employment situation improved only modestly or deteriorated even further. In China, large layoffs due to the implementation of reforms in the state sector present a serious problem for policy makers.

Inflation in most countries of the region continued to fall or remained flat, reflecting excess capacities, competitive pressures and, in a number of countries, improved agricultural production and currency appreciation. Import prices began to rise partly due to higher oil prices, but with little impact on inflation so far. In 2000, however, inflation in these countries is expected to rise due to lagged effects of the expansionary policy and oil-price increases as well as wage increases and rising domestic demand. In China, deflation, rather than inflation, has been the concern to date, as retail prices have declined for more than 20 months in a row. Weak effective domestic demand associated with uncertainties of the reforms in the state sector is a major cause of the deflation in China.

Imports rebounded in most countries of the region as domestic demand picked up and depleted input inventories were replenished, and began to outpace the recovery in exports during 1999. Current-account surpluses have narrowed but remained sizeable. As investor confidence improved, foreign portfolio inflows increased somewhat, which, combined with the current-account surplus, contributed to the build-up of foreign reserves.

Macroeconomic policies in virtually all economies of the region remained expansionary in 1999 and made a major contribution to the recovery. The stabilized exchange rate and moderating inflation allowed these countries to cut interest rates sharply and to lower reserve requirements to boost domestic demand. In some countries, interest rates fell below their pre-crisis level. However, banks have remained cautious in lending, and firms have tended to resort to equity and bond issues. The easy monetary policy is expected to continue until these economies have returned to a more sustainable growth track. Monetary policy has become more accommodative in China as well. In China, interest rate for one-year deposits now standing at 2.25 per cent, lowered from 11 per cent in 1996. In addition, a new bill was passed to tax interest income from saving deposits to encourage consumption.

Expansionary fiscal policy has played a key role in reviving domestic demand in most countries of the region and in facilitating structural adjustment. In China, for instance, public spending accelerated during 1999. As deflationary conditions persisted, the Government increased spending on infrastructure and decided to inject about 60 billion yuan (about $7 billion) in the economy in the form of wage, pension and unemployment benefits to stimulate private consumption directly.

Fiscal deficits have deteriorated in crisis-hit countries, reflecting continued expansionary fiscal policy and costs associated with restructuring the financial and corporate sectors. Indonesia has experienced a large budget shortfall due mainly to the huge cost of restructuring the financial system and the funding of public works. As a result, the public debt is estimated to exceed 100 per cent of GDP by the end of 1999, compared with 24 per cent in mid-1997. Both Malaysia and Thailand envisage further increases in public expenditure for fiscal 2000, due to the costs related to the restructuring of the economy, and the public deficit will continue to widen in these countries. In the Republic of Korea, on the other hand, fiscal consolidation will start in 2000 and a mild reduction in the public deficit is thus expected.

Progress with structural reforms in crisis-hit countries has been rather slow, although uneven across countries. Reforms are most advanced in the Republic of Korea. Corporate restructuring, however, proved to be more difficult to implement (as the recent experience with the restructuring of the Daewoo conglomerate demonstrated). Recently, however, the process has been speeded up under strong government leadership. Except for the Daewoo Company, about 80 per cent of structural adjustment in four large conglomerates has so far been completed in spite of resistance from vested interest groups.

Indonesia and Thailand have accelerated their efforts of banking restructuring this year but the actual progress has been slow. In particular, Indonesia still faces the daunting task of resolving huge non-performing bank loans and corporate debts, including to foreign banks (an estimated $80 billion). In Thailand, bank restructuring was mainly left to private initiative and progress has been slow. Corporate restructuring there, as in Indonesia, has been impeded by the lack of funds. In Malaysia, on the other hand, financial-sector restructuring has progressed more successfully, with a significant share of existing non-performing loans being already cleared.

Prospects for the near-term are favourable. The recovery in the region is expected to be stronger and more broad-based in 2000, and to stabilize along a sustainable growth path in 2001. Assuming continued expansionary macroeconomic policy and smooth progress in reforms, but barring adverse weather, the aggregate real GDP growth in the region (excluding China) is forecast to accelerate further to 5.7 per cent in 2000 and 2001.

Growth in individual countries will be less uneven in 2000 than it was in 1999.

China is expected to maintain its current performance and GDP growth rate is forecast to stabilize at 7.0-7.5 per cent. Progress in reforming the SOEs is a major uncertainty. Without progress with SOE reforms, however, increased government spending will most likely feed inefficient SOEs, rather than boost the economy.

