

UNITED NATIONS

ECONOMIC COMMISSION
FOR LATIN AMERICA
AND THE CARIBBEAN



Distr.
LIMITED
LC/WAS/L.23
30 March 1994

ORIGINAL: ENGLISH



INTERNATIONAL ECONOMIC HIGHLIGHTS

1993

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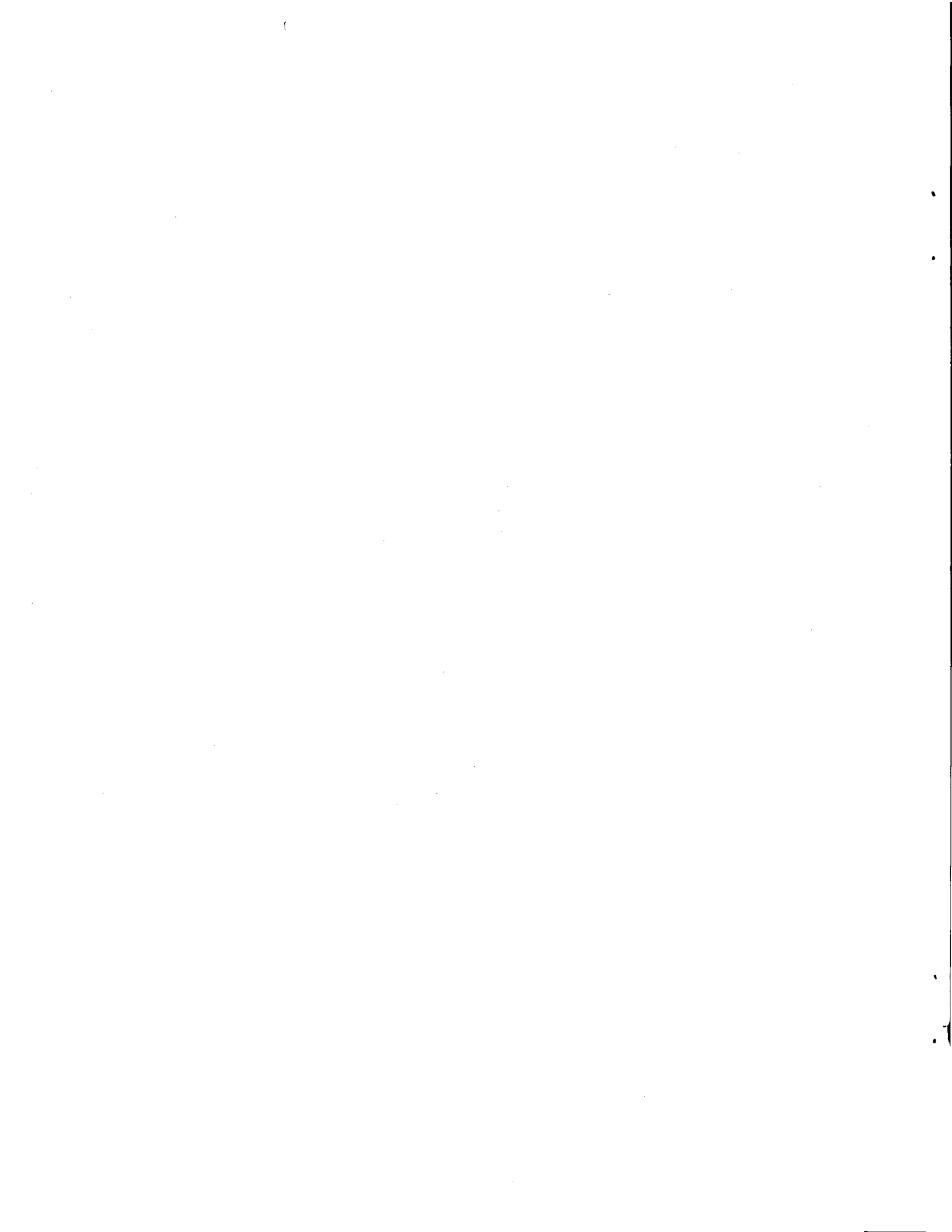


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PRESENTATION

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

For their presentation here, the dispatches are classified by subject and ordered chronologically within each chapter, with each heading indicating the relative saliency of those issues within the international economic agenda.

The three most important issues that dominated the international economic agenda, throughout the concluding year, are listed here according to what, avowedly, is a very subjective ordering of their relative importance.

1) The inauguration of President Clinton initiated what appeared as a year of introversion, plagued with exhausting and barely won battles. However, contrary to projections based on this initial performance, by the end of the year President Clinton achieved a "triple play" in the field of international trade, amid several signals that the U.S. economy was entering sustainably the path toward strong reactivation.

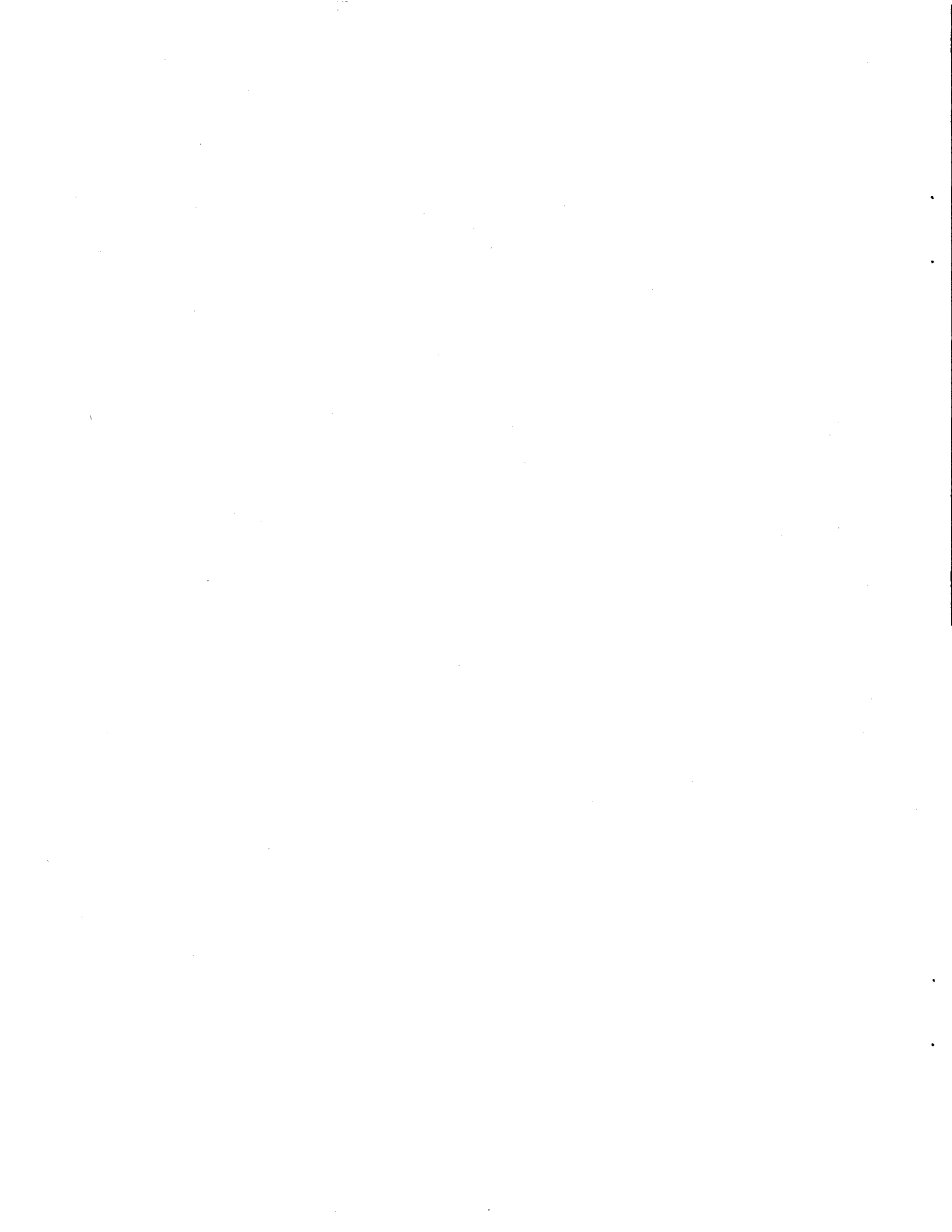
2) The "triple play" in international trade consisted of three decisive events. First, the approval, after an intense and fascinating debate, of the North American Free Trade Agreement (NAFTA). Second, the turn toward the Pacific Rim, with the G-Seven Tokyo Summit and the more recent meeting in Seattle of the Asia Pacific Economic Cooperation (APEC) forum. And third, the successful conclusion of the Uruguay Round.

3) Finally, for the developing economies, despite the prolonged slump experienced in Japan, Germany and the United States, a new pattern of private market financing began to emerge. This new pattern, characterized by the securitization of flows, with disintermediation by the commercial banks, promised to entail less systemic risks than the bank credit flows that prevailed in the previous decades.

Some of these issues were described in the weekly dispatches transmitted regularly throughout the year. They are gathered here with the purpose of making them available for easier consultation, in case the Washington D.C. vantage point they present still has some testimonial value.

To conclude, those readers who are not familiarized with them should be reminded that each dispatch tries to remain within the self-imposed limit of 750 words, because their purpose is only to bring an issue to the reader's attention.

¹ ECLAC Washington, International Economic Highlights, 1987 (LC/WAS/L.2) 17 August 1988; 1988 (LC/WAS/L.4) 17 March 1989; 1989 (LC/WAS/L.8) 15 March 1990; 1990 (LC/WAS/L.11) 22 March 1991; 1991 (LC/WAS/L.14) 11 March 1992; 1992 (LC/WAS/L.17) 11 March 1993.



I. THE WORLD ECONOMY

I. 1. MODERATE OPTIMISM FOR 1993 (WDW/1/93 20 JANUARY 1993)

Three major factors are contributing to the moderate optimism which presently prevails among decision-makers and forecasters. First, the reactivation of the U.S. economy is still perceived as moderate; second, the degree to which the slump in Japan and Germany will influence the pace of worldwide reactivation; and third, the expectation about the new economic team which today starts managing the U.S. economy.

Despite the relatively good news about the performance of the U.S. economy during the third quarter of 1992, when growth of GDP amounted to 3.4 percent, there seems to exist consensus among private as well as public forecasters that the economy will continue growing at a moderate pace in 1993.

For instance, the outgoing Council of Economic Advisers estimates that "during 1993, the economy is expected to grow at a moderate pace early in the year and then pick up later in the year, with real GDP growing around 3 percent during the year."

Private forecasters coincide. According to the semiannual survey carried out by The Wall Street Journal among forty-four economists, the consensus forecast is that "the economy, after adjusting for inflation, will expand at a 2.8% annual rate in the first half and a 3.2% clip in the second." Furthermore, "all 44 economists predict the economy will be recession-free for at least the next 12 months."

The sluggishness of the U.S. recovery, to which some observers attribute a decisive role in the November electoral outcome, still remains a puzzle. As admitted by the outgoing Council of Economic Advisers, "the pace of growth during the recent recovery has been much slower than it was during other postwar recoveries." While "growth averaged about 9 percent during the first year and a half after previous troughs," this time, "real GDP increased only 2.9 percent, less than one-third the post war average."

The second factor contributing to moderate optimism is the even more sluggish performance of the other industrialized economies, particularly of Germany and Japan, as well as among other members of the Group of Seven (G-7). For instance, both Germany and Japan entered into recession during 1992 and the United Kingdom remained in recession as well. Canada resumed growth at a slow pace, while sluggish growth rates of between 1 to 2 percent persisted throughout 1992 in France and Italy.

At issue is the increasing role of exports in the performance of the U.S. economy, which have risen from 8 percent of real GDP in 1987 to over 11 percent in 1991, representing about 20 percent of U.S. industrial output. Rising exports were one of the key factors in moderating the impact of the last recession, generating 1.5 million jobs from 1989 to 1991. However, the most positive trend in U.S. exports next year is in Latin

America, where they are expected to continue growing at least at the spectacular pace of 22 percent at which they grew last year. Other positive growth projections on U.S. exports are less impressive but still encouraging, such as to East Asia, without Japan, where they are expected to grow at 6.7 percent and to Canada at almost 8 percent. Meanwhile, U.S. exports to the European Community and Japan are expected to remain as flat as they were in 1992.

Finally, the last factor contributing to moderate optimism comes from the expectation generated by the incoming economic team. As described by The Washington Post, earlier than expected, "reality " is already melting some of the new Administration's campaign promises.

First of all, based on worst than expected news about the budget deficit, the new Administration has reconsidered its promise of cutting the budget deficit in half during the next four years. Second, another casualty immediately caused by the bad news about the deficit is the promised tax cut for the middle class, because of the need to raise new revenue.

Finally, the same fate seems to await the "stimulus package," promised in the form of a "Rebuild America Fund" to spend \$80 billion in the next four years in public works. This proposal has placed the new Administration already at loggerheads with the Federal Reserve Board's concern with keeping the reactivation at a pace which preserves the moderate rates of inflation which presently prevail. For this purpose, in 1993, the Fed is aiming at lower target ranges in the growth of the money supply to underscore the Fed's commitment to lower inflation. Such tightness from the Fed would only be consistent with the fact that in 1992 the money supply, as measured by M2, grew only at 2.1 percent, below the range of 2.5 to 6.5 percent originally set.

To overcome the standoff, one of the most prominent supporters of President-elect Clinton, Nobel Laureate and MIT Professor Paul Samuelson recently proposed a new "social compact." Professor Samuelson said "the new President and Congress should try to strike a deal with the Federal Reserve: if the central bank agrees to lower interest rates, the president and Congress should promise in turn to adopt tough measures to cut the deficit." However, Professor Samuelson concluded, "I have no confidence that the Federal Reserve would agree to such a social compact." Consequently, he endorsed what he characterized as "a second-best policy of short-term fiscal expansionism," as opposed to "tolerating the slow pace of the current economic recovery."

These are some of the factors responsible for the moderate optimism presently prevailing. Stay tuned.

1. 2. WORLD ECONOMIC OUTLOOK (WEO) UPDATED
(WDW/7/93 24 FEBRUARY 1993)

It is uncommon for the staff of the International Monetary Fund (IMF) to update the WEO. Usually, the WEO is released regularly in May and October, for the spring and annual

IMF-World Bank meetings. Something unusual or unanticipated must happen, to force the revision of the forecast and the release of an updated version. In the present case, the "weaker-than-expected activity" in the industrialized countries, as well as the tensions in foreign exchange markets, "have cast new doubts on the prospects for recovery in the industrial world after what had already been two years of weak growth or recession in many countries."

The WEO's "interim assessment," released to the press on 22 December 1992 and published in late January 1993, contains the following chapters: I) Recent Developments and Short-Term Prospects, examines exchange market developments, the stance of fiscal and monetary policies, and the revised projections for the industrial and developing countries, as well as for the former centrally planned economies; II) Macroeconomic Imbalances and Financial Strains, focuses on the factors underlying recent exchange market turbulence in Europe, medium-term consequences of the budget deficit in the United States, and the ongoing process of asset price and balance sheet adjustment; and III) Policy Implications, discusses systemic issues, requirements in individual countries, as well as economic confidence and the need to strengthen international cooperation. Finally, an annex is dedicated to the Stance of Monetary Policy and a box presents a detailed chronology of the events preceding and following the September 1992 crisis in the European Monetary System (EMS).

