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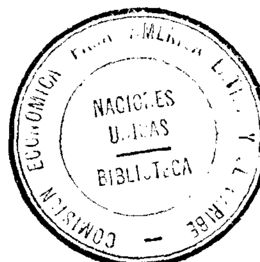
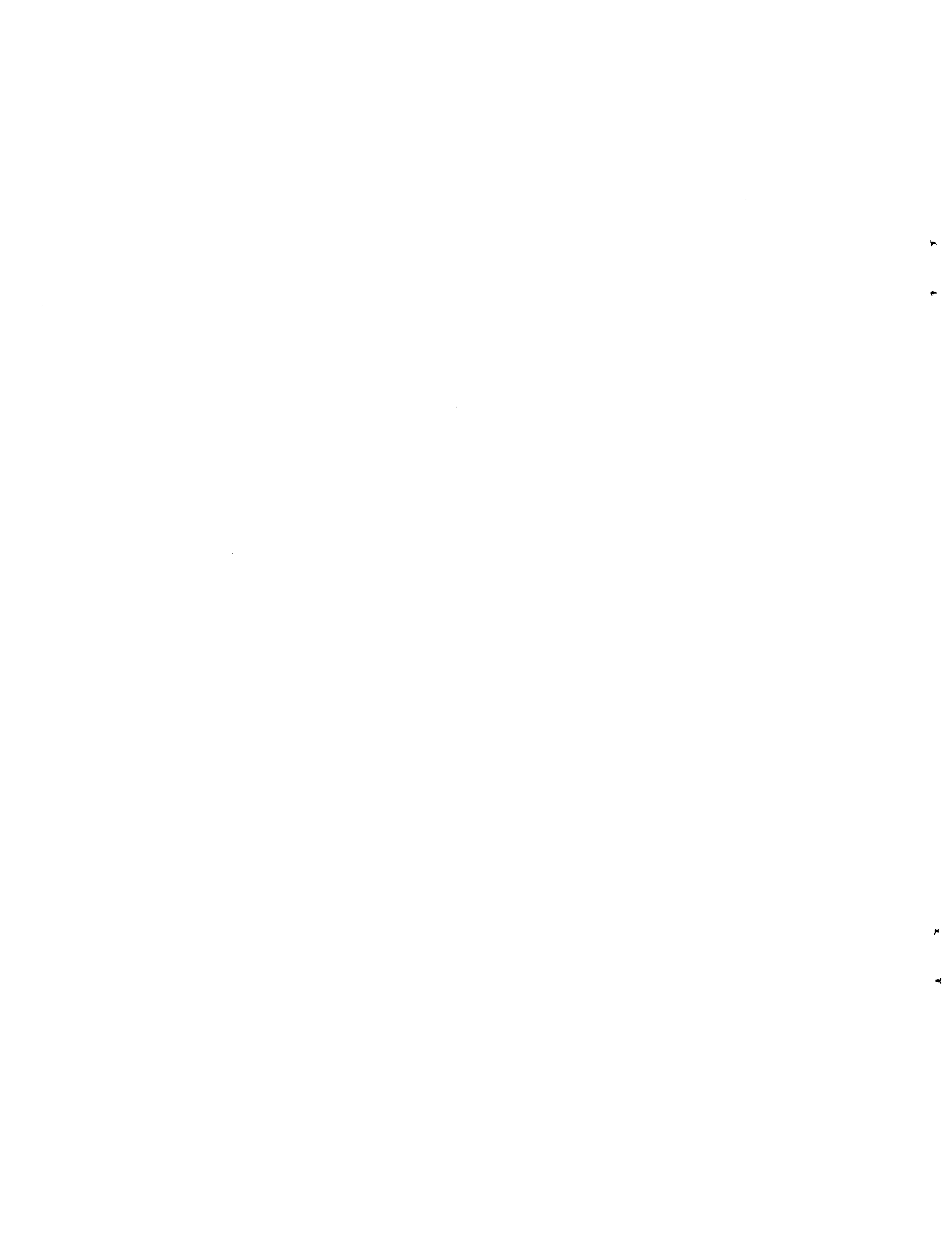


INTERNATIONAL ECONOMIC HIGHLIGHTS 1990



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PRESENTATION

This is the fourth year that the weekly dispatches transmitted during a year, by ECLAC Washington to ECLAC Santiago and other regional offices, are gathered in a single document.[1]

For their presentation here, the dispatches are classified by subject and ordered chronologically within each chapter. The heading of each chapter indicates the saliency, during the year of certain issues of the international economic agenda. For instance, measured by the number of dispatches transmitted, more prominently appear the evolution of the world economy, as well as Inter-American economic relations, followed by trade and the functioning of the multilateral financial institutions. While more distantly behind come other issues such as the U.S. economy and the tension with Japan.

By contrast with 1989 when the agenda was dominated by "high politics," in the terms of Richard Lawrence from The Journal of Commerce, 1990 was "a lively year for trade policy."

For instance, the Uruguay Round negotiations entered the final stretch, in full suspense, with their outcome still uncertain by the end of the year.

In the Western Hemisphere, agreement was reached about beginning negotiations between Canada, Mexico and the United States for the creation of a North American Free Trade Area (NAFTA). Additionally, President Bush set the Inter-American economic agenda by proposing, as part of the Enterprise for the Americas Initiative (EAI), the creation of a free trade area "from Anchorage to Tierra del Fuego."

Finally, as a result of the so-called Structural Impediments Initiative (SII) Talks held throughout the year, the trade

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[1] ECLAC, International Economic Highlights 1987 (LC/WAS/L.2) 17 August 1988; International Economic Highlights 1988 (LC/WAS/L.4) 17 March 1989; International Economic Highlights 1989 (LC/WAS/L.8) 15 March 1990.

imbalance between Japan and the United States failed, for the time being, to become the relationship of major tension of the present international economic system.

Similarly, the events in Eastern Europe, that by the end of 1989 threatened to become a major factor of instability, were absorbed by the world economy, without major disruption. A united Germany led the way, by year's end, enjoying what the Bundesbank President Karl Otto Poehl characterized as a "strong boom," accompanied by "--touch wood--reasonable price performance."

However, during the second half of 1990, from elsewhere appeared two major spoilers of this relatively optimistic outlook. First, at the peak of the summer, the tension in the Persian Gulf led to an immediate doubling of oil prices, disrupting trade accounts and fueling inflation. Second, of more significance was the contribution this disruption made to deepening the already sluggish behavior of the U.S. economy, raising the specter of a long recession in the leading economy. By the end of the year, there was consensus that the U.S. economy was in recession, the question was for how long.

Some of these and other issues were covered in the dispatches transmitted throughout the year. The purpose of gathering them in a single document is to make them available for easier consultation, in case the Washington D.C. vantage point they present still has some testimonial value.

To conclude, unfamiliar readers should be reminded that each dispatch tries to remain within the self-imposed limit of 750 words, because their purpose is only to bring and issue to the readers' attention, leaving open the decision if it demands or not further consideration.

I. THE WORLD ECONOMY

I. 1. WHITHER EUROPE? (WDW/6/90 - 21 FEBRUARY 1990)

Not so long ago, not even a year ago, the future of Europe seemed comfortably centered around the deepening of the European Community (EC), through "the completion of the internal market by 1992." The events in Eastern Europe have radically redefined the terms of this debate, to the point that now all of Europe's future seems to be at stake, on account of the incessant succession of vertiginous transformations that have been taking place in what used to be known as the Socialist camp.

The best evidence of present perplexities can be found in the hollowness that have acquired some of the recent statements made in preparation for the attainment of the legislative program contained in the EC's Commission 1985 White Paper on Completing the Internal Market, endorsed by the EC Summit of the same year.

For instance, in the most ambitious research project launched to evaluate the costs and benefits of attaining a single market in 1992, better known as the Cecchini Report, the issues are viewed in rather simple terms, as "the removal of non-tariff barriers," such as border controls and customs red tape; divergent standards and technical regulations; as well as conflicting business laws and protectionist procurement practices.

In the preface of the Cecchini report's summary, published in 1988, the President of the Commission, Mr. Jacques Delors, declared that the members of the European Community "needed a common objective which could raise their sights above daily routine problems and thereby concentrate their energies."

Furthermore, the size of the "costs of non-Europe" and consequently the potential gains were evaluated in 200 billion 1985 ECUs, which in terms of additional growth was estimated to represent "between four and seven percentage points of the Community's domestic product."

From abroad, beyond the immediate, sometimes almost paranoid, reaction couched in very general terms as the fear of a "fortress Europe," the issues were viewed also in specific and simple terms. As recently as in November 1989, a task force from the private sector Advisory Committee for Trade Policy and Negotiations (ACTPN), of the United States Trade Representative (USTR), issued a report on Europe 1992.

In the view of the ACTPN, "the issues raised by the single market program are therefore on the cutting edge of international trade policy, and their resolution will require the pursuit of innovative solutions in both bilateral and multilateral arenas." Accordingly, six issues were identified as those "in which the U.S. has a substantial interest in helping shape the direction of change." These issues were: discriminatory rules of origin; protectionist public procurement; drafting and recognition of standards and certification; local content requirements in technology transfers; and national treatment and reciprocity.

Even in the Annual Economic Report for 1989/90, issued by the EC Commission, on November 1989, the "two major challenges" for the European Community are described as "to strengthen further the determinants of growth, and to improve convergence toward stability."

Similarly, the last special summit of West European leaders, held on November 18, only ten days after the fall of the Berlin Wall, was called to deal specifically with the changes that are taking place in Poland and Hungary. In that occasion, admittedly, the issue of German unification was not discussed because, as an unidentified participant declared, "nobody brought it up."

Since then, German unification has swiftly moved to the forefront of the European agenda, making the "simple" issues raised by the completion of the internal market in 1992 pale in comparison.

Just ten days after the special EC summit of November 18, Chancellor Kohl unveiled a 10 point plan for the unification of Germany. Also, in stark contrast with West Germany's traditional resistance to deliberate steps that might force the pace of economic policy coordination and monetary unification, to the Bundesbank's dismay, Chancellor Kohl announced a plan for the monetary union of East and West Germany.

This prospect by itself, given the D-mark's pivotal position within the European Monetary System (EMS), was enough to generate an immediate reaction among the other Community members.

Nonetheless, on top of these events, last week came the so-called "two plus four" agreement, between the two Germanies and the four victorious allies, France, Great Britain, the Soviet Union and the United States. As a result, the two Germanies will begin talks about the internal aspects of unification, soon after the East German elections of March 18. Later, the external aspects of German unification will be discussed with the other four occupying powers under whose responsibility German security still remains.

President Delors, of the European Commission, immediately declared that the swiftness of German unification created "unease as well as possibilities" for the European Community. Consequently, last Friday, another special summit of West European leaders was announced, for April in Dublin, this time to deal specifically and exclusively with the Community's response to German unification.

Among the issues singled out as critical are the consequences of German monetary unification for the EMS; for the completion of the internal market in 1992; and finally, if East Germany will have access to the subsidies that the Community's regional policy makes available to least developed regions.

The events in Eastern Europe have radically altered the European agenda because the unification of Germany not only lies at the core of the creation of the European Community, it has also been the central issue of European diplomacy for more than a century. The future of the European Community has been overtaken by "high politics."

I. 2. THE IMF'S WORLD ECONOMIC OUTLOOK (WDW/13/90 - 16 MAY 1990)

Immediately before last week's Spring meetings, the staff of the International Monetary Fund (IMF) released advanced copies of this year's first issue of its bi-annual World Economic Outlook (WEO), to be published in full by the end of this month.

The advanced copy contains the following chapters: recent developments in the world economy, with projections for 1990 and 1991 in both developed and developing countries; a medium-term baseline scenario for the industrial countries, with alternative scenarios that examine two basic issues: the consequences of a concerted program to achieve price stability and the impact of prospective cuts in defense spending, particularly in the United States; selected policy issues in industrial countries, such as price stability, fiscal consolidation, current account imbalances, as well as the prospects of European economic integration and of individual countries; a medium-term baseline scenario for the

developing countries; finally, indicative of the times, the economic reforms in Eastern Europe and the U.S.S.R.

World economic activity slowed in 1989 to about 3 percent, from 4 percent in 1988. The slowdown is expected to persist in 1990, with the growth in output moderating further, at 2 1/4 percent, while in 1991 a moderate pick-up is projected at 3%. This is mainly the result of the restrictive monetary policies implemented in most industrial countries. This restrictive policy stance is expected to persist while inflation remains a main concern and while monetary policy continues bearing the major burden, without receiving much support from fiscal policy, particularly in those countries that exhibit high budget deficits.

In the developing countries, growth of real GDP fell in 1989 to 3 percent, from 4 percent in 1988. It will remain unchanged in 1990 and reach 4 1/2 percent in 1991. Besides the implementation of stabilization policies, three factors emanating from the unfavorable international environment are singled out as responsible: slower growth in world trade, the firming of international interest rates, and the weakening of primary commodity prices.

The immediate prospects of the world economy will be "significantly influenced by a number of major developments," mainly derived from the domain of high politics. First, the scheduled completion of a single European Community market in 1992 is expected to boost investment and output. Second, the impact of the adoption and implementation of fundamental economic reforms in Eastern Europe will involve significant transitional costs, by weakening economic activity and employment in the short-run, but will improve significantly the economic performance of these economies in the medium-term. Third, the consequences of German unification, with its anticipated increases in government spending, pressure on prices and higher interest rates.

As a result of the slowdown in economic activity and weakening of investment, the volume of world trade will experience further reductions, to 6 1/2 percent in 1990 and 5 3/4 percent in 1991, which contrasts with the expansion of 7 1/4 percent and 9 percent experienced in 1989 and 1988, respectively. Some recent progress is recognized in the reduction of current account imbalances among the major industrial economies, with the surplus in Japan and the deficit in the United States declining substantially, while Germany's surplus continued increasing. Nonetheless, if German unification leads to increases in domestic demand and investment, the surplus in Germany is bound to "diminish considerably."

In most of the heavily indebted developing countries, the situation "remains extremely difficult." Even so, "strong domestic adjustment measures" are still "the key to achieving sustained growth and balance of payments viability over the medium term."

However, the Brady initiative's emphasis on "a degree of debt service reduction" is recognized as necessary, "to increase the incentives for adjustment and investment and to improve business confidence." Although it is considered "disappointing" that the progress of negotiations has been "slow," signaling the risk that the debtor countries may experience "substantial delay in the restoration of growth."

In the medium term, the following requirements for the achievement of higher growth in the indebted countries are identified: first, that markets remain open in the industrial countries; two, that world interest rates experience a lasting decline, because of a sufficient supply in world saving; and three, that the flow of financial resources to developing countries is not reduced to increase official financial assistance to Eastern Europe.

Finally, medium-term projections for 1992-1995, as well as alternative scenarios are presented for both developed and developing countries.

Under the customary assumption of "unchanged policies," as well as of constant real exchange rates and unchanged oil prices in real terms, GNP growth in the industrial countries is expected to average above 3 percent throughout the period, with inflation declining to around 3 1/4 percent by 1995.

One alternative scenario describes the possible consequences of "a concerted program to achieve price stability in the industrial countries," or aiming at zero inflation, over a period of six to eight years. Although the long-run benefits of achieving and maintaining price stability are "likely to be substantial," these benefits should be weighed against the cost of bringing down inflation. On this point, the analysis concludes that "the costs of disinflation are temporary and that they can vary substantially depending on the degree of wage/price flexibility and on the credibility of the monetary authorities' commitment to achieve its objective."

The other alternative scenario analyzes the possible impact of prospective cuts in defense spending in the industrial economies in general, as well as for the fiscal position of the United States in particular. The conclusion is that "the macroeconomic implications of defense cuts are small," with significant regional and sectoral effects, particularly in defense-related industries, such as primary metals, aircraft, and electronic equipment, which are expected to suffer relatively large losses in output and employment. Still, these "shocks" would be temporary and "should be absorbed by the industrial economies without major disruptions."

Perhaps too conscious of the staleness exhibited by the outlook, the press summary released with the WEO proposed the following most revealing headline: "IMF sees slower economic growth, but no recession." Leonard Silk, in The New York Times, coined a new term, "slugflation," to describe this state of combined "sluggish growth with sluggishly rising prices."

I. 3. WHITHER EASTERN EUROPE? (WDW/15/90 - 30 MAY 1990)

The importance of the inquiry about the economic prospects of Eastern Europe has been recently emphasized by the attention it has received in two rather different quarters. First, in a rare glimpse of its "post-cold war" analytical capabilities, the Central Intelligence Agency (C.I.A.) has made public a report, prepared at the request of the Joint Economic Committee of the U.S. Congress, titled Eastern Europe: Long Road Ahead to Economic Well-Being. Second, the last issue of the World Economic Outlook (WDW/13/90), prepared by the staff of the International Monetary Fund (I.M.F.), contains a chapter dedicated to the analysis of the economic reforms, as well as a supplementary note on the recent economic developments, in Eastern Europe and the U.S.S.R. It is interesting to contrast some of the differences and similarities that appear in both of these timely analyses of this relevant issue.

Although phrased somewhat differently, there seems to be agreement about the explanation of what went wrong with the previous economic performance of these economies.

For the CIA, "the legacy" confronted by the new governments is characterized by "slow or stagnant growth, declining productivity, energy-intensive and obsolete heavy industries, heavy foreign debts, poor quality goods and noncompetitive exports, massive environmental problems and deteriorating infrastructures, to name a few."

For the IMF, the relatively successful performance of the earlier postwar years in these economies, manifested in rates of growth comparable to those of the industrialized market economies, can be explained by "large increases in labor and capital inputs and readily available natural resources." This pattern of growth, characterized as "extensive," became unsustainable in the 1980s as "a result of declines in the growth of labor input as the sectoral migration from agriculture to industry came to a standstill," as well as because of domestic pressures for improved standards of living that "led to reductions in investment."

The IMF recognizes that these economies were relatively successful in the "high degree of job security and aspects of social policy, such as the provision of universal health care, basic schooling and literacy." Because of this recognition it finds all the more surprising the relatively poor performance of these economies "in areas where equity considerations are important or where markets may fail to reflect the full costs of benefits to society." For instance, the environmental record is judged to be "poor." Also, the pattern of resource allocation is "far from optimal and does not respond flexibly to changes in the relative scarcity of factors of production," as revealed by the energy intensity of productive patterns after the oil shocks of the 1970s. Finally, the mix of goods and services produced "is not consistent with the preferences of the population."

There seems to be broad agreement among both institutions about what is required by the economic reform of these economies.

For the CIA, it is necessary to decentralize management; to change performance indicators, from total output and sales to profits; to free prices; to expand the private sector; to increase financial discipline; to encourage competition; to liberalize restrictions on foreign investment; to establish contract law; and to enhance individual incentives.

For the IMF, "the main features of reform" are indicated by the fact that "the information contained in market prices is ignored or suppressed; there is an absence of competition and competitive markets; and the incentives faced by enterprises, workers, and consumers do not encourage efficiency and motivation."

On the basis of these premises, a "comprehensive reform strategy" entails, first, that "the system of microeconomic management of the economy would need to be replaced with a system of macroeconomic management and control operating through fiscal and monetary policies." This means primarily that "the government budget would have to be brought into broad balance and the growth of money and credit controlled." Second, the intermediation role of financial markets should be more fully developed. Third, to reduce the size of the public sector by privatizing "many, if not most, public enterprises." Fourth, "governments will have to take on new responsibilities and create new institutions," such as changes in the legal system and commercial codes, as well as the establishment of "a social safety net of unemployment benefits and a system of income transfers to the poorest members of society," to allow for enterprise autonomy over the hiring and firing of labor. Finally, it is "particularly important to end the institutional monopoly over foreign trade."

Having specified the requirements of reform, both institutions focus on the more complex issue of the transition.

The CIA sees "formidable obstacles ahead," in the form of "four major threats:" 1) a deep economic recession; 2) a fragile financial position, on account of heavy debt burdens and poor prospects of increasing export revenues; 3) inexperienced governments; and 4) the struggle over privatization, over how to distribute the wealth accumulated by the state. In conclusion, "the public's tolerance for prolonged austerity will be key to the success of the reforms," with the prospect of unemployment, more than price rises and the fall of real wages, as the critical concern. The CIA is optimistic about the "ultimate outcome," although it recognizes that in the short-run "the realities of the economic situation facing the region are daunting." With the added paradox that the "near term performance may be poorest in those countries pushing reform the hardest--Poland, Hungary and Yugoslavia--with output slowing and even declining as efforts to stabilize their economies and implement structural reforms prove disruptive." Even so, the long term growth prospects of these countries are said to be better than "those of the slow reformers."

The IMF coincides with the conclusion about the pace of economic reforms. Recognizing that there is neither theory nor precedents, the main issues are identified as the speed, the comprehensiveness and the sequencing of reforms.