Private consumption and exports will continue to lead the recovery in these economies. The former will assume a more important role as the inventory rebuilding and external demand of electronics products decline. Private investment, which has been recently sluggish in most countries, will also pick up in response to rising sales and profit, eased credit conditions, improving business confidence and the need for upgrading or replacing production facilities. Increased domestic demand will set off a virtuous circle of multiplier effects through trade in goods and services, which should benefit the region, thus supporting output growth in both industry (particularly manufacturing) and service sectors. With the recovery, however, imports will grow and combined with a larger oil bill, will narrow current-account surpluses in most economies.

Several factors are crucial for sustaining the recovery in Asian emerging economies. First, the strength of external demand is pivotal in supporting their exports. A major concern in this regard is that the sustained recovery in Europe and Japan as well as strengthening intraregional trade should more than offset the soft landing of the United States' economy and the expected fading of the Y2K-induced global electronics' boom in early 2000. The yen appreciation against the currencies of these countries, if it continues, can provide an extra boost to their exports, particularly, for the Republic of Korea and Taiwan Province of China.

Second, an increase in foreign capital inflows, particularly long-term ones, is a key element to the sustainability of higher growth in these resource-constrained economies. However, this depends, among other things, on the successful implementation of restructuring programmes. Delays in the implementation of structural reforms, particularly in Indonesia and Thailand, can compromise the resumption of normal bank lending, thus hindering business activity and limiting the effectiveness of expansionary monetary policy. The high cost of restructuring and policy makers' complacency induced by strengthening recovery may dilute the political momentum for reforms, particularly in countries facing elections in the near-term. But this will imply weak financial and corporate sectors, which will remain weak and vulnerable to instability in world financial markets.

Third, the growth forecast is based on continuation of the expansionary macroeconomic policy to support domestic demand in the near-term. From late 2000 on, however, rising inflation and large public debt will begin to put a number of countries (particularly, the Republic of Korea) under an increasing pressure to tighten their policies. Hopefully by then, these economies would have already embarked into a more self-sustained growth pace.

South Asia: mixed performances

These economies have exhibited a rather divergent performance in 1999 mainly due to domestic factors. External factors such as the negative effects of the financial crisis and, in the cases of India and Pakistan, the imposition of economic sanctions, have mostly faded and improvements in global demand have begun to have a positive effect on their exports. On the other hand, differences in weather condition, political situation, policies and structural problems led to diverging performance across the region. On average, however, the region performed relatively well during the year with GDP growth of about 5.5 per cent in 1999.

Real GDP growth in Bangladesh, despite the severe damage caused by floods in the summer of 1998, recovered faster than expected, thanks to the 1999 bumper crop. Growth has picked up in India due to a favourable crop, increased consumer durables' production, relaxed monetary conditions, and improving confidence. On the other hand, the economic performance of Nepal, Pakistan and Sri Lanka has been less satisfactory. Economic activities in Pakistan continued to be impeded by political uncertainties and restrictive measures to address persistent balance-of-payments problem. In Sri Lanka, output growth in agriculture and manufacturing sectors was weak, and so was export growth. Through mid-1999, policy uncertainties and some structural factors hampered growth in Nepal.

Inflation, which had risen to double-digit levels during 1998 in most countries of the subregion, returned to single digits in the first half of 1999. In India, consumer price inflation subsided due to the increased supply of agricultural products, low commodity prices, and intense price competition. Inflation in Nepal also abated but still remained around 10 per cent early in the year due to continuing high food prices.

Fiscal consolidation remains a critical policy challenge in the subregion. Most of these countries face unsustainable fiscal positions which, if not addressed, will continue to be a source of inflation and restrain private investment and growth. The fiscal deficit remains markedly higher in India and Sri Lanka than elsewhere. In India, despite the recent policy shift to fiscal consolidation, the budget deficit in fiscal year 1999 remained large due to delays in the privatization programme and increased government spending. Sri Lanka made some progress in improving tax collection and controlling military spend-

ing in the past several months, but its deficit is estimated to exceed 7 per cent of GDP in 1999 due to low privatization proceeds and the high cost of the civil war.

In view of subdued inflation, monetary policy has been eased in a number of countries. The Reserve Bank of India cut its bank rate further to 8 per cent in March 1999 and lowered the cash reserve ratio by one percentage point to 9 per cent in October. Sri Lanka also lowered the statutory reserve requirement and the bank rate by one percentage point to 11 and 16 per cent, respectively, in August 1999. Pakistan, after rescheduling its external debt obligations, was also able to lower interest rates.