The "interim assessment" is dedicated primarily to the major industrial countries, updating the projections for approximately 30 of the largest economies, which account for 85 percent of world output. "A more complete analysis of the outlook for the developing countries and for the former centrally planned economies" will be included in the next WEO's regular edition, to be released in May 1993. In the updated version, the projections for these last countries were only "updated incrementally to reflect changes in global economic conditions."

Two reasons are offered to explain what the updated WEO characterizes as "the pervasive sluggishness of growth." First, "the most important is the deflationary impact in a number of countries of balance sheet adjustments by the private sector following the recent correction of inflated asset prices." And second, the "negative effects of high interest rates in Europe, stemming from the strong fiscal expansion that accompanied German unification, and inadequate progress towards inflation convergence and budgetary consolidation in a number of countries."

The influence of these factors reflects itself in the revised projections. In the industrial countries, real GDP is estimated to have increased by 1 1/2 percent in 1992, projected to rise by 2 percent in 1993, which amounts to a revision downwards of 1/2 of 1 percentage point in 1992 and 1 percentage point in 1993. These changes in 1993 include "downward revisions of 2 percentage points for Germany; 1 to 3/4 of 1 percentage point for Japan, France, Italy, and Canada; and 3/4 of 1 percentage point for the United Kingdom." The outlook for the United States remains essentially unchanged, with real GDP rising at an annual rate of almost 4 percent in the third quarter of 1992.

In the developing countries, the slowdown in the industrial countries in 1993, added to weaker commodity prices, are "expected to be partially offset by the beneficial effects

of lower world interest rates and, for oil importing countries, by somewhat lower oil prices."

The "largest revisions" were made in the Western Hemisphere, "where real output is now projected to increase by only 2 percent in 1993," roughly half of what was projected in October. This is mainly the result of "a sharp downward revision for Brazil attributable to political difficulties in implementing a macroeconomic stabilization program." Relatively smaller revisions for other developing countries take into account factors such as "an erosion of competitiveness, declining terms of trade, and a slowdown in direct investment and other capital inflows." However, "recent debt reductions and the pursuit of sound policies" contribute to a favorable medium-term outlook.

Finally, the chapter on "policy considerations," addresses the concern "that the medium-term strategy pursued since the early 1980s is not living up to its promises and that a different approach is warranted." For the IMF staff, it is "inappropriate to conclude that the strategy has failed." Rather, "the problem" is that "key aspects of the strategy have not been implemented." Examples of some of these "policy failures" are found in North America and many European countries, in the form of "missed opportunities to consolidate budgetary positions;" in Europe, "continued high levels of unemployment point to the urgent need for labor market reforms;" in the "failure to adjust macroeconomic policies and the lack of adequate prudential oversight" to support the "far reaching liberalization of financial markets;" as well as in "important setbacks in the area of trade, mainly in the form of quantitative restrictions and other nontariff distortions."

For these reasons, the updated WEO concludes that "the unfinished agenda of the 1980s remains a valuable guide for tackling both systemic problems and the challenges facing individual countries."

I. 3. THE IMF'S FIRST WORLD ECONOMIC OUTLOOK (WEO) (WDW/11/93 5 MAY 1993)

The advance copy of the first WEO, as usual, was released to the press, on April 26, before the Fund-Bank Spring meetings. However, unusual and illustrative of these abnormally uncertain times is that the growth projections, already revised in an extraordinary "interim assessment" (WDW/7/93) released only last January, have been revised again. These newly revised, medium-term baseline projections and alternative scenarios will be included in the WEO's final version, to be released by the end of this month.

The first WEO's advance copy contains the following chapters: I) overview; II) world economic situation and short-term prospects; III) policies for stronger noninflationary growth in industrial countries; IV) convergence and divergence in developing countries; V) economic stability and transformation in countries in transition; VI) trade as an engine of growth.

The recovery of global economic activity "remains hesitant and uneven," because "encouraging signs of stronger growth in North America contrast with the recent marked deterioration in economic performance in Japan and especially in Europe, where recessionary tendencies are expected to persist through 1993." The good news is that "inflation has continued to abate in most industrial and developing countries."

The growth of world output exhibited "the third consecutive year of below-trend performance," since it "picked up only modestly, from 1/2 to 1 percent in 1991 to 1 3/4 percent in 1992." The projections for 1993 are that world output will grow by 2 1/4 percent and that it will strengthen by 3 1/2 percent in 1993. Still, for Japan "growth in 1993 has been revised down to 1 1/4 percent," from 2 1/2 percent in January 1993 and from 3 3/4 percent in October 1992. In Europe the slowdown is even sharper, with the revised projections revealing "stagnation in 1993," by contrast with growth of 1 percent projected in January 1993 and 2 1/4 percent in October 1992. Thus, the projections of the last WEO for Japan and Europe have been drastically revised downwards.

By contrast, "many developing countries have continued to show resilience to the weakness of activity in industrial countries." However, among many of the poorest countries "economic performance has remained unsatisfactory, and living standards are continuing to decline," particularly in Africa. In the developing countries "output is expected to expand by 5 percent in 1993 and 1994, only slightly less than in 1992."

Some of the reasons for this resilience among developing countries are found in "low interest rates on dollar-denominated external liabilities, and considerable capital inflows in some cases, have helped to offset the effects of declining terms of trade for commodity exporters and of generally weak demand in the industrial countries." Even so, "the most important reason," to explain the "comparatively strong performance of a growing number of developing countries," is found in "the beneficial effects of sustained stabilization and reform efforts in the context of outward-oriented economic strategies."

For the developing countries as a whole the medium-term prospects are "encouraging perhaps more so than they have been in decades." Based on the assumption of continued efforts to achieve macroeconomic stability and the reduction of what are characterized as "structural distortions," output in the developing countries "is projected to grow at an average of 5 3/4 percent in 1995-98." Alternatively, a "policy-slippage scenario" for the same period reveals that average inflation would be "about 30 percentage points higher than in the baseline case, with a particular rise in the Western Hemisphere and in the most heavily indebted countries."

Among the developing countries of the Western Hemisphere, "major reforms in the areas of trade, foreign investment, and financial and labor markets, together with the declining debt overhang, are projected to boost growth markedly in the medium term."

Between 1995-98, real GDP in the developing countries of the Western Hemisphere is projected to grow at an annual average of 4.8 percent and an investment ratio of almost 25 percent. This medium term outlook for the Western Hemisphere developing economies "depends crucially on the assumption that the region continues to ensure macroeconomic stability and to sustain the momentum of reforms." Still, these figures contrast with the

projected growth rates for Asia, during the same period, at 7 percent growth in real GDP and an investment ratio of 30.9 percent.

For the former centrally planned economies, now described as countries in transition, "the economic situation also remains difficult." However, some of the countries of central Europe, such as the former Czechoslovakia, Hungary and Poland, "output has begun to recover, and inflationary pressures have been relatively contained." In the Baltic countries, as well, "there are encouraging signs that reforms are taking hold and are being supported by strong stabilization efforts." By contrast, in most of the countries of the former Soviet Union, "inadequate stabilization efforts now threaten to lead to hyperinflation, which could derail the reform process."

Finally, on trade policy, the early and successful conclusion of the Uruguay Round is essential to "reverse the rise in protectionist barriers," as well as it is "a central element of any cooperative effort to strengthen growth worldwide." Several recent studies "suggest that completing even the partial liberalization now envisaged would raise annual world real income permanently by \$120 to \$200 billion."

I. 4. THE TOKYO SUMMIT (WDW/20/93 14 JULY 1993)

President Clinton achieved a remarkable success at his debut in summitry, particularly because of some of the circumstances which preceded his arrival in Tokyo, of all places. The President was preceded by his first five months plagued by frequent stumbling, an adverse press and by declining rates of approval, as well as a budgetary package just narrowly approved by both houses of Congress. Additionally, as remarked by experienced observers, such as Brent Scowcroft and Lawrence Eagleburger, former National Security Adviser and Secretary of State, respectively, in the Bush Administration, each of the summit participants appeared "so politically weak that parochial pressures from home threaten to undermine any achievement at all." Finally, both Europe and Japan were seen as bogged down in recession, to the point that no major breakthroughs were expected even in crucial matters such as the Uruguay Round.

Given these initial apprehensions, it was remarkable how the President and his team were able to turn around these allegedly unfavorable circumstances into the positive reasons later invoked to explain the success achieved by the summit.

First of all, the narrowly approved budgetary package gave the President an advantage, because as he warned on his way to Tokyo, it was the other partners' turn to respond by lowering trade barriers and reactivating their economies. Even if these measures did not immediately follow, the truth is that President Clinton appeared more credible than his predecessors.

Second, the relative weakness of the other participants in effect enhanced President Clinton's role. For instance, Prime Minister Miyazawa's political difficulties, at times, left

enough room for President Clinton to play even the host's role. Consequently, the other participants weakness, by contrast, enhanced President Clinton's relatively secure position.

Finally, the early announcement of a "breakthrough" on the issue of market access in the Uruguay Round negotiations dispelled some of the bleakness prognosticated by skeptical observers. As expressed by GATT's new Director General Peter Sutherland, if no accord was reached in Tokyo, "the whole multilateral process...developed since 1947 is endangered."

The outcome can be also credited to the art of skillful "packaging," carried out under the stewardship of the ubiquitous new counselor of President Clinton, David Gergen. Paraphrasing McLuhan, upon reading both the political and the economic declarations, it can be said that "the packaging is the message."

The political declaration gave strong support to the United Nations and to regional organizations; to the protection of human rights and to the reforms in the "former centralized economies;" to the combat against the proliferation of weapons of mass destruction, singling out North Korea. Also, the Seven commented on the situation in Yugoslavia, Cambodia, the Middle East, Haiti, they also warned Iraq, Libya and Iran and they finally welcomed the "progress toward nonracial democracy in South Africa."

However, as anticipated by Secretary of the Treasury Lloyd Bentsen, on July 1st., the "pleasant surprise" about the Tokyo Summit was that "economics is actually at the top of the agenda. " As characterized by Secretary Bentsen, "what impressed me about this Economic Summit is that we acted on issues like jobs that have a direct effect on pocketbooks." Or on what he called "pocketbook economics--jobs, growth and trade."

In his closing press conference, President Clinton agreed, saying that "some have called this a jobs summit, and they are right, because the creation of new jobs in the United States and in all the other countries here present was at the center of all our discussions." As explained by the President, "all of the advanced nations are having difficulty creating new jobs, even when their economies are growing."

Among the accomplishments contained in the economic declaration President Clinton mentioned first, the agreement to open manufacturing markets, which "could bring the largest reduction in tariffs in world history." Second, there was also agreement that "the other industrialized nations will send their top education, labor and economic ministers to Washington in the fall for a serious conference on the creation of jobs." Third, a \$3 billion program was approved "to help Russia move to a market system." The economic declaration also mentioned the environment and the developing countries, particularly the poorest countries in Africa, which "deserve special attention."

Finally, at the last minute, President Clinton and the Prime Minister Miyazawa announced an agreement on "a framework for a new economic partnership," or what the Washington Post called "an agreement on how to approach an agreement." However, this should not be belittled, because the framework was agreed with a Prime Minister that had been written off as a lame duck.

President Clinton summarized the results as follows: "I came to this summit in the hope that we could get an agreement to open more markets to manufactured products, in the hope that we could get a strong program for Russian aid, in the hope that together we could demonstrate resolve to restore the ability of all our countries to create jobs and opportunities for our people. I believe those objectives were achieved and I am pleased at the first of these G-7 meetings which I was able to attend."

I. 5. THE IMF'S SECOND WORLD ECONOMIC OUTLOOK (WEO)
(WDW/26/93 29 SEPTEMBER 1993)

It is a sign of the uncertainties that characterize the short-term prospects of the world economy that the IMF has revised, for the third time this year, the output projections for most industrial countries (WDW/7,11/93). The reasons offered to account for these revisions are that "in Japan, recent indicators suggest that the recovery stalled in the spring; recovery in continental western Europe appears unlikely to begin until late this year or early in 1994; and in North America the expansions are somewhat weaker than expected."

These newly revised medium-term projections appear as Annex III of the second WEO, released by the IMF staff on September 22, just before the annual Bank-Fund meetings. Consequently, instead of the 1.7 percent in output growth for 1993 and almost 3 percent for 1994, projected last April for the industrial countries, the revised projections are 1.1 percent for this year and 2.2 percent for 1994.

However, this "weaker-than-expected activity in the industrial countries is offset by stronger growth in the developing countries," projected at 6.1 percent in 1993 and 5.5 percent in 1994. This "strong growth in many developing countries remains the most positive feature of the global situation."

In all, world output is expected to grow by 2.2 and 3.2 percent in 1993 and 1994, respectively. Thus, 1993 "marks the fourth consecutive year of sub-par growth performance for the world economy."

The technical assumptions for the industrial countries' projections include "unchanged fiscal policy, except for measures already announced and likely to be implemented; unchanged monetary policy (generally interpreted as nonaccommodating, with short-term interest rates moving in response to changes in inflationary pressures and cyclical conditions); constant real effective exchange rates . . .; and specific assumptions about commodity and oil prices."

Two scenarios are projected for the developing countries. "The baseline scenario assumes that the economic policies underlying IMF-supported adjustment and reform programs will be fully implemented." This "optimistic assumption" is tempered, "in view of earlier experiences," by the introduction of "an alternative scenario . . . that illustrates the implications of possible policy slippages."

Besides the assumption that the developing countries will continue implementing reforms, "exchange rates are assumed to remain unchanged in real terms." While nonfuel commodity prices "are assumed to increase by 4 1/4 percent a year in 1995-98." Finally, "total financing flows to the net debtor developing countries are expected to increase in the medium-term (compared with 1983-92) as recently resumed commercial bank lending continues (particularly to several Latin American countries) and as flight capital continues to return."

On the basis of these assumptions, in the Western Hemisphere, "GDP growth is projected to rise to about 4 1/2 percent a year in the medium term, from 2 percent a year in 1983-92. This would imply annual per capita growth of nearly 2 1/2 percent, compared with no growth in 1983-92." In the short-term, "increases in output in the developing countries of the Western Hemisphere are expected to average 3 1/2 percent in 1993-94."

The prospects for what are called "countries in transition" are positively characterized, since "several central European countries appear to have started the process of recovery, but high inflation and excessive budget deficits threaten to prolong the crisis in most countries of the former Soviet Union."

On the bright side, "for most of the industrial countries, inflation remains one of the most positive features of the current situation." Among the developing countries of the Western Hemisphere, inflation is expected to remain under the average projected for all the developing countries, of 42 3/4 percent in 1993 and of 34 3/4 percent in 1994. "Excluding Brazil, inflation in the region is expected to moderate from 23 percent in 1992 to 16 percent in 1993, and to 11 1/2 percent in 1994."