On the speed, it is recognized that the transition will not be painless because inflation and unemployment may tend to increase. Even so, a "central lesson" is found in the "importance of establishing macroeconomic stability in the early stages of reform." Thus, the conclusion that "a rapid implementation of market-oriented reforms may be preferable to a gradual approach."

Given multiple linkages, it is better if each element of the program reinforces other elements, as well as if the costs and benefits are broadly shared rather than concentrated. Consequently, speed and comprehensiveness not only complement each other but make less important the issue of sequencing, all of which also argues against the proverbial search for a "third way," placed "between a centrally planned and a market economy."

Be it as it may, at least these recommendations do not sound as those coming out of certain academic circles recently described, by Nobel laureate and MIT Professor Paul Samuelson, as "undiluted, Charles Dickens capitalism."

I. 4. <u>THE HOUSTON SUMMIT</u> (WDW/21/90 - 18 JULY 1990)

The comments on the global significance of "the first economic summit of the post-cold war era" did not wait for the ink to dry on the signatures of the final communique, issued by the seven heads of state and government from the participating industrialized democracies --Canada, France, Italy, Japan, the United Kingdom, the United States and most probably for the last time, West Germany.

For instance, R.W. Apple Jr. in <u>The New York Times</u> saw the emergence of a "new, more subtle balance of power," based on the dominant presence of Chancellor Helmut Kohl of West Germany and the less dramatic but firm assertiveness of Prime Minister Toshiki Kaifu of Japan.

David Hoffman in <u>The Washington Post</u> found evidence of the emergence of "a multipolar world in which the United States is but one of several players." To this effect, British Prime Minister Margaret Thatcher was quoted as saying, "there are three great groups of nations at the summit, one based on the dollar, one based on the yen, and one based on the deutsche mark."

Finally, Professor Jeane Kirkpatrick in her syndicated column said she discovered that the U.S. President has "a trilateral vision that features Japan and Germany in starring roles alongside the United States and a new active triangular diplomacy based on the reality of the great economic power of these three nations."

Nonetheless, these conclusions are not all that clear when the results are observed by focusing on the conclusions, that appeared in both the political and the economic communiques, issued at the end of the summit meeting.

First of all, not many divisive subjects appeared in the political declaration, issued on July 10. The main theme was to welcome the turn towards democracy all over the world, including "the intention of the Soviet Union to move toward a democratic political system, as well as Soviet attempts to reform their economy along market principles."

The main differences were found in what were judged as the three issues that dominated the economic discussions: aid to the Soviet Union and to China, agricultural subsidies and the fate of the Uruguay Round, as well as the environment.

Instead of approving a specific commitment of financial assistance, as the Europeans supposedly wanted, there was agreement that "technical assistance should be provided now to help the Soviet Union move to a market-oriented economy and to mobilize its own resources." Furthermore, the proverbial prescription "when in disagreement order a study" was observed by requesting from the IMF to convene the World Bank, the OECD and the designated president of the EBRD "to undertake, in close consultation with the Commission of the European Communities, a detailed study of the Soviet economy." True, this did not stop Chancellor Kohl from going to the Soviet Union immediately afterwards, to deliver only $3.5 billion in bilateral assistance already promised. Also, this did not stop Prime Minister Kaifu from announcing from the beginning to President Bush, "gently but firmly," that Japan planned to resume its financial aid and lending to China. This was considered evidence that Japan was taking "a new and more assertive role," or as "a Senior administration official" put it, "We can't stop them. They were going to do it anyway."

On agricultural subsidies, by far the most important issue on the summit's agenda for the developing countries, President Bush was described as "mounting an aggressive attack" against them. The result was a recognition that "the negotiations on agriculture should therefore be conducted in a framework that includes a common instrument of measurement, provides for commitments to be made in an equitable way among all countries, and takes into account concerns about food security." Moreover, it was decided that "agreement on such framework by the time of the July meeting of the Trade Negotiations Committee is critical to the completion of the Uruguay Round as a whole." Also, the seven supported "the text submitted by the Chairman of the Agricultural Negotiating Group as a means to intensify the negotiations," while also declaring their intention "to maintain a high level of personal involvement and to exercise the political leadership necessary to ensure the successful outcome of these negotiations." Consequently, whatever the final outcome, the fate of all the Uruguay Round now depends on the success that can be attained on the issue of agricultural subsidies.

Finally, by contrast with last year's summit, the environment receded from the top of the agenda. First of all, no consensus emerged on a German proposal, supported by other European leaders but opposed by President Bush, on setting a timetable for limiting the emission of gases that contribute to global warming. By contrast, all the participants were "ready to cooperate with the Government of Brazil on a comprehensive pilot program to counteract the threat to tropical rain forests in that country." The World Bank, in close cooperation with the Commission of the European Communities, was asked to prepare the proposal and to present it to the next Economic Summit.

Given these results, it seems a bit premature to signal the birth of a new balance of power, of a multipolar world, or of a trilateral diplomacy, as the outcome of the first post-cold war summit. Rather, what these results reveal is that in the absence of a common enemy, despite the emergence of open disagreements, these differences are still not profound or bitter enough as to set the participants apart. Or, as President Bush observed in his closing remarks, in these "rapidly changing times . . . dealing with entirely different times . . . we're not urging everybody to march in lockstep."

I. 5. WORLD POVERTY, ACCORDING TO THE WORLD BANK (WDW/22/90 - 25 JULY 1990)

This year's World Development Report, issued by the staff of the World Bank, is dedicated to analyze world poverty and the means for its reduction. First, it measures poverty, qualitatively as well as quantitatively; second, it draws lessons from successful experiences in poverty reduction; and third, it ends posing "a question that is also a challenge," what can be achieved in attacking poverty in what is left of the present century.

As usual, the Report contains a single chapter on the "trends in the world economy." The titles of the other eight chapters illustrate the wide scope of the treatment of this year's central issue: what do we know about the poor? progress on poverty: lessons for the future; promoting economic opportunities for the poor; delivering social services to the poor; transfers and safety nets; the 1980s: shocks, responses and the poor; international factors in reducing poverty; and finally, prospects for the poor.

The focus on poverty is all the more timely, in view of the performance of the world economy in 1989. First of all, if "the 1980s closed happily for the industrial countries," with the exception of East Asia, "many developing countries have not merely failed to keep pace with the industrial countries; they have seen their incomes fall in absolute terms," particularly in Latin America and sub-Saharan Africa. These contrasting performances between developed and developing countries accurately depict the "diverging trends in the world economy."

Concerning the prospects, the Report warns that "if the patterns of regional income growth seen in the 1980s were to be repeated in the 1990s, the results would be disastrous for most of sub-Saharan Africa as well as for parts of Latin America and South Asia." In these terms, "the legacy of the 1980s remains evident,"

because while "all regions are expected to have positive per capita income growth, Latin America and sub-Saharan Africa are unlikely to achieve their long-run potential."

Turning to poverty, the Report focuses on where to find the poor. It reveals that in 1985 more than a quarter of the world's population, or 1,115 million persons, lived with less than one dollar a day, or below an upper poverty line of $370 a year. Nearly one half of the world's poor thus defined live in South Asia, a region that accounts for roughly one third of the world's population. Sub-Saharan Africa accounts for more than 16 percent of world poverty, a smaller, but still highly disproportionate share, since it comprises only about 11 percent of world population.

Qualitatively, the worst forms of poverty are found among the rural poor, in the large households of ethnic minorities where women and children are often worse than men, among whom nearly all income is spent on consumption, with about half spent on food.

Successful experiences, such as Indonesia and Malaysia, can be explained by the application of a two-pronged strategy. A "first component provides opportunities," encouraging a pattern of economic growth to encourage the use of "the poor's most abundant asset--labor." The second component "increases the capacity of the poor to take advantage of these opportunities," by the provision of basic social services, such as primary education, primary health care and family planning.

Still, to reach almost all the poor, it is necessary to implement "a program of well-targeted transfers and safety nets as an essential complement to the basic strategy." The transfers should be aimed at the sick, the old, the disabled, widows and orphans. The safety nets should be aimed at those who remain vulnerable to natural disasters and macroeconomic shocks.

The eighties also showed that in a context of painful macroeconomic adjustment, in the short term, the poor are at risk, because "policies to reduce poverty involve a tradeoff." In what amounts to one of the major statements contained in the REPORT, this tradeoff "is not between growth and the reduction of poverty." Rather, "the principal tradeoff, specially in the short run, is between the interests of the poor and those of the nonpoor."

Admitting that this tradeoff is "politically sensitive," the Report concludes that the two-pronged strategy is "more feasible than other strategies." For instance, Korea and Japan are mentioned as successful examples of land redistribution, but wherever these reforms encounter great political obstacles, "investment in education as the best way of augmenting the assets of the poor, is more likely to succeed."

Also, "the strategy requires an increase in certain categories of public spending that specifically benefit the poor." Nonetheless, the Report recognizes, without getting into the details of where to cut, that "it is possible to shift public spending in favor of the poor, even within an overall framework of fiscal discipline."

President Conable recognizes in the foreword that, "although domestic policy is critical to the reduction of poverty, international assistance is needed to support countries' efforts." Consequently, in another major statement on conditionality, President Conable proposes that "the allocation of aid should be more closely linked to a country's commitment to pursue development programs geared to the reduction of poverty."

Additionally, a "unique opportunity" is identified from the present easing of international tensions, because "a cut of only 10 percent in military spending by the countries of the North Atlantic Treaty Organization would pay for a doubling" of the $51 billion of official development assistance granted in 1988.

Looking ahead to the present decade, the Report projects that a rate of growth of 3 percent in the industrialized countries, as well as an increase in real aid flows at the same rate, to support the successful application of the two-pronged strategy, can contribute to a reduction of 400 million of the developing world's poor, bringing the total to 825 million by the turn of the century. This goal is considered feasible because "the principal elements of an effective strategy are well understood and that the external resources needed to support it could be made available at little cost to the industrial countries."

I. 6. THE RETURN OF OIL (WDW/23/90 - 5 SEPTEMBER 1990)

That the largest amounts of commercial energy worldwide are consumed by a very small group of industrialized countries and originate from the most unstable and tense region of the present international system has led to the third oil shock of the last two decades. Such concentrations of supply and demand more easily give ground to simple explanations than they support the adoption of corrective measures aimed at reducing the persistent degree of vulnerability of the present world economy to such destabilizing shocks.

On the supply side, petroleum accounted in 1989 for almost 40 percent of world commercial energy, followed by 28 percent from coal; 21 percent from natural gas; 7 percent from hydroelectricity;

and 6 percent from nuclear power. Geographical concentration of production also prevails because almost two thirds of the world's proven oil reserves are located in the Persian Gulf, with 45 percent of them in Kuwait (9.3 percent); Iraq (9.9 percent) and Saudi Arabia (25.2 percent).

Similar degrees of concentration can be found on the demand side. For instance, over half of the world's oil is consumed by the industrialized countries. In 1989, OECD members accounted for 56 percent of world oil demand, with the United States as the most voracious consumer, accounting for 26 percent. The United States imported 8 million barrels per day (b/d), or 46 percent of its domestic supply, with 2.1 million b/d, or about 12 percent, from the Persian Gulf. This shows that, in 1989, the United States was twice as dependent on Persian Gulf oil than in 1973, when the same imports amounted to about one million b/d, or about 6 percent of total U.S. supply.

Overall, in 1989, North America and Western Europe consumed nearly half of the world's oil output, but contributed only 23 percent to world supply. By contrast, the Persian Gulf nations accounted for 26 percent of global oil supply and only for 4.5 percent of world demand. Other regions of the world, such as Latin America, were relatively marginal, producing slightly more than 10 percent of global oil production and consuming about 8 percent of total demand. Also, the Soviet Union and Eastern Europe supplied one fifth of world production, while they consumed about 18 percent of global demand.

In the long run, left to itself, this disparity between producers and consumers can only accentuate itself, given the imbalance between current production and proven reserves. For instance, the ratio of proven reserves to annual production reveals that at present levels of production proven reserves in North America will only last a decade. The same ratio for Western Europe indicates that reserves will only last about 13 years. By contrast, if the Persian Gulf nations continue producing at present rates, their reserves will last over a century. Also, the reserves-to-production ratio for OPEC is around 92 years.

Since these trends are so obvious why, it can be asked, producers and consumers alike have not designed policies and strategies to counter this concentration through the diversification of sources. Besides other culprits such as the environmental movement, free market ideology, regional disputes, or worsening budget deficits, there is the fact, mentioned by James J. MacKenzie, from The World Resources Institute, that before the Iraqi invasion, in constant dollars, gasoline prices in the United States were at the lowest level of the last 40 years. To the point that, in the United States in 1989, "gasoline was cheaper than any other liquid, including bottled water."

Furthermore, public opinion in the United States, as revealed by a Wall Street Journal/NBC News poll, remains profoundly ambivalent about acceptable measures to counter these imbalances. For instance, in the abstract, 80 percent of the respondents favor "tougher conservation measures," but 62 percent oppose taxing gasoline to encourage conservation and 57 percent oppose the construction of new nuclear power plants. This only demonstrates, concluded Barbara Rosewicz in The Wall Street Journal "chronic unwillingness to suffer short-term pain for long-term gain."

In these circumstances, it is most likely that the third oil shock will give the final push into recession to an already sluggish economy. The Federal Reserve has revealed that in July the U.S. economy's "pace was slow or had slackened markedly." By contrast with the previous two oil shocks, that led to the recessions of 1973-75 and of 1981-82, this time, there seems to be agreement that the increase in oil prices will only precipitate the recession that was already looming. Nonetheless, some "optimists" can still be found that are predicting only the return of stagflation as a result of the third oil shock.

I. 7. THE SECOND WORLD ECONOMIC OUTLOOK (WEO)
(WDW/28/90 - 10 OCTOBER 1990)

The second issue of the World Economic Outlook released by the staff of the IMF during the annual meetings, was almost buried under the barrage of speculation unleashed by the hike in oil prices. When these prices soared beyond the $26 per barrel anticipated for 1990, the WEO's projections were immediately dismissed as too optimistic.

Nonetheless, in the agitation generated by the Gulf crisis, several mid-term projections that appear in the second WEO were overlooked. In the excerpt of the WEO released to the press, on September 19, chapter I reviews recent economic developments and the forecasts for 1990 and 1991, with an appendix containing a scenario illustrating the possible effects of the rise in the world price of oil. Chapter II presents the medium-term baseline projections for the industrial countries, including an examination of the likely implications of German unification and a review of recent progress toward economic integration in the European Community. Finally, Chapter III describes the medium-term baseline scenario for developing countries, as well as an alternative scenario based on "a less optimistic set of assumptions about domestic economic policies."

For instance, even before the events in the Middle East, the WEO saw the world economy experiencing a "global slowdown," in 1990, to about 2 percent, from 3 percent in 1989.

In the industrial countries, real GNP is projected to rise by 2 1/2 percent, in both 1990 and 1991, down from an average of almost 4 percent in 1988-89. While in the developing countries, real GDP is expected to decline from 3 percent in 1989 to 2 1/4 percent in 1990. The slowdown in the developing countries is attributed to the short-run effects of the most recent tightening of financial policies, as well as to the effects of "unfavorable external conditions." Singled out among these last are the less rapid expansion in world trade, the persistence of the decline in the prices of non-oil primary commodities, as well as the continuation of high international interest rates.

Beyond the short-term implications of the events in oil markets, the medium term outlook for the world economy is seen as "strongly influenced by the far-reaching changes currently taking place in Europe," with three sets of events considered decisive.

First, the restructuring of the economies in Eastern Europe and in the U.S.S.R., "from relatively inefficient production and distribution systems based on central planning toward more market-oriented systems." In the short-run, output is expected to decline in most of these countries in 1990 and to stagnate in 1991, as a result in part of the stabilization measures and the economic reforms being implemented.

Second, the unification of Germany in the short-run is also expected to generate a temporary fall in output and employment, while aggregate demand for imported investment goods is expected to expand. German unification will also result in a rise in global investment relative to world saving. In the prevailing context of high levels of capacity utilization in almost all the industrial countries, this is expected to cause some upward pressure on prices, on interest rates and on the value of the German mark.

Finally, the ongoing movement toward economic integration within the European Community, particularly the scheduled completion of a single market in 1992, will boost investment and sustain output growth near capacity limits, for the next several years in the twelve member countries.

The transformations in Europe will generate a rise in the demand for resources that, together with the pressing needs of the developing countries, are bound to lead to a shortage of capital, to such an extent as to "underscore the importance and the urgency of increasing world saving." To achieve this, "the most effective way" is to intensify "the process of fiscal consolidation, particularly in those countries where fiscal deficits remain high,

such as Canada, Italy, the United States and many of the smaller industrial countries."

Dealing with inflation still ranks as the top priority of monetary policies in the industrial countries because, besides the pressure on interest rates exercised by the demand for resources from Eastern Europe and Germany, a worsening of inflationary expectations has appeared. Thus, the conclusion is derived that "a significant relaxation of monetary policy would yield neither an enduring reduction in interest rates nor a lasting improvement in employment." This conclusion was highlighted by the U.S. press because it takes the side of the Federal Reserve in its ongoing debate with the Treasury about interest rates.

In the case of the developing countries, economic policies are singled out as having played "a critical role," because "growth has been strong and inflation has remained relatively low" in those countries "that have avoided debt-servicing difficulties." While those "that have encountered debt-servicing difficulties," have experienced slow growth and accelerated inflation. Even so, "external factors" also played a significant role. Among them, the plight of non-oil commodities is specifically recognized, because their prices "declined sharply during 1989," as a result of the slowdown in world economic activity, as well as improved supplies. Furthermore, continuing its decade-long downturn, it is projected that non-oil commodities will decline by 8 percent in 1990. Thus, in the ten years since 1980, the Fund's index for these products' prices has "dropped by some 40 percent relative to the export price of manufactures of industrial countries."

II. THE U.S. ECONOMY

II. 1. INTO THE NINETIES (WDW/1/90 - 17 JANUARY 1990)

As if the calendar had the power to influence the evolution of events, the eighties concluded with a rush to get rid of several situations that apparently were deemed inadequate for the new decade. In a way, this is only an anticipation of what can be expected to happen with the coming change of millennium. Thus, with the nineties, has arrived the "fin de siecle" atmosphere that will intensify as we inexorably move towards the new century.

The eighties brought many surprises that discredited almost all predictions. Recall, for instance, the Club of Rome's Malthusian limits to growth or the specter of energy shortages.

The decade began with the U.S. economy experiencing double-digit inflation and with its subsequent collapse opening the door to the longest period of sustained peacetime expansion--seven straight years of economic growth, surpassed only by the nine years of expansion of the sixties. Finally, to deliberately mislead forecasters, the second half of 1989 witnessed a vertiginous succession of events that astonished even the most skeptical, signalling the end of the Cold War and the beginning of a relaxation of the major tension of the present international system.

Such a decade, particularly its exhilarating epilogue, apparently has sobered even the most audacious forecasters, because almost all the predictions that have been offered recently barely venture into 1992.

For instance, a survey of forty economists by The Wall Street Journal reveals that, if helped by lower interest rates, the U.S. economy will experience its eighth consecutive year of expansion. This optimism is tempered by the recognition that growth in 1990 will be sluggish, because according to another survey by the National Association of Business Economists, the U.S. economy will expand at only 1.8 percent.

Nonetheless, even such sluggishness has given ground to the obstinate question--raised by Leonard Silk in The New York Times, followed by Jodie Allen in The Washington Post and by Donald Lambro in The Washington Times--if the business cycle has gone "out of business."

Admittedly, it all depends from the rift that has appeared between the White House and the Federal Reserve. As pointed out by Harvard Professor and former Dukakis adviser Lawrence Summers, "all previous recoveries have died not of old age, they've been murdered."

Be it as it may, better watch closely the confrontation between Budget Director Richard Darman and the FED Chairman Alan Greenspan. Briefly, Mr. Greenspan considers that the White House is not doing enough to reduce the budget deficit, while Mr. Darman considers that the FED is almost exclusively focused on the fight against inflation. For Mr. Darman, slow-growth policies are partially responsible for the persistence of the budget deficit, consequently, a sluggish economy will only step-up the pressures on the FED to ease monetary policy by lowering interest rates.

Still, optimists hold that "structural changes" in the U.S. economy have led to the "end of the traditional business cycle." Jodie T. Allen, in The Washington Post, identified some of these changes, in the form of more fluid financial markets, a less vulnerable manufacturing sector, faster reactions and feedback to

market signals, more flexible labor markets and better policy making.

Also, there are some grounds for hope. The European Community's becoming a single market in 1992, as well as the changes in Eastern Europe, have led to predict that, at least in the first half of the nineties, Western Europe will grow between 3 and 3.5 percent, by contrast with the United States that is expected to grow at an average of around 2.5 percent. In these terms, Europe would perform the "locomotive role as the U.S. economy slows down."

Forecasters are frequently criticized because they project present trends. This time, the present does not lend itself to easy projections, the nineties look perplexing and fascinating.