The near-term prospects for South Asian countries are positive. Most countries, except for Pakistan, are expected to exhibit somewhat higher growth in 2000. The return of normal weather and the improved external environment, together with a more relaxed monetary policy, will support growth. Rising rural incomes and, in a number of countries, increasing confidence will boost domestic demand. However, the widening fiscal deficit, if it is not corrected effectively, will continue to crowd out private investment and, to the extent of its monetization, eventually exacerbate inflation. Exports are also expected to increase due to the upturn in demand in Asia and in Europe.

Western Asia: oil prices rebound but growth does not

GDP growth decelerated in Western Asia in 1999. Despite the strong growth in Iraq, the region's GDP is estimated to have grown by only 0.4 per cent in 1999 (see table A.3). Without Iraq, however, that growth in the region would have fallen by about 0.5 per cent in 1999.

Higher oil prices had a positive impact on the oil exporters of the region by improving their external and internal balances, thus lifting these countries from the recession experienced in 1998. Growth in these countries, however, was modest reaching 2.1 per cent for this subgroup as a whole. Oil output was cut in most countries due to the OPEC agreement in March 1999 (see chapter II) and public investment was constrained, which affected the non-oil sector of these economies. Iraq is the exception to this trend, for its own specific circumstances, and grew fast during the year.

Economic growth collapsed in the oil-importing countries of the region, and GDP growth for this subgroup of countries was negative in 1999. Drought devastated agriculture in Jordan. Tourism remained depressed as uncertainties over the Middle East peace process persisted. Economic activity was weak in Israel in 1999 due to reduced exports and stagnating domestic demand. The recovery in Asian countries has not yet translated into higher import demand from Israel. Meanwhile, increased competition from Asian countries in international markets has shrunk Israel's market shares since late 1998. In another important development in the region, earthquakes devastated Turkey in August and November 1999. The August earthquake caused extensive damage to Turkey's industrial base and infrastructure. More tragically, the earthquake has had a huge social impact. Over 15,000 lives were lost and many were injured. Employment losses in the worst affected areas are estimated to range from 20 to 50 per cent. Addressing these social costs will impose a heavy burden on Turkey's social protection system.

Although inflation remains low in the region, the trend of declining inflation observed during the past few years was somewhat reversed in 1999 as fiscal consolidation pushed governments to cut back subsidies and increase user charges for utilities such as electricity and water. The sharp depreciation of several currencies against the dollar has also contributed to the revival of inflation in the region. There are some exceptions to this general trend. For instance, inflation in Jordan and Qatar is expected to decline in 1999, reflecting a sluggish economy in both countries.

Export earnings in West Asia as a whole recovered in 1999 from the steep fall recorded in 1998. Higher oil prices contributed to a reduction of the current-account deficit in most oil-exporting countries. The oil-importing economies of the region, however, recorded a deterioration of their current-account positions due to the increased oil bill and weak export growth.

Oil-exporting countries of the region registered some improvement in their budget positions. Because most countries framed their budgets assuming low oil prices, the oil-price recovery brought an unexpected windfall gain. Yet, most countries maintained their tight fiscal policy, and budget deficits declined in 1999. Turkey, on the other hand, given the increase in expenditures associated with the aftermath of the earthquake, incurred a sharp deterioration of its fiscal position, with the budget deficit estimated at 15 per cent of the GDP by year end.

For the region as a whole, GDP growth is expected to reach almost 4 per cent in 2000 but, again, thanks to a strong performance of the Iraqi economy. Iraq is the only oil-exporting country where economic growth is expected to be strong—albeit from a small base —in the next few years. The oil-importing economies of the region will do relatively better as weather conditions return to normal thus benefiting Jordan and Syria. Turkey will experience a substantial recovery in growth due to reconstruction efforts and the resumption of activities by manufacturing and tourism. It will perhaps also benefit from the EU's decision on 10 December 1999 to consider the country a credible candidate for eventual accession. Though that in itself may

come to fruition only in the longer run, the country should already in the interim benefit from credibility effects of being more closely associated with the EU.

Latin America and the Caribbean: is growth ahead?

After poor economic growth in 1998, conditions further deteriorated in Latin America and the Caribbean in 1999. After having experienced eight years of uninterrupted—albeit uneven—growth, aggregate GDP in 1999 barely maintained its 1998 level, but is expected to pick up in 2000. The overall average rate of growth for 1999, however, masks contrasts among countries in the region and reflects changes in outcomes from forecasts in early 1999.