Average nonfuel commodity prices are expected to continue falling by 2 1/2 percent in 1993, as a result of several pressures, such as weak overall demand in the industrial countries, mounting stocks and difficulties with international price support agreements, as in the case of beverages. Prices of metals have also declined because of weak demand and continued exports from the former Soviet Union. In 1993, average petroleum prices are expected to fall to \$16.68 and to increase to \$17.23 in 1994.

The advanced copy of the second WEO was released in two volumes. The first volume contains the following chapters: I) overview; II) world economic situation and short-term prospects; III) recent changes in the European Exchange Rate Mechanism; IV) the critical need for fiscal adjustment and labor market reform in industrial countries; V) domestic and foreign saving in developing countries; VI) stabilization and enterprise reform in the countries in transition. The second volume contains the boxes, a statistical appendix and the following annexes: I) structural budget indicators for the major industrial countries; II) economic benefits of reducing military expenditures; and III) medium term projections.

I. 6. THE APEC MEETING
(WDW/35/93 1 DECEMBER 1993)

Armed with the solid victory of the NAFTA approval (WDW/34/93), President Clinton went immediately afterwards to the meeting of the Asia-Pacific Economic Cooperation (APEC) forum. The purpose was, according to Secretary of State Warren Christopher, to accomplish the second out of a "triple play," which would hopefully conclude in Geneva with the completion on deadline of the Uruguay Round negotiations.

This "second out," was as ambitious, if not more, than the other two. As reminded by Nicholas Eberstadt from the American Enterprise Institute (AEI), in The Washington Times, the challenges in the Pacific Rim "are more political than economic." In Eberstadt terms, "four great political questions loom over the Asia and Pacific region today."

First, the "most pressing" issue remains how the division of the Korean peninsula will be resolved. Second, Japan, as the second largest economy in the world, "cannot forever remain a one-legged giant," totally dependent from the United States for its security. Third, the future of China's transition and the emergence of what the World Bank describes as "a fourth growth pole" (WDW/16/93). Finally, the question remains if the United States will turn inwards, refusing to exercise the role of leader and arbiter that decisively influences the stability of the Pacific Rim.

With these issues looming in the background, both meetings of the ministers and of the leaders of APEC, held in Seattle on the 17-20 November, were no minor accomplishments.

As revealed in the joint statement issued by the ministers, at the conclusion of their meeting on November 17-19, the range of topics was impressive: 1) the report proposing a vision, by the Eminent Persons Group (EPG); 2) economic trends and issues; 3) trade and investment issues; 4) the APEC work program; 5) participation issues; and 6) organizational issues.

The report of the Eminent Persons Group was presented by the chairman, C. Fred Bergsten, from the well known, Washington-based think tank, Institute of International Economics (IIE). It offers "a vision for APEC," consisting of a "four-part program," aimed at the creation of "a true Asia Pacific Economic Community." The first component of the proposal is "to declare an ultimate goal of free trade for the Asia Pacific region." Without, however, suggesting a "target date," only mentioning that such date would be set by 1996. Second, to "launch an immediate trade facilitation program." Third, to "initiate an extensive program of technical cooperation." Fourth, "to begin a process of modest institutional development," by creating "a permanent Secretariat with a director general at ministerial level."

The Ministers "warmly welcomed the Report's broad thrust and direction," and "instructed senior officials to develop pragmatic programs to implement the EPG recommendations."

This modest outcome revealed the basic divisions that persist among the heterogeneous members about APEC's future. Some would like to move quickly, such as Australia, Singapore and South Korea. In the terms of the Foreign Minister of South Korea, Hang Sung Joo, the "aim is to bring the Eastern Pacific and the Western Pacific together, to get America more committed to Asia, and to get Asia together."

Not so fast, says the group of member countries of the Association of South-East Asian Nations (ASEAN), with the support of Japan. These members do not disagree openly with the ultimate goals, as described by David Sanger in The New York Times, "as long as they are kept in the sufficiently distant future."

Finally, there is one dissident, absent from Seattle and described by The Journal of Commerce as "the specter at the feast." It was the Prime Minister of Malaysia, Mahatir Mohamad who favors the creation of an East Asia Economic Caucus that pointedly excludes the United States and Australasia.

On other topics, the Ministers agreed to "initiate regular exchange among APEC members of key economic statistics." On trade and investment, the Ministers adopted a framework and a work program. Also, a post-Uruguay Round ministerial meeting was decided and the work program for the functioning of the ten working groups that exist within APEC.

Probably the most significant departure consisted in the admission of Mexico and Papua New Guinea to APEC, while Chile's admission was postponed until the ministerial meeting of 1994. Also, the Ministers "agreed to defer consideration of additional members for three years." Finally, the "successful establishment" of APEC's Secretariat was noted with satisfaction and a Central Fund of \$2 million was also approved.

The meeting of leaders, so-called to avoid using the term heads of state, issued a "vision statement." They supported the completion of the Uruguay Round on December 15 and envisioned a community among the APEC members. The leaders also welcomed the challenge of achieving free trade in the region, without setting a deadline; they agreed to convene a meeting of APEC finance ministers; the establishment of a business forum; and of an education program.

Summarizing the outcome of the whole event, "an unidentified official," was quoted in The Washington Times saying that it is still "premature to see APEC as an embryo body that might lead to tariff cuts among its members."

II. THE U.S. ECONOMY

II. 1 PRESIDENT BUSH'S ECONOMIC VALEDICTORY (WDW/3/93 3 FEBRUARY 1993)

This year's Economic Report of the President was the last presented by the Bush Administration to the U.S. Congress. Issued just a few weeks before the inauguration of President Clinton, the Report surveys the accomplishment and shortcomings of the economic policies applied during the last four years.

In the letter of transmission to the Congress, President Bush attempts to draw a balance on the economic performance of the last four years. Some accomplishments, such as low inflation and interest rates are highlighted, as well as the 1990-91 recession, characterized as "relatively short (8 months compared to a postwar average of 11)," while the subsequent recovery is described as "quite slow by historical standards."

The annual report of the Council is divided in the following chapters: 1) perspectives on the economy and economic policy; 2) recent developments and the economic outlook; 3) monetary and fiscal policy in the current environment; 4) the economics of health care; 5) markets and regulatory reform; 6) economic growth and future generations; 7) whither international trade and finance?

The interpretation offered by the Council of Economic Advisers of these and other events of the last four years is still of interest, given the decisive role allegedly played by the performance of the economy in the outcome of the elections. Here is a summary of some of the highlights contained in these chapters.

The Report begins arguing against two current interpretations generated by the slowdown in the U.S. economy. First, the "declinists," who hold that the U.S. economy is in decline, are criticized because their "complaints cannot survive a thorough scrutiny based on readily available factual information and sound economic analysis." Second, against the "revisionists," who blame the economic policies practiced during the last twelve years for the present predicament, the Report asserts that "on balance, economic policy since 1980 has been much superior to that of the late 1960s and the 1970s."

By contrast, the Report holds responsible several structural imbalances and adjustments for the sluggish performance of the economy. For instance, "shifting demographic trends" explain the reduced demand for new housing and durable goods. Also, the end of the Cold War transformed defense spending from "a large net stimulus for the economy to being a sizable drag," amounting to a "negative effect of nearly 0.4 percentage point on the growth rate of real GDP."

In the financial sector, constraints on credit resulted in a "credit crunch," which together with the overbuilding of commercial real state and high levels of consumer and corporate debt, constrained both private investment and consumption.

Finally, the short-term relationships between money--as measured by M2--and nominal GDP have not been as stable as in the past. Specifically, during 1992, "nominal GDP grew at a rate of around 5 percent, while the M2 monetary aggregate grew at a much lower rate--less than 2 1/2 percent--demonstrating that the relationship between the growth of money and credit and the growth of the economy had changed during this period." This changing relationship between M2 and economic activity made it "harder to judge the extent to which current monetary policy is stimulating or restraining the economy."

Still, the soft-landing strategy adopted by the Federal Reserve, although it "failed to avert a recession as a result of unexpected events," is characterized as "highly successful in reestablishing progress toward lower inflation."

The outlook is moderately optimistic, with real GDP predicted to grow about 3 percent in 1993 and expected to remain within this 3-percent range through the mid-1990s.

To conclude, the last chapter of the Report surveys several aspects of international trade and finance. On the evolution of exchange rate arrangements, the emergence of regional currency blocs is anticipated, built around the dollar, the single European currency and the yen.

The changing role of the International Monetary Fund (IMF) is also examined, particularly the shift in its role from provider of financing for the industrialized countries to provider of "technical assistance and recurrent financing to the developing countries, bringing its activities close to those of the World Bank."

The North American Free Trade Agreement (NAFTA) is summarized and positively described, as part of a process of regional integration seen as complementary to the overriding objective of expanding open and transparent trade worldwide. In this same sense, regional integration, such as the creation of a Hemispheric-wide free trade area from Alaska to Argentina and the completion of the Uruguay Round are seen as complementary.

Finally, a trade policy agenda for the future describes several important trade issues which will have to be confronted in the "not-too-distant future." These include the relationship between trade and competition policy, to make the latter more compatible and enforceable across borders; a code of conduct to regulate government support of high-technology industries; and the clarification of the linkage between trade and the environment, with the purpose of ameliorating environmental problems without unnecessary disruptions of trade relations.

**II. 2. PRESIDENT CLINTON'S ECONOMIC PACKAGE
(WDW/6/93 3 MARCH 1993)**

In what was almost unanimously recognized as a masterful delivery, last Wednesday, President Clinton presented to a joint session of Congress the package addressing the issue which granted him the victory at the polls last November.

As described in A Vision of Change for America, the budget document presented to the Congress, "the over-arching theme of the Clinton Administration's economic plan is increasing public and private investment." This objective will be pursued by means of three basic elements: stimulus, investment and deficit reduction.

The stimulus component seeks "to ensure that recovery from recession is strong and durable." It contains a combination of \$30 billion in outlays and tax incentives which together will create almost 500,000 new jobs by the end of 1994.

The investment component increases spending in infrastructure, in enhancing the skills of workers, in the development and use of science and technology and in the delivery of health care, while increasing also tax incentives for business. In all, between 1994 and 1997, the stimulus and investment component amounts to \$169 billion.

Finally, the deficit reduction component contains what are characterized as the "difficult and unglamorous steps," aimed at cuts in ongoing spending as well as selected tax increases, amounting to slightly less than one-half of 1 percent of GDP per year over four years.

The largest cuts are in defense discretionary outlays, amounting to \$76 billion, out of a total reduction of \$247 billion between 1994 and 1997. Revenue increases will basically come from raising taxes on the wealthiest and on corporations, as well as from the introduction of a broad-based energy tax, projected to generate almost \$246 billion between 1994 and 1997.

The assumptions about future changes in the key economic variables--growth, inflation, unemployment and interest rates--are said to avoid "rosy scenarios" and "gimmicks." First, the recovery from the recent recession is projected at "well below the historical average, with real annual economic growth peaking at 3 percent," slowing gradually to around 2 percent a year. Unemployment is projected to reach "the minimum level consistent with low inflation--about 5.5 percent unemployment--shortly after the end of the five-year forecast period." Due in part to the modest rate of economic growth, inflation is projected to decline, with consumer prices increasing in the long run by 2.7 percent a year, while the GDP implicit deflator is expected to increase by only 2.2 percent in the long-run. Modest economic growth and low inflation are expected to bring long-term interest rates down, although short-term interest rates are projected to increase by a full percentage point.

In President Clinton's terms, the spending cuts and the tax increases were necessary to "accomplish both increased investment and deficit reduction, something--he added--no American government has ever been called upon to do at the same time before."

This goal required setting aside some campaign promises, particularly the pledge to cut taxes on the middle class, replaced by a new tax on energy.

According to The New York Times, on this issue, President Clinton's economic team split in two camps. On one side, budget director Leon Panetta and his deputy Alice Rivlin, supported by Treasury Secretary Lloyd Bentsen, were "the deficit hawks," or the "pain-is-good" faction, favoring higher taxes. On the other side, the chairperson of the Council of Economic Advisers Laura D'Andrea Tyson, Labor Secretary Robert Reich and Commerce Secretary Ronald Brown were in favor of stimulating the economy and creating jobs.

Three "vital audiences," said The Washington Post, were kept in mind by the decision-makers: the public, the Congress and the financial markets. The public's immediate reaction was positive. Two national polls released over the weekend found ample majorities in support of the President. By contrast, the day before the speech, the markets blinked by taking a nose dive, although later in the week the impression was that business was divided about the plan. Meanwhile, long-term interest rates appeared supportive by reaching the lowest point since the 1973 oil embargo.

Additionally, strong support came from the Federal Reserve Chairman Alan Greenspan--who Wednesday night, "Clintonologists" remarked, was symbolically seated at the First Lady's left hand side. Mr. Greenspan said he was "quite pleased" that deficit reduction "is on the table and is going to get resolved."

However, the key rests in Congress. On the Republican side, Senator Robert Dole of Kansas led the opposition noting that the plan did not live to the pledge of \$2 in spending cuts for every \$1 in new taxes, which unleashed what was characterized as a "battle of the calculators." President Clinton anticipated this criticism by challenging "those who say we should cut more be as specific as I have been." Even so, the most critical concerns were coming from some fellow-Democrats, particularly because they raised the possibility of untying the package. As expressed by Senator David Boren of Oklahoma, "a lot of us will be extremely uncomfortable with voting more money for anything before we lock in deficit reduction." Also, the powerful chairman of the Senate Armed Services Committee, Senator Sam Nunn of Georgia warned that the \$76 billion reduction in military spending "is certainly more than I recommend." Finally, some farm-state legislators are worried about deep cuts in agricultural subsidies. The White House, however, stuck to the preference that the plan be approved as a package.

III. U.S.-JAPAN ECONOMIC RELATIONS

III. 1. NEGOTIATING THE U.S. JAPAN FRAMEWORK FOR A NEW ECONOMIC PARTNERSHIP (WDW/21/93 21 JULY 1993)

One of the outstanding outcomes of the last Tokyo Summit (WDW/20/93) was the announcement by Prime Minister Miyazawa and President Clinton, only three hours before his scheduled departure for Korea, that they had agreed on a new "framework" for discussing their trade tensions.

This new framework is the successor of what were known as the Structural Impediments Initiative (SII) talks, which were launched in July 1989, to focus on the "structural obstacles" held responsible by both the United States and Japan for the obstinate trade imbalance which prevails among them.

Proof of the problem's persistence can be found in the approval of the new framework and in President Clinton's statement that there should be "no illusions." He said, "we announce today a framework to govern specific agreements yet to be negotiated." As described in the afternoon edition of the Nihon Keizai Shimbun, Japan's respected financial daily quoted in The Washington Post, the agreement was like Tamamushi, "an insect that appears to change colors when viewed from different angles."

However, the agreement should not be prematurely belittled. In the terms of The Wall Street Journal, it is a remarkable accomplishment "pitting the final wishes of a politically humiliated Japanese prime minister against the ambitions of a novice U.S. president."

Even more so, because the preliminary conversations had failed on June 28, when the U.S. negotiating team had to return home empty handed. What brought the parties back to the negotiating table was a letter from Prime Minister Miyazawa to President Clinton, sent over the July 4 weekend, urging the President to try again and asking the U.S. negotiators to return to the negotiating table.