II. 2. THE ECONOMIC STATE OF THE UNION
(WDW/5/90 - 14 february 1990)

On February 6, 1990, President Bush issued the first Economic Report of his mandate. In the message of transmission to Congress, the President addresses the following issues: 1) goals and principles; 2) macroeconomic prospects and policies; 3) encouraging economic growth; 4) regulatory reform; 5) the global economy; and 6) looking ahead.

President Bush emphasizes that "since 1982, American firms and workers have produced the longest peacetime expansion on record and created more than 20 million jobs," with the coincident "containment of inflation" considered "a milestone in postwar history."

In 1989, the United States regained its position as the world's "leading exporter," and retained the position of the world's "leading job creator." Beyond these accomplishments, the task ahead is "to improve on that record, deal with inherited problems, and meet the new challenges and seize the new opportunities."

The Administration's primary economic goal is defined as "to achieve the highest possible rate of sustainable economic growth," by following five principles:

1) "Reduce government borrowing by slowing the growth of Federal spending while economic growth raises revenue until the budget is balanced, and reduce the national debt thereafter;"

2) "Support a credible, systematic monetary policy program that sustains maximum economic growth while controlling and reducing inflation;"

3) "Remove barriers to innovation, investment, work, and saving in the tax, legal, and regulatory systems;"

4) "Avoid unnecessary regulation and design necessary regulatory programs to harness market forces effectively to serve the Nation's interest;" and

5) "Continue to lead the world to freer trade and more open markets, and to support market-oriented reforms around the world."

Macroeconomic performance in 1989 is described as "more moderate," with GNP growth at 1.9 percent. Although "in sharp contrast to most past periods of low unemployment and high capacity utilization, inflation was kept firmly in check," at 4.1 percent in 1989, down from 4.5 percent in 1988. For 1990, the rate of expansion is projected at a "slightly faster pace."

The encouragement and promotion of economic growth will be based on the removal of "obstacles to saving, investing, innovating, and working," with investments in plant, equipment, technology, education and research singled out as the main instruments.

Certain contrasts appear with the previous Administration, particularly regarding regulatory policies, which led Paul A. Gigot, in the Wall Street Journal to suggest that "whatever you do, don't call them supply-siders."

For instance, "a key function of government," is said to be the construction of "a legal framework that enhances the health and vigor of the private sector," or that "government action may be called for where competitive private markets do not exist or cannot function."

There are also other manifestations of the "pragmatism" that is said to define the present Administration, such as the requirement that "regulatory targets should be chosen by careful cost-benefit analysis," as well as the conclusion that "in some cases, well-designed regulation can serve the public interest." Thus, Gigot concludes that the Report is better characterized as "prudent voodoo."

On the global economy, the Administration is "staunchly opposed to managed trade," with "the highest trade policy priority" described as the "successful completion of the Uruguay Round of negotiations," while market-oriented reforms are recommended for the Eastern European and the heavily indebted developing countries.

Finally, "looking ahead," the President concludes with the upbeat message that with the proposed "economic principles and policies," the United States "can enjoy strong, sustainable economic growth and use the fruits of that growth to raise living standards, solve longstanding problems, deal with new challenges, and make the most of new opportunities."

The annual report of the Council of Economic Advisers, that follows the President's message of transmission to Congress, is divided in the following seven chapters: 1) building on success; 2) developments in 1989 and future prospects; 3) design of fiscal, monetary, and financial policies; 4) investing in America's future; 5) human resources in the 1990s; 6) the economy and the environment; and 7) growth and market reform in the global economy.

The first chapter summarizes the contents of the report and concludes that "sustained, robust growth will raise living standards, maintain the Nation's position of global leadership, bring greater opportunity for Americans, and provide the resources necessary to make progress toward satisfying an array of public and private needs and wants."

On the prospects, the conclusion is that "as the U.S. economy moves into the eighth year of growth, there is a strong basis for continued expansion in the 1990s," because "the remarkable length of the current expansion, by itself, does not increase the likelihood of an imminent recession."

Macroeconomic policies should "emphasize long-run economic performance" by means of "increased national saving and investment, controlling and gradually reducing inflation, and fostering a safe and competitive financial marketplace." Such policies will "ensure both continued leadership by the United States in the world economy and rising living standards for American families."

Investing in America's future demands an increase in the "rate of investment in physical, intellectual, and human capital," as well as to "raise the low national saving rate."

Human resources in the 1990s are characterized by "a new set of labor market concerns," that move away from "the availability of jobs that has dominated macroeconomic policy discussion since the Great Depression." These new concerns center around "the availability of workers and skills."

On the economy and the environment, "both economic growth and environmental quality are desirable policy goals," with three principles guiding regulation: first, realistic and risk-reduction goals that balance benefits and costs; second, strategies that work

with rather than against market incentives, instead of less effective command and control regulation; and third, dissemination of scientific and technical information about environmental and health risks.

Finally, the challenge in the global economy is to build upon the success of the U.S. economy "to continue support for economic and political freedom around the world."

II. 3. RECESSION IS HERE (WDW/34/90 - 21 NOVEMBER 1990)

One question recently heard and about which there is no easy answer is when does a recession really start? The accepted wisdom is that recession happens when the gross national product (GNP) decreases for six consecutive months. One difficulty with this measurement is that it can only be verified "post-festum," after the six months have elapsed, once the figures have been released and then revised.

The National Bureau of Economic Research, a prestigious private research institution considered "the arbiter of when recessions begin and end," offers the following definition: "a recurring period of decline in total output, income, employment and trade, usually lasting from six months to a year and marked by widespread contractions in many sectors of the economy."

This is close to the definition offered in recent testimony by the FED Chairman Alan Greenspan, who described a recession as a "cumulative unwinding of economic activity," by contrast with a few months of mildly negative GNP growth that can be reversed by the revision of earlier figures. What is required, according to the FED's Chairman, is a steep, widespread decline in economic activity.

This same definition was used by the FED Chairman, in testimony before the U.S. November elections, to refer to the economy's health as only "very sluggish," because during the first semester of 1990 GNP grew by only one percent and even by less than that during the second quarter.

Nonetheless, the consumers have already made up their minds. In response to a survey from the University of Michigan, 71 percent thought that bad times were ahead, compared with 42 percent in July and 29 percent a year earlier. Furthermore, the University of Michigan Index of Consumer Confidence, compared to a February 1966 survey representing 100, fell to 63.9, or 24.3 points since July,

the sharpest fall in consumer confidence in any three month period registered in 44 years. Still, this was not the lowest figure in the Index, which remained at 51.7 percent registered in 1980.

On November 8, President Bush announced that he would meet at Camp David with his top economic advisers --Secretary Brady, Budget Director Darman, Vice-President Quayle, Chief of Staff Sununu and Chief Economic Adviser Boskin-- because the nation is "in some tough times now," or as acknowledged by Mr. Boskin the economy "at best is in a lull." These meetings led to the recognition by President Bush, a week later, that he was concerned about "a downturn" and "a slowdown."

This practically settled the discussion about the recession's existence. President Bush said the answer to "the major question mark in terms of the depth of the slowdown or recession" depends from the rise in oil prices, caused by the Persian Gulf crisis. Thus, the President also set the terms of the debate that usually follows the recognition of the phenomenon's existence, concerning how long it will last.

Apparently in recessions, as in wars, it is almost always assumed that they will be short, when they begin. Or as Stephen McNees from the Federal Reserve Bank of Boston declared, "you never expect a big one."

This time, given the central role attributed to the rise in oil prices, as the "final straw" that pushed the U.S. economy into recession, different scenarios about oil prices have become the basis for most of the predictions that have been offered about the length of the recession.

According to the World Bank, there are four possible scenarios: 1) "rapid return to normalcy," in which oil prices will rapidly average between $17 and $18 per barrel, not very far from the $16.40 dollars averaged during the first half of 1990; 2) "short-term uncertainty," predicts an average oil price for the rest of this year of between $31 and $32 per barrel, and an average price of $29 and $25 for 1991 and 1992, respectively; 3) "prolonged uncertainty," forecasts an average of $29 per barrel during the next five years; and 4) "war," will immediately drive the price to $65, to fall and remain once the war ends between $30 and $40 during the next five years.

Of course, there are other factors invoked to justify the belief that the recession will be short. First, it is said that the FED does not want a long recession, as Princeton University Alan Blinder declared, "this Fed seems much more recession-averse than previous Feds." Second, politics is offered as another reason, because if the economy returns to a growth path in 1991, it will make a decisive contribution to the re-election of President Bush. Third, also cited are modern techniques, such as "just-in-time"

inventory management, that make for "lean and trim" ratios of inventories to sales, to avoid the traditional accumulation of unsold goods by retailers that leads to drastic cuts in production. Finally, there is the low dollar and the prospect of its further decline, as a consequence of interest rate reductions, which will make U.S. exports "the economy's silver lining."

In conclusion, the bottom line of "the case for a mild recession," wrote David Wessel in The Wall Street Journal "rests on faith--not only in Fed policy-makers, but in the resiliency of the U.S. economy to withstand oil shocks, bank failures and turbulent markets."

II. 4. U.S. RELIANCE ON IMPORTED OIL (WDW/35/90) - 28 NOVEMBER 1990)

Some of the circumstances that have led the world economy to experience its third oil shock in less than twenty years can be found in the pronounced levels of concentration of supply and demand.

For instance, on the supply side, levels of geographic concentration are of such magnitude that almost two thirds of the world's proven reserves are located in the Persian Gulf, with the concentration of almost half in three countries --Kuwait, 9.3 percent; Iraq, 9.9 percent; and Saudi Arabia, 25.2 percent (WDW/23/90).

Similar or worst levels of concentration can be found on the demand side. The United States with only four percent of the world's population consumes almost forty percent of the world's production of gasoline. In 1989, oil represented 42 percent of the U.S. total energy supply, with 12 percent imported from the Middle East.

There is also high concentration within these already concentrated levels of demand for oil. According to James J. MacKenzie, from the Washington-based ecological think-tank World Resources Institute (WRI), the transportation sector absorbs almost two thirds of total U.S. oil demand, with motor vehicles consuming about half, followed by industry using 24 percent and buildings as well as electric utilities together consuming about 13 percent.

Furthermore, since the first oil shock, with the notable exception of transportation, impressive reductions in oil consumption have been registered in many sectors of the U.S. economy, by means of greater degrees of efficiency and substitution. Electric utilities have reduced oil consumption by

more than half, residential and commercial buildings by 40 percent and industry by 10 percent.

Nonetheless, since 1973, transportation has registered an increase of 20 percent in the consumption of oil. Consequently, despite some impressive cuts in other sectors of the U.S. economy, in 1989, total consumption of oil remained at the same level it had attained in 1973.

From the previous analysis, in a study released recently by WRI, J. MacKenzie derives the conclusion that to achieve additional reductions in the demand for oil in the United States "the greatest opportunities lie in transportation, where improved fuel efficiency and --in the longer term-- the substitution of alternative energy sources can lead to major cuts in petroleum use."

More than ninety percent of the energy used by the U.S. transportation sector is derived from oil, with passenger cars and trucks accounting for more than two thirds. Only motor vehicles, in 1989, accounted for 80 percent of all energy consumed in transportation, with passenger cars accounting for 40 percent.

Moreover, the consumption of gasoline has been increasing, by as much as 15 percent since 1982. In MacKenzie's terms, this "national indifference about rising petroleum use," is no surprise, because it is the result of the decline in the price of motor vehicle fuel in the United States, which in constant dollars in 1988 "dropped to a forty-year low."

An exploration of several alternative transportation options to the present gasoline/diesel technology leads MacKenzie to the following conclusions.

First, ethanol would be nationally produced but it would be relatively expensive and it requires large amounts of land to grow corn, which in the end consumes almost as much energy as the ethanol that would be produced. By contrast, methanol and compressed natural gas would be imported and both would provide only small clean-air benefits compared to gasoline.

The most attractive option for the next decade, according to MacKenzie, would be electric vehicles because they represent a low-polluting and oil-free form of transportation. The main obstacles to their development are the difficulties that have been found in designing adequate "electricity-storage devices." The U.S. Energy Department and the automobile industry "are pressing for a major new initiative to develop a commercial battery for electric cars."

The degree in which electric cars are clean and non-polluting depends from where comes the energy to charge the batteries. For instance, coal-fired electricity plants will produce sulfur dioxide and other gases that contribute to smog, acid rain and possible global warming.

Nonetheless, even after emissions at the power plant are taken into account, a comparison reveals that electric cars produce much smaller quantities of hydrocarbons and carbon monoxide as well as less ozone, the main ingredient in smog. As for "greenhouse" gases, such as carbon dioxide, which contribute to climatic warming, electric cars would produce about 25 percent less per mile than gasoline engines.

Finally, in the long-run, if hydrogen costs could be lowered, MacKenzie concludes that hydrogen-powered vehicles would become very attractive, because they would reduce oil imports as well as the emission of greenhouse and air-polluting gases.

In the meantime, as long as gasoline prices remain low, technological innovations in the automobile industry, instead of improving fuel economy, will be dedicated to improve "performance," understood as the number of seconds necessary to take a car from a standstill to 60 miles an hour.

III. TRADE

III. 1. FREE VS. MANAGED TRADE (WDW/3/90 - 31 JANUARY 1990)

The debate about the trade deficit of the United States is acquiring ominous dimensions. To explore alternatives, the Twentieth Century Fund, a prestigious, non-profit and non-partisan research foundation, that supports "timely analyses of economic, political and social issues," created "an independent Task Force."

The Fund commissioned a background paper from Professor Gary Clyde Hufbauer, from Georgetown University. Also, distinguished personalities were invited to participate in the task force, with Professor Anne Krueger, from Duke University, acting as chairperson. The other participants were: Lawrence J. Brainard, Bankers Trust; Patrick D. Choate, TRW Inc.; Harry L. Freeman, American Express Company; Paul Krugman, MIT; Robert Kruttner, The New Republic; Robert Z. Lawrence, The Brookings Institution; Clyde V. Prestowitz, The Carnegie Endowment; Howard D. Samuel, AFL-CIO; Herbert Stein, The American Enterprise Institute; Alan Wolff, attorney.

More impressive than the composition of the task force is that its members were unable to agree on a single report. Instead, the Fund published a book, The Free Trade Debate, containing two separate reports and Professor Hufbauer's background paper. As stated in the preface, this result "mirrors the divisions among even the most knowledgeable on these difficult issues."

The task force fractured along very revealing lines. For instance, the free trade report was signed by all the academics--Professors Krueger, Krugman and Hufbauer; by both bankers--Messrs. Brainard and Freeman; and by two of the senior fellows from well known Washington think tanks--Messrs. Lawrence and Stein. By contrast, the other report was signed by two well-known Japan critics-- Messrs. Choates and Prestowitz; as well as by Mr. Kuttner, the journalist, Mr. Samuel, the trade union representative and by Mr. Wolff, the attorney.

This corresponds to present U.S. attitudes, where a new "revisionist" school holds that, to "contain" Japan, the U.S. should employ the same tactics of managed trade that apparently have worked wonders for Japanese external economic policy. Believers in free trade are seen as naive, while some of their universities and think tanks are said to be "on the Japanese payroll." This is the result of a massive effort by Japan to influence "American hearts and minds," to counter the growing resentment against its persistent trade surplus, that amounted to lobbying expenditures estimated in $150 million for 1988 and $250 million for 1989.

Against this background should be placed both reports' main conclusions.

As indicated by its title, "The Case for Free Trade," identifies five different schools in the present public debate: 1) unilateral liberalization with limited exceptions; 2) reciprocal concessions; 3) threat of restrictions; 4) accommodation to foreign styles of industrial policy; and 5) selective unilateral restrictions.

Only the first three are claimed as theirs by the supporters of free trade. "Established approaches to trade policy" are said to "have worked well." Also, "putting aside the tactics of liberalization," they conclude that "relatively free trade within a world system of common rules should continue to serve as the guiding star of U.S. policy."

On the causes of the U.S. trade deficit, the free traders assert that these "have a macroeconomic character: namely, savings and investment imbalances in the United States and abroad, particularly in Europe and Japan." Furthermore, "trade policy on its own can make little if any dent in the trade deficit."

The free traders differ from the dissenters on three critical issues. First, national differences in the organization of trade policy, "make it difficult for the big economic powers to find common ground." Thus, "as a starting point," they suggest "a world system of consistently applied rules and approaches." Second, free traders prefer a "rules-oriented" approach, against a "results-oriented" approach, particularly because "sector-by-sector" policies are seen as "a great danger." Third, free traders are very critical of "aggressive reciprocity," because "the new emphasis on unilateral retaliation will ultimately erode political support for an open trading system." Finally, free trade areas and common markets are considered "a promising approach for the development of agreed rules and the eventual removal of behind-the-border distortions." Moreover, "after the Uruguay Round, an OECD-plus common market" is proposed, "encompassing present OECD members and new arrivals." Even so, they "strongly urge the Bush administration to concentrate its immediate efforts on the Uruguay Round," warning that for the GATT talks "to achieve any degree of success, the United States must be prepared to make concessions to receive concessions."

The dissenters' report is titled "A Fresh Look at Trade Policy." Global economic imbalances are "troublesome," because in the U.S. they have "led to job loss in export and import competing industries, sectors that tend to pay higher wages;" second, the deficit has transformed the United States "from the world's largest creditor (+$141.1 billion in 1981) to the world's largest debtor (-$532.5 billion in 1988);" finally, imbalances "threaten the stability of the world economy," and make the United States "depend from the kindness of strangers."

For the dissenters, the industrial and technological leadership of the United States continues to erode, because beyond the internal causes for this decline, U.S. trading partners "adopt conscious policies to promote strategic industries." Finally, the GATT multilateral trading system, is in a "rickety" state, because of the emergence of regional blocs, the ubiquity of export restraint agreements, a weak dispute settlement mechanism, and a wide range of uncovered activities, such as agriculture, services, intellectual property and investment.

The debate on trade policy in the United States is seen as centered around three fundamental questions: 1) whether to adopt different trade policies for trading partners with different industrial policies; 2) how to "respond to foreign export targeting;" and 3) how to choose among "multilateral, plurilateral, bilateral or unilateral trade policy approaches."

The adoption of "tailored trade policies" is proposed, because "the 'rules-based' approach has been tried and found wanting," thus, "setting market-share objectives may be necessary on a transitional basis to push the market to operate more freely."

Also, certain "market outcomes," such as "the loss of a 'critical' industry" can be "unacceptable." Finally, "the real question is which of the different approaches is most ideally suited for which problems."

The dissenters propose "a trade surplus by 1993," because "in the final analysis, the United States cannot allow critical decisions about the evolution of its economy to be made by default, dictated by the narrow and chauvinistic trade and industrial policies of other countries."

So much for the terms of this crucial debate, whose outcome, given the relative weight of the United States, will determine the prosperity of the world economy.

III. 2. THE U.S. NEGOTIATING PROPOSAL ON INVESTMENT (WDW/4/90 - 7 FEBRUARY 1990)

As with agriculture and services, on January 29, 1990, the U.S. delegation submitted in Geneva a proposal of agreement to regulate what are called "trade related investment measures (TRIMs)." As described by the U.S. Trade Representative, Ambassador Carla Hills, "a GATT agreement on TRIMs would help reduce distortions in the trading system and encourage much needed investment in developing countries." Considered "a high priority issue," the U.S. position is that "a successful Uruguay Round outcome must include a comprehensive, effective agreement to discipline TRIMs."

The proposal was presented in the form of "a draft legal text," containing seven articles and an annex of definitions, before the GATT Negotiating Group on Trade Related Investment Measures. Admittedly, it moves a "step further" from the more general presentation made by the U.S. delegation, on 7 July 1989, in the form of a document titled A Structure for Negotiating a Comprehensive Agreement on TRIMs (MTN.GNG/NG12/W15).

In that opportunity, several delegations remarked that the proposal needed to go beyond the conceptual level, of notions such as transparency and non-discrimination, to contribute meaningfully to the negotiations. Consequently, with the presentation of the "draft TRIMs Agreement," the U.S. delegation hopes to move the discussions "from the general to the specific, from the conceptual to the concrete."

First of all, a TRIM is defined as "any investment measure which restricts or distorts trade by, for example, restricting or displacing imports; restricting, displacing or requiring exports;

or otherwise nullifying or impairing any benefits accruing directly or indirectly to a contracting party, taking into account imports or exports which would have occurred had the measure not been imposed."

A "two-tiered approach" is proposed to "discipline" these measures. Article I "prohibits" those that "inherently restrict or distort trade." The term "inherently" means that "one can reasonably presume that there will be trade restriction or distortion because the adverse trade effects are inseparable from the underlying measure."

Some of the specifically prohibited investment measures are those which "accord a preference to domestic goods over imports, or act as quantitative restrictions on imports or exports."