The initial forecasts for Brazil in the aftermath of the devaluation in January 1999 of its currency, the real, were extremely pessimistic. However, following an initial overshooting, the exchange rate stabilized in the second quarter of 1999 and Brazil succeeded in adjusting to a new flexible exchange rate framework. Inflation remained subdued but accelerated later in the year. Interest rates were gradually but substantially reduced, thus providing some relief to the economy and to public finances in particular. Whereas a decline had been anticipated, GDP grew modestly in 1999 due to the significant growth in agricultural output in the first half of the year, the rebuilding of inventories, and the substitution of domestic products for imports following the devaluation.

Nevertheless, the spillovers of the Brazilian recession seriously affected its main trading partners through the contraction of intraregional trade. Additionally, low commodity prices constrained financial conditions and political uncertainties imposed a toll on the economic performance of many South American economies. Argentina was particularly hit. Colombia and Venezuela experienced severe recessions exacerbated by domestic political factors (internal armed conflict and constitutional reform, respectively) that delayed investment decisions and provoked capital flight. The Ecuadorian economy experienced the sharpest GDP decline in the region due to the severe effects of the external shocks suffered in 1998, the political crisis that hampered economic reforms, and the debt crisis that erupted in the second half of the year. Even Chile, after having expanded at an annual average rate of 7 per cent during 1991-1998, is expected to record negative growth in 1999.

In contrast to the adverse economic situation in South America, Mexico and most of the Central America and Caribbean economies had a relatively better performance in 1999. Mexico continued to benefit from the buoyancy of the United States economy, its major export market. Similarly, the economies of the Caribbean and Central America benefited from strong import demand by the United States. Honduras, however, is still struggling to overcome the effects of hurricane Mitch and its GDP contracted in 1999.

Despite the poor performance of exports, the regional trade deficit narrowed significantly in 1999 due to curbs in imports, especially in the countries experiencing recession. Moreover, private capital flows into the region became scarce and more expensive, further constraining the availability of import finance and the formation of fixed capital. Therefore, the region's current-account balance narrowed from around 4.5 per cent of its GPD in 1998 to around 3.2 per cent in 1999. The region also witnessed a change in exchange-rate regimes as flexible exchange rates were introduced in some countries of the region. In September 1999, Chile and Colombia abandoned the trading bands of their currencies against the dollar, following similar steps taken by Brazil and Ecuador earlier in the year.

In general, fiscal policies remained tight in the region in 1999. Budget imbalances none the less deteriorated in many countries, owing to higher debt-servicing costs and lower receipts. Monetary policy started to be cautiously accommodative in the summer, once inflationary pressures were contained. Monetary policy was eased considerably in Brazil, Chile and Venezuela. In Colombia interest rates were increased several times in an attempt to defend the currency, before the crawling band was abandoned in September. Interest rates fell after that.

Weak domestic demand and low activity kept inflation under control in the region. Economic recession even brought deflationary pressures to countries such as Argentina, El Salvador and Paraguay. In contrast to Brazil, Ecuador was not able to control prices after the devaluation of its currency in early 1999, and inflation accelerated. Another consequence of the recession was a deterioration of labour conditions in many countries. In Colombia, for example, the unemployment rate in seven metropolitan areas reached a record high of 20 per cent of the economically active population in September, while in Chile it surpassed 11 per cent by mid-1999, rising from 7.2 per cent at the end of 1998.

The short-term outlook for Latin America is for a widespread, though uneven, economic recovery. The region is forecast to grow by about 3.5 per cent in 2000. The sources of the recovery in the region are difficult to generalize due to the heterogeneity of the economic situation in the various countries. However, export revenues are expected to expand in most countries due to improved commodity prices and stronger world demand. Additionally, a modest improvement in international financing conditions in 2000 is expected to boost fixed investment, especially in countries where political uncertainties are supposed to abate.

The two largest economies in the region—Brazil and

Mexico—are expected to lead the recovery, but less so in Brazil. The acceleration of economic growth in Mexico is likely to be based on the strengthening of domestic demand, while exports are estimated to be negatively affected by the slowdown of the United States economy. Conversely, exports will be the main engine of the recovery in Brazil in 2000.

Individual country performances are expected to vary across the region due to some country specific factors. Among the latter, the various exchange-rate regimes operating in the region will affect the recovery path. For instance, the Argentine economy, whose competitive position worsened significantly after the devaluation of the Brazilian real, is constrained by its currency-board regime, thus expected to experience a slower recovery than countries with floating exchange regimes. Prospects for recovery are also partially conditioned by the situation of financial sectors, banking in particular, in specific countries. The banking systems of several Latin American countries have accumulated non-performing loans due to the economic crisis and are reluctant to extend credit. Therefore credit conditions remain tight in some countries despite lower official interest rates. In this regard, fragile conditions in the banking sectors of Colombia, Ecuador, Guatemala, Peru and Venezuela, among others, will constitute a hindrance for a solid recovery in these countries.