The same message was presented in Washington by the Japanese Ambassador Takakazu Kuriyama to Treasury Secretary Lloyd Bentsen, Secretary of State Warren Christopher and National Economic Council Chairman Robert Rubin. This personal request from the host of the forthcoming G-7 summit bypassed the opposition from the powerful Ministry of International Trade and Industry (MITI) and from the Ministry of Finance.

The issue around which the initial conversations broke down was the demand by the U.S. that a target, or a benchmark, should be set to reduce by half the Japanese trade surplus, from 3 percent of GDP to 1.5 percent. The Japanese negotiators dismissed this proposition as an attempt at "managed trade," or interference with the free play of market forces. Also, behind the Japanese resistance to targets was the fear they could be used

as triggers for unilateral retaliation. The outcome reveals how much each side moved away from their original proposals, by adopting a text which could be interpreted by each of them as giving credit to their respective positions, or what was characterized as the "Tamamushi factor."

First of all, the United States accepted that the agreement should not include numerical targets. In exchange, the Japanese delegation agreed to implement policies to achieve a "highly significant decrease in its current account surplus," as well as "a significant increase in global imports of goods and services, including from the United States." Additionally, the Japanese delegation accepted the use of "sets of objective criteria, either qualitative or quantitative or both," to evaluate progress in the following five areas: government procurement, regulatory reform and competitiveness, automobiles and parts, economic harmonization of foreign direct investment regulations, and the implementation of existing arrangements and measures.

On the basis of this mutual accommodation, each side could claim that its own interpretation prevailed. For instance, President Clinton said, "now at least we agree on what the outcome of these negotiations needs to be: tangible, measurable progress." By contrast, the chairman of the powerful business association Keidanren, Mr. Gaishi Hiraiwa, praised the accord for not including numerical targets. Also, Prime Minister Miyazawa stressed the importance of a clause specifying that "consultations will be limited to matters within the scope and responsibility of government," which may become an escape clause, in case the Japanese private sector refuses to cooperate.

Finally, the United States did not give up the imposition of Section 301 sanctions in case of non-compliance. However, according to Japanese officials quoted in The New York Times, "in a side letter to the agreement that has not been made public, Japan says it reserves the right to drop out of any negotiations if faced with a threat of sanctions."

Probably the bottom line was better described by "a senior Administration official," quoted in The New York Times, saying the agreement "establishes the rules of the game," but "the game is still to be played." Be it as it may, the sole fact that there was agreement was a remarkable outcome, considering that the Japanese Prime Minister was afflicted by what The Washington Post described as a severe case of "lameduckhood."

In recognition, President Clinton closed the press conference announcing the agreement, as described in The Wall Street Journal, "by ad libbing an effusive tribute to the prime minister." President Clinton said, "he has shown wisdom, determination and genuine leadership...I do not believe that this day would have come to pass had it not been for Prime Minister Miyazawa."

III. 2. IMPLEMENTING THE U.S. - JAPAN ECONOMIC FRAMEWORK (WDW/31/93 3 NOVEMBER 1993)

It is becoming increasingly evident that the new framework to deal with the obstinate trade imbalance that persists between the United States and Japan, announced

at the last minute of the Tokyo summit (WDW/20/93), represents a significant departure. Even if it is still too early to judge if the new framework will generate the expected results, the initial negotiations (WDW/21/93) and the first meetings already reveal a profound change of objectives and of tactics.

According to Ambassador Charlene Barshefsky, Deputy U.S. Trade Representative for Asia and the Pacific, this time the negotiation is "results-oriented." This means that "process and procedural change is not enough unless it leads to concrete change in the marketplace." To measure the results, "objective indicators, both quantitative and qualitative," will be used in terms of "tangible progress toward market access and sales."

This emphasis on results has been interpreted as a victory for the so-called "revisionists." They assert that Japan practices a different kind of capitalism and that trade relations cannot be spontaneous, they have to be managed. Thus, the previously dominant paradigm, represented by the so-called "Chrysanthemum Club" has been overthrown. As described by Ian Buruma, the Chrysanthemums hoped that "the Japanese given some patience, would be one day just like" the United States. As evidence of the demise of the dominant paradigm, in the victorious ranks of the revisionists appear some prominent members of the Clinton Administration, such as Laura Tyson, the White House chief economic adviser, described in The Wall Street Journal as "chief revisionist." In Ms. Tyson's terms, Japan practices "a capitalism that wasn't like the capitalism I understood."

Consequently, negotiations to accomplish results, "under a firm timetable," are already under way in the five "baskets" identified in the framework--government procurement, autos and auto parts, regulatory reform and competitiveness, economic harmonization, and implementation of existing arrangements and measures.

Some of the difficulties that appear in the government procurement "basket" were described by Ambassador Barshefsky in a recent testimony, to the Subcommittees on Asia and the Pacific and Economic Policy and Trade of the U.S. House Committee on Foreign Affairs.

For instance, in computers, foreign manufacturers have "41 percent of the private market in Japan," but they supply "less than one percent of the central Japanese government mainframe market." In supercomputers, while U.S. manufacturers "have 84 percent of the installed base in the government supercomputer market in Europe, they represent barely ten percent in Japan." In telecommunications, "the U.S. share of NTT's total procurement has never exceeded seven percent," and while the "average foreign share of the private and public telecommunications market in the industrialized world other than Japan is 25 percent . . . the foreign share of the same market in Japan is only five percent."

This is only an example of the sort of issues that are on the negotiating table, which reveals how fixated on the persistent trade imbalance remains the tension between Japan and the United States. Admittedly, there are powerful reasons for this fixation. After all, as described by the new President of the Federal Reserve Bank of New York, William J. McDonough, for the past ten years, "the U.S. has run, on average a \$45 billion annual merchandise trade deficit with Japan." However, these trade "linkages," in President McDonough's terms, also "have their financial counterparts, and each country has,

particularly over the past decade, significantly increased its presence in the other's financial markets."

In a recent address to the Japan Society of New York, President McDonough presented some of these indicators of financial interdependence, which reveal the existence of other imbalances between Japan and the United States. For instance, "Japanese official institutions and private creditors . . . hold roughly 25 percent of all foreign-held U.S. government debt." Also, "in terms of foreign investment . . . Japan, which had holdings of some \$100 billion in the U.S. at the end of 1992, has invested far more in the U.S. than the roughly \$26 billion the U.S. has invested in Japan."

Concerning banking relationships, President McDonough recognized that "the presence of Japanese banks in the U.S. markets is far more dominant than the presence of U.S. banks in Japan's markets." For example, by the end of 1992, "Japanese bank branches, agencies, and subsidiaries in the U.S. accounted for about \$100 billion in commercial and industrial loans, equivalent to roughly 17 percent of all such loans and a dramatic increase from the 5.5 percent share these institutions held in 1985." By contrast, "in aggregate, Japanese banks in the U.S. held some \$400 billion in assets by the end of 1992 at the same time as U.S. banks in Japan held only about \$70 billion in assets."

Having reviewed these multiple levels of trade and financial interdependence, the President of the New York Fed concluded stating that "our common goals are so obvious we simply cannot afford to allow our cooperation to lapse or to permit ourselves the luxury of tending single-mindedly to our own gardens."

IV. THE DEVELOPING ECONOMIES

IV. 1. PROSPECTS FOR THE DEVELOPING ECONOMIES (WDW/12/93 12 MAY 1993)

This is the third year in which the World Bank's Global Economic Prospects and the Developing Economies is released as part of the annual series drawn by the International Economics Department from the analysis prepared for the forthcoming World Development Report. The previous two focused on specific issues, such as international trade in primary commodities and in manufactures. This year's focuses on the role of external finance in development and it contains three parts: I) The Financial Environment in the 1990s; II) Major Issues in International Finance in the 1990s; and III) Developing-Country Prospects.

Despite a mixed outlook for the international economic environment during the next decade, as well as uncertainties about the recovery of the industrial economies, the prospects for the developing countries in what remains of the 1990s "hold out the promise of higher growth rates." By contrast with the 1980s, these relatively brighter prospects are "to a large extent the dividend of the wide-ranging --and often painful-- economic policy reforms of the past decade."

The growth rate of developing countries for the next decade is projected to increase at a yearly average of 4.7 percent, or about 2 percent per capita, which contrasts with the performance of the eighties at an average GDP growth of 2.7 percent per year with stagnant per capita GDP in real terms.

A "downside scenario," based on a relatively more pessimistic set of assumptions, cuts in half the rate at which the per capita income of developing countries is projected to grow, to about 1.3 percent a year. This would represent an increase over the decade of about 80 million in the number of absolute poor, as opposed to an equivalent decrease projected by the base case.

The international economic environment for the next ten years presents a mixed outlook, with "both large problems and opportunities," which furnishes the key assumptions for the Bank's projections.

First, "economic activity in the industrial countries has not only a poor short-term outlook but also an underlying trend of slow growth in productivity, which has prevailed since 1973. Second, "real interest rates (mainly long-term interest rates) are likely to stay high because of a decline in public savings in industrial countries." Third, "world trade faces an uncertain future, pending completion of the Uruguay Round, but growth in intraregional trade is likely." Fourth, "commodity prices are expected to stabilize in real terms--a sharp break from their twenty-year declining trend--partly because of the extent to which developing countries are shifting out of primary production." Fifth, "for creditworthy developing countries, external finance is likely to be in good supply from private sources, but countries without market access will face a limited or even shrinking aid pie."

In this context, there are differences among several developing regions. For instance, in Sub-Saharan Africa GDP growth "is expected to increase, but not at a rate much higher than population growth." The outlook is characterized as "especially fragile since it is dependent upon the end of the decline of real commodity prices."

By contrast, in the Middle East and North Africa growth is projected at between 4 and 5 percent, the best performance since the 1970s, on account of the price of oil exports, expected to rise in the second half of the decade.

South Asia is expected to grow at an average of around 5 percent, "with faster growth in the second half of the decade as reforms take hold in India, the region's dominant economy." Significant rates of annual growth, of about 7.3 percent, are expected to persist in East Asia, still a slower pace than the previous decade. However, within this region the Bank foresees the emergence of a "fourth growth pole" of the world economy, the so-called "Chinese economic area (CEA)" formed by China, Hong-Kong and Taiwan. This emergent "growth pole" is characterized by "large and growing economic mass, strongly affecting other economies; persistence of medium-term economic growth in the face of shifting external circumstances; and high degree of sustainability of long-term growth."

The recovery in Latin America is expected to continue with GDP growth of around 4 percent a year considered "achievable over the long-run," on the condition that both "improved policies are sustained and external creditor confidence is maintained, in the form of continuing foreign direct investment (FDI) and portfolio inflows." In the 1990s, the investment-to-GDP ratio "is expected to rise by about 5 percentage points compared to the depressed levels in the 1980s," while the savings-to-GDP ratio is projected to grow by more than 4 percent. Also, as a result of numerous privatization programs, "increased investment will come more from the private sector," although "public investment in infrastructure will still have to complement private investment." On the downside, "in an extreme case, it could be argued that there is the possibility of another external financing crisis" in Latin America, "stemming from the volatility of some of the newer capital flows."

Finally, although forecasts for Europe and Central Asia "are subject to the greatest degree of uncertainty," the "structural reforms and the shift to market mechanisms are expected to pay dividends with growth of about 2 percent per year in the 1990s, recovering the sharp decline of recent years."

IV. 2. THE FOURTH GROWTH POLE (WDW/16/93 9 JUNE 1993)

It has become almost a habit, among some practitioners of "international political geometry," to describe the world in terms of the emergence of a neat partition in three distinctive blocs. Even the former Prime Minister of Britain Margaret Thatcher, at the Houston G-Seven Summit of July 1990, 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."

Perhaps there is a touch of nostalgia for the neatness of the by-gone bipolar world among those who see the world already divided in three blocs. Also, this search for blocs may represent another manifestation of what is known as the "rooster syndrome," which afflicts those who sing early to make the sun rise earlier (WDW/14/93). Because, despite repeated assertions, these three blocs are still nowhere to be found, with the tidiness that is already attributed to them.

For instance, neither the Western Hemisphere nor Japan and its neighbors form a bloc. The only group of countries which is presently acting with the discipline of a bloc, at least in the Uruguay Round of trade negotiations, are the members of the European Community (EC). However, even the implementation of a common commercial policy by the EC can be seen as exceptional, when contrasted with the recent vagaries of the European Monetary System (EMS), not to mention the inability to deal jointly with the major crisis in Europe's own "backyard," which has splintered the former Yugoslavia. As Stanley Hoffmann said recently, in an article titled "Goodbye to a United Europe," in The New York Review of Books of 27 May 1993, "many Europeans find it difficult to identify with a 'Europe' that remains a purely economic and bureaucratic construction and shows few signs of becoming a nation."

Also, those who see the North American Free Trade Agreement (NAFTA) as the nucleus of a future bloc in the Western Hemisphere should look carefully at its accession clause (WDW/15/93), deliberately left open to the participation of any interested country, without specifying geographic criteria.

Finally, those who see Japan emerging as the hub of a new bloc in East Asia should go to their history books, as well as to recent reports by the World Bank and the International Monetary Fund about economic trends in that part of the world.

First of all, the recently released World Bank's Global Economic Prospects and the Developing Economies 1993 (WDW/12/93), sees the trends in East Asia and the Pacific moving in a different direction than those who already see the existence of a Japanese bloc. Instead, the World Bank sees the emergence of a "Chinese economic area (CEA), comprising China, Hong Kong, and Taiwan," as a "fourth world pole of the global economy." The key factors leading the World Bank to conclude that the CEA is emerging as a new growth pole in the world economy are: "large and growing economic mass, strongly affecting other economies; persistence of medium term growth in the face of shifting external circumstances; and high degree of sustainability of long-term growth."

The World Bank sees the CEA as a leading market and as a competitor in lower technology, labor-intensive products, contributing to the short-term stability of the world economy and performing as "a counter-cyclical force in the Pacific Basin." In confirmation of these trends, the recently released IMF'S World Economic Outlook (WDW/11/93) contains an annex introducing "a new set of weights for aggregation of output across countries based on estimates of purchasing power parities (PPPs)," different from the "previous weights, which were based on market exchange rates."

On the basis of the new calculation, China's GDP increases from \$400 billion to \$1.7 trillion, making it just slightly smaller than the Japanese economy, as opposed to the

10th position it occupied according to market exchange rates calculations. Moreover, the World Bank projects that by the year 2002, at standard international prices, the Chinese economic area's GDP will amount to \$9.8 trillion, slightly above the \$9.7 trillion projected for the United States in the same year. The main difference remains in per capita income, projected to increase in the United States to \$36,000 in the year 2002, while the CEA's per capita income will only amount to \$7,300 in the same year.

Furthermore, according to a study by Hong Kong's Trade Development Council, described in The Journal of Commerce, increasing levels of economic integration already exist between China, Hong Kong and Taiwan in certain industries. For instance in footwear, Hong Kong last year exported \$4.8 billion, including footwear originating in mainland China, which makes it the second largest world exporter of footwear, only behind Italy. Also, Taiwan is investing in footwear production in mainland China, through the establishment in Hong Kong of subsidiaries of more than 1,000 Taiwanese companies.

MIT Professor Paul Krugman commented in The New York Times that "the main importance of this is geopolitical. It's a remainder that China is a great power already, which is something many people haven't quite grasped yet."