Article II covers those investment measures that "do not inherently restrict or distort trade but may have adverse trade effects in some circumstances." Instead of directly prohibiting them, the agreement establishes two obligations. The first is non-discrimination, by which a foreign company should be treated "at least as well" as is treated "the most favored foreign or domestic firm, whichever receives the better treatment." The other obligation is that even if the measures are applied on a non-discriminatory basis, contracting parties should abstain from applying them "in a manner that adversely affects the trade of another party." Finally, a mechanism is provided for consultations among affected parties.

Some examples of these "non-prohibited" TRIMs are the requirement that some equity be held by nationals of the host country, restrictions on remittances and access to foreign exchange.

In recognition that the application of the agreement demands "significant adjustments," article III allows different transition periods for developed and developing countries.

The notion of "transparency" is addressed in article IV, by requiring that participants should "make public all measures of general application which are TRIMs or authorize the use of TRIMs." Also, the same article establishes the obligation of giving information about TRIMs that are applied to specific companies.

To conclude, a Committee would be created within GATT to oversee the implementation of the Agreement, according to the consultation and dispute settlement provisions of the GATT.

As in the case of the proposals on services and agriculture, with the proposal on TRIMs, the U.S. delegation continues setting the agenda in the Uruguay Round. If approved, the proposed agreement will certainly represent a considerable task expansion

that will place the GATT at the forefront of one of the most sensitive issues of the international economic agenda.

Gone seem to be the days when the legitimacy of the GATT was challenged on the grounds that it ignored international asymmetries, because its functioning rests on the assumption of formal equality among trading partners. The problem, defined by Ambassador Hills, is that "trade has outgrown the GATT," because there are "areas poorly covered by GATT rules, like agriculture, or not covered at all, like services, investment and intellectual property," that have become "of much greater importance than they once were." Today, with the debates within the Uruguay Round on issues such as services, intellectual property rights (IPRs) and TRIMs, the GATT appears as a dynamic institution, expanding its mandate into those new issues constitutive of the international economic agenda of the nineties.

III. 3. THE U.S. TRADE POLICY AGENDA FOR 1990
(WDW/9/90 - 14 MARCH 1990)

As mandated in Section 1641 of the 1988 Omnibus Trade and Competitiveness Act (1988 Trade Act), "the President shall submit to the Congress during each calendar year (but not later than March 1) a report on A) the operation of the trade agreements program ... and B) the national trade policy agenda for the year in which the report is submitted." Both have been published by the U.S. Trade Representative (USTR) in a single volume, released on 28 February 1990.

The objectives included in this year's agenda are grouped under the following three headings:

"1) Strengthen and expand the international trading system by successfully negotiating an ambitious package of results in the Uruguay Round.

2) Complement Uruguay Round goals by conducting bilateral and regional market-opening and market-expanding initiatives.

3) Enforce and implement U.S. trade laws in the way that best advances the goals of open markets and fair trade."

Each one of these objectives is broken down into specific actions and initiatives in what amounts to a detailed description of the Administration's intentions in the field of international trade for 1990.

For instance, "the successful conclusion of the Uruguay Round by December 1990" is described by the USTR Ambassador Carla Hills,

as "the United States' highest trade priority." This entails the completion of agreements on the following issues:

-the reform of international agricultural trade by phasing out government intervention in the form of trade distorting subsidies and access barriers, as well as by harmonizing sanitary and phitosanitary regulations, "so that farmers can grow what they want, when they want, and earn a decent income without government interference;"

-increase market access for goods by significantly lowering tariff and nontariff barriers;

-establish rules governing trade in the "new areas" of services, intellectual property rights, and trade related investment measures;

-limit trade-distorting government subsidies; and

-increase the integration and responsibility of developing countries within the GATT system and limit trade restrictions justified on balance-of payments grounds.

Under "market-opening and market-expanding initiatives," to complement the Uruguay Round, actions are classified according to geographic and sectoral criteria.

The geographic initiatives comprise a very significant enumeration of bilateral and regional actions.

First listed is the Pacific Rim and within it the first objective is "to ensure that the Japanese market operates in an open, competitive fashion," by means of sectoral negotiations. Additionally, through the Structural Impediments Initiative (SII) talks "the United States expects an interim assessment in spring 1990 and both a 'blueprint' for concrete structural change and 'down payment' of substantive first steps in July."

In East Asia, "intensive bilateral consultations and negotiations" with Korea and Taiwan are under way "to lower trade barriers in these countries," with the purpose of "increasing their responsibilities within the global trading system." Also, an ASEAN-US initiative is under study "to open markets and protect intellectual property rights." Finally, the Asia-Pacific Economic Cooperation process, started in Canberra, Australia, in November 1989, by which the United States and 11 other countries, representing about one half of world trade, "strongly supported an ambitious, successful outcome for the Uruguay Round."

In North America, the first priority is the implementation of the U.S.-Canada Free Trade Agreement. Also, by contrast with 1989

when it was listed as the first priority in Latin America and the Caribbean, the other "North American" priority is the continuation of the Trade and Investment Facilitation Talks with Mexico.

In Europe and the Mediterranean, the Administration is "actively monitoring the EC 1992 project to ensure it does not result in new trade barriers at the EC's frontiers while it lowers them internally." Also, in Eastern Europe and the Soviet Union, the Administration "is taking several important steps to facilitate the movement...toward market-driven economies and open-trading regimes." Also, implementation of the U.S.-Israel Free Trade Agreement is mentioned as another priority.

In Latin America and the Caribbean, the Administration intends "to expand and improve" the Caribbean Basin Initiative (CBI), as well as to grant to the Andean nations additional preferences under the GSP, to "orient their economies away from trade in drugs."

The sectoral priorities comprise the steel liberalization program, to eliminate subsidies and other trade distorting practices, as well as a shipbuilding initiative to eliminate subsidies and other forms of assistance to shipbuilders.

Finally, to promote "open markets and fair trade," the Administration indicates its disposition to use the instruments contained in the 1988 Trade Act, including super 301, special 301, telecommunications and "Buy America" provisions."

Briefly, for the Western Hemisphere, the main highlights contained in the U.S. trade strategy for 1990 are the inclusion of Mexico as a "North American" trading partner; the preferences granted to imports from the Andean nations; and in general, the absence of a policy encompassing all of Latin America and the Caribbean.

III. 4. <u>FOREIGN BARRIERS TO U.S. EXPORTS</u> (WDW/16/90 - 6 JUNE 1990)

The annual publication, by the U.S. Trade Representative (USTR) of the <u>National Trade Estimate Report</u> describing the significant barriers confronted by U.S. exports in the markets of selected trading partners, usually passed almost unnoticed. This changed with the approval of the Omnibus Trade and Competitiveness Act of 1988, confirming not only that the <u>Report</u> had to be issued every year on March 30, but also that it should serve as the basis for the selection, one month later, of those countries that were to be submitted to scrutiny under the much dreaded "super" and "special" 301 provisions of the 1988 Trade Act.

As it can be recalled, last year's Super 301 "hit list" included Brazil, India and Japan and six priority practices. This year, on April 27, Ambassador Carla A. Hills announced that the USTR was "not naming any new countries or practices as 'Super 301' priorities."

As a result of recent negotiations, Japan agreed to modify the three practices for which it was cited in last year's "hit list." Also, in recent months Japan agreed to further open its telecommunications market, as well as to provide greater protection for foreign sound recordings. Finally, as a result of the Structural Impediments Initiative (SII) talks (WDW/10/90 and WDW/12/90) Japan agreed, in Ambassador Hills' terms, "to dismantle a broad array of structural barriers to trade." For all these reasons, this time, it was judged "counterproductive" to initiate new Super 301 investigations against Japan.

In the case of Brazil, Ambassador Hills mentioned that the new Brazilian government "is in the process of embracing market-driven reforms that are his country's greatest economic hope." Besides, in April, Brazil dismantled the import licensing practices that had led to its inclusion in last year's "hit list." Consequently, Ambassador Hills declared that these actions resolved the U.S. concerns.

Only India remained in this year's list, because according to Ambassador Hills it had been "unresponsive" to repeated requests "to lower its barriers to insurance and investment," that led to its inclusion in last year's Super 301 list. Consequently, the deadline for completing the undergoing investigations begun last year on India's practices is still 16 June 1990.

Furthermore, no new priority countries were identified this year as subject to "Special 301" investigations on intellectual property rights. However, four countries were still placed in a Priority Watch List, among which Brazil is the only Latin American country, and nineteen other countries were placed in a Watch List, among which appear Argentina, Chile, Colombia and Venezuela.

Finally, the USTR decided that no countries could be identified as discriminating in their government procurement practices.

Still, the <u>1990 National Trade Estimate Report on Foreign Trade Barriers</u> describes the barriers to U.S. exports existing in thirty five nations and two regional trading bodies, that together constitute the largest export markets for the United States. Unlisted countries were excluded because of the relatively small size of their markets or because no complaints were submitted against them by domestic producers. Six Latin American countries are listed: Argentina, Brazil, Chile, Colombia, Mexico and Venezuela.

The Report classifies trade barriers under the following eight categories: 1) import policies; 2) standards, testing labeling and certification; 3) government procurement; 4) export subsidies; 5) lack of intellectual property protection; 6) services barriers; 7) investment barriers; and 8) other barriers that encompass more than one category or that affect a single sector.

For instance, Argentina is congratulated for the recent reforms undertaken to lower tariff rates to 30 percent ad valorem and to abolish the "buy national law." It is criticized for lack of intellectual property protection of pharmaceutical products; barriers to insurance providers; and for levying a higher tax on soybean exports than on soybean oil and meal exports.

Brazil is criticized for its import licensing policies and its "buy national" government procurement practices; for several export subsidy programs of manufactured and processed agricultural products; lack of intellectual property protection for chemical compounds; several services barriers, particularly on insurance, data processing and motion pictures; and investment and other barriers remaining in the informatics sector, after the termination, on October 1989, of the 301 investigation.

Colombia's import policies are criticized despite recent reforms. Tariff levels are still high and because of import licensing, as well as some quantitative restrictions; for the granting of export subsidies, particularly of certificates rebating taxes on exports; for government procurement practices, such as the requirement of government-to-government contracts in several major public sector projects; for lack of intellectual property protection, because of deficiencies in patent law; for services barriers, requiring that at least half of import or export cargo be carried on Colombian flag ships; for those investment barriers that still remain, after the implementation of the Andean Pact's Decision 220; and for other barriers, such as pricing policies in the pharmaceutical sector.

Mexico is congratulated for its import policies, because its trade weighted average tariff has reached approximately 11 percent, considered "a significant achievement for a developing nation," as well as for the gradual elimination of import licensing permits and investment barriers. Mexico is criticized for its lack of intellectual property protection in chemicals, pharmaceuticals, alloys and foods; for its services barriers, particularly because ownership and operation of air, maritime and land transportation continues to be reserved to Mexican nationals.

Finally, Venezuela is congratulated for implementing a World Bank-IMF reform program that has led to reducing the maximum tariff from 135 to 80 percent and for the adoption of a timetable that will gradually bring down the maximum tariff to 20 percent by 1993. Other welcome changes anticipated as a result of the program are

the reduction of export subsidies, as well as perfectioning patent, trademark and copyright laws and liberalizing investment barriers.

III. 5. THE U.S. NEGOTIATING PROPOSAL ON AGRICULTURE
(WDW/31/90 - 31 OCTOBER 1990)

The four-year old Uruguay Round of trade negotiations, involving nearly 100 nations that represent more than 85 percent of world trade, was hailed originally as the negotiation to regulate more than $1 trillion out of almost $4 trillion of world trade in 1990. It was launched to include traditional areas inadequately covered by the General Agreement on Tariffs and Trade (GATT), such as agriculture, as well as new areas not covered at all, such as services, intellectual property rights and investment.

Less than five weeks before their scheduled completion in Brussels on 3-7 December, in what may become one of the major ironies of contemporary international economic relations, these forward-looking negotiations, in the terms of Ambassador Carla Hills, have found "a serious stumbling block" in agriculture, the most backward-looking sector of the industrialized economies.

On 19 September, addressing the European Parliament, Ambassador Hills made it very clear that "the importance of agricultural reform goes far beyond saving the billions lost in wasteful policies." She warned that, if there is no agreement on agriculture, "in all likelihood the Uruguay Round will collapse."

The issue is of such importance that other exporters of staples, such as Argentina, Australia, Brazil and Canada, formed what is known as the Cairns Group, to support the impulse towards the reform of world agriculture within the GATT. Also, this issue has cut across the traditional split between North and South, with the United States leading the reformist group, among which appear numerous developing countries that are net exporters and even some net importers of food.

In this context, on 15 October, the United States submitted to the Uruguay Round a new proposal on agriculture, with three key elements: export subsidies, import access barriers, and internal support policies. The summary that follows reveals why in Geneva it has been baptized as the "90-75-75" proposal.

As agreed at the Houston Summit (WDW/21/90), as well as by the July meeting of GATT's Trade Negotiating Committee, the U.S.

proposal follows closely the draft text on agriculture prepared by the Dutch Chairman of the Agricultural Negotiating Group, Mr. Aart deZeeuw.

The objective of this new proposal is still "to begin the process of fundamental agricultural reform that will lead to a more fair and market-oriented agricultural trading system," in the form of specific reduction commitments by all countries and for all agricultural products, over a 10-year period beginning in 1991.

The key elements of the proposal are:

First, the reduction by 90 percent over 10 years of export subsidies of primary agricultural products, including differential export taxes. Also, export subsidies of processed agricultural products would be phased-out in six years. The accomplishment of this objective demands specific commitments on quantities exported, as well as on budget outlays for export subsidies.

Second, the conversion of all non-tariff import access barriers into bound tariffs, as well as the binding of all existing tariffs. The newly converted and the existing tariffs would be reduced by an average of 75 percent over 10 years, with a final ceiling rate that should not exceed 50 percent and a tariff snapback mechanism for the transition period, based either on a price-trigger or a quantity-trigger. Finally, depending on the level of income per capita, developing countries that are net importers of a commodity would be allowed a longer transition period, of up to 15 years, to implement these commitments.

Third, internal support policies, such as those directly linked to the production or price of a specific commodity, would be reduced by 75 percent over a period of ten years, with reduction commitments measured according to agreed indicators, called "aggregate measures of support (AMS)." Still, a wide array of policies would be available to implement national agricultural objectives, if and when they are designed in a way that produces minimal impacts on trade, such as income support, environmental protection, land conservation, domestic food aid, marketing, research and extension services.

Fourth, new rules would have to be agreed for the settlement of trade disputes involving sanitary and phitosanitary barriers.

The reactions were immediate among several participants. First and foremost, the Commission of the European Community counterproposed the adoption of an overall reduction of 30 percent in ten years. Unfortunately, this was so divisive that the decision-making instances of the Community were paralyzed and were unable to produce a decision. The stalemate was overtly recognized

this week, with the postponement "sine die" of the next meeting of European Ministers of Agriculture, until there are more indications that a consensus can be reached.

On the other hand, almost fifty developing countries, led by Argentina, declared their intention to walk out of the negotiations, refusing agreement in all the other issues, until there is consensus on agriculture.

Thus, paradoxically, the most backward looking sector of the industrialized economies has become the major "stumbling block" against the progress of the most forward-looking trade negotiations.

IV. U.S.-JAPAN TENSION

IV. 1. U.S.-JAPAN SII TALKS APPROACH CRUCIAL POINT (WDW/10/90 - 21 MARCH 1990)

The yen's weakness, the interest rate increases in Japan, or the strategic-technological marriage between Daimler-Benz and Mitsubishi, all of these have definitely not helped. Still, the largest contribution to disharmony between the United States and Japan comes from trade relations.

This time, the epicenter is located in one of the three trade negotiating instances that are simultaneously under way between Japan and the United States. The first is the Uruguay Round, mainly concentrated on the new areas uncovered by the multilateral, GATT framework. The second takes the form of negotiations on specific products, such as telecommunications, construction services, forest products, supercomputers, semiconductors and satellites. Finally, the flare was ignited by the U.S. frustration with the meager results generated thus far by the third negotiating instance, the so-called Structural Impediments Initiative (SII) talks.

This "unique bilateral undertaking" was launched in July of 1989, precisely, to avoid the weariness of the product-by-product approach, by focusing on the "structural" obstacles held responsible both by the United States and Japan for the obstinate trade imbalance that prevails among them.

In the terms of the Deputy United States Trade Representative (USTR), S. Lynn Williams, the SII talks are an "iterative and mutual" process, without "set patterns and or benchmarks." Better

still, as President Bush said, "let's face it, these talks are a two way street."

On the table are the following Japanese "structural" barriers to imports, as identified by the United States: savings and investment policies; land use policies; the distribution system; exclusionary business practices; pricing mechanisms; and cross-shareholding arrangements, known in Japan as financial "keiretsu." For its part, Japan identified the following "structural" shortcomings contributing to the loss of U.S. competitiveness: low savings ratio, as well as low investment in education and in research and development.

The first two rounds of the SII talks were held in 1989. The third, scheduled for January 1990, was expected to deal with "concrete, detailed proposals." Nonetheless, the coming elections led the Japanese government to request a postponement, until 22-23 February. The results of this last round were disappointing for the United States and therein lies the immediate cause of the present crisis.

Frustration with the results of the third round of SII talks led President Bush to invite recently elected Prime Minister Kaifu to a hastily arranged, two-day "summit in the sun," held on Saturday 3 March, at the Morningside Country Club, surrounded by the San Jacinto Mountains of Palm Springs, California. Only two weeks before, Prime Minister Kaifu had won what was seen as "a surprisingly strong victory in a parliamentary election." The weekend summit was squeezed between Prime Minister Kaifu's inaugural speech to the Diet, delivered on Thursday, and the session to answer questions set for the following Monday.

The results of the summit were described as positive and friendly, with the President and the Prime Minister addressing each other, after three and a half hours of meetings and two meals, as "George" and "Toshiki."

Prime Minister Kaifu declared that he was "determined to firmly tackle structural reforms... as one of the top priorities." Furthermore, a Japanese spokesman said that the Prime Minister had felt "a sense of urgency" on trade issues. Finally, both leaders encouraged their respective negotiating teams to "redouble their efforts to achieve meaningful results."

A week later, Secretary of Commerce Robert Mosbacher visited Japan to convey this "sense of urgency about the trade problem." To emphasize it, while Secretary Mosbacher was in Japan, U.S. negotiators declared that they were halting talks about satellite sales, until the Japanese present "constructive and productive" proposals. The reason for the suspension of the talks was better depicted by somebody who was quoted only as a "U.S. official." He said, "we were dancing in circles. No matter how much we liked our

dancing partner, we were getting no closer to the destination and the music was running out. We were getting nowhere."

The music was in fact running out. The fourth round of the SII talks, set for April 2 and 3 in Washington, has to produce an interim "progress report." Additionally, the recently released U.S. trade policy agenda for 1990 (WDW/9/90), asserts that at the conclusion of the SII talks, by July, the United States expects "both a 'blueprint' for concrete structural change and 'down payment' of substantive first steps."

To deal with what Foreign Minister Nakayama depicted as this "hair-trigger situation," the Japanese cabinet, only this week, decided to undertake "crisis management of U.S.-Japan ties," by approving a list of concessions to be presented to the next SII April meeting in Washington. The list will contain the following actions:

-Relaxation of Japan's Large Scale Store Act, shortening the waiting period to open a new store from up to ten years to less than two years.

-To increase spending in infrastructure, roads parks and other amenities, although due to the resistance from Minister of Finance Rytaro Hashimoto, it remains to be seen if the target of ten percent of GNP requested by the United States will be met.

-To increase the penalties for monopoly behavior and to strengthen the Fair Trade Commission, charged with enforcing Japan's Anti-Monopoly Act.

-To bring down the price of land in Tokyo, by the abolition of the tax break for urban farmland.

-Finally, at least in two of the three sectoral issues submitted to "Super 301," concessions will be offered on the purchase of U.S.-made communications satellites, as well as on increased purchases of supercomputers, while no accommodation will be offered on imports of U.S. forest products.

Thus, apparently the time has come when it will be known if, as stated by the USTR Ambassador Carla Hills, the Japanese "will risk killing the goose that laid the golden eggs."

IV. 2. THE NIKKEI SINKS (WDW/11/90 - 28 MARCH 1990)

There are strong indications that, as 1989 was the year when the Berlin Wall crumbled, 1990 will be known by the tumbling of Tokyo's apparently unbeatable Nikkei Stock Average.

On Monday, March 20, Tokyo's stock market opened to what became one of the most hectic and panic-ridden sessions on record. At closing time, the mighty Nikkei had plunged 4.1 percent, its third worst slide since the worldwide crash of Black Monday, in October 1987.

On Tuesday's morning session, once again, the Nikkei was down 0.5 percent, despite the Bank of Japan's announced decision to boost the discount rate for the fourth time in a year, by a full percentage point to 5.25 percent. Even so, at closing time, the Nikkei was down 1.5 percent, thus reaching its lowest level amounting to a cumulative drop of 21 percent throughout the year.