The economic forecast for 2000 is also subject to a number of downside risks. International financial markets are closely monitoring the performance of the main economies and market sentiment towards the region is still volatile. Unfavourable developments in individual countries, even in those of relatively minor economic weight, could spill over into the rest of the region, incurring financial constraints and reducing growth prospects. Recovery in Brazil—important for the future prospects of other economies in the region—depends crucially on further progress with fiscal consolidation, which is still uncertain. While Brazil has been meeting the fiscal targets of its revised agreement with the IMF, largely due to temporary and emergency measures, new revenue and spending measures are required to secure a larger primary budget surplus in 2000. In this regard, difficulties in implementing fiscal reforms may exacerbate the Brazilian currency's vulnerability. This will then affect inflationary pressures and force interest rates to remain high therefore choking off economic growth. Finally, any sharp asset-price correction in the United States followed by a severe slowdown in its economy would not only worsen export prospects for Latin America, Mexico in particular, but it could also result in further severance of external financing to all countries in the region.

ANNEX TABLES

Table A.1.
DEVELOPED MARKET ECONOMIES: RATES OF GROWTH OF REAL GDP AND RATES OF INFLATION AND UNEMPLOYMENT, 1998-2000

	Growth[c]			Inflation[d]			Unemployment[e,f]		
	1998	1999[a]	2000[b]	1998	1999[a]	2000[b]	1998	1999[a]	2000[b]
All developed economies	2.0	2.5	2½	1.3	1.1	1½	6.9	6.7	6½
United States	4.3	3.9	3	1.6	2.1	2½	4.5	4.3	4¼
Canada	3.1	3.6	3	1.0	1.3	1¼	8.4	7.7	7½
Japan	-2.8	0.8	1	0.6	-0.3	-½	4.1	4.8	4¾
Australia	4.8	3.5	2½	1.6	1.5	2¼	8.0	7.4	8
New Zealand	-0.3	2.5	3¾	1.3	1.4	2¼	7.5	7.2	6½
EU-15	2.6	2.1	2¾	1.5	1.2	1¾	10.0	9.4	9¼
EU-11	2.7	2.1	2¾	1.2	1.1	1½	11.0	10.3	10
Austria	3.3	1.9	2¼	0.9	0.7	1¼	4.7	4.4	4¼
Belgium	2.9	1.8	2½	1.0	1.0	1½	9.5	9.1	9
Finland	5.6	3.2	3¼	1.4	0.9	1¾	11.4	10.3	9¼
France	3.2	2.3	2¾	0.7	0.5	1	11.7	11.2	10¾
Germany	1.9	1.7	2¾	1.0	0.9	1¾	9.4	9.1	8¾
Ireland	9.5	8.1	6½	2.4	1.7	2½	7.8	6.8	6¼
Italy	1.4	1.1	2	2.0	1.6	1¾	12.3	12.0	11¾
Luxembourg	4.7	4.2	4½	1.0	1.0	1½	2.8	2.8	2
Netherlands	3.7	2.8	2½	2.0	2.0	1¾	4.0	3.3	3
Portugal	3.5	3.5	3¼	2.8	2.4	2½	5.1	4.7	4¼
Spain	3.8	3.5	3	1.8	2.2	2	18.8	16.1	15
Other EU	2.5	1.9	2½	2.8	1.5	2½	6.8	6.6	7
Denmark	2.9	1.7	1½	1.8	2.7	2	5.1	4.6	4¾
Greece	3.5	3.5	3¾	4.8	2.6	2	10.1	10.2	10
Sweden	2.9	3.8	3¼	-0.1	0.3	1¼	8.3	7.2	6¾
United Kingdom	2.2	1.4	2½	3.4	1.5	2¾	6.3	6.2	6¾
Other Europe									
Iceland	5.0	5.1	4½	1.7	1.7	2	3.1	3.3	2¾
Malta	2.0	1.8	1¾	2.8	2.0	2½	5.1	5.4	5¼
Norway	2.0	0.5	3½	2.3	2.3	2	3.3	3.1	3½
Switzerland	2.1	1.1	1½	0.1	-0.5	¼	3.2	2.4	2¼
Memo item:									
Major industrialized countries	1.8	2.4	2¼	1.3	1.1	1½	6.4	6.3	6¼

Source: UN/DESA, based on IMF, *International Financial Statistics* and OECD.

a Partly estimated.
b Forecast, partly based on Project LINK.
c Data for country groups are weighted averages, where weights for each year are the previous year's GDP valued at 1995 prices and exchange rates.
d Data for country groups are weighted averages, where weights for each year are 1995 GDP in US dollars.
e Unemployment data are standardized by OECD for comparability among countries and over time, in conformity with the definitions of the International Labour Office (see OECD, Standardized Unemployment Rates:Sources and Methods (Paris, 1985).
f Greece and Malta are not standardized.