Of course, the Chinese government immediately rejected the new calculations. A spokesperson from the Chinese Foreign Ministry, quoted in The Journal of Commerce, declared that the IMF report "overestimated the economic output of China," adding that "it had a long way to catch up even with what he called medium developed countries."

IV. 3. HEALTH AND DEVELOPMENT (WDW/19/93 30 JUNE 1993)

This year's World Development Report (WDR) is dedicated to investing in health. As described in the foreword by World Bank President Lewis Preston, it complements the previous three WDRs, dedicated to "an overview of the goals and means of development," which focused on poverty, development strategies and the environment. By contrast, this year's dedication to "a single sector in which the impact of public finance and public policy is of particular importance" will be also observed next year by focusing on infrastructure. Thus, having dealt with some of the key global issues, the World Bank continues setting the development agenda, starting this year also with certain key sectors.

A recognition of some of the past accomplishments leads to an identification of present challenges. For instance, "over the past forty years life expectancy has improved more than during the entire previous span of human history." In 1950, life expectancy in the developing countries was forty years; in 1990, it was 63 years. However, "despite remarkable improvements, enormous health problems remain." For instance, mortality rates in developing countries are still "unacceptable high;" while child mortality rates are still "ten times higher" than those of what are called "established market economies."

The reasons for the persistence of these problems is found in some of the characteristics exhibited by the health systems of developing countries. First, through

misallocation of resources in "interventions of low cost-effectiveness," whereby a single teaching hospital can absorb up to 20 percent of the budget of the ministry of health. Second, inequity through the poor's lack of access to basic health services, because "government spending for health goes disproportionately to the affluent." Third, inefficiency through wasted expenditures, such as "the purchase of brand-name pharmaceuticals instead of generic drugs." Fourth, because of expanding costs, with expenditures growing faster than income, particularly in middle-income developing countries. In these conditions, "the potential for misallocation, waste and inequitable distribution of resources is huge."

Even so, a major government role in the provision of health services is unavoidable, for the following reasons. First, health related services are public goods which private markets by themselves scarcely provide. Also, health services have large externalities and "governments need to encourage behaviors that carry positive externalities and to discourage negative externalities." Second, "cost-effective services to the poor is an effective and socially acceptable approach to poverty reduction." Third, "government action may be needed to compensate for problems generated by uncertainty and insurance market failure."

In such conditions, some of the policy choices available, especially to address the health needs of the poor, are described in terms of "a tree-pronged approach."

First, to "foster an environment that enables households to improve health," by implementing growth policies that will benefit the poor, through the expansion of investment in schooling, particularly for girls, and of the rights and status of women.

Second, to concentrate spending in "efficiently financing services that will particularly benefit the poor". This entails spending "on average 50 percent less...on less cost-effective interventions and instead double or triple spending in basic public health programs such as immunizations." As a consequence, spending should be redirected to implement "a package of public health interventions to deal with the substantial externalities surrounding infectious disease control, prevention of AIDS, environmental pollution and behaviors...that put others at risk." Also, a package of "essential clinical services" should be financed particularly in the low-income countries. Finally, the management of government health services should be improved, through decentralization and contracting out of services.

Third, "leave the remaining clinical services to be financed privately or by social insurance within the context of a policy framework established by the government." Also, foster competition and diversity, to drive down costs in the rest of health care services, provided privately but paid by government or social insurance.

Some of these recommendations are more relevant for different groups of countries. For instance, low-income countries are advised to emphasize "basic schooling for girls, strengthening of public health programs, and support for expanded public financing of essential clinical services." Middle-income countries should focus on "reducing public subsidies for insurance and discretionary care." The formerly socialist economies should prioritize "improving the management of government health services and developing

sustainable health-financing systems that maintain universal coverage while encouraging competition among cost-conscious suppliers."

Finally, the international community should support these policy reforms by "redirecting donor money from hospitals and specialist training to public health programs and essential clinical care." Also, those "countries that are willing to undertake major changes in health policy should be strong candidates for increased aid, including donor financing or recurrent costs."

IV. 4. THE EAST ASIAN MIRACLE (WDW/29/93 20 OCTOBER 1993)

Prodded by the Japanese Executive Director and funded by the Japanese government, the World Bank has completed and published an evaluation of the "miracle" experienced by the economies of East Asia--Japan, "the Four Tigers," Hong Kong, Korea, Singapore and Taiwan, and the "newly industrializing economies (NIEs)," Indonesia, Malaysia and Thailand.

The "essence of the miracle," consists of the rapid growth of these economies, since 1960, at an average of more than five percent, unsurpassed by any other region of the world. Real income per capita increased "more than four times in Japan and the Four Tigers and more than doubled in the Southeast Asian NIEs."

Additionally, these economies were "unusually successful in sharing the fruits of growth." These are "the only economies that have high growth and declining inequality," and where "the fastest growing East Asian economies, Japan and the Four Tigers, are the most equal." For instance, the proportion of people living in absolute poverty, dropped "from 58 percent in 1960 to 17 percent in 1990 in Indonesia, and from 37 percent to less than 5 percent in Malaysia."

Besides this impressive performance, these economies also differ from other developing economies on three basic factors. First, "high rates of investment, exceeding 20 percent of GDP on average between 1960 and 1990, including in particular unusually high rates of private investment." Second, "high and rising endowments of human capital due to universal primary and secondary education." These two factors "account for roughly two-thirds of the growth" in these economies. Finally, "the remainder is attributable to improved productivity," resulting from "the combination of unusual success at allocating capital to high-yielding investments and at catching up technologically to the industrial economies."

The report's contents illustrate how these issues are addressed: 1) distinguishing characteristics: rapid growth with equity; 2) policy explanations: the relationship between public policy and economic growth; 3) pragmatism and flexibility in policy formulation: macroeconomic stability and rapid growth of manufactured exports; 4) the role of institutions: the interaction between a technocratic elite with key leaders of the private sector; 5) public policy and the rapid accumulation of physical and human capital; 6) public

policies, the efficient allocation of resources and productivity growth; 7) conclusion: East Asian pragmatism and policies in a changing world economy. However, it is the explanation offered to account for this "miracle" that is illustrative of the more profound debate about the role of public policy.

If these economies did it by "getting the basics right," these "fundamental policies do not tell the entire story," because "the government intervened--systematically and through multiple channels--to foster development, and in some cases the development of specific industries."

Two broad views are presented as explanations of the role of public policy. First, the "neoclassical view" emphasizes the "success in getting the basics right." Second, the "revisionist view" has shown that "East Asia does not wholly conform to the neoclassical model," because "industrial policy and interventions in financial markets are not easily reconciled with the neoclassical framework."

The authors of the "East Asian Miracle" try to remain somewhere in between. First, they indicate that it is "very difficult to establish statistical links between growth and a specific intervention and even more difficult to establish causality." Even so, they admit that "in a few economies, mainly in North East Asia, in some instances, government interventions resulted in higher and more equal growth than otherwise would have occurred."

In the end, the report supports the eclectic viewpoint laid out in the World Development Report 1991, that "expands on the neoclassical view" to propose a "market-friendly strategy." In such a strategy, "the appropriate role of government is to ensure adequate investments in people, provide a competitive climate for private enterprise, keep the economy open to international trade, and maintain a stable macroeconomy." Otherwise, "governments are likely to do more harm than good, unless interventions are market friendly."

No wonder, the former Japanese Executive Director of the World Bank Masaki Shiratori, who sponsored and secured the financing for the study and now is the Vice-President of Japan's Overseas Economic Cooperation Fund, declared that "the Bank is still obsessed with neoclassical thinking." However, Mr. Shiratori recognizes that the study is "a good first step."

Nancy Birdsall, a member of the research team that carried out the study who recently left the World Bank to become Executive Vice-President of the Inter-American Development Bank (IDB), also believes that "despite its conservatism it marks an important shift." Because, "until now the World Bank has been viewed as putting the burden of proof on others." With the publication of the "East Asian Miracle," Birdsall says, "the burden of proof is on those who want to show intervention is clearly harmful."

IV. 5. POVERTY REDUCTION IN EAST ASIA: THE REAL MIRACLE
(WDW/30/93 27 OCTOBER 1993)

The debate that led to the publication by the World Bank of The East Asian Miracle (WDW/29/93) has been cast in terms of the role of public policy in the accomplishment of the phenomenal growth performance of these economies. However, this emphasis on the role of the state and rapid economic growth, to a certain extent, obscures the remarkable results accomplished by these economies in the fight against poverty.

The impressive figures of poverty reduction in East Asia are described in a World Bank Discussion Paper, by Frida Johansen, released in July 1993 by the East Asia and Pacific Division. According to Johansen, "absolute poverty has decreased dramatically in East Asia," from more than a third of the population in 1970, to a fifth in 1980 and to an estimated tenth in 1990.

However, "absolute numbers are perhaps more impressive than percentages." Focusing on six countries that account for more than 90 percent of the population of East Asia--China, Indonesia, Korea, Malaysia, the Philippines, and Thailand--"the absolute poor in the six countries numbered some 380 million in 1970, 290 million in 1980, and some 150 million in 1990. . . reductions all the more remarkable as the East Asian population grew by some 425 million persons over the two decades." These figures contrast with those of other regions. For instance, "in 1990 the absolute poor remained at around half of the population in South Asia and Africa and a fourth in Latin America."

Of the six countries studied, "China has made the most impressive progress in poverty reduction, perhaps ever. From 275 million absolute poor in 1970, or one of every three people, progress started to accelerate in the late 1970s and continued at a high pace until the mid-1980s, that resulted in only one of every ten--100 million--being poor by 1990." The number of persons involved is also impressive. "Since 1970, China has lifted 175 million out of poverty and added 300 million more people above the poverty line."

The case of Indonesia is equally outstanding given the numbers involved. In the 1970s, Indonesia had "more than half of its population in absolute poverty--some 70 million--and after steady progress, by 1990 the poverty incidence was only some 15% and the number of poor, 27 million." The number of persons involved is again impressive. "Indonesia lifted 43 million out of poverty and added 60 million more people above the poverty line."

The cases of Korea and Malaysia do not involve as many persons, "but it probably was as difficult because they reached the marginal poor normally bypassed by overall economic growth." Consequently, "in 1990, less than 5% of the populations of Korea and Malaysia remained in absolute poverty."

Finally, the case of the Philippines is even more striking, since it reduced "the incidence of absolute poverty by about a third in the 1980s, to 20% of the population," or 13 million, "without much economic growth."

Social indicators are also used as a complement to the measurement of the incidence of poverty. "Just as absolute poverty was much reduced, social indicators were much improved even in countries where economic growth faltered." For instance, average per capita food intakes increased by more than 10%; life expectancy at birth increased by three to four years, to an average of 63 years; infant mortality declined by almost one-third; fertility rates decreased with the use of contraceptives, while death rates fell faster and the population increased at a slower pace; average illiteracy rates were reduced by a third, and the goal of universal primary education was achieved; the percentage of population in cities rose from a fourth to a third; and the proportion of people served with safe drinking water and sanitation also increased.

The factors behind these improvements are summarized as follows: "increased provision of basic services, targeted interventions, and broad-based economic growth." Among the provision of public services there prominently appear water and sanitation, health services, including family programs, and primary education. Targeted programs were required to "make inroads into the deeper poverty pockets."

However, the vice-president of the East Asia and Pacific Region of the World Bank states that "there is no room for complacency." Still, "180 million people remain poor in East Asia--about equal the number of poor in Sub-Sahara Africa. And the poverty that remains is of the more intractable kind found in pockets thus far bypassed by the general growth and social programs that have raised others out of poverty."

To meet these challenges the East Asian governments need "to better identify the poor and their most pressing needs" and to carry out "substantial institution-building to design and implement programs to improve assistance delivery." Also, present "demographic trends imply changing rather than lessened demand on health services." Additionally, the quality of family programs "is a challenge because the number of women in childbearing age continues to grow." Finally, public expenditure in universal primary education and food availability must be preserved. In these terms, "further reducing the number of poor in the 1990s, the study concludes, is likely to be more difficult than it was in the 1980s."

V. CAPITAL FLOWS TO THE DEVELOPING ECONOMIES

V. 1 REMEMBER THE DEBT CRISIS? (WDW/2/93 27 JANUARY 1993)

As recalled by the World Bank's Chief of the Debt and International Finance Division, Massoud Ahmed and by the former Chief Economist, Lawrence Summers, now Undersecretary of the Treasury-Designate for International Affairs, "ten years have passed since Mexico's inability to service its debts triggered a rapid succession of similar moratoria by other debtor countries."

Accordingly, this year's World Debt Tables 1992-93, released by the World Bank on 17 December 1992, include a retrospective from which some lessons are drawn about the making and the management of the debt crisis.

As a sign of the times, two new features also appear in this year's Debt Tables. First, data on portfolio flows are included to calculate the aggregate net flows and net transfers for developing countries. Such equity flows have been of considerable importance for some middle-income countries, those with a per capita income of between \$636 and \$2,555, particularly in Latin America. Second, since the republics of the former Soviet Union (FSU) are now members of the Bank, the Tables include data on the debt of these republics, estimated to amount to \$67 billion.

Here are some of the highlights contained in the first volume of Analysis and Summary Tables:

1) at the end of 1992, the total external debt of all developing countries is projected to increase to \$1,703 billion, from \$1,608 billion at the end of 1991.

2) The debt-to-exports ratio for developing countries in 1992 is expected to remain almost unchanged at 178 percent, while the debt service-to-exports ratio is expected to decline to 19 percent from 21 percent in 1991, continuing the downward trend of recent years.

3) Total debt stocks owed by Latin America and the Caribbean are expected to increase slightly in 1992 to \$447 billion, from \$440 billion in 1991. These stocks represent almost 37.6 percent of GNP, down from 41.4 percent in 1991, or 248.4 percent of total exports of goods and services, down from 258.4 percent in 1991. In these terms, the debt service-to-exports ratio rose slightly from 29.5 percent in 1991 to 30.3 percent in 1992.

4) Aggregate net resource flows to developing countries, understood as net flows on long-term debt, grants excluding technical assistance, and net flows on equity investment, including foreign direct investment (FDI) and portfolio direct investment (PDI), increased sharply in 1992 (by \$19 billion), to reach a projected \$134 billion. As a

percentage of GNP, in 1992 aggregate net transfers amounted to 1.2 percent, compared to 0.9 percent in 1991.

5) Latin America and the Caribbean showed the most marked increase in capital inflows, with aggregate net flows, as well as transfers, remaining generally unchanged in 1992. Also, for several Latin American countries, such as Chile, Costa Rica, Mexico, Venezuela and Uruguay, debt indicators have fallen to pre-1982 levels. However, it is recognized that these countries "have paid a heavy price in foregone development and falling per capita incomes but, for them, the debt crisis is finally over."

In response to the question if the debt crisis is over, the conclusion is that "for the commercial banks and some of their middle-income developing-country borrowers, the debt crisis that began ten years ago is largely over." This is so mainly because "developing-country debt no longer poses a systemic threat to the international banking system." However, for many low and lower-middle-income countries in Sub-Saharan Africa, indebted to official bilateral creditors, "the crisis is certainly far from over."