On Thursday, the Nikkei experienced one of its most volatile performances, with a nosedive of more than 1600 points in one hour, to close with a loss of 3.1 percent.

By the end of the week, coinciding with Friday's San Francisco meeting between Secretary Brady and Minister Hashimoto, the battered Nikkei stood at 29,843.34 yen, 25.5 percent below its late December all-time high and quite far from the 31,500 level, considered by technical analysts as the starting point of a long-term "bear market."

In a week, "the highest flying market in the world, a symbol of Japan's financial power and an engine for its massive investment at home and abroad," experienced a staggering loss of one hundred trillion yen.

One of the best illustrations of the magnitude of the losses, can be found in the value of Nippon Telegraph and Telephone Corp. (NTT) shares. Since the giant communications firm was privatized, its stocks were a symbol of Tokyo's "unsinkable" market. During Thursday's panic they went from a peak of $21,000 per share in 1987 to a low of $6,839. Thus, when this symbol fell below its original selling price of $7,742, investors understood that something had changed in the outlook of the Japanese economy.

The search for the culprit did not make itself wait and it was found primarily in the dollar-yen exchange rate. As The Wall Street Journal editorialized about "the nervous Nikkei," a decline of 20 percent in the Dow Jones Industrial Average "would make Americans nervous too. But such shocks are an inevitable consequence of exchange-rate manipulations."

The yen has been falling and Japanese authorities appear unable to arrest the drop. In this year only, despite massive efforts by the Bank of Japan, the yen has fallen more than 8 percent against the dollar. During the week when the Tokyo stock exchange was plunging, the yen soared past 155 to the dollar, to a 38-month low. Obviously, this does not augur well for the prospect of correcting the stubborn Japanese trade surplus, neither does it contribute to the harmonious progression of the undergoing Structural Impediment Initiative (SII) talks (WDW/10/90) with the United States.

Furthermore, as demonstrated by the Bank of Japan's reaction to the stock market's volatility, by increasing the discount rate, what appears adequate to deal with one issue may be counterproductive to deal with another issue. The increase in interest rates, aimed at stopping the yen's decline, will also discourage stock purchases and make fixed-income investments more attractive, as well as hurt corporate earnings by slowing economic growth.

These perceptions were not dispelled by the outcome of the conversations between Secretary Brady and Minister Hashimoto. A "senior U.S. official" said, even before the meeting started, that there were "no plans at the moment" to issue "statements aimed at calming the Japanese markets." The yen's fall was characterized by the same official as "a domestic Japanese issue."

Additionally, there are also indications that the resilient Japanese trade surplus might be beginning to dwindle, although at a slower pace with the United States. For instance, just this past January, Japan posted its first current account deficit since 1982 and even the United States reported that its trade deficit with Japan had fallen to $2.9 billion, the lowest monthly figure since 1984. Also, Japanese imports from the United States doubled from $22.6 billion in 1985 to 44.6 billion in 1989. In all, Japan's trade surplus has declined steadily from 4.5 percent of GNP to 1.9 percent.

To overcast even more the outlook of the Japanese economy, certain cracks have burst open in the otherwise disciplined Japanese economic decision-making team. One of the most poignant is the confrontation, at times unusually public and acrimonious, between the Bank of Japan and the Finance Ministry about increasing interest rates. The Bank of Japan has been publicly criticized for taking too long in increasing interest rates and lagging behind West Germany.

But even more ominous is the linkage between low interest rates and the boom in land prices, fueled by a discount rate kept, from 1985 until last May, at a historic low of 2.5 percent. Highly valued land-holdings have allowed Japanese corporations to raise

capital with relative ease and have allowed investors to borrow against their land to invest in the stock market.

These linkages between land values and the stock market raise anxieties because there is the possibility that land prices might tumble as stocks did, because land prices have sky-rocketed as much as stocks. For instance, according to the Long-Term Credit Bank of Japan, the 1988 value of land in Japan at $15 trillion was five times that of the United States. This has raised fears in Japan of land values fueling "inflationary psychology," as well as of prospects of social polarization between those who own land and those who do not. No wonder, one of the complaints voiced by the U.S. delegation in the SII talks is that land values in Japan have become a barrier to trade and investment.

For all these reasons, that last Monday was the second best day ever for Tokyo's stock market, defying the falling yen and soaring 4.8 percent, has not made analysts sure that the market had touched bottom. Confirming this apprehension, on Tuesday, March 27, the Nikkei continued falling and on the morning session of Wednesday, 28 March, the Nikkei fell again 1.62 percent, while the dollar was rapidly approaching 160 yen.

The worry now is that the Nikkei's fall is more than the "bursting of a speculative bubble," or as depicted by a "senior Bank of Japan official," on Monday when it all began, "a kind of adjustment or correction, a little bit larger than expected."

The fear is that, as evidenced by the falling yen, the magic side of economic policy has been punctured, that the confidence in the robustness of the Japanese economy has been hurt.

IV. 3. THE U.S.-JAPAN SII TALKS INTERIM REPORT (WDW/12/90 - 9 MAY 1990)

Skepticals that still doubt if the relations between Japan and the United States have become the "relationship of major tension" of the present international economic system are advised to examine in detail the interim report issued, on April 5 in Washington, at the conclusion of the last round of the Structural Impediments Initiative (SII) talks (WDW/10/90).

The report should also be mandatory reading for those interested in finding out the scope and extent that is necessary today for the management of economic interdependence, among two trading partners of the size and relative weight of the United States and Japan. As recalled recently by the Deputy U.S.T.R., Ambassador S. Lynn Williams, together, these two countries

represent more than one third of the world's GNP and account for more than one fourth of total world exports, with the U.S. as the world's largest exporter and Japan as the third largest.

The scope of the SII talks can be illustrated by focusing on each one of the "structural problems" placed on the negotiating table by each partner.

On one side, the United States identified the following areas of the Japanese economy: 1) savings and investment patterns; 2) land use; 3) distribution system; 4) exclusionary business practices; 5) business groupings or "keiretsu" relationships; and 6) pricing mechanisms.

On the other side, Japan identified the following areas of the U.S. economy: 1) savings and investment patterns; 2) corporate investment activities and supply capacity; 3) corporate behavior; 4) government regulations; 5) research and development; 6) export promotion; and 7) workforce training and education.

This wide-ranging and penetrating agenda only confirms why the SII talks were characterized, by the White House Press Secretary, as "unique in the history of bilateral trade and economic discussions." Rarely, if ever, have such intimate structural characteristics been subject to negotiation among trading partners. In the end, this only reveals the profound interdependence attained among these economies, which has led, in the terms of Ambassador Williams, to the point that "one needs to look at everything in order to solve anything."

The extent of the talks can be illustrated by describing some of the mutual admissions and concessions granted by each partner in each one of the items of the agenda.

For instance, in the area of savings and investment, Japan made a commitment to increase substantially investment in infrastructure, by formulating "a new comprehensive plan of public investment for the coming ten years." Also, to encourage consumption in the private sector, the Japanese government, starting this April, will launch a trial of 40 hour weeks for government employees on shift work schedules, as a first step in the direction of the establishment of 5 day weeks for all government employees.

For its part, the United States signaled the reduction of its federal budget deficit as a top priority, as well as to accelerate the recent upward trend in the savings ratio of individuals.

On land use, the Japanese government committed itself to undertake a comprehensive review of land taxation systems, particularly of the deferment system of payment of the inheritance tax and the fixed assets tax on the agricultural land available in

the major metropolitan areas, aiming at implementation from fiscal year 1992.

In the area of corporate behavior, the U.S. Treasury created a working group on savings and the cost of capital, as part of a comprehensive effort to foster a long-term investment horizon among corporate managers. Among the factors that will be reviewed is the influence of compensation packages on the time horizons of executives and other employees.

On the distribution system, the Japanese government promised to improve harbors and import-related infrastructures, as well as to expedite import procedures, to attain one-day customs clearance by contrast with the present three days. Also, the large-scale retail store law will be reformed, to facilitate the opening of new stores, shortening the procedures of approval to less than one and a half years and allowing more space for import sales, as well as by relaxing the regulations on closing time, "from after six o'clock p.m. to after seven o'clock p.m."

The United States agreed to eliminate certain government regulations that discourage international trade and competition, such as a relaxation of procedures within the Coordinating Committee for Multilateral Export Controls (COCOM), given the changing strategic situation, as well as the elimination of many export controls on energy exports.

In the area of exclusive business practices, the Japanese government agreed to enforce more vigorously anti-trust legislation, by means such as increasing the number of personnel of its Fair Trade Commission, the establishment of an Ombudsman system and by resorting to more criminal penalties.

The United States confirmed its plans to advance research and development in both the private and the public sectors, by means of increasing budgetary allocations, the establishment of the position of Undersecretary for Technology at the Commerce Department and by making permanent the present research and experimentation credit to firms that qualify.

On the issue of "business groupings," or "keiretsu," the Japanese government agreed to liberalize its foreign investment regime and to review disclosure rules of substantial ownership in shares.

The United States government holds in high priority the promotion of exports by means of implementing a special program aimed specifically at Japan.

In the area of prices, the "unreasonable price differentials" that exist in Japan between domestic and overseas markets will be closely monitored, as a "barometer of success in eliminating

structural barriers," by means of the continuous implementation of surveys and the dissemination of information to consumers and industries.

Finally, as a means to enhance competitiveness, the need was recognized to improve the education and training of the United States workforce, by means of increased budgetary allocations to strengthen education systems in mathematics and science.

Several conclusions may be drawn from this list of mutual concessions, although there still remains to be seen how powerful the contribution of the agreed measures will be to the closing of the obstinate trade gap that persists among these two economic giants.

Apparently, just by their timing, the results were sufficient to arrest the mounting protectionist pressures in the U.S. Congress. Once again, the rituals of commercial policy have momentarily deterred protectionist urgings, allowing for the more enduring effects of macroeconomic policies to make their contribution.

Thus, at least, an escalation in the confrontation between these giants was prevented, because the U.S.T.R., Ambassador Carla Hills decreed, what was immediately judged as a cease fire, that Japan would not be included in this year's Super 301 hit list. Additionally, several outstanding bilateral issues were also settled between Japan and the United States, such as steel and textiles, telecommunications, supercomputers, satellites and wood products. In the final analysis, these immediate results can be credited to what in Japanese is known as "gaiatsu," or to the role played by foreign influence in domestic politics.

IV. 4. "HAPPY ENDING" IN THE U.S.-JAPAN SII TALKS (WDW/20/90 - 11 JULY 1990)

There seems to be consensus that the "Achilles' heel" that led to the demise of the Bretton Woods framework of multilateral financial arrangements was the inability to deal with surpluses. By contrast, dealing with deficits, particularly with those of the less influential actors of the present international financial system, was relatively easier.

The recent conclusion, on June 28 after a four day marathon in Tokyo, of the ongoing saga known as the Structural Impediment Initiative (SII) Talks (WDW/10 and 12/90), between Japan and the

United States, has evidenced that the two economic giants of the present international economic system still prefer to deal with such issues bilaterally.

This "unprecedented cooperative effort" to deal with the obstinate trade surplus exhibited by Japan ended, on schedule just before the Houston summit, with the approval of a joint report. This "historic document" includes Japanese and U.S. commitments, as well as an agreement to establish "an open, flexible follow-up process, which will include regular meetings, a review of progress, and an annual report with a joint press release."

The President of the United States immediately welcomed "the clear commitment by Japan to reduce further its current account surplus," indicating that the SII process is "an important framework in which the underlying causes of trade imbalances can be removed." Nonetheless, President Bush also recalled that "removing structural impediments is a two-way street," because "as Japan tackles its structural problems, so must the United States."

Japanese commitments include: the levels of public investment; land use; distribution; exclusionary business practices; formal and informal ties among companies ("keiretsu"); and pricing mechanisms. U.S. commitments include: saving and investment patterns; competitiveness; corporate behavior; government deregulation; research and development; and workforce training and education.

These are the same areas that appeared in the Interim Report approved last April, but without the details that are included in the final report.

For instance, the most difficult issue --almost mirroring a typical discussion between the IMF and a deficit country-- was Japanese spending in public works. The United States initially wanted a promise of increases, in terms of a specific percentage of GNP. In the end, a global figure was accepted, amounting to almost $3 trillion in the next ten years, of which $2.8 trillion in public expenditures and $100 billion from two recently privatized companies, Nippon Telegraph and Telephone and Japan Railways. This figure represents an increase of 63 percent over the next ten years in Japan's public expenditures in housing, airports, ports, parks and sewers.

On the reduction of the U.S. fiscal deficit, Deputy Trade Representative L. Williams declared that the SII talks had been "an important influence" in the decision to raise taxes, announced by President Bush the day before the SII talks' conclusion. This action was said to have proved to the Japanese that the United States is "serious" about deficit reduction, which they see as a crucial requirement for the reduction of U.S. dependence on foreign capital.

Another area where mutual concessions were exchanged was on the follow-up mechanism that was finally agreed. Originally, the Japanese resisted the creation of the mechanism. By the end, a Japanese spokesman said the U.S. proposal had been accepted, on the condition that no new issues be taken up in the follow-up meetings and that these should take place no more than twice a year. From the U.S. perspective, as described by Commerce Undersecretary for International Trade, Michael Farren, the follow-up mechanism will not take up new areas of friction, "only in the context of the ideas" that are already included in the final report. "We can raise issues," declared Mr. Farren, "as they become relevant to other sectors."

The final agreement on the follow-up mechanism says that progress will be reviewed on the "issues identified in the Final Report;" but other "matters relevant to problem areas already identified in the SII talks" can be discussed as well; and "in the spring of each year a written report" will be examined, "on the progress made by each country toward solving its structural problems," both reports will be reviewed together and a joint press release will be issued. Finally, there was agreement on preserving the SII process indefinitely, with annual meetings and joint reports at least for the next three years. In this manner, the SII talks between these two giants have become a permanent feature of U.S.-Japan economic interdependence.

To conclude, besides the positive statements with which President Bush and Prime Minister Kaifu greeted the outcome, some skeptical reactions immediately appeared. From the U.S. Congress came the conclusion that the "bottom line" should be sought in the agreement's impact on the stubborn U.S. trade deficit with Japan. The powerful chairman of the Finance Committee, Senator Lloyd Bentsen (D-Texas), declared "the worth of the agreement can only be measured by hard results. In that sense, the jury is still out."

By contrast, in Japan some reactions were bitter-sweet. For instance, the managing editor of the daily Tokyo Shimbun, Mr. Tsuyoshi Sato, in an op-ed published in The Journal of Commerce, recalled that this was "the third crisis in modern Japanese history precipitated by American pressure." The first was the forceful end of Japanese seclusion in the 1850s, by U.S. Commodore Matthew Perry. The second was the transformation of Japan, after "the Pacific War," by the directives of General Douglas MacArthur. And the third was the "blueprint for restructuring the Japanese economy," by President George Bush.

In this last respect, on one hand, Mr. Sato admits that "no independent country has ever received from another government such a detailed agenda for domestic reform." Even if he considers this "a national disgrace," Mr. Sato acknowledges that "changes in response to U.S. demands will hurt the Japanese bureaucracy and certain business sectors," while "consumers stand to benefit in

many ways." Mr. Sato concludes with the rather joyful assertion that it would be "wonderful if famous shops in New York, London and Paris could sell their brand-name items in Tokyo at reasonable prices."

V. INTER-AMERICAN ECONOMIC RELATIONS

V. 1. WHITHER LATIN AMERICA? (WDW/7/90 - 28 FEBRUARY 1990)

It has become a cliche that the "galloping changes" that are taking place in Europe will result in a diversion of financial resources, otherwise destined to the developing world. Recently, the President of the Inter American Economic and Social Council (IA-ECOSOC), Ambassador Eladio Knipping, from the Dominican Republic, declared that "the explosion of liberty and freedom in the East of Europe, that is very laudable, cannot be a pretext for the industrialized nations and the financing organisms to relegate the Latin American and Caribbean countries."

Such statements, support a number of rather somber scenarios that have been recently depicted in the United States about the future of its relations with Latin America.

Some of these predictions announce "a new dark age for Latin America;" or that there will be no "new hemispheric pact," because "no Latin American country, save one, will be of sufficient value or interest" for the United States; or "a two-tiered" approach, leading to special bilateral relationships between the United States and Mexico or Brazil, while the rest is managed through multilateral channels.

Although it must be sheer coincidence, these scenarios have been produced by scholars affiliated to some of the most respected conservative think-tanks. For instance, the author of the "dark age" prediction is Mr. David Ronfeldt, a political scientist with the Rand Corporation. The author of Latin America's loss of value and interest is Mr. Mark Falcoff, a resident fellow at the American Enterprise Institute (AEI). Finally, the proponent of the "two-tiered approach" is Mr. Georges A. Fauriol, Senior Fellow and Director of the Latin American Program at the Center for Strategic and International Studies (CSIS).

Instead of the common belief that a multipolar international system and the relaxation of U.S.-Soviet tension benefits Latin America, in the forthcoming issue of Hemisphere, Mr. Ronfeldt sees a somber future. It is characterized by "the failure of democracy and a plunge into a new dark age," of unrestrained "violence and chaos under a new generation of dictators."

Weakened by economic stagnation and by the resurgence of skepticism about the "superiority of democracy," in most Latin American countries, "dictators and demagogues will take over--some through elections, others through force." Nonetheless, rather than another "cyclical return to military regimes," Mr. Ronfeldt asserts that "something deeper will be happening: the rise of a new generation of Caudillos who prefer corporatism to democracy."

Three trends are identified as contributing to this "dark age." First, "the continued disengagement of the United States and the U.S.S.R. from conflict in Latin America." Second, the rejection by Latin American leaders of "the old pan-American vision," to be replaced by a "two-Americas" vision. And third, "ideology would decline while racism, regionalism and religion would increase as motives for violence."

The conclusion derived from this bleak scenario is that U.S. policy should avoid getting entangled in "dark age" conflicts and it should better concentrate on North America's development, including Mexico and Canada.

The main outcome of the end of the Cold War in Latin America is described by Mr. Falcoff in the first issue of the AEI's The American Enterprise. In this scenario, "Washington will be free to disengage from the region," on account of some "unacknowledged changes" that have "altered the regional environment."

The first of these changes is that most of the Latin American countries are "substantially non-aligned. . .they are no longer politico-military allies of the United States, but are neutrals."

The second change is considered "a bigger challenge to the old system." This is called "the decline of economic complementarity," by which "Latin America's relative importance to the United States has been steadily dropping for many years." To illustrate this point, it is recalled that Latin America's share in total U.S. direct investment dropped from 19.1 percent in 1965 to 12.7 percent in 1985. Another indicator mentioned is the decrease in U.S. dependence from Latin American imports, from 17.3 percent of total U.S. imports in 1965 to 12.6 percent in 1985.

From these indicators Mr. Falcoff derives the conclusion that only Mexico deserves U.S. attention, because of its sharing of a common border. Even so, "Latin America will continue to affect the United States in ways that can only be described as problematic,

particularly in their export of drugs or illegal immigrants." Thus, for the rest of Latin America, Mr. Falcoff prescribes that "each will have to cut its own deal with the United States (and the rest of the world) as best it can."

Finally, less pessimistic but basically in the same direction is Mr. Fauriol's "two-tiered approach"--published in the last issue of Foreign Affairs. He does not see a decline in the relative importance of the region. On the contrary, "for all its current problems," he asserts that "Latin America will remain a source of U.S. economic interest as it has for more than a century. The region's political and security proclivities and manifold development problems will ensure the existence of a unique relationship."

As a result of "global restructuring," Mr. Fauriol sees the emergence "of a new inter-American state system predicated on the concept of a two- or three-tiered 'American Community.'" With the result that "such a community would displace the notion of a single-hemisphere partnership and replace it with a series of subregional compacts adapting to varying hemispheric situations."

Some of these "compacts" are briefly sketched. "Among several possible configurations, Washington is likely to draw the most interest from those countries that are closest to it geographically, economically and socially. In its broadest framework, that scenario could evolve into a U.S.-Canada-Mexico North American free trade area with its attendant political implications." Also, as a complement, "a two-tiered structure is evident in U.S. policymaking and is already in place regarding Mexico; it could apply to Brazil as well."

In this context of "distinct bilateral relations" that "assure continued U.S. involvement in the region by providing strong strategic policy anchors," Mr. Fauriol suggests that the rest of the relations between the United States and Latin America "may evolve along multilateral lines, and force more attention on common agendas (drugs, the environment, technology) and effective regional and subregional institutions that address those issues."

V. 2. TOWARDS A MEXICO-U.S. FREE TRADE AREA (WDW/17/90 - 20 JUNE 1990)

Preceded by the signature, only a week before, of an extension of the "social pact" between workers, business and government, that has sustained the adjustment and stabilization of the Mexican economy, on June 10, President Carlos Salinas initiated his second state visit to Washington.