Table A.2.
ECONOMIES IN TRANSITION: RATES OF GROWTH OF REAL GDP AND RATES OF INFLATION, 1998-2000

	Growth[a]			Inflation[d]		
	1998	1999[b]	2000[c]	1998	1999[b]	2000[c]
Economies in transition	-0.8	0.6	2½	22.0	32.1	23
Central & Eastern Europe and Baltic States	2.4	-0.5	3½	16.8	14.2	8¾
Central and Eastern Europe	2.3	0.8	3½	17.2	14.7	9
Albania	7.9	5.0	8	21.0	3.0	4
Bulgaria	3.0	1.5	4	22.3	1.5	6
Croatia	2.7	-1.0	1½	6.0	4.0	6
Czech Republic	-2.7	-0.5	1½	10.7	2.2	4
Hungary	5.1	4.0	4½	14.2	9.5	7
Poland	4.8	4.0	5¼	11.7	6.5	7
Romania	-6.6	-4.8	½	59.3	48.1	30
Slovakia	4.4	1.5	2½	6.7	14.0	9
Slovenia	4.0	3.5	3¾	8.0	7.5	5
The former Yugoslav Republic of Macedonia	3.0	1.0	3	1.0	4.0	4
Federal Republic of Yugoslavia	2.6	-50.0	..	30.4	100.0	..
Baltic States	4.1	-1.2	2¾	6.4	2.6	3¾
Estonia	4.0	0.0	4	10.6	3.5	4½
Latvia	3.8	-0.5	2½	4.7	2.2	3
Lithuania	4.4	-2.5	2	5.1	2.3	4
Commonwealth of Independent States	-3.6	1.6	1¼	26.2	46.6	34¼
Armenia	5.5	6.0	8	8.7	1.0	2½
Azerbaijan	10.0	5.7	8	-0.8	-6.0	10
Belarus	8.3	0.0	3	73.2	280.0	150
Georgia	4.0	3.0	6	3.6	9.3	15
Kazakhstan	-2.5	0.3	2	7.3	20.0	5
Kyrgyzstan	4.6	3.8	3½	12.1	45.0	20
Republic of Moldova	-5.0	-9.0	-1	7.7	40.0	25
Russian Federation	-4.8	2.0	1	27.8	45.0	35
Tajikistan	5.3	2.0	4	43.1	28.0	30
Turkmenistan	4.5	12.0	4	16.8	17.0	30
Ukraine	-1.7	-1.0	1	11.0	22.0	15
Uzbekistan	2.8	0.0	2	29.0	29.0	30

Source: UN/DESA and ECE.

[a] Country group aggregates are averages weighted by GDP in 1995 dollars (for methodology, see *World Economic and Social Survey, 1992*. (United Nations publication, Sales No. E.92.II.C.1 and corrigenda), annex, introductory text).
[b] Partly estimated.
[c] Forecast, based in part on Project LINK.
[d] For Croatia and Macedonia, retail prices are used.