On the basis of an evaluation of the past decade, Ahmed and Summers "with a great deal of humility" derive some lessons:

First, "heavy borrowing that is not accompanied by productive investments is a disaster for creditor and debtor alike."

Second, "countries that 'opted out' of the international financial system have generally done worse as a result."

Third, "economic adjustment takes time and things often get worse before they get better, so attention to the political and economic sustainability of reform is in the interest of both the creditors and the debtors."

Fourth, "there is a compelling need for official action to overcome free rider problems that complicate debt reschedulings and reductions." Unfortunately, "during the heyday of Laissez Faire enthusiasm during the mid-1980s, at least some officials lost sight of it."

Fifth, "treating the debt crisis purely as a liquidity problem delayed the search for a stable and real solution."

Thus, "the debt crisis, may no longer be the principal preoccupation of the international commercial banks, but it is far from over for many of the countries involved, among them some of the poorest." For these countries, "the real need is to increase concessional financing," thus, "doubling of all the net resource flows to developing countries last year would add a little over \$16 billion to the aid bill of the industrialized world--just 1 percent of what the world spends on defense each year."

To conclude with a positive note, Ahmed and Summers assert that "as recently as five years ago, few could have predicted that much of Latin America would today be wrestling with the question of how to manage large-scale capital inflows."

V. 2. EXTERNAL FINANCE AND DEVELOPMENT
(WDW/18/93 23 JUNE 1993)

The last Global Economic Prospects and the Developing Countries 1993 (WDW/12,16/93), issued by the World Bank, is dedicated to the role of external finance in development. The topic is timely and constitutes probably the most salient issue of the nineties in development economics.

As the debt crisis and the profound recession dominated the eighties, the nineties already seem dominated by what the World Bank characterizes as a "new pattern of external finance," resulting from the "increased financial integration of developing countries with global capital markets."

The new pattern in external finance can be illustrated by contrasting the figures for the beginning of the eighties with those of the beginning of the nineties. For instance, in 1981, official loans, grants and suppliers and export credits amounted to 44 percent of all financial flows to developing countries, with bonds, portfolio equity and foreign direct investment (FDI) amounting to 9.6 percent, while commercial bank loans dominated with 46.1 percent. In 1991, by contrast, grants, official loans and suppliers and export credits amounted to 57.6 percent, followed by 25 percent in portfolio equity, bonds and FDI, and commercial bank loans representing only 17.4 percent.

These more intense levels of financial integration for the developing countries are described as "a mixed blessing," whereby the consequent "increased vulnerability" to both outflows or capital flight, as well as to speculative inflows of hot money, through careful management, can be "outweighed by reduced cost of capital and better possibility to hedge external shocks."

At issue is if the developing countries have an option to avoid the external shocks to which they are exposed, because they are more vulnerable to such adverse shocks. As measured in terms of GDP, external shocks of about 4 percent are "not unusual in low and middle income countries (LMICs)."

The main source of these external shocks is found mostly in adverse terms of trade, such as oil price shocks, as well as volatility in commodity prices. Other sources of adverse shocks, such as external finance and interest rates, have been relatively less important.

The industrial countries are less exposed to large shocks and they are usually able to finance their way out by running greater current account deficits or lower surpluses. By contrast, the developing countries traditionally do not rely on financing to weather shocks and they are generally exposed to capital flight, or what the World Bank calls "one-way integration." The suggested alternative is described as enhancing "two-way integration that permits capital inflows and private institutional outflows."

The policy issues generated by these increased levels of financial integration are relatively well known. On one side, there are certain benefits, such as "a lowering of the

cost of capital, an increase in the sharing of risks...and a promotion of the efficiency of resource mobilization and allocation through improved relative prices." However, policy-makers will also confront both "reduced room for maneuver and the external creditor's tolerance for poor performance," as well as monetary and exchange rate dilemmas.

Be it as it may, each one of the sources of finance available generates its own policy dilemmas. For instance, while FDI increases access to technology and export performance, the Bank recommends it "should not be relied upon for medium-term balance-of-payments financing, in part because profit remittances are often high." Additionally, FDI requires "a transparent legal framework that does not discriminate between local and foreign investors; adopting a liberal foreign exchange regime; and creating investor-friendly regulations and institutions."

Perhaps the most spectacular increase is found in private portfolio flows, since "both bonds and equity have grown explosively from 1989 to 1992." For instance, to the Latin American countries, "gross equity portfolio flows...have grown more than tenfold in four years, from US\$ 434 million in 1989 to an estimated US\$ 5.6 billion in 1992, while international bond issues have shown equally dramatic growth."

The main benefit to developing countries of these flows, in the form of "repatriated flight capital, some high risk-high return funds, and some--the minor part--institutional investment by pension funds, insurance companies, trust funds, and money market funds," is a reduction in the cost of capital. To illustrate the potential magnitudes available, it is estimated that "if industrial country investors held developing country securities in the same proportion as the emerging markets share of global market value (currently 6 percent), resource flows would increase by US\$ 40 billion per year...an increase that is bigger than the current flows of FDI."

Contrary to some commonly held beliefs, "concerns over the sustainability of portfolio flows stem largely from the fear of a change in source-country economic conditions." Even so, "access to portfolio flows should prove to be reasonably durable, provided recipient countries persist in their policy reforms." However, the Latin American countries are advised that they "should not expect to receive such large flows in future years as they did in 1991 and 1992."

Finally, at the end of the Cold War, aid or official development assistance (ODA) "needs to increase, be better focussed and less tied to donor procurement."

V. 3. THE COMMERCIAL BANKS WANT GUARANTEES (WDW/28/93 13 OCTOBER 1993)

Everybody is liking its wounds after the ruffling of the debt crisis. For instance, the commercial banks have declared that they are willing to return to lending to the developing countries, but under certain conditions.

This is the message contained in this year's letter addressed to the Belgian Finance

Minister Philippe Maystadt, the chairperson of the Interim Committee, by the new Managing Director of the Institute of International Finance (IIF), Mr. Charles Dallara.

The IIF, it should be recalled, was created in 1983 by the largest commercial banks, at the height of the debt crisis, "to collect and disseminate timely and impartial information and analysis on the economic and financial situation, policies and prospects of developing countries having substantial debts toward the banking community."

With the dwindling of the debt crisis, and a decrease in membership from 200 to 175 commercial banks, the IIF has now a new Managing Director in search of a new role. Mr. Dallara's public and private background gives him the necessary credentials to try to find such a role. From 1989 to mid-1991, he was Assistant Secretary of the U.S. Treasury for International Affairs; in 1988-89 he was Assistant Secretary of the U.S. Treasury for Policy Development; and from 1984 to 1989, he was U.S. Executive Director at the International Monetary Fund (IMF). Most recently, he was managing director at J.P. Morgan, responsible for operations in central Europe and the former Soviet Union. As he recently declared, "public policy issues will never look the same to me . . . I learned what it really takes to make cross-border banking business attractive for major banks."

In many ways, this year's letter by the IIF to the Interim Committee, reveals this search for a new role for the commercial banks. The letter addresses "the need to restore more vigorous growth in the industrial world," and "the need to achieve definitive progress in trade liberalization." The letter also deals with "the need to support the economic reform efforts of emerging market countries and to catalyze private capital flows to these countries," and "the need to ensure that the policies of the multilateral institutions are effectively advancing your objectives in these critical areas."

It is in relation to the last two points that the letter makes some new proposals. First, there is a recognition that the developing countries "have taken a new significance in contributing to global growth and trade," since these countries "now account for more than one-third of the world's output and trade." Second, the letter registers the positive response from private capital markets, indicating that private capital flows to these countries--from which the commercial banks remain conspicuously absent--"have increased from \$23 billion in 1988 to \$85 billion in 1992." Furthermore, "equity investment flows have doubled, from about \$20 billion in 1988 to almost \$40 billion in 1992."

The letter also points out to the increasing role that Latin American borrowers have played in these flows, tapping the "international markets for more than \$20 billion in new financing over the last three years." Additionally, portfolio investments in Latin American capital markets have "also grown impressively." Finally, the letter admits that "commercial bank loans to Latin America are beginning to expand, but nevertheless remain modest to date, reflecting in part the still recent memories of the debt problem."

However, the letter also indicates that "external financing raised in international bond and equity markets, as well as through local capital markets, will not be sufficient and will need to be catalyzed through special programs." Additionally, "large-scale commercial bank project financing will also be needed," and this poses a challenge to which the international financial institutions (IFIs) will have to respond.

First, "the task of fostering commercial bank flows" is now different, since "it is mostly in the form of trade or project financing, not the general balance of payments financing of the past." For this, "a modest participation by the World Bank Group in a supportive role in project financing or joint venture might be sufficient to catalyze significant private capital." There are cases where "aspects of political risk in many emerging markets are so great as to pose overriding disincentive to private capital." In these cases, "focusing IFI instruments on what is needed at the margin to make projects more attractive to private lenders, for example, could be particularly effective."

Finally, since there are still some leftovers from the debt crisis, the letter calls for "solving the remaining debt problems," such as those of Brazil, Russia, Poland, Peru, Ecuador and Panama. It warns that "the continued 'tolerance' of arrears poses a serious disincentive to renewed commercial bank lending, including project financing." Not everybody agrees, Harvard Professor Jeffrey Sachs has countered that "the IMF should use its leverage to force commercial banks to reach quick agreement on reasonable terms."

In essence, the commercial banks are willing to return to lending to developing countries. However, this time they just need some credit enhancements to reduce the risks.

V. 4. PRIVATE MARKET FINANCING FOR DEVELOPING COUNTRIES (WDW/32/93 10 NOVEMBER 1993)

In recognition that there is a new pattern of external finance for the developing economies (WDW/18/93), in this year's report on capital markets, the International Monetary Fund (IMF) includes a chapter dedicated exclusively to this issue. Divided in two parts, the chapter first "describes recent experience with securitized capital flows," comprising international bonds, short-term debt instruments, and equities.

Developing countries issued bonds in international markets amounting to a record \$23 billion, almost double the amount of 1991. Still, this represented "7 percent of global issuance activity, compared with 4 percent in 1991." More than half of this amount, or \$12 billion, corresponded to borrowers from the Western Hemisphere, with Mexico again as "the leading borrower in the international bond market, raising close to \$6 billion." Also, Argentine borrowers almost doubled their participation in the international bond market, while Brazilian and Venezuelan entities also increased their participation. Additionally, newcomers from Latin America and the Caribbean gained access to the international bond market, with Uruguay and Trinidad and Tobago raising \$100 million each. Asian borrowers also expanded their access, raising around \$6 billion.

This "increased availability of bond financing was accompanied by a gradual broadening of the range of borrowers," with private sector issuers representing 42 percent in 1992, compared with 31 percent in 1991. On the supply side, this was a consequence of the privatization programs and the high interest rates prevailing in Latin America. On the demand side, this was a result of the decline of yields on public sector issues in most countries.

In dollar denominated short-term securities, "Mexican banks were in the vanguard in developing the market for Euro-certificates of deposits (Euro-CDs), but the range of borrowers in this market broadened in 1992 to include borrowers from Argentina, Bolivia, Brazil, Mexico, Peru and Venezuela." The amount of Euro-CDs issued by Latin American banks, by April 1992, "amounted to \$13 billion." Due to regulations imposed by the Banco de Mexico on short-term external borrowing by commercial banks, after April 1992, issues of Euro-commercial paper (Euro-CP) "picked up markedly." By contrast with the "9 Euro-CP programs" launched in 1991, "with a total issuance ceiling of about \$1.1 billion, 20 programs were set up in 1992, with a total issuance ceiling of \$3.2 billion; issuers were mainly Mexican corporates but also included the United Mexican States and several private sector Argentine and Brazilian companies."

There was some international interest even "in certain domestic-currency denominated short-term debt instruments." For instance, "in 1992, \$5.9 billion was invested by foreigners in Mexican government papers, mainly in Cetes--Mexico's federal government treasury bills."

By contrast to the 1980s, "the recent interest of international investors in emerging markets and the wave of privatizations in several countries have led to a surge in international equity placements by developing country companies." The cumulative amount issued by these companies since 1990 in international equity markets amounted to \$16 billion. "In 1992 alone, companies from 21 developing countries raised \$9.4 billion in this market (some 41 percent of total international primary equity issuance)."

Latin American companies "were at the forefront of the new issue boom and accounted for over 60 percent of all international equity issues by developing countries." However, during the second half of 1992, "equity issues by Latin American corporations dropped abruptly, reflecting the sharp decline in share prices in most of the main Latin American stock markets."

In response to this market correction, "in contrast with 1991, when a sharp increase in issuance of mutual funds targeting Latin America was observed, funds issued in 1992 targeted mainly emerging markets in Asia." Furthermore, "managers of existing global funds reportedly reallocated their assets away from Latin American markets toward Asian markets, while managers of Latin American funds substantially increased cash holdings."

Syndicated bank lending, in 1992, "remained subdued," given the banks' reluctance "to take on new exposure to developing countries." Short-term credits, essentially trade finance, remained dominant, while "medium- and long-term bank loan commitments to capital importing developing countries declined from \$16.7 billion in 1991 to \$14.1 billion in 1992." In the tighter international credit conditions prevailing, "Asian borrowers accounted for 74 percent of new syndicated bank credit commitments to capital importing developing countries in 1992." Simultaneously, "some renewed interest emerged in lending to selected Latin American borrowers (including Chilean corporates and Mexican and Venezuelan public sector oil exporters), although banks remained cautious about new exposure to the region."

This contrasted with the buoyancy prevailing in the secondary market for bank claims on developing countries. Securitized bank debt in developing countries, by the end of 1992, "increased to \$65 billion, comprising \$58 billion in 'Brady bonds' and \$7 billion of bonds issued by Brazil in November 1992 securitizing interest arrears accumulated in 1989 and 1990."

V. 5. A NEW PATTERN OF DEVELOPING COUNTRY FINANCING
(WDW/33/93 17 NOVEMBER 1993)

The second part of the chapter dedicated to financing for the developing economies, in the recent study by the International Monetary Fund on capital markets (WDW/32/93), highlights some issues raised by the "new financing pattern." It deals with the broadening of the investors base; the 1992 market correction; the role of regional financial centers; and the systemic implications of the evolving financing pattern.

By contrast with Asia, which continues attracting "mainstream institutional investors such as pension funds and insurance companies from industrial countries," Latin America is different. What is called "the rediscovery of Latin American securities," was brought about "by capital flight and global investment funds." Even so, the study recognizes that "the investor base for Latin American securities has begun to broaden in the past year with increased participation by mainstream institutional investors."

According to a survey of institutional fund managers active in emerging markets, "these managers quadrupled the share of their international portfolios allocated to emerging markets, from 2.5 percent of global international portfolios in 1989 to 10 percent in 1992." Latin America "accounts for 39 percent of institutional investors' emerging markets portfolios," while the Pacific Rim accounts for 49 percent and only 10 percent has gone to Eastern Europe.

Still, mainstream institutional investors "appear to have followed a more conservative investment strategy," investing in "emerging market equities" not even five percent of total foreign equity holdings, or an amount equivalent to only 0.2 percent of total assets.

However, there are differences among "source regions." For instance, "U.S. based investors, including flight capital and investment funds, have shown the most interest in Latin American market re-entrants." This is attributed to "the substantial presence of flight capital as well as other investors familiar with high-yielding, if risky, subinvestment grade securities."