The expected highlight of this second visit was the agreement authorizing negotiators to begin discussions on the establishment of a free trade area between the United States and Mexico.

As prescribed by Section 1102 (c) of the 1988 Trade Act, the United States can enter into negotiations only if this is requested by the foreign government. Previously, on May 22, President Salinas had accepted a recommendation from the Mexican Senate to undertake such negotiations, citing as reasons "Mexico's geographical location, history of trade relations and the complementary relation with the U.S. economy."

Expressing a "commitment to forge a vigorous partnership for sustained economic growth and opportunity," in a Joint Statement issued on June 11, Presidents Bush and Salinas "determined that a comprehensive Free Trade Agreement is the best vehicle to achieve these ambitious objectives." Consequently, they "directed Ambassador Carla Hills, the United States Trade Representative, and Dr. Jaime Sierra Puche, the Minister of Commerce and Industrial Development of Mexico, to undertake the consultations and preparatory work needed to initiate such negotiations." Additionally, the negotiators were asked to report back to the Presidents "as soon as practicable, but in any event before their next meeting," to be held in Monterrey, Mexico, next December.

According to the Joint Statement, the agreement should include: 1) the gradual and comprehensive elimination of trade barriers, including the "full, phased elimination of import tariffs;" 2) the elimination or fullest possible reduction of non-tariff barriers; 3) the establishment of clear, binding protection for intellectual property rights; and 4) means to improve and expand the flow of goods, services and investment.

The evidence indicates that the decision to establish a free trade area among Mexico and the United States basically constitutes the formalization of the intense, wide and deep levels of economic interdependence that already exist among these trading partners.

As stated by Ambassador Hills, only three days after the Joint Statement, in testimony before the Subcommittee on Trade of the Ways and Means Committee of the House, Mexico is the U.S. "third single largest trading partner." Two-way trade amounted in 1989 to $52 billion, with $25 billion corresponding to U.S. exports and $27.2 billion to Mexican exports.

Furthermore, in Latin America and the Caribbean, Mexico is the most important U.S. trading partner. In 1988, out of a total of $53.7 billion imported by the United States from the region, almost half, $23.5 billion, came from Mexico. Moreover, in the same year, more than half of these imports entered the United States under preferential treatment, of which $10.8 billion through what was previously known as the 806/7 program ("maquila"), as well as $2.2

billion under the Generalized System of Preferences (GSP). Finally, as mentioned by Ambassador Hills, United States investment in Mexico amounts to $5.5 billion, or 62 percent of all foreign direct investment, while almost two thirds of Mexico's foreign trade is with the United States.

Perhaps because of this profound and pervasive asymmetry in the relations between Mexico and the United States the accepted wisdom, with some remarkable exceptions such as Professor Sidney Weintraub's "marriage of convenience," was that Mexico would reject an invitation to participate in any kind of global free trade agreement with the United States.

Nonetheless, as an indication of how commonly held perceptions are crumbling in today's international economy, in a reversal called "ironic" by Robert Pastor, the skepticism and the willingness have switched camps.

Just a few days before President Salinas' visit to Washington, the U.S. press revealed that there was a split within the Administration about the "timing" more than about the "wisdom" of an eventual free trade agreement with Mexico.

On the side of the skepticals, having in mind the conclusion of the Uruguay Round in December, appears none other than Ambassador Carla Hills herself, as well as Secretary of Agriculture Clayton Yeutter. Ambassador Hills went as far as to state, during a question and answer period at a National Press Club luncheon on May 24, that "there is not going to be any immediate negotiations," because of a crowded legislative calendar. Also joining the ranks of the skepticals was House Ways and Means Committee Chairman Dan Rostenkowski (D-Ill.)

On the other side, the group of those in favor of moving quickly, called "the Texans," is just as, if not more, formidable, it includes Secretary of State Baker, Secretary of Commerce Mosbacher and the powerful Senate Finance Committee Chairman Lloyd Bentsen (D-Tex.)

The wording of the Joint Statement reveals that, to the satisfaction of the skepticals, no formal negotiations were announced, which would have entailed requesting authorization from the U.S. Congress. Nonetheless, the negotiators were instructed "to undertake the consultations and preparatory work needed to initiate" formal negotiations, after the expected conclusion of the Uruguay Round in December of this year.

Furthermore, strong opposition was voiced in the United States by the executive council of the powerful AFL-CIO, because "a free trade agreement will only encourage greater capital outflows from the United States and bring about an increase in imports from Mexico . . . it will also do little to improve the lives of Mexican

workers." By contrast, the Business Roundtable, a powerful group of corporate leaders chaired by James Robinson III, the American Express CEO, reportedly "endorsed a free-trade agreement in glowing terms."

No immediate reactions from Latin America and the Caribbean were reported in the U.S. press, although perhaps in anticipation, on June 4 in Asuncion, Paraguay, Ambassador Carla Hills solemnly announced to the General Assembly of the Organization of American States (OAS), a "new hemispheric partnership" that "seeks to expand trade within the region, looking toward a hemispheric zone of open trade." Also, this past week, Secretary of Commerce Robert Mosbacher initiated a trade mission to Chile and Brazil.

V. 3. ENTERPRISE FOR THE AMERICAS (WDW/19/90 - 4 JULY 1990)

Amidst a loud uproar generated by the major departure from his most salient campaign promise of "no new taxes," last Wednesday, President Bush outlined a package of economic measures under the heading of "Enterprise for the Americas." In the characteristic decision-making style of the present Administration, the presentation was put together somewhat hurriedly and surprised many observers.

The timing was intriguing, particularly because it was known that the Administration was undertaking a major revision of its Latin American policies, in anticipation of President Bush's announced visit to South America in September.

As explained by a "senior official," the purpose was to focus attention on Latin America before the Houston summit, to balance the emphasis that will receive the emerging European order. It was also seen as helping to ease some of the concerns that Latin America and the Caribbean would be forgotten. As Secretary Brady said, meeting with reporters later, "as Eastern Europe has undergone a dramatic political and economic reform effort, a quieter but equally dramatic revolution has occurred in Latin America and the Caribbean."

Finally, some congressional critics immediately pointed to a domestic political reason for the announcement, as a means to deflect some of the controversy unleashed by the decision to raise taxes, trying to remove it from the front pages.

The initiative rests on three substantive pillars and one institutional dimension. It deals with debt, investment and trade, placing the Interamerican Development Bank (IDB) at the center of the first two, where the proposal exhibits its most concrete

elements. Although the commercial aspects are relatively less defined, it is here that some observers have found the greatest potential.

On the side of debt and investment, dimension seems to be directly proportionate to concreteness. For instance, it addresses what is recognized as "the growing problem of official debt," by proposing "legislation to permit substantial reduction and restructuring of existing U.S. concessional loans (including AID and PL-480 claims) to Latin American and Caribbean countries with serious debt servicing difficulties." The amount that will be covered is $7 billion of concessional loans, out of the $12 billion of total official debt owed to the U.S. government. This amount is evidently small, although as pointed by President Bush, "in many cases, the heaviest official debt burdens fall on some of the region's smallest nations --countries like Honduras, El Salvador, Jamaica." Furthermore, the IDB is asked to "become an additional source of enhancements under the existing debt strategy," together with the World Bank and the International Monetary Fund (IMF), "to back specific transactions negotiated by Latin American and Caribbean countries with their commercial banks."

On investment, the proposal covers several fronts. First, "a new investment sector loan program" to support privatization efforts and the liberalization of investment regimes. The IDB is also given the responsibility of carrying out this program, in conjunction with the World Bank. Second, a multilateral investment fund, administered by the IDB as well, "to advance comprehensive investment reforms." This fund would provide grants of "up to $300 million annually," with the U.S. pledging $100 million and seeking to obtain matching contributions from Japan and Europe.

Finally, the proposal on trade is as forward looking, as it is broadly defined, although perhaps for this reason here the initiative exhibits the greatest potential. As described, "it sets forth a vision and a challenge" to Latin America and the Caribbean.

First, the long term goal is described as "a free trade zone stretching from the port of Anchorage to Tierra del Fuego." Second, in the long run, the attainment of this Hemispheric free trade area is envisaged by means of the subscription of free trade agreements with "groups of countries that have associated for purposes of trade liberalization." The first step in this process is the free trade agreement with Mexico. Third, those countries that "are not yet positioned to embrace a free trade agreement" are offered the possibility of entering into "bilateral framework agreements," in order to "help establish principles for bilateral cooperation on trade issues."

Given these ingredients, an observer concluded that this initiative "is potentially the most sweeping since the Alliance for Progress," although admittedly it contrasts with this precedent

because, as emphasized by President Bush, this time it is proposed to "shift the focus," from aid to trade.

Another outstanding trait of the proposal is the challenge it represents for the Latin American and Caribbean countries, because different negotiating possibilities are left open to formalize trading relationships with the United States.

First of all, there is the least intense alternative of seeking the bilateral subscription of a "framework agreement" on trade issues. This sort of instrument apparently would be similar to the 1987 framework agreement that preceded the informal negotiations that were recently announced between Mexico and the United States (WDW/17/90). In a way, this bilateral alternative would be similar to the experience of the thirties, when as a result of the breakdown of the multilateral trading system, trade relations between Latin America and the United States were regulated by what were known at the time as "reciprocal trade agreements," negotiated separately with each country.

Second, there is the alternative envisaged by the proposal of seeking to negotiate free trade agreements with groups of countries, with Central America, the Caribbean and the Andean countries as the most likely candidates. Administration officials were immediately quoted as saying that this alternative would be preferred to the bilateral, "piecemeal" approach. Although it would not cover some important trading partners, such as Brazil, Argentina, or Chile.

Finally, left unmentioned, perhaps the most potentially enticing alternative was suggested immediately afterwards by the Minister of Foreign Affairs of Argentina, Domingo Cavallo. He revealed that consultations would be held with the government of Brazil about the possibility of adopting a position by both governments that would serve as the basis for a common South American position. Admittedly, this is the least realistic of the negotiating options, particularly if it is pondered against recent experiences of scarce Latin American solidarity on other pressing issues, such as the external debt. Nonetheless, it should be recalled that in the debt negotiations, the strategy sponsored by the creditors was based on the case by case principle.

Be it as it may, the least that can be said about President Bush's initiative is that it has set the trade agenda with Latin America and the Caribbean for the 1990's.

V. 4. FOREIGN DIRECT INVESTMENT IN LATIN AMERICA (WDW/24/90 - 12 SEPTEMBER 1990)

It is indicative of where are the most hopeful sources of external finance for Latin America in the nineties, that the Institute of International Finance (IIF) has published a study entitled Fostering Foreign Direct Investment in Latin America (July 1990).

Established in 1983, the IIF groups more than 200 international commercial banks with the mandate of keeping its members informed. This original mandate was later expanded to include liaison and advocacy roles, such as "the formulation of long-term constructive solutions to the debt problem while expanding its base of cooperation and liaison with key international organizations, national authorities and regulators, and government policy makers."

Persuaded that "the promotion of direct foreign investment, or investment associated with foreign ownership and management control, must be a major ingredient in any strategy to rekindle sustained economic development in Latin America," the IIF focuses on the factors affecting such investment, the main policy issues that have to be addressed to promote investment flows, as well as the short term outlook.

Submerged in the text, but essential to the IIF's analysis, is the dismissal of the apprehension recently voiced in Latin America about the potential diversion of capital flows to Central and Eastern Europe. The argument is that "because overall capital flows to Latin America have been less than 1 percent of gross flows in worldwide capital markets, it is difficult to sustain the argument that there is likely to be substantial diversion of private investment away from the region."

Within this context, the recent evolution of direct foreign investment in ten major Latin American countries --Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Peru, Uruguay and Venezuela-- is compared with five Asian countries --Indonesia, Malaysia, Philippines, Singapore and Thailand-- as well as with two Iberian countries --Portugal and Spain.

This comparison reveals a Latin American performance that is judged "disappointing." For instance, between 1984 and 1989, direct foreign investment in Latin America represented less than 1 percent of GDP, averaging only 0.7 percent, while in the Asian and Iberian countries mentioned, during the same period, this indicator was twice as large. Moreover, in 1989, foreign direct investment as a proportion of GDP declined in Latin America.

There are differences among the Latin American countries in their capacity to attract foreign investment. Chile is individualized as the most successful, as well as others that have used debt-equity swaps, such as Brazil, Mexico and Argentina.

By sector, the bulk of foreign investment in Latin America is concentrated in manufacturing, because of the restrictions that are found on investments in mining, petroleum and services, particularly in the financial sector. Furthermore, reinvestment of retained earnings accounted, in 1989, for 34 percent of all foreign investment in the ten Latin American countries mentioned.

By source, the United States is by far the largest, exceeding fifty percent of all foreign investment and heavily concentrated in manufacturing activities, such as chemicals, transportation equipment and machinery.

Among the factors affecting foreign investment flows, high transfer, or convertibility risk is identified as the main culprit. Also, rates of return on investment are lower in Latin America, despite recent increases, from 6.6 percent in 1984 to 12.5 percent in 1989, than in all other developing countries where they varied annually between 13.2 and 24.9 percent during 1984-1988.

Several factors are singled out to explain the lower returns on foreign direct investment in Latin America. Among them, falling overall output and income is said to be "perhaps the most important." Variables such as a higher rate of return and a stronger export performance, as well as debt-for-equity swap programs, are found to correlate positively with foreign direct investment, while interest arrears are found to be negatively correlated.

Economic policies by the host government are said to have a "critical effect" on foreign investment, with the fight against inflation, to generate a "stable business environment," identified as "the most pressing task of economic policymakers in most Latin American countries." More directly, the lifting of restrictions on foreign ownership and management control, as well as of regulations of profit and capital remittances are individualized as another priority for economic policy.

Finally, investment can also be an indirect way of gaining access to loan capital. Both are seen as complements, because parent companies can borrow in international capital markets, to finance the activities of their subsidiaries in Latin America.

To conclude, regarding the outlook, the IIF projects "an upturn in foreign direct investment in the region in 1990 and 1991 from the depressed level of 1989." Moreover, it expects that "such investment would exceed the earlier peak registered in 1988." Also, if the major economies of Latin America "achieve inflation

control," it is anticipated that the share of foreign investment in domestic capital formation will "reach 10 percent in 1993, double the average of the last five years." This "projected upswing" is seen as resulting from "the outlook for improved economic policies," as well as from "extensive use of debt-for-equity swaps in privatizations in Argentina, Brazil and Mexico."

V. 5. DEBT AND INVESTMENT IN THE ENTERPRISE FOR THE AMERICAS (WDW/30/90 - 24 OCTOBER 1990)

Almost eclipsed by the news from the Persian Gulf and the debate over the budget deficit, on September 14, President Bush submitted to Congress a legislative proposal to implement the investment and debt elements of the Enterprise for the Americas (WDW/19/90). In a ceremony held at the White House, in the presence of the Secretary General of the Organization of American States (OAS) and the President of the Inter-American Development Bank (IDB), President Bush said the legislative proposal "advances both the investment and debt portions of the initiative and contains an innovative approach to the environment."

The basic purpose of the proposal is "to encourage and support market-oriented reform and economic growth in Latin America and the Caribbean," by means of: 1) contributions to an investment fund administered by the IDB; 2) support for an investment sector lending program at the IDB, in support of investment reforms; 3) the creation of a facility at the U.S. Treasury Department to support debt reduction operations; 4) the reduction of official debts and the use of interest payments on reduced obligations to support environmental programs; and 5) the sale, reduction or cancellation of certain assets and loans to facilitate debt/equity or debt-for-nature swaps.

The investment fund is expected to be multilateral, it will be administered by the IDB and can commence operations based initially on the U.S. contribution. Also, as discussed during the Houston Summit (WDW/21/90), contributions to the Fund will be sought by the U.S. Treasury from European countries, Japan and Canada, until the goal of US $1.5 billion is reached.

For this purpose, the U.S. government is seeking legislative authorization to contribute US $100 million annually, over five years, beginning in FY 1992. The purpose of the fund is to provide grants to support investment policy initiatives and reforms, as well as technical assistance for privatization, development of business infrastructure, and worker training and education programs.

The IDB will also establish a sector lending program to provide support for investment reforms, through the liberalization of investment regimes, as a means to attract scarce capital and the reflow of flight capital.

The Enterprise for the Americas facility at the Department of the Treasury will support market oriented and investment reforms, as well as environmental protection, by administering debt reduction operations for eligible countries.

Latin American and Caribbean countries will be eligible for debt reduction operations administered by the facility if they have: 1) IMF or World Bank economic programs; 2) an IDB loan to support major investment reforms or otherwise implement an open investment regime; and 3) a negotiated financing program with commercial banks.

For the reduction of concessional debts, of the Agency for International Development (AID) and P.L. 480, the Secretary of the Treasury will chair an interagency procedure for the exchange of outstanding obligations for new, reduced obligations bearing concessional interest rates. Also, Eximbank loans and credit guarantees from the Commodity Credit Corporation can be reduced, sold or canceled to facilitate debt/equity swaps or debt-for-nature swaps.

The proposal also contains an environmental component. Each country eligible for debt reduction will negotiate an environmental agreement with the United States that will allow interest payments in local currency of reduced obligations. The agreement will establish an Environmental Fund owned by the debtor country, to receive the interest payments, as well as to determine the use of these resources, through the provision of grants for environmental projects and programs. A local committee, composed of eligible country representatives, as well as U.S. Government and local private environmental group representatives, will be charged with the formulation of such programs and projects.

Finally, on 31 December of each year, the President will transmit to the U.S. Congress an annual report on the operations of the Enterprise for the Americas facility.

Several conclusions can be derived from this brief description of the debt and investment components of the Enterprise for the Americas. First, the leading role that the U.S. Treasury Department is performing in the implementation of the initiative. Second, the decisive role granted to the IDB in both the debt and investment components. Third, the emphasis on the environment and the role given to private environmental organizations. Fourth, by contrast, the commercial aspects of the Enterprise for the Americas

seem to be lagging behind, since there still does not seem to exist a comparably clear definition of these aspects, and there are has not yet clearly emerged a leading agency to implement them.

On trade, in the presentation at the White House of the legislative proposal, President Bush recalled that the "long-term objective" was "a hemispheric free trade zone from Alaska to Argentina." He mentioned "as a step in that direction," that the immediate objective was "to negotiate framework agreements" and he also recalled that such agreements had already been signed with Mexico, Bolivia, Colombia and Ecuador, as well as that others were in progress.

V. 6. PROGRESS REPORT ON THE U.S.-MEXICO TRADE NEGOTIATIONS (WDW/32/90 - 7 NOVEMBER 1990)

On September 25, in response to a letter from Mexican President Salinas, dated August 21, proposing formally the negotiation of a free-trade agreement between the United States and Mexico, President Bush notified to the U.S. Congress the initiation of such negotiations. In the same notification, President Bush also informed the Congress about the desire recently expressed by the Government of Canada "to participate in the negotiations, with a view to negotiating an agreement or agreements among all three countries."

The Administration's request started the clock by which the Congress has sixty legislative days, or at least four months, to determine if such an agreement conforms to U.S. interests. If it is so determined, President Bush would be granted "fast track authorization," giving the USTR full negotiating powers. The Congress is left with the possibility of voting only up or down, without making any changes in the agreement thus negotiated.

Two days after the presentation of President Bush's request, on September 27, both the Senate and House Committees requested jointly from the U.S. International Trade Commission (ITC) the preparation of a detailed study on the potential impact of the free trade agreement. The study is due in February or March, to serve as the basis for the decision that Congress will have to make sometime in April of next year. Covering twenty specific industrial sectors, such as automobiles, electronics and textiles, the study will also try to measure the potential impact on specific regions, including the U.S.-Mexico border to be considered as a single geographic unit.

The announcement of the request came as a surprise to many, particularly those that expected that the negotiations with Mexico

would wait for the conclusion of the Uruguay Round. This was the impression left after President Salinas' visit to Washington in June (WDW/17/90). The final communique instructed the appointed negotiators, USTR Ambassador Carla Hills and Mexico's Secretary of Commerce and Industrial Development, Dr. Jaime Serra Puche, to report back to the Presidents "as soon as practicable, but in any event before their next meeting," to be held in Monterrey, Mexico, next December.

When it was leaked, in early August, that the request for fast-track authorization would be sent to Congress in September, Ambassador Carla Hills made it very clear that formal negotiations with Mexico could not begin until next year, when the Congress would grant the negotiating authority. Consequently, she said, this was no distraction from the Administration's highest trade priority for 1990, namely, the successful completion of the Uruguay Round in December.

Two explanations were offered about the timing of the request to Congress. The New York Times, citing "Administration officials" linked the decision to the Persian Gulf crisis. Although described as "not the only reason," The Times said "the Middle East crisis has focused the world's attention on global oil supplies. Mexico, with the eighth-largest reserves in the world, would be likely to attract more outside capital with a trade pact to help tap those reserves."