Table A.3.
DEVELOPING COUNTRIES: RATES OF GROWTH OF REAL GDP AND RATES OF INFLATION, 1998-2000

Annual percentage change

	Growth[c]			Inflation[d]		
	1998	1999[a]	2000[b]	1998	1999[a]	2000[b]
Developing countries	1.3	3.2	5	10.8	6.9	7½
of which:						
Latin America and the Caribbean	1.9	-0.2	3½	8.2	10.0	8
Net fuel exporter	3.1	0.3	3¾			
Net fuel importer	1.5	-0.4	3½			
Africa	2.8	3.0	4½	6.7	8.0	7½
Net fuel exporter	3.0	4.0	4¾			
Net fuel importer	2.6	2.4	4			
West Asia	1.7	0.4	3¾	28.5	18.1	22
Net fuel exporter	1.2	2.1	3½			
Net fuel importer	2.6	-1.9	4¼			
East and South Asia	0.5	6.0	6	9.2	2.3	3¾
Region excluding China	-2.2	5.5	5¾	12.9	3.5	4½
of which:						
East Asia	-4.6	5.5	5¾	14.3	2.6	3½
South Asia	5.6	5.5	5¾	8.3	6.6	7
Memo items:						
Sub-Saharan Africa (excluding Nigeria and South Africa)	3.5	3.8	5	9.2	10.6	8¾
Least developed coutries	3.7	3.6	4½	15.0	15.7	12½
Major developing economies						
Argentina	3.9	-3.6	3	0.9	-0.5	-1½
Brazil	0.1	0.2	3¼	3.2	9.5	8
Chile	3.4	-1.5	5	5.1	3.5	3½
China	7.8	7.1	7	-0.8	-1.3	2
Colombia	0.6	-4.7	2	20.4	15.0	12
Egypt	5.7	4.9	5½	4.2	3.8	4¼
Hong Kong SAR	-5.1	1.5	3	2.8	-1.5	-1
India	6.0	6.1	6½	8.5	6.4	6¾
Indonesia	-13.2	0.5	3½	64.7	12.5	8¼
Iran (Islamic Republic of)	-2.5	0.3	2			
Israel	1.9	2.2	3½	5.4	5.0	4½
Korea, Republic of	-5.8	10.0	7	8.6	0.1	3¼
Malaysia	-6.7	4.3	7	5.6	2.2	3½
Mexico	4.8	3.5	5	15.9	16.8	11
Nigeria	1.9	3.7	4	10.2	22.0	25
Pakistan	3.7	3.1	3	7.2	7.0	8½
Peru	0.7	2.8	5¾	7.2	4.0	6
Philippines	-0.5	3.4	5	9.6	7.0	7
Saudi Arabia	-2.0	1.0	1½	-0.4	1.5	2
Singapore	0.3	5.7	6¾	-0.3	0.5	1
South Africa	0.5	1.7	2½	6.9	6.5	7
Taiwan Province of China	4.8	5.3	6½	2.6	0.5	1½
Thailand	-10.4	4.1	5	8.1	0.6	3¾
Turkey	3.0	-4.5	5¼	84.6	40.0	50
Venezuela	-0.7	-6.8	1¼	35.8	24.0	20¼

Source: United Nations/DESA, based on IMF, *International Financial Statistics*.

a Preliminary estimates.
b Forecast, based in part on Project LINK.
c Covering countries that account for 98 per cent of the population of all developing countries.
d Weights used are GDP in 1995 dollars.

Table A.4.
WORLD TRADE: RATES OF GROWTH OF VOLUMES, 1998-2000

Annual percentage change

	Volume of exports			Volume of imports		
	1998	1999[a]	2000[b]	1998	1999[a]	2000[b]
World	3.9	3.4	6	4.8	4.4	5½
Developed economies	4.4	3.7	6¼	8.9	4.8	5¼
of which:						
North America	3.1	5.5	7¾	10.5	8.3	3
Western Europe	6.5	3.1	6¼	10.3	4.2	7
Japan	-2.8	3.0	2½	-4.9	-2.9	1½
Economies in transition	9.3	-3.4	4½	3.2	-3.5	5
Central and Eastern Europe[c]	16.6	1.8	6¾	19.8	4.2	4¾
CIS	2.1	-9.3	1¾	-23.5	-23.0	5¾
Developing countries	2.3	3.4	5¼	-3.8	4.4	6½
Latin America and the Caribbean	6.9	3.9	6½	10.8	-4.6	8¼
Africa	2.2	1.4	2½	8.6	4.7	2¾
Western Asia	-1.4	-0.9	5¼	-0.1	4.5	2¾
East and South Asia	0.5	4.3	4½	-13.7	5.4	7
China	4.1	3.1	7	6.3	17.8	8½
Memo items:						
Fuel exporters	2.4	2.4	5¾	1.4	9.0	8½
Non fuel exporters	2.2	4.0	4¾	-6.3	2.1	5½

Source: United Nations/DESA, based on data of United Nations Statistics Division, ECE, ECLAC and IMF.

a Preliminary estimates.
b Forecast, based in part on Project LINK.