In conclusion, "although investor base has broadened recently, involvement by mainstream institutional investors in developing country securities remains limited."

Some "main constraints to investment on developing country securities" are singled out, such as "concerns about economic and political fundamentals." Also constraining is "limited information and the poor liquidity of emerging market assets." In these conditions,

"the market re-entry by Latin American issuers was subject to a correction from June 1992 on the equity side and during the last quarter of 1992 on the bond side." Additionally, "international equity issues from the region almost completely dried up during the second half of 1992."

This correction led to "a general reappraisal of the market for Latin American securities as investors and investment banks realized that progress toward expanding the investor base beyond flight capital and high net worth investors was more limited than many had wanted to believe."

Hong Kong and Singapore are presently the "two major full-service offshore centers" located in developing countries. This is a result of "high rates of saving and relative wealth, the close network of interrelationships of the overseas Chinese community, and the increasing importance of intraregional trade and investment flows." In Latin America in the long-run, it is predicted that "intraregional flows will grow in importance ... as incomes increase, local financial centers become more sophisticated and capable, and progress is made toward regional integration and cooperation."

To conclude, some "systemic implications" of this new financing pattern, characterized as "securitization of flows/disintermediation from the commercial banks," are spelled out. First, the resilience of the international financial system is helped by the "greater scope now exists for price adjustments, which may signal emerging difficulties before the situation deteriorates to where access is cut off." Second, since "an increasing proportion of cross-border flows are in the form of securities held by non-banks, balance of payments difficulties experienced by developing countries would not directly put at risk banks and the international payments system." In these terms, third, "adjusting to debt-servicing difficulties would likely involve a drop in the price of securities and result in the decline of financial wealth of investors."

Consequently, "the new financing pattern seems to imply lower systemic risks than the bank credit flows of the 1970s and the 1980s." Even so, emerging markets still have "a fairly shallow domestic investor base, a limited range of actively traded shares, and financial asset prices that have been particularly volatile." The hope is that "greater openness may help broaden the investor base, deepen the market, transfer more sophisticated investment strategies, and ultimately stabilize emerging markets." Meanwhile, "competition among international asset managers, combined with the narrow range of liquid markets in which they can invest, could mean that a concerted move in the same direction might generate a large amount of financial asset price volatility."

VI. TRADE

VI. 1. PRESIDENT CLINTON ON TRADE (WDW/8/93 10 MARCH 1993)

In the middle of the intense campaign to get his domestic economic package approved (WDW/6/93), President Clinton found the time to go to American University to address the issue of trade. The speech constitutes a recognition, in the President's terms, that "the truth of our age is this--and must be this: open and competitive commerce will enrich us as a nation...It promotes global growth without which no rich country can hope to grow wealthier." Briefly, "in the face of all the pressures to do the reverse, we must compete not retreat."

President Clinton sees the United States facing, at the end of the Cold War, "the third great moment of decision in the 20th century." The choice is between "the mistakes of the 1920s or the 1930s by turning inward," or "the successes of the 1940s and the 1950s by reaching outward."

To enforce his vision, the President outlined the following "five steps:"

First, to put the "economic house in order," by doing "what no generation of Americans has ever been called upon to do before: to increase investment in our productive future, and to reduce our deficit at the same time."

Second, "to make trade a priority element of American security," based on reciprocity, by which "none of us should expect something for nothing." In this context, the President promised to support "a prompt and successful completion of the Uruguay Round," and also repeated his support to the North American Free Trade Agreement (NAFTA), if it can "ensure that the environment, that living standards, that working conditions, are honored." He then turned to Asia, offering to "work with organizations, such as the Asian-Pacific Economic Cooperation Forum, to liberalize...trade across the Pacific as well."

Third, the President promised "to exercise leadership among the major financial powers to improve...coordination on behalf of global economic growth." However, he realistically recognized the limits of such cooperation, saying that "None of us is very good at it. America doesn't want to give up its prerogatives. The Japanese don't want to give up theirs. The Germans don't want to give up theirs." Even so, "the fact is that the world can't grow if America is in recession, but it will be difficult for us to grow coming out of this recovery unless we can spark a renewed round of growth in Europe and in Japan."

Fourth, the "need to promote steady expansion of growth in the developing world" was recognized, "not only because it's in our interest, but because it will help them as well."

The final step was defined as to support "the success of democracy in Russia and in the world's other new democracies." Forcefully, the President concluded, "if we are willing to spend trillions of dollars to ensure communism's defeat in the Cold War, surely we should be willing to invest a tiny fraction of that to support democracy's success where communism failed."

These steps were characterized as "an agenda for American action in a global economy," where "there is no such thing as a purely domestic policy."

The reactions to the speech did not make themselves wait. In London, where the finance ministers of the G-Seven were meeting, the reaction was positive. The Chancellor of the Exchequer, Norman Lamont declared, the speech "demonstrates the commitment of the United States to free trade."

By contrast, The Wall Street Journal saw the speech as evidence that the President is practicing "a good cop-bad cop stance," resulting from a fractured economic team where Secretary of the Treasury Lloyd Bentsen and his deputy Lawrence Summers are the "good cops," pushing for free trade, while the USTR Mickey Cantor is the "bad cop," pushing for retaliation against European subsidies to the Airbus. In a similar vein, an editorial in The Journal of Commerce saw the President "walking a tightrope," asking "can someone who believes government should intervene early and often in the marketplace tolerate the Darwinism of free trade, particularly when that means short-term suffering for some U.S. industries?"

Latin American observers were perplexed because the President did not mention the extension of the NAFTA to other trading partners in the Hemisphere. Some wanted to believe this was a consequence of the delays in appointing the Administration's Latin American team. However, these interpretations were dispelled by a statement made by Paula Stern, former "senior economic and trade advisor to President Clinton during the campaign" and one of the leading contenders to head the USTR. In an op-ed in The Journal of Commerce, the former chairwoman of the International Trade Commission praised the President for avoiding the "danger that the new administration would follow in the footsteps of its predecessors and appear to give inordinate attention to the Western Hemisphere." She praised the President because he "deftly moved to allay the fears of our Asian trading partners, as well as some in Europe, by demonstrating that he does not seek to establish a Western Hemisphere trading bloc that will shut them out."

Beyond these interpretations, soon there will be an opportunity to assess the Administration's interest in pursuing the negotiations of the Uruguay Round and in the Western Hemisphere, because the time is running out to request a renewal of the fast track authorization, which expires on May 31.

VI. 2. THE U.S. TRADE POLICY AGENDA FOR 1993
(WDW/9/93 17 MARCH 1993)

The release of this year's trade policy agenda has experienced some delay, although the document is ready with an introduction by the new U.S. Trade Representative, Ambassador Michael Kantor.

As mandated by Section 1641 of the Omnibus Trade and Competitiveness Act of 1988, "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 are presented in a single volume titled 1993 Trade Policy Agenda and 1992 Annual Report of the President on the Trade Agreements Program.

In the introduction, Ambassador Kantor summarizes the last speech by President Clinton on trade, made at American University on February 26 (WDW/8/93), highlighting "several key principles that guide the Administration's thinking on trade issues."

First, as presented in the President's economic package (WDW/6/93), trade policy is "part of a coordinated and integrated economic strategy;" second, the overall objective is defined as "expanding trade through market opening measures backed by the rigorous enforcement of U.S. laws;" third, trading partners are "expected to live up to their commitments so that their markets become comparably open;" fourth, those seeking relief are expected to "undertake reforms designed to boost their future competitiveness;" fifth, economic interests will no longer be "automatically subordinate" to foreign policy or defense concerns because "national security is closely bound with...economic strength here at home."

The five "main priorities" of this year's agenda are:

- to "vigorously press forward" with the Uruguay Round;
- to "achieve the objectives of the North American Free Trade Agreement by negotiating critically important supplemental agreements;"
- "other bilateral and regional initiatives" in the Pacific Rim and in the Western Hemisphere, in that order, highlighting the Asia Pacific Economic Cooperation forum as "particularly promising;"
- "resolutely enforce existing trade agreements and U.S. trade laws to open more export markets;"
- to incorporate new issues in the agenda, such as environmental protection, competition and technology policies.

The comparison between these five priorities with the three objectives of the 1992 Agenda reveals the degree of continuity and change brought about by the new Administration. First, there is coincidence on the completion of the Uruguay Round.

Second, even with the addition of the "supplemental agreements," there is coincidence as well on the approval of the NAFTA. Third, the most conspicuous difference is found in the regional agreements, because this year's agenda gives the same priority to the Pacific Rim and to the Western Hemisphere, with the reference to the Asia Pacific Economic Cooperation forum contrasting with the silence about the Enterprise of the Americas (EAI). Fourth, while this year's agenda promises to "resolutely enforce" laws and agreements, last year's relied more on the "strength of the U.S. domestic market." Finally, the new issues mentioned this year are by all means new.

On the Uruguay Round, the agenda recognizes the impossibility of completing it before the expiration of the existing fast-track authorization, thus, "the Administration is proposing legislation that would renew the fast-track authority." However, no mention can be found about requesting fast track authority to negotiate free trade agreements with the rest of the Hemisphere.

On the conclusion of the NAFTA, it is hoped that the supplemental agreements will be concluded "as soon as possible to maintain NAFTA's scheduled implementation in January 1994."

Under "other bilateral and regional initiatives," first comes the Pacific Rim, particularly the relations with Japan and China. Europe follows, emphasizing the European Community, Eastern Europe and the Former Soviet Union. Last come "the Americas," dealt with in a single paragraph, which recognizes that "several nations in this region have instituted far-reaching reforms designed to shrink their budget deficits, reduce their foreign debts, and open up their economies to global competition." The paragraph concludes positively, recalling that "President Clinton has said that success in the NAFTA could well pave the way for trade expanding arrangements with other market-oriented countries in the Western Hemisphere."

The enforcement of agreements and laws deals with several current disputes, such as government procurement with the European Community; dumping and subsidies in steel; the resurrection of Section 201 of the 1974 Trade Act, as amended, providing remedies to domestic industries injured by increased imports; finally, it is announced that "the Clinton Administration is considering the increased use of Section 301 in appropriate circumstances, in order to encourage the opening of more foreign markets."

On the new issues, besides environmental protection, competition and technology policies, "a more intense focus" is promised on labor standards, intellectual property rights, and investment.

VI. 3. BARRIERS TO U.S. EXPORTS (WDW/10/93 28 April 1993)

This year's National Trade Estimate Report on Foreign Trade Barriers is the first one issued under the stewardship of the new United States Trade Representative (USTR) Mickey Kantor. It was released on March 31, as mandated by section 1304 of the

Omnibus Trade and Competitiveness Act of 1988. It used to be that the yearly release of this Report was awaited with some anxiety. After all, it was the behavior cited in the Report which served as the basis for the initiation of the much dreaded "super 301" investigations. In their turn, such investigations could lead to U.S. retaliation against alleged imposition of barriers against U.S. exports. This year's Report should be read having in mind the possibility of a resurrection of such investigations. Ambassador Kantor recently announced that "USTR staff have begun a comprehensive review of the most significant barriers in the NTE Report and are identifying those barriers that can best be addressed through the use of Section 301, if our current bilateral or multilateral efforts do not result in market-opening measures."

For this reason, without going all the way back to such practices, discarded by the previous Administration, Ambassador Kantor indicates that the Report "will facilitate the achievement of the Administration's overall trade policy objective which is to expand trade through market opening measures backed by the rigorous enforcement of U.S. laws."

This is somewhat stronger than last year's description of the 1992 Report by then USTR Carla Hills as "a useful tool for tracking barriers to U.S. exports and for reporting progress in eliminating them."

The definition of trade barriers used in the Report remains unchanged and it comprises "government laws, regulations, policies, or practices that either protect domestic products from foreign competition or artificially stimulate exports of particular domestic products."

These barriers are classified in eight different 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) barriers that encompass more than one category or that affect a single sector.

The Report describes the barriers existent in "the largest export markets for the United States," including for the first time under one category the so-called "newly independent states"--Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Moldova, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan--as well as two regional trading bodies--the European Community and the Gulf Cooperation Council.

By contrast with last year, the list of Latin American countries cited remains unchanged, including Argentina, Brazil, Chile, Colombia, Ecuador, El Salvador, Guatemala, Mexico, Paraguay and Venezuela.

The exclusion of countries is "due primarily to the relatively small size of their markets or the absence of a major U.S. industry and agriculture trade complaints." However, those absent are specifically cautioned that "the omission of particular countries and barriers does not imply that they are no longer of concern for the United States."

Measured by the length of their citations, Japan appears in the first place with 28 pages, followed by the European Community with 16 pages; Canada with 15 pages; China 12; Australia, Korea, Mexico and Taiwan 10 pages each; and India 9.

Each country is listed alphabetically and the enumeration of the barriers is preceded by ranking each country according to its relative importance as an export market for the United States. The Report also includes the magnitude of the U.S. deficit or surplus with each trading partner, the amount of U.S. imports, exports and investment, as well as estimates of the impact on U.S. exports of specific foreign trade barriers.

Not all the practices of the Latin American countries cited are negative. For instance, the government of Argentina is praised for the reduction of traditional border as well as non-border measures. Brazil and Ecuador are praised for the reduction of traditional border measure barriers, particularly the near elimination of import licensing, while Chile preserves its clean record.

However, almost all the Latin American countries, with the exception of Mexico, are criticized by the lack of intellectual property protection, as well as by the imposition of some investment and some services barriers.

For lack of intellectual property protection, six of the Latin American countries-- Argentina, Colombia, Ecuador, El Salvador, Guatemala and Venezuela--are on the "watch list," while Brazil is in the "priority watch list" under the "special 301" provision of the 1988 Trade Act. Ambassador Kantor recently said that the USTR is reviewing the performance of those countries included in these "watch lists" and that the results of the review would be announced by April 30.

Finally, El Salvador and Guatemala are cited for the implementation of import restrictions on poultry and of a price band mechanism for basic grains, while Guatemala is also cited for allowing imports of wheat flour by permit only.

VII. THE NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA)

VII. 1. PRESIDENT CLINTON'S INTER-AMERICAN POLICY (WDW/5/93 2 OCTOBER 1993)

One of the first Latin American and Caribbean actions of the Clinton Administration remains snarled in a confrontation which is bringing back the scent of some anachronistic Cold War ingredients. The appointment of the next Assistant Secretary of State for Inter-American Affairs has been paralyzed by a debate dominated by accusations of softness against communism and by counter-charges of racism.

Meanwhile, this skirmish about the appointment of what admittedly is the most visible and the highest ranking Latin American position in the State Department, in effect, has overwhelmed other signals which are indicating that the Inter-American policy of the incoming Administration may have already been adopted.

The basic objectives of the new policy are contained in the last report of the Inter-American Dialogue, Convergence and Community: The Americas in 1993, timely released by mid-December of last year.

The Dialogue describes itself as "Washington's only center for policy analysis dedicated primarily to U.S.-Latin American relations, and to convening policymakers, business and financial leaders, heads of non-governmental organizations and intellectuals seeking practical responses to hemispheric problems."