The Wall Street Journal attributed the speed-up of the decision to a victory by "the Texans in the Bush Administration," in what it described as "the behind-the-scenes struggle to give Mexico a prominent place on the nation's agenda."

According to The Journal this marked a defeat for those who "argued that early negotiations with Mexico could interfere with efforts next year to win congressional support for a new global trade agreement under the General Agreement on Tariffs and Trade."

Among "the Texans" The Journal found Secretary of State James Baker and Commerce Secretary Robert Mosbacher, who "argued vigorously that a free-trade pact with Mexico should be a top priority for the Administration." Both, reportedly, "also got an assist from another Texan, Democratic Sen. Lloyd Bentsen, who helped persuade the key members of Congress to support the talks."

In the opposition appear Ambassador Carla Hills and Secretary of Agriculture Clayton Yeutter, assisted by Labor Secretary Elizabeth Dole, who reportedly "expressed the reservations of organized labor to the U.S.-Mexico pact."

Meanwhile, in what The Washington Post called "a rare display of official cooperation in a politically touchy area," the U.S. and Mexican commerce ministers, on October 22, undertook a journey

across the United States to explain to business and civic leaders the advantages of greater U.S investment in Mexico. In the terms of Secretary Mosbacher, "we are going to be selling the advantages of a free-trade agreement that makes both countries more competitive," in Houston, Dallas, New York, Chicago and Los Angeles.

Finally, limiting the negotiations, Mexico's trade negotiator, Mr. Herminio Blanco, told a meeting at the Overseas Development Council (ODC), in Washington on October 25, "this will be an agreement on trade issues," excluding other more controverted matters, such as labor rights, drug controls, immigration, the environment and energy. The USTR's director of Mexican affairs, Mr. Robert Fischer agreed, because their inclusion could "kill the trade deal," turning it into "a Christmas tree."

V. 7. THE NEW CARIBBEAN BASIN INITIATIVE (CBI II)
(WDW/33/90 - 14 NOVEMBER 1990)

After a long legislative ordeal, that started in August 1987, President Bush signed into law, on 20 August 1990, the Caribbean Basin Economic Recovery Expansion Act (CBERA), better known as CBI II. As far as the list of products eligible for duty-free treatment is concerned, the new legislation does not contain any major breakthroughs. Even so, several changes were introduced that may have some impact on the trade and investment flows between the designated beneficiary countries and the United States. As Senator Lloyd Bentsen (D-TEX) declared, "better to pass a narrow bill than to see a more ambitious version defeated."

Total United States imports from the 28 CBERA beneficiary countries climbed from the previous year by 10 percent, to $6.6 billion in 1989. Even so, after six years of operation of the CBERA, this figure represented a decrease from the $8.6 billion imported by the United States from these countries in 1984. In all, the share of imports from the CBERA countries in U.S. imports has been declining, from 2.7 percent in 1984 to 1.4 percent in 1989.

By contrast, U.S. exports to the CBERA countries have increased, from $5.9 billion in 1984 to $8.1 billion in 1989, although their share in total U.S. exports has declined, from 2.8 percent in 1984 to 2.3 percent in 1989.

Duty free imports under the CBERA amounted to $906 million in 1989, a 15 percent increase over the $791 million attained in 1988, representing nearly 14 percent of total imports from beneficiary countries. In 1984, the first year of CBERA operation, duty free imports accounted for 7 percent of total imports from beneficiary countries.

For the third consecutive year, in 1989, the United States registered a surplus with CBERA beneficiary countries amounting to $1.5 billion, due mainly to an increase in exports of 8 percent over the 1988 level. Beef remained the leading CBERA duty-free import, amounting to $118.5 million in 1989, with Costa Rica as the principal supplier of $25.2 million. Raw cane sugar followed, amounting to $106.4 million in 1989, with more than two thirds, or $72.7 million, supplied by the Dominican Republic.

Out of the $906 million of total customs value of U.S.-CBERA duty-free imports, only 37 percent, or $331 million, were granted duty-free entry, or only 5 percent of the customs value of total imports from CBERA beneficiaries.

Overall investment figures in beneficiary countries reveal that in 1989 there were 316 new or expansion investment projects, out of which 263 projects amounted to $406 million. By subregions, in 1989, the Central Caribbean reported the highest amount of new investment, with $170 million, while Central America and the Eastern Caribbean reported $116 million and $112 million, respectively.

Finally, according to the U.S. International Trade Commission (ITC), "the estimated net welfare cost to the United States of granting duty-free treatment to the 30 leading items that actually benefitted from CBERA ranged from $2.4 million to $8.2 million in 1989." The concept of net welfare costs used by the ITC is based on the "foregone benefits to U.S. producers and the U.S. Treasury minus the gain to U.S. consumers."

These results served as background to the recent approval of CBI II, whose lengthy and frustrating legislative ordeal is in stark contrast with the small magnitudes of trade flows and the products involved. Originally, several important modifications were proposed to the existent legislation, such as guaranteed sugar quotas or increased market access for textiles and leather goods, but these were deleted or disappeared as a result of legislative negotiations.

Even so, certain innovations survived, among which the repeal of the 30 September 1995 termination date for the CBI, made the program permanent. Second, a reduction of 20 percent in the tariffs of certain leather products, except footwear, such as flat goods, leather apparel and work gloves, phased over five years with no more than a 2.5 percentage point reduction permitted on any one product. Third, articles produced in Puerto Rico and sent to be processed in a CBI country, if the materials added are of CBI or U.S. origin, can return to the U.S. duty free. Fourth, the most important new provision allows for duty and quota-free entry for products assembled or processed of components of the United States and it eliminates the 35 percent value added criteria. Fifth, other provisions require Puerto Rico to ensure that at least $100 million

of section 936 funds, derived from tax preferences granted to U.S. firms to encourage reinvestment of profits, are invested during each calendar year after 1989 in qualified CBI countries. Finally, Nicaragua was designated as beneficiary country and workers rights criteria were harmonized with GSP standards.

In addition to these legislative changes, on 1 November 1990, President Bush approved a package of measures designed to improve the operation of the CBI in trade, investment and tourism, as well as in promotion and marketing and in the provision of technical assistance. This implicitly recognizes that the performance of the CBI remains behind expectations, as demonstrated by the unbalanced trade flows, as by the rates of utilization of CBERA benefits, which have gone from 31.3 percent in 1985 to 46.5 percent in 1989.

VI. FINANCIAL INTERDEPENDENCE

VI. 1. THE AMOUNT OF THIRD WORLD INDEBTEDNESS (WDW/2/90 - 24 JANUARY 1990)

This year's World Debt Tables are presented in two volumes. The first volume of Analysis and Summary Tables contains a very accurate and complete, "blow-by-blow," description of what is termed "the implementation of debt reduction," as well as summary debt data tables for all the reporting countries, grouped geographically and according to income indicators. The second volume of Country Tables contains statistics for each one of the 111 countries that report public and publicly guaranteed debt to the World Bank's Debtor Reporting System (DRS).

Twelve Latin American and Caribbean countries appear prominently among the group of nineteen severely indebted middle-income countries (SIMICs). The only exception is Guyana, that appears among the group of twenty seven severely indebted low-income countries (SILICs), as well as the Dominican Republic, Guatemala, Jamaica and Paraguay, that appear among the group of sixteen moderately indebted middle-income countries (MIMICs).

Here are some of the highlights contained in the first volume:

1) Total external debt owed by developing countries in 1989 increased $0.6 billion, or 5 percent, to reach $1,290 billion, or about 44 percent of their aggregate GDP. Also, preliminary projections for 1990 indicate that total debt is expected to grow at a rate of about 2 percent.

2) Total external debt owed by Latin America and the Caribbean in 1989 increased to $434 billion, from $427.4 billion in 1988, or about 50.9 percent of GNP and 297 percent of total exports of goods and services.

3) In 1989, official creditors accounted for an estimated 48 percent of the long-term external debt of developing countries, compared with 38 percent in 1982. By contrast, net commercial lending is expected to be slightly negative, since repayments exceeded disbursements.

4) Compared to 1988, the pace of debt reduction slowed mainly because of a decline in debt-equity swaps and because the new debt strategy had not yet been applied.

5) Thus, the face value of total 1989 debt reduction, including voluntary transactions with commercial banks, amounted to an estimated $14 billion, compared with $33 billion in 1988.

6) The appreciation of the dollar, against some of the major currencies in 1989, continued to curb the rise in the stock of dollar-denominated debt, by lowering the value of non-dollar debt obligations.

7) Net lending to developing countries increased in 1989, with disbursements of long-term loans amounting to $99 billion, compared with $95.7 billion in 1988.

8) Net flows (disbursements less principal repayments) amounted in 1989 to $25.6 billion, compared with $20.3 billion in 1988.

9) Higher interest payments offset the increase in net flows and led to net transfers (net flows minus interest payments) from developing countries of $52 billion, amount almost similar to the previous year.

10) A more comprehensive measure of financing flows is proposed in the form of aggregate net resource transfers-- defined as net foreign direct investment, net unrequited transfers (including official grants), net lending from private and official sources, and the change in arrears less interest and dividend payments. In these terms, in 1988, net resource transfers from developing countries to their creditors amounted to $9.8 billion.

Beyond the rich descriptive data, the World Bank draws some interesting conclusions about the implementation of the new debt strategy, particularly concerning the severely indebted middle-income countries.

Even when it is considered "still too early to judge its eventual success," several questions are raised about the new

strategy, as it applies to the SIMICs. For instance, the amounts available for credit enhancement from official sources do not allow for much hope about the extent of debt service reduction. Moreover, while a significant rise in official resources is seen as "highly unlikely," the commercial banks "appear to have very little incentive for or interest in lending to developing countries in general and to SIMICs in particular." Furthermore, there are questions about the contribution that can be made by bank advisory committees, given "the wide divergence in commercial bank positions." Finally, several commercial banks are reluctant to support debt and debt service reduction for fear that it will "contaminate" their portfolios, although it is recognized that no debtors, until now, have "deliberately attempted to reduce the market price of their debt."

Additionally, for the new debt strategy to work as intended, the Bank identifies some decisive factors, such as a favorable external environment for debtor countries; growing debt inflexibility, due to conversions and buybacks exempt from future restructuring, "leaves little room for future policy slippages by debtor countries;" debt reduction packages should include different elements, such as new money, to appeal to different banks; tax authorities and regulators can determine the degree of participation of commercial banks in debt reduction packages; sufficient external finance should be available in the event of adverse external shocks; an equitable framework of burden sharing among creditors should be put in place; finally, the present debt strategy does not address the problems of SIMICs that owe their debt mainly to bilateral official creditors.

The preceding, very brief summary reveals that in this year's Debt Tables a more active stance is adopted, by frankly enumerating some of the limitations exhibited by the prevailing debt strategy. No longer the solution, as in the 1986 TABLES, is a "common good," that cannot be expected to come from the market "left to itself." Neither is it only, as in the 1987 TABLES, a problem whose "costs" have been "borne largely by the debtors." Nor should debt reduction be adopted to avoid the political dangers of "radicalization," as in the 1988 Tables. This year, the World Bank sets aside these "analytical" perspectives, by adopting the position of an active participant, perhaps because of its increasing exposure.

VI. 2. FINANCIAL MARKET GLOBALIZATION AND VOLATILITY
(WDW/18/90 - 27 June 1990)

The U.S. Federal Reserve Board Chairman, Alan Greenspan, in recent testimony to the Financial Institutions Supervision, Regulation and Insurance Subcommittee, of the House Committee on Banking, Finance and Urban Affairs, described some of the factors leading to "globalization and interdependence," which he characterized as "the dominant elements of world finance."

For instance, one of the main factors underlying the present globalization of financial markets can be found in the dramatic increases in the amount and velocity of money and financial capital flows. In the terms of the FED Vice-Chairman, Manuel Johnson, financial flows "now drive trade flows rather than the other way around."

For instance, in 1989, foreign purchases and sales of U.S. Treasury securities surpassed $4 trillion on a gross basis, a figure that contrasts starkly with the $3 trillion attained by world merchandise trade in the same year. This figure is all the more impressive when it is considered that foreign purchases of U.S. Treasury securities, at the beginning of the eighties, oscillated between $100 and $200 million.

Underlying these spectacular increases in the amount and velocity of financial flows, another key factor identified by Chairman Greenspan were the "quantum advances in technology," that have led to an explosive growth in information-gathering and processing techniques. "Computer and telecommunications technology," according to Chairman Greenspan, are "boosting gross financial transactions across national borders at an even faster pace than the net transactions supporting the increase in goods and services." Moreover, given the role of the dollar as the key international currency, such flows have been and "may continue to be, disproportionately into assets denominated in the dollar."

Another factor is the world-wide trend towards financial market deregulation, as well as the consequent proliferation of financial instruments, the unbundling of financial risk leading to increasingly specialized risk management, by means of new opportunities for arbitrage and hedging around domestic regulations, controls and taxes, all of them undermining domestic policies.

There seems to be agreement that the globalization of financial markets has generated many benefits through increased

competition, expanding the choices for savers and investors, reducing the costs of intermediation, and improving the allocation of saving and investment nationally and internationally.

Even so, as characterized by the President of the Federal Reserve Bank of New York, Mr. Gerald Corrigan, the trend towards globalization has also become "a two-edged sword." Because the same forces that are pushing towards globalization "have also increased volatility in financial markets, introduced new and highly complex elements of risk --possibly even increasing systemic risk."

Underlying these trends are the dramatic changes experienced by the patterns of international savings flows. As summarized by President Corrigan, during the eighties, "Germany and Japan emerged as massive surplus nations; the newly industrial countries in Asia emerged as major forces in world trade and finance; the net savings flows into the developing world slowed to a trickle; and, the U.S. net external position deteriorated in a major and almost unimaginable manner."

Quantitatively, these trends have meant, for instance, that the U.S. current account deficit of $100 billion, in 1989, "represented the equivalent of almost ten percent of the net savings of Canada, France, Italy, Japan, Switzerland, the United Kingdom and West Germany combined."

Given the pivotal role played by the United States in all these impressive changes, two characteristics of the U.S. banking and financial system, identified recently by President Gerald Corrigan, may also be contributing to the volatility of the present international system.

First of all, the U.S. financial system has witnessed, in recent years, "a disproportionate number of financial disruptions." And second, the banking system of the United States has been experiencing a slippage in competitive performance, both domestically and internationally.

Five major factors were recently identified by President Corrigan to explain this dual condition of instability and competitive slippage in the U.S. banking and financial system.

First, U.S. macroeconomic performance and policies, such as volatility in GNP and inflation, low savings and a weakened external position, contrast with Japan's strong overall economic and financial performance.

Second, "the historic value of the banking franchise is under great pressure" in the United States, to the point that "the most creditworthy corporate borrowers can now fully bypass the entire banking and financial system for many of their day-to-day credit needs."

Third, as a result of "the competitive implications of the technological and market forces described above," in the United States, there is "excess capacity in large segments of banking and finance." Such a situation "seems, at times, to create a vested interest in volatility," that "reinforces the unrelenting preoccupation with the short run."

Fourth, the legal and institutional framework within which U.S. banking and financial institutions operate is "outdated," to the point that the banking system is considered "simply out of step with the rest of the world and, more importantly, it is out of step with the realities of the marketplace." Moreover, fragmentation makes the U.S. banking system "risk and accident prone," due to an inhibition of the "diversification of risks."

Finally, in the U.S. there is a "relatively high incidence of financial disruptions," due to "gaps or lapses in the supervisory process." The most recent example is the savings and loans collapse, a situation characterized by President Corrigan as "far more a fatal flaw in the legal and supervisory process than it was in the architecture of the deposit insurance system."

In conclusion, some time ago, Charles Kindleberger explained the Great Depression because of the absence of a leading country willing and able to assume the role of "stabilizer." No wonder, the trend towards the globalization of financial markets, as well as the characteristics of the banking and financial system of the United States, both generating unprecedented degrees of volatility also raise ominous questions about the health of the overall international economic system.

VI. 3. ADJUSTMENT LENDING REVISITED (WDW/29/90 - 17 OCTOBER 1990)

Almost a year after the World Bank undertook a thorough evaluation of adjustment lending, its Country Economics Department has revisited the subject and gathered its main findings in a document released in September for an internal discussion.

This new evaluation tries to respond to some of the issues identified as demanding further analysis when the Bank's Board of Directors discussed the first evaluation. Some of these were: the sustainability of growth effects; the impact of external factors on economic performance; the impact of adjustment on poverty and living conditions; the role of the debt overhang; the experience with the design and implementation of programs; the need for increased dialogue among aid-giving agencies; the importance of

political and institutional realities; and the policies needed in adjustment programs to increase investment, saving and growth in the adjusting countries.

To respond to some of these concerns, the most recent evaluation is divided in two parts: first, a review of the Bank experience with adjustment lending contains chapters on the effectiveness of adjustment programs; the impact of structural adjustment on living conditions; the design and implementation of adjustment programs; and on adjustment lending and Bank exposure. The second part analyzes how to restore growth and contains chapters on investment, saving and on the determinants of growth.

The report's main conclusions can be summarized under the following headings:

1) On the aggregate effects of structural reforms, those countries that have adopted adjustment programs have on average grown faster than other countries, as measured by larger increases in the average rate of GDP growth.

2) On average, in those countries with better growth performances, investment fell as a share of GDP. Even after explicitly controlling for other factors, such as external shocks, external financing, initial conditions and determinants of the demand for adjustment programs, adjustment lending usually increased the ratios of domestic saving and exports to GDP, but reduced the average ratio of investment to GDP.

3) Adjustment programs are more likely to fail when a stable macroeconomic framework is not in place, even when the adjustment package focuses mainly on microeconomic or sectoral policies.

4) On the effects on poverty and living conditions, the report finds no evidence that adjustment lending caused an increase in the overall misery of the poor. Orderly adjustment, supported by Bank lending, is found to be less costly for most of the poor and for the general populace than disorderly adjustment without Bank support. No systematic relationship is found between changes in the available socioeconomic indicators of living conditions and adjustment lending. Short-run indicators, such as current consumption, nutrition and immunization have improved, as well as long-run indicators of living conditions, such as infant and child mortality. Even so, the share of central government expenditure on the social sector has fallen, as have declined per capita social expenditures by the central government. For instance, declines in education expenditure have been accompanied by falling primary school enrollment ratios.

5) To prevent declines in socioeconomic indicators, the Report proposes to increase social sector expenditures targeted toward the poor. The main constraint faced by these "targeted interventions" is found not in their fiscal cost, but rather in the degree of commitment by the government to assist the poor, as well as in the institutional capacity to reach the poor.

6) Increases in the efficiency of investment, through the abolition of a critical mass of distortions, rather than minor decreases in extremely high distortions, can reduce the need for more saving.

7) To sustain adjustment and restore growth, there must be an increase in investment, which demands macroeconomic stability, removing legal and bureaucratic impediments, expanding public investment, and ensuring sufficient external financing.

8) Saving rates have to increase to sustain desirable rates of investment and initially the most effective way is to increase public saving.

9) Other refinements refer to the sequencing of reforms, with the restoration of macroeconomic balances placed at the top, whenever high inflation and large current account deficits are present. Also, sequencing must take into account linkages among sectors.

10) Finally, more attention needs to be given to reforming and developing institutions, particularly to the strengthening of public institutions, despite the reduction in resources going to the public sector.

To conclude, the timeliness of the report should be considered, because the relative importance of adjustment lending is decreasing as a percentage of total Bank operations. According to the last Annual Report (WDW/26/90), during FY90, adjustment lending represented only 19 percent of all Bank commitments, by contrast with FY89, when they amounted to 30 percent of all commitments. Unfortunately, the report uses figures that go up to the end of CY89, revealing that "adjustment lending as a share of total approvals rose, by value, from 25 percent in CY88 to 27 percent in CY89."

VII. MULTILATERAL FINANCIAL INSTITUTIONS

VII. 1. RESEARCH ON DEVELOPMENT AT THE WORLD BANK (WDW/8/90 - 7 MARCH 1990)

During fiscal year 1989, expenditures on research activities at the World Bank amounted to $20.2 million, of which $14.6 million covered 121.7 staff-years, up from 89.2 staff-years in FY 1988, and $5.5 million covered support activities. As in previous years, these expenditures absorbed roughly 3.9 percent of the Bank's administrative budget.

In a recently released yearly report on its research program, the Bank basically includes activities such as those performed by a "think tank," in the form of policy papers, as well as "academic research," that "addresses issues of fundamental concern to the institution and the development community at large."

Other analytical activities performed by the Bank are not covered by the report. These include economic and sector work (ESW), such as country analysis, as well as policy work, both in support of specific lending operations. As a percentage of overall analytical activities, in FY 1989, research represented almost 16 percent, ESW almost 59 percent and policy work 25 percent.