Table A.5.
COMMODITY PRICES, 1997-1999

Annual percentage change

	1997	1998				1999			
		QI	QII	QIII	QIV	QI	QII	QIII	QIV
Combined index, nonfuel									
Dollar	0.0	-8.5	-14.0	-14.8	-15.3	-16.8	-17.4	-12.4	-7.7
SDR	5.2	-5.2	-11.1	-13.2	-17.2	-19.6	-17.9	-13.4	-6.5
Food and tropical beverages	2.8	-5.2	-15.3	-17.8	-20.2	-21.9	-22.7	-16.6	-10.8
Tropical beverages	33.3	9.9	-27.9	-24.5	-23.4	-29.9	-20.2	-21.8	-6.6
Cocoa	11.2	16.3	8.6	-0.3	-7.2	-16.9	-34.9	-36.4	-40.4
Coffee	54.7	3.6	-40.7	-38.2	-32.0	-37.0	-22.4	-23.3	-3.3
Food	-3.5	-9.1	-11.0	-15.6	-19.2	-19.4	-23.3	-15.8	-12.0
Bananas	4.3	-31.3	9.4	6.5	13.4	13.5	-21.7	-10.8	-16.1
Maize	-25.3	-8.3	-13.4	-14.8	-17.4	-13.7	-6.1	1.6	-2.2
Rice	-10.7	-13.6	2.2	10.6	8.4	-5.4	-23.5	-23.6	-20.6
Sugar	-4.9	-0.2	-20.1	-28.9	-34.0	-35.6	-36.3	-26.9	-18.3
Wheat	-22.6	-19.4	-22.9	-22.3	-12.6	-14.2	-11.3	-1.4	-16.2
Vegetable oilseeds and oils	-0.9	2.6	9.8	13.3	6.8	-12.0	-22.4	-30.8	-30.7
Palm oil	2.8	14.4	22.9	33.5	22.1	-13.4	-32.1	-47.9	-45.8
Soybeans	-3.3	-13.8	-18.7	-19.9	-19.2	-22.2	-19.2	-12.5	-12.7
Agricultural raw materials	-10.3	-14.6	-11.6	-8.5	-7.0	-6.5	-10.2	-12.2	-12.5
Cotton	-1.5	-13.2	-17.1	-16.0	-24.5	-19.2	-10.8	-23.9	-47.2
Rubber	-28.3	-40.0	-33.8	-24.7	-14.6	-10.7	-18.5	-18.2	-3.0
Tropical logs	-5.5	-8.2	-3.8	3.0	4.6	0.8	-6.4	-8.7	-14.0
Minerals, ores and metals	0.0	-16.0	-18.0	-17.7	-14.0	-12.9	-8.0	3.1	11.8
Aluminum	6.2	-8.3	-14.0	-19.4	-18.8	-18.3	-4.2	9.2	17.0
Copper	-0.8	-29.8	-30.9	-27.8	-19.2	-17.3	-15.3	2.4	12.6
Iron ore	1.1	2.8	2.8	2.8	2.8	-9.2	-9.2	-9.2	-9.2
Lead	-19.4	-21.4	-12.4	-14.5	-12.0	-5.9	-5.3	-6.1	-2.3
Nickel	-7.6	-28.3	-31.9	-37.8	-35.7	-14.6	5.4	53.3	96.6
Phosphate rock	7.9	0.0	0.0	4.9	4.9	6.5	7.3	2.3	2.3
Tin	-8.4	-9.9	3.3	2.8	-3.4	-1.2	-7.1	-6.2	5.1
Zinc	28.4	-9.5	-18.9	-36.2	-19.4	-6.5	-3.4	10.6	21.4
Memo item:									
Manufactured export prices of DME	-7.5	-5.9	-6.0	-3.1	-1.0	1.1	1.1	0.0	-2.1
Real prices, nonfuel	8.2	-2.8	-8.5	-12.1	-14.4	-17.7	-18.3	-12.4	-5.7
Crude oil	-6.0	-32.8	-27.5	-30.0	-36.9	-16.4	22.6	58.9	100.3

Source: UNCTAD, *Monthly Commodity Price Bulletin.*

Table A.6.
INFLOWS AND OUTFLOWS OF FOREIGN DIRECT INVESTMENT BY REGION, 1996-1999

	Inflows				Outflows			
	1996	1997	1998	1999	1996	1997	1998	1999
World	363	468	660	827	382	479	648	..
of which:								
Developed countries	212	276	468	609	323	414	596	..
Western Europe	116	138	246	-	206	247	407	..
European Union	109	128	237	269	184	224	390	..
Other Western Europe	8	9	9	-	22	23	17	..
Japan	-	3	3	-	23	26	25	..
United States	76	109	189	-	75	110	133	..
Developing countries	139	173	174	198	58	62	51	..
Africa	6	8	9	10	-	1	1	..
Latin America and the Caribbean	46	68	73	97	6	15	16	..
Asia	85	96	90	91	52	46	34	..
West Asia	4	5	4	-	2	-	-2	..
Central Asia	2	3	3	-	-	-	-	..
South, East and South-East Asia	80	88	83	84	50	46	36	..
The Pacific	-	-	-	-	-	-	-	..
Central and Eastern Europe	13	18	19	20	1	3	2	..

Source: UNCTAD.

Note: Due to rounding, the sum of the subregions might not add up to the total.