Two major sources of funding are available to finance research activities at the Bank. First, the Research Support Budget, administered by the Research Committee, disbursed $5.6 million during FY 1989, compared with $5.1 million in the previous year, which added to the staff time dedicated to research projects amounted to $9.3 million, or 46 percent of all expenditures. Second, the resources from the different departments, mainly staff time, which amounted to $14.6 million, or 54 percent of overall research expenditures.

Substantive "special emphasis areas" absorbed almost 70 percent of all research expenditures during FY 1989. The breakdown was: debt restructuring and adjustment (14.8 percent); human resources (11.4 percent) poverty alleviation (10.8 percent); public sector management (10.6 percent); environment (7.2 percent); privatization (5 percent); food security (4.4 percent); financial intermediation (2.8 percent); women in development (2.5 percent); and coordination, publication and dissemination (6.5 percent).

The recent restructuring undergone by the Bank set two basic goals for Bank's research, "the creation of a research portfolio that reflected new institutional priorities and to rebuild and diversify the Bank's centrally funded research program."

The list of substantive "special emphasis areas" reveals that the research portfolio addresses the major themes covered by Bank operations. This list of issues is subject to constant updating. For FY 1990, three current topics have been added as subjects of special emphasis: the environment, the development of the private sector, and the reform of the socialist economies. Certain regional issues will also receive increased research attention, such as Sub-Saharan Africa, as well as other international and domestic issues of particular concern for developing countries, such as the Uruguay Round, as well as technology change and comparative advantage.

The overall objective of becoming "an intellectual leader on development issues" is identified by President Conable in the memorandum presenting the report to the Executive Directors. To fulfill this objective, besides producing "technically sound research," the Bank also tries to communicate its research findings through a program of effective dissemination.

Additionally, "outreach" activities are carried out to link Bank researchers to development researchers and policymakers, through a Visiting Research Fellow Program and the Annual Bank Conference on Development Economics (ABCDE).

In FY 1989, seven fellows visited the Bank for periods of three to six months and covered the following issues: macroeconomic policies and poverty alleviation in Latin America; problems of macroeconomic adjustment in centrally planned economies; transport and agriculture in Africa; global climatic change; project appraisal; and the indebtedness of developing countries.

In April 1989, the first ABCDE was held in Washington and participants discussed six major papers on the Uruguay Round, saving behavior in developing countries, social sector pricing policy, the role of institutions in development, the policy implications of "strategic" trade theories, and agricultural output response to public policy. The proceedings of the first conference have been recently issued as a book.

The second ABCDE has already been scheduled for April 1990, to discuss papers on environmental sustainability, the macroeconomics of transition from stabilization and adjustment to growth, experiences in evaluation of development projects and programs, as well as population and development.

The dissemination of the research program's results is described as a "perennial concern" and is carried out by means of the publication of two journals. <u>The World Bank Economic Review</u>

written by and for economists, with a circulation of over 9,000 subscribers in developing countries and The World Bank Research Observer written to be accessible to the noneconomist and nonspecialist economist, with a circulation of 4,000 subscribers in developing countries.

The widely circulated monthly Finance and Development, published jointly with the IMF, also includes results of Bank research, as well as the quarterly newsletter Research News, that goes to more than 10,000 subscribers.

Finally, during the second half of 1990, a monthly Research Bulletin, will be launched "to ensure that all those interested in development economics are aware of this considerable output and to keep policymakers apprised of the cutting edge of Bank research."

VII. 2. THE WORLD BANK-IMF SPRING MEETINGS (WDW/14/90 - 23 MAY 1990)

This year's Bank-Fund spring meetings, held in Washington, from 4 to 8 May, were dominated by the IMF's Ninth General Review of Quotas. In the arcane language used in the solemn communiques issued at the end of each one of the meetings, other decisions were postponed because "further work" was still necessary.

As it can be recalled, the quota increase was long overdue. According to the IMF's Articles of Agreement (Art. III, Section 2) "a general review of members quotas shall be conducted by the Board of Governors at intervals of not more than five years." Since the Eighth General Review of Quotas was concluded on 31 March 1983, the Board of Governors was required to conduct the next review at the most by 31 March 1988.

To meet this deadline, according to rule D-3 of the Fund's Rules and Regulations, the Executive Board's Committee of the Whole was convened, on March 17, 1987, to work in the first instance on the quota review. Nonetheless, it was only after twenty Executive Board meetings and three postponements of the deadline --from the end of March 1988 to end-December 1989, then to end-March 1990, and further to June 30, 1990-- that consensus emerged among the main contributors.

Several factors were hindering the decision. First and foremost, the opposition expressed by the U.S. Secretary of the Treasury, during last year's annual Bank-Fund meetings, in the sense that "a decision on quotas must be based on an agreed vision of the role of the Fund in the 1990s and on fundamental progress being made in resolving the arrears problem in order to strengthen

the revolving, monetary character of the institution." This translated itself into a wide-ranging disagreement that went from the 100 percent increase proposed by the IMF's Managing Director, to the 35 percent increase supported by the United States, the United Kingdom and Saudi Arabia.

Second, there was the obstacle acknowledged by the Interim Committee's communique of the previous spring meeting, in the sense that "the size and distribution of any quota increase should take into account changes in the world economy since the last review of quotas, as well as members' relative positions in the world economy and the need to maintain a balance between different groups of countries." This had to do with the hierarchy of voting power, crucial in an institution ruled by weighted voting, determined according to each member's contribution. In this case, at issue was the position of Japan within the IMF's pecking order, ranking fifth, behind the United States, Great Britain, West Germany and France.

The final consensus announced in the Interim Committee's communique partially reveals the way in which some of these hurdles were vanquished.

First of all, on the amount, Secretary Brady announced that the United States had joined the consensus on increasing the quotas by fifty percent, from SDR 90 billion to SDR 135 billion, despite its original support for a smaller amount. On the next review of quotas, it was agreed that it should be conducted by 31 March 1993, instead of the maximum of five years allowed by the Articles of Agreement, the period originally sought by the United States. Finally, the Executive Board was "requested to prepare and complete for final decision" the quota increase, by 30 June 1990.

There was also agreement on how to deal with those countries that fall into arrears with the Fund. As proposed by the U.S. delegation, "as part of the overall quota increase package, no increase in quota shall become effective" before the entry into force of an amendment to the Articles of Agreement providing for the suspension of the voting rights of those members in arrears that persistently refuse to cooperate with the Fund.

Finally, on the pecking order, the result was that Japan will now share the number two position with West Germany, each one increasing their participation to slightly more than 6 percent. Also, the following position will be shared by Great Britain with France, by increasing their participation to 5.5 percent each. This arrangement was described by the West German Finance Minister, Mr. Theo Waigel, as "an Olympic solution," awarding "two silver and two bronze medals."

No other issue commanded such attention during the meetings, neither were equivalent decisions attained on the rest of the items contained in the agendas of both the Interim and the Development Committees.

For instance, on the debt issue, the Development Committee "reaffirmed its support for the strengthened debt strategy as endorsed at its last meeting and welcomed the progress achieved so far."

On the establishment and funding of an environmental facility at the World Bank, the Development Committee concluded that "efforts should continue to develop proposals for a pilot mechanism."

Also, on increasing the resources of the International Financial Corporation (IFC), despite repeated clarion calls supporting the private sector, the Development Committee "encouraged the IFC's Executive Board to continue its discussion on the adequacy of the capital of the Corporation, including modalities of subscription."

Finally, a brief mention by the Group of Seven noted that "German monetary and economic union should contribute to higher global activity and a reduction of external imbalances," as well as it welcomed "the far-reaching market-oriented reforms pursued in some Eastern European countries." Although the G-7 "stressed that the attention given to Eastern European countries will not detract from the continued support for developing countries."

In conclusion, this year's Bank-Fund spring meetings were almost exclusively dedicated to a single issue, the IMF's Ninth General Review of Quotas. To attain this long postponed decision, in the terms of Canada's Minister of Finance and Chairman of the Interim Committee, Mr. Michael Wilson, every main contributor "had to put a little water in its wine."

VII. 3. THE IMF'S ANNUAL REPORT (WDW/25/90 - 19 SEPTEMBER 1990)

The performance of the International Monetary Fund, during the financial year that ends on April 30, is reviewed by the Executive Board in the Annual Report released every year before the annual meetings of the Board of Governors.

The first part contains an overview of the world economy, based on the World Economic Outlook (WEO), originally released by the staff, in May 1990 (WDW/13/90). The second part is dedicated to

a review of the policies and activities of the Fund, under the following headings: surveillance; the external debt situation; financial support to member countries; trade policy; and financial operations and policies.

Surveillance of the members' domestic and external policies takes the form of regular consultations and discussions on the world economic outlook. The present moderation in world economic activity is attributed in part to the implementation of monetary policies aimed at easing inflationary pressures. This concern in the industrialized countries over inflation, according to the Report does not warrant a relaxation of the cautious monetary stance, while there remains a need for the reduction of the external imbalances that persist.

The existence of constraints on external financing leads to the recommendation to developing countries of "sustaining sound domestic policies," while the heavily indebted countries are advised to "boost saving and investment, and adopt structural reforms."

Finally, the transition to market-oriented economies in Eastern Europe is said to be "likely to involve short-term adjustment costs" and demands "monetary and fiscal policies to foster a stable economic environment."

On the external debt situation, the Report welcomes the strengthening of the debt strategy and underlines the need for a flexible, case-by-case approach, with the Fund's financial assistance "catalyzing" lending and debt reduction from other sources. In these terms, the Report considers that "progress in implementing the strengthened debt strategy has been good" and as evidence in support of this assertion it mentions the agreements reached by Costa Rica, Mexico, the Philippines and Venezuela, as well as the tackling of the problems caused by the official debt of low-income countries.

The financial support granted by the Fund to member countries, during the financial year, amounted to SDR 11 billion, in the form of 26 new arrangements, the largest amount of the last six years. Nine of these new arrangements were with the following countries of the Western Hemisphere: Argentina, Chile, Costa Rica, Ecuador, Haiti, Jamaica, Mexico, Trinidad and Tobago and Venezuela.

On trade policy, the REPORT asserts that "stronger efforts are urgently needed to counter protectionism," considering "essential to reach a successful conclusion of the Uruguay Round."

The review of financial operations and policies reveals that: 1) commitments of IMF resources increased markedly for the second year in a row, to SDR 11.3 billion. compared with SDR 4.6 billion and SDR 3.0 billion, respectively, in the previous two years. 2) Drawings (purchases) also increased, to SDR 4.4 billion. 3) Payments (repurchases) decreased only slightly to SDR 6.0 billion. 4) The negative transfer of resources to the Fund decreased to SDR 1.6 billion, from SDR 4.0 billion in the previous year. 5) Overdue financial obligations increased to SDR 3.3 billion, from SDR 2.9 billion. 6) Holdings of uncommitted and usable resources fell to SDR 41.2 billion, from SDR 42.9 billion at the end of the previous financial year. 7) Finally, for the performance of these activities the Fund employed 1,731 persons from 104 countries and its total administrative budget increased to SDR 185.7 million, from SDR 171.7 million the previous financial year.

In several respects, FY 1989/90 was "momentous" for the institution. For instance, as a result of the Ninth General Review, the Board of Governors agreed to expand the financial resources of the Fund by means of a 50 percent quota increase, to approximately SDR 135 billion.

Also remarkable was the support the Fund granted to what it termed "the unprecedented efforts of the Eastern European countries to restructure their economies." Thus, Hungary and Poland received financial and policy assistance from the Fund in their transition to a more market-oriented system, while Angola became a member and Czechoslovakia, Bulgaria and Mongolia applied for membership. Finally, Namibia and Switzerland submitted applications to become full members.

The overdue financial obligations to the Fund of some members increased to SDR 3.3 billion and continue posing "a serious problem." Nonetheless, some progress was registered in resolving such arrears, when the eligibility of Guyana and Honduras was restored in June 1990. Even so, nine members still were in arrears of six months or more, including Peru and Panama from the Western Hemisphere.

This brief overview of the activities performed by the Fund, during FY 1989/90, reveals a dynamic institution that is increasing its membership and that is playing a decisive catalytic role, at the center of most international financial rescue operations.

VII. 4. THE WORLD BANK'S ANNUAL REPORT
(WDW/26/90 - 26 SEPTEMBER 1990)

The 1990 Annual Report of the World Bank --covering the fiscal year from 1 July 1989 to 30 June 1990-- in seven sections describes: 1) the Executive Board's activities; 2) a global perspective on the economic scene; 3) the Bank's operations; 4) the Bank's finances; 5) the Bank's activities, including those of the International Finance Corporation (IFC); the Multilateral Investment Guarantee Agency (MIGA); and the International Centre for Settlement of Investment Disputes (ICSID); 6) regional perspectives, including a segment dedicated to Latin America and the Caribbean; and 7) a summary of the projects approved during FY 1990.

Global economic performance is described by groups of countries and reveals the slowness registered in the pace of development of the industrialized countries, as well as in the previously fast-growing Asian economies. By contrast, the severely indebted and the African countries are said to have fallen far short of growth elsewhere, especially in per capita terms. Thus, the Bank notes the persistence of "two-track development," whereby the performance of the economies of Latin America and Africa, in 1989, lagged behind the performance of other regions.

This overview of the world economy also includes the fundamental changes that took place in Central Europe, as well as "some successes in debt and debt reduction operations," to which the Bank contributed, such as the agreements signed by Mexico, the Philippines, Costa Rica and Venezuela. Finally, the Report notes the continuation of the increase in international initiatives to address global environmental concerns.

During FY 1990, lending commitments by the Bank amounted to US$ 20.7 billion, of which $15.1 billion from the Bank and $5.5 billion from the International Development Association (IDA). Thus, the level of Bank's commitments declined by $1.2 billion from the previous year's total, while IDA commitments increased by $588 million, to register a record high. In FY 1990, net disbursements from the Bank increased to $5.7 billion, from $1.9 billion during FY 1989. IDA net disbursements increased $224 million, to a total of $3.6 billion. Also, overall net income decreased to $1,046 billion, from $1,094 billion.

Several areas received "special operation emphases" within the Bank's lending activities, during FY 1990. First, specific

initiatives were adopted for Sub-Saharan Africa and in Central Europe. Second, debt and adjustment were also emphasized, as the Bank participated actively in debt reduction operations within the Brady Plan. Net disbursements during FY90 to the group of twenty severely indebted, middle income countries reached $4.0 billion, an increase of almost 250 percent over the $1.6 billion for FY89. Thus, net transfers from the Bank to this group of countries became positive, amounting to $1.4 billion, by contrast with 1989, when net transfers were negative $911 million.

In all, adjustment lending represented only 19 percent of FY90 commitments, by contrast with FY89 when these operations represented 30 percent of the total. Other areas that received special attention throughout the fiscal year were poverty reduction, women in development, the environment, private sector development and public sector management.

Finally, in the segment dedicated to Latin America and the Caribbean, the REPORT registers the persistence of what it calls "the region's disappointing overall growth," noting several exceptions, such as Chile, Colombia, Paraguay and some Caribbean islands. Also, the need for the restoration of fiscal discipline is individualized as the main priority of economic policy.

In FY90, Bank's activities in Latin America and the Caribbean can be summarized as follows: 1) lending increased by $123 million over the previous year to reach a total of forty-one operations amounting to $6.0 billion. 2) Gross disbursements reached $6.2 billion, an increase of 79 percent over the $3.4 billion for FY89. This sharp increase was accounted, in large part, by the fast disbursements for debt-reduction operations in Mexico. In these terms, during the five-year period 1986-90, gross disbursements have totaled more than $21 billion, or an annual average of $4.3 billion. 3) Almost 41 percent of Bank commitments in Latin America and the Caribbean adopted the form of nonproject and adjustment lending to support economic policy reforms aimed at consolidating macroeconomic stability, to assist in debt reduction programs within the Brady Plan, as well as to support privatization efforts. 4) Finally, the volume of cofinancing increased by almost 60 percent, to $4.1 billion for 18 projects. This increase was largely the result of three Bank loans to Mexico, amounting to $875.5 million, of which $1.7 billion was provided by export-credit agencies and the association of the Inter-American Development Bank (IDB) and the Export-Import Bank of Japan with IBRD lending in several countries. The largest sources of bilateral official cofinancing and of export-credit financing for the region remained the Overseas Economic Cooperation Fund and the Ex-Im Bank of Japan, respectively. Also, participation by the IDB in sector lending contributed to the substantial increase in the availability of cofinancing resources, with seven World Bank projects drawing cofinancing from the IDB for a total of $1.3 billion.

To conclude, in the present fiscal year 1991, the World Bank expects to extend between $21 and $24 billion in loans to developing countries, of which between $16 and $18 billion from the Bank and $5.7 billion from IDA.

VII. 5. THE IMF-WORLD BANK ANNUAL MEETINGS (WDW/27/90 - 3 OCTOBER 1990)

Under the specter of the "third oil shock," this year's annual meetings of the Bank and the Fund were dominated by three issues: first, the impact of the oil price hike on the world economic outlook; second, the participation in the Bretton Woods institutions of what were known as the "centrally planned economies;" and third, the arrears of some of the most indebted middle-income countries.

The abruptness of the oil price increase led to the presentation of hastily revised projections. For instance, the IMF's assumption of oil prices below $30 immediately became optimistic, when prices soared beyond this threshold. Still, the dominant perception was that the overall effects for the industrialized economies would be moderate.

However, the Finance Ministers and the Central Bank Governors of the G-7 --Canada, France, Germany, Italy, Japan, the United Kingdom and the United States-- noted that the rise in oil prices posed the double risk of inflation and of lower economic growth. Despite this recognition, the final statement by the G-7, as well as the communique of the G-10 --the seven plus the Netherlands, Sweden and Switzerland-- only recommended the adoption of "stability oriented monetary policies." This less direct wording was interpreted as resulting from a difference caused by the predilection of the U.S. Treasury for lower interest rates.

The plight of the developing countries was mentioned in the press communique released by the Development Committee, recognizing that some of them "were being affected adversely" by several factors, such as the events in the Middle East, the economic slowdown in some industrial countries, higher interest rates and the weakening of non-oil commodity prices.

Of all these issues, the increase in oil prices fractured the deliberations of the G-24 developing countries in two camps. On one side, the net oil importers led by India and Pakistan proposed the creation, as it was done in response to the first oil shock, of a special oil facility at the IMF, with the contributions of the oil exporters and the industrialized countries. On the other side, some

of the oil exporters, such as Venezuela, Mexico, Iran and Trinidad and Tobago opposed the creation of such a facility, arguing that it could not be anticipated if oil prices would remain high. Consequently, they preferred the more flexible utilization of existing mechanisms. World Bank President Conable found the response between these two positions. He proposed that "a new pool of financial aid" would have to be created, "if the crisis continues for a protracted period of time --that is, if the price of oil stays up," and he defined "protracted" as an extension of the crisis into 1991.

Without the Middle East crisis, the presence of what were formerly known as "centrally planned economies" would have easily been the major attraction of the meetings. The main issue confronting these economies has to do with the pace of transition, or the alternative between gradual vs. quick transition to a market system. Besides the admission of Czechoslovakia and Bulgaria as members, the alternative between gradualism or swiftness was poignantly illustrated by the presence, as "special guests" of an official Soviet delegation of five members, representing gradualism, and a private delegation of twelve persons promoting the "Shatalin 500 Day Plan."

Finally, the indebtedness of the middle-income, developing countries attracted some attention, although in no way comparable to the concerns about the oil price increase and the pace of transition in Central Europe.

The arrears of the indebted countries appeared briefly at the forefront, in large part, as a result of the pressure exercised by the Institute of International Finance (IIF), the powerful advocate of more than 200 commercial banks from all over the world.

In this year's letter addressed to the Chairmen of the Interim and Development Committees, the Managing Director of the IIF demanded that "the IMF and the World Bank need to make clear that they will not provide finance to countries until they have stopped adding to arrears and agreed with their creditors to a program to eliminate the arrears within a reasonable time frame."

In these terms, the IIF's letter, without identifying the culprits by name, constituted a general statement of the commercial banks' interests, and as such it would have remained only a mere expression of an advocate. What transformed it into almost a major policy definition was the more concrete version of the same requirement that appeared in the final statement issued by the Ministers and Central Bank Governors of the G-7. They emphasized that they "expect Brazil to resolve its arrears problems with its external creditors in the context of the adoption of a formal IMF arrangement."

At issue here was one of the major ingredients of the Brady Plan, the "decoupling" of the access to the international financial institutions from the simultaneous agreement with commercial creditors. After the G-7 statement nobody seems to know what should happen first. Every debtor will be closely watching the evolution in the next days of the Brazilian negotiation to see if both the agreement with the Fund and the agreement with the commercial banks will be attained simultaneously.

Finally, a note of optimism for Latin America took the form of the election of Chile's Minister of Finance, Mr. Alejandro Foxley Rioseco, as chairman of the Development Committee. This appointment gives hope that Latin American and Caribbean interests will be asserted at the right time and in the appropriate instances.