Co-chaired by Peter Bell from the United States and by the former Secretary General of the United Nations Javier Pérez de Cuéllar, the Dialogue's President, until January 20, was Richard Feinberg.

The report begins stating that it "cannot recall a time when the opportunities for constructive and sustained cooperation among Western Hemisphere nations have been greater--or when the potential payoffs from such cooperation have been larger."

Two major factors are identified as contributing to these new times: first, "the Cold War is over and U.S. policy toward Latin America is no longer shaped and constrained by a preoccupation with security matters;" second, "Latin American concerns about U.S. political and economic dominance in the region have subsided, along with fears of unilateral U.S. intervention."

The following three main challenges are identified by the Dialogue as facing the hemisphere in the 1990s and they define the main guidelines of its policy recommendations:

1) "To forge an economic community that will span the Americas and, within a generation, could incorporate nearly one billion people." For this purpose the Dialogue

urges immediate action on the ratification of the North American Free Trade Agreement (NAFTA), giving appropriate attention to the environment and to workers' rights; the forging of viable sub-regional trade pacts in Latin America and the Caribbean, while sustaining internal processes of economic reform and trade liberalization; to begin consultations on criteria, procedures, and timetables for building NAFTA into a Western Hemisphere free trade pact; to promptly begin negotiations with those countries which meet the entry requirements to the NAFTA, with Chile as the likely first candidate; negotiations should also begin with the countries of Central America and the Caribbean, because NAFTA will "impose some immediate losses on these countries;" finally, the establishment of a "new multilateral organization to guide and coordinate progress toward a Western Hemisphere Economic Community," asking that "existing regional economic organizations--the Inter-American Development Bank (IDB), Organization of American States (OAS) and United Nations Economic Commission for Latin America and the Caribbean (ECLAC)--should play prominent roles in the new coordinating body, along with private business, trade unions, and other non-governmental organizations."

2) To sustain and deepen the progress "toward the formation of a democratic political community in the Western Hemisphere," the Dialogue proposes to promote negotiated settlements of the remaining guerrilla conflicts; to examine the missions, size, weapons, and costs of the armed forces of the Western Hemisphere, "with the objective of establishing firm civilian control over the military;" to respond rapidly to breakdowns of democratic rule, as decided in the Santiago resolutions of the OAS; to enhance the capacity of the OAS to play a leadership role in situations of democratic breakdown.

3) "The most difficult challenge facing the Americas today," is identified as the struggle against social and economic inequity. For this purpose the same priority should be given to alleviating poverty and to the promotion of growth; anti-poverty strategies should emphasize efforts to raise productivity among the poor, particularly women; income transfer programs should be targeted to the neediest and most vulnerable; programs to reduce poverty must be consistent with macroeconomic stability and should be financed through some combination of increased taxes, the reallocation of existing expenditures, and external aid; finally, external organizations should support national anti-poverty programs.

Recent signals indicate that these may become the central elements of the new Administration's Inter-American policy. Particularly relevant is the appointment of several signatories of the Dialogue's report to key positions in the new Administration, such as Bruce Babbitt, Secretary of the Interior; Henry Cisneros, Secretary of Housing and Urban Development; Dianne Feinstein, elected Senator from California; Federico Peña, Secretary of Transport; Peter Tarnoff, Under Secretary of State. Last but not least, former Dialogue President Richard Feinberg is now Special Assistant to the President and Senior Director for Latin American and Caribbean Affairs, at the National Security Council (NSC).

VII. 2. THE OPPOSITION TO THE NAFTA
(WDW/23/93 8 SEPTEMBER 1993)

Gone are the days when it was common wisdom that a small country should avoid becoming involved with a bigger partner. There was an inherent disadvantage for the smaller partner emanating from asymmetry. However, if you listen to the arguments presented by those who are against the approval of the North American Free Trade Agreement (NAFTA), those days are gone because the reverse is now true. It is the biggest partner who is bound to experience the most profound losses, because of the stampede--described by Mr. Ross Perot as the "giant sucking sound"--of jobs and investors moving south of the border. This is better illustrated by the title of Mr. Perot's book, written with Mr. Pat Choate, well known for his criticism of foreign lobbyists, Save your Job, Save our Country. Why NAFTA must be Stopped--Now!

The debate has now moved beyond academic arguments about winners and losers into the level of sound-bites and the Larry King show. In the terms of the conservative columnist and former presidential candidate Pat Buchanan, "the heart has reasons that the mind knows not," because Americans "do not want to see this republic married off to a Third World nation of 80 million whose average wage is 15 percent of our own." Consequently, Mr. Buchanan concludes, "NAFTA is about America's sovereignty, liberty and destiny . . . NAFTA is an economic Munich, an American Maastricht."

The other partners make the coalition against the NAFTA look as formidable as it is heterogeneous. Very few issues have exhibited the capability of bringing to the same side of Mr. Perot and Mr. Buchanan leaders such as the Reverend Jesse Jackson and almost all members of the congressional black caucus; the consumer advocacy group Public Citizen, founded by Mr. Ralph Nader and several environmental groups, such as the Sierra Club and the Humane Society; and Mr. Lane Kirkland of the AFL-CIO and MIT Professor Noam Chomsky.

Out of this heterogeneous gathering, the environmental groups were the only ones to experience a profound fracture. Once the negotiation of the side agreement on the environment was completed, some of the most powerful environmental organizations came out in support of the NAFTA. Among them, the National Wildlife Federation, the World Wildlife Fund, the Nature Conservancy, the Audubon Society, the Environmental Defense Fund, the Natural Resources Defense Council and Defenders of Wildlife. Not surprisingly, those organizations which remained in the opposition, such as the Sierra Club and Friends of the Earth, decided to go to court. They supported a petition, presented by the Public Citizen to a district judge, requiring that the Administration, before sending the NAFTA to Congress, should carry out an environmental impact assessment.

Even so, the campaign against the NAFTA, unleashed by what The Washington Times characterized as such an "unusual coalition," does not seem to reflect the opinion prevailing among the majority of the citizens. According to a recent NBC-Wall Street Journal survey, 44 percent of those interrogated declared they did not have an opinion, because they did not know enough about the agreement; while only 27 percent were in favor and 25 percent were against it.

Given these startling figures, the real weight of the opposition against the NAFTA should be measured in strictly political terms. The outcome depends on the number of those who vote in favor or against it in both the House of Representatives and the Senate, where the approval of the NAFTA needs 218 and 51 votes, respectively.

According to some recent vote counts, in the Senate the NAFTA will pass with the support of at least 34 of the 46 Republicans and 16 of the 54 Democrats. In the House, the NAFTA will pass if it obtains between 125 and 140 votes from the 175 Republicans and between 75 to 85 votes from the 258 Democrats. Presently, the NAFTA has the firm support of only 67 Democrats.

This small number of supporters among the Democrats is a reflection of the profound divisions that this issue has caused among them, and of the consequent cautiousness that the Administration has exhibited about the issue.

However, where these divisions have appeared more poignantly is among the House Democratic leadership. First, the House Speaker Thomas Foley of Washington declared that he personally "tended to support" the NAFTA, although "the House Democratic Leadership was so badly divided that it would not take a position on the vote."

The second highest ranking Democrat in the House, Majority Leader Richard Gephardt of Missouri declared, after looking at the side agreements on the environment and on labor standards, that he would be unlikely to support the agreement. Finally, the most active opposition is coming from the third highest ranking Democrat, House Majority Whip David Bonior of Michigan who declared that "there is no official position in our caucus here; we're free to do what we want."

With the Democratic Party leadership profoundly divided, the NAFTA can only be approved with the strong support of the Republicans. This will compensate for some of the strong opposition that presently exists within the ranks of the Democrats.

VII. 3. THE NAFTA VOTE

(WDW/34/93 24 NOVEMBER 1993)

Rarely has the most salient trait of the contemporary U.S. trade policy-making process been played out with such clarity. The debate and approval last week of the North American Free Trade Agreement (NAFTA) fully confirmed the script of what Robert Pastor has characterized as the "cry and sigh syndrome." In this characterization of trade policy-making, the "cry" corresponds to the protectionist uproar that emanates from Congress whenever it is asked to enact trade legislation. This is followed by the "sigh," which comes when it is realized that the resulting legislation is not as protectionist as the preceding debate anticipated. What seems to happen is that the voices of protectionism are so loud that they end up conjuring enough opposition to counter the initial threatening impulse.

With the benefit of hindsight, the NAFTA debate followed faithfully the script depicted by the "cry and sigh syndrome," except during several moments when it was felt

that the initiative was tilting in the opposite direction. For instance, the coalition assembled against the NAFTA was as formidable as it was heterogeneous (WDW/23/93). "Ideologically chaotic," according to Thomas Edsall of The Washington Post, it was "the strangest coalition ever assembled on a key issue," said Norman Ornstein from the American Enterprise Institute (AEI).

This coalition comprised nativists and protectionist Republicans, as Pat Buchanan; ill-defined populist centrists, as Ross Perot; a solid bloc of environmental and consumer activists, as the Sierra Club and the even better known advocate Ralph Nader; some bulwarks of the Democratic Party, as the most powerful representatives of organized labor from the AFL-CIO; several individuals representative of the liberal wing of the Democratic Party, as the Reverend Jesse Jackson; finally, there were some prominent dissident academics, such as MIT Professor N. Chomsky. However, more important was that this heterogeneous coalition counted with the support of the second and third highest ranking Democrats in Congress, none other than the House Majority Leader Richard Gephardt (D-Mo.) and the Majority Whip David Bonior (D-Mich.)

Against this formidable lineup, no wonder at times the NAFTA was thought dead and beyond resuscitation. First, President Clinton took a while before he came out in full force in favor. With hindsight, this initial hesitation can be explained because the issue was generating profound divisions within the President's own party.

Even so, it was the attempt by the Texas billionaire Ross Perot, to lead the opposition against the NAFTA, which triggered the top echelons of the Clinton Administration to come out forcefully in favor of its approval. This transformed the free trade debate into a nasty dispute for the populist factions of both the Republican and the Democratic parties. Thus, the public campaign for the NAFTA started with Perot's maneuver and closed illustratively with the debate between vice-president Gore and Perot himself, spectacularly won by the vice-president.

There were other moments of pessimism. First, the defeats by the Democratic candidates in the City of New York, and the states of New Jersey and Virginia, weakened President Clinton's coattails in the eyes of those representatives that are due for reelection. Then came the crushing defeat experienced by the Canadian incumbents, who supported the NAFTA enthusiastically. Finally, just a few days before the vote, while the Republicans stood ready to deliver their share of the votes required, the President was seen as still struggling to obtain enough votes within his own party. And it was in this last stage when the President was seen at his best, in Ornstein's terms, "twisting arms, making deals and reviving a presidency."

The final yes votes in the House revealed the toughness of the battle, 132 out of 175 Republicans, or three fourths, and 102 out of 258 Democrats, or less than half. Still, the Republicans delivered a dozen votes more than expected, which led to the spectacular victory of 234 to 200.

The divisiveness of the issue was evident in the Hispanic caucus, split between nine in favor and eight against, revealing that the Hispanics have yet to articulate a common position in foreign affairs. The two Cuban Republicans from Florida voted against, as did the two most prominent Puerto Ricans from New York and the only Puerto Rican from New

Jersey. Most of the Mexican-Americans, led by Bill Richardson (D-NM), came out in support, except Henry Gonzalez (D-TX). By contrast, out of the forty members of the Black Caucus, only nine voted yes.

Additionally, according to a study by the pro-Democratic Economic Policy Institute (EPI), quoted in The Washington Post, "the NAFTA vote pitted the nation's cities against the urban areas. Urban members of Congress from both parties opposed NAFTA 68 to 51 . . . while suburban and rural representatives were 183 to 132 in favor."

The NAFTA vote provided President Clinton, in the terms of The Wall Street Journal, with a "crucial victory," that placed international trade issues at the center of the political spectrum, based on a bipartisan majority. If this coalition in favor of an open international trading system holds, the NAFTA vote will become a decisive setback for the nativists, the protectionists and the isolationists from both parties.

VIII. BEYOND NAFTA

VIII.1. THE INSTITUTIONAL DIMENSION

(WDW/14/93 26 MAY 1993)

A debate is taking place in Washington, "inside-the-Beltway," on the best institutional alternative to support the expansion of the North American Free Trade Agreement (NAFTA) to the rest of the Hemisphere. However, in institutional as well as in other matters, Shakespeare in The Merchant of Venice (Act I, Scene II) warned some time ago that "if to do were as easy as to know what were good to do, chapels had been churches and poor men's cottages princes' palaces."

The debate was ignited and fueled by a proposal made by two prominent figures from the group of Washington-based non-governmental organizations (NGOs), dedicated to Latin American and Caribbean affairs. Some time ago, Richard Feinberg, then Vice-President of the Overseas Development Council (ODC) and Peter Hakim, then Staff Director of the Inter-American Dialogue, proposed the creation of an "Americas Commission," a whole new institution dedicated to push forward the process of Hemispheric trade liberalization. The Feinberg-Hakim reasoning was simple, "none of the hemisphere's existing institutions, as presently constituted, can adequately address the exigencies of the trade component."

Also, from the West Coast came another proposal aimed at the creation of a new institution. Given the costs of implementing the NAFTA, particularly the environmental clean-up along the U.S.-Mexico border, University of California Professors A. Fishlow, R. Hinojosa-Ojeda and S. Robinson proposed the creation of a new "North American regional development bank and adjustment fund." The creation of this new bank, at some point, received some endorsement at high decision-making levels of the Mexican Government.

However, as Shakespeare knew very well, accomplished institutional outcomes are better explained by values and culture, rather than by the successful imposition of decrees based on the pondering of arm-chair strategists.

For these reasons, premature institutionalization entails some risks and perils. First, an old maxim from architecture warns that "form should follow function," or against putting the cart before the horse. Second, the "rooster syndrome" afflicts certain Third World roosters who hope that by singing earlier, they can make the sun rise earlier. Finally, in these times of budget cuts and resource constraints, unnecessary duplications should be carefully avoided.

Additionally, recent institutional outcomes, in the NAFTA and the Common Market of the South (MERCOSUR), reveal that governments may be exhibiting a certain degree of resistance regarding the creation of new permanent institutions. In the case of NAFTA, overseeing the enforcement of the agreement is entrusted to a Commission integrated by government representatives at ministerial level, while a secretariat formed by offices within

each member government will support the functioning of the Commission. The same can be found in MERCOSUR, where there exists only a very small administrative secretariat, staffed with personnel from the Uruguayan government and charged with servicing the communications and documentation required by the numerous inter-governmental bodies entrusted with enforcing mutually agreed obligations.

In other words, given the risks and perils of premature institutionalization, as well as recent sub-regional institutional experiences, there is a good case for trying to use the existing institutions before concluding that what is necessary at this point is the creation of a new commission or a new bank.

As indicated by very recent signals, the new Administration in Washington has decided that it is willing to espouse, with even more fervor than its predecessor, the objective of building a Hemispheric-wide free trade area. As opposed to the alternative of doing this through separate bilateral agreements, probably the best means for such a purpose will be found in opening the membership in the NAFTA, by implementing the accession clause.

In such a case, the immediate issue will rather be how to enhance the readiness to negotiate among the potential candidates. Presently, the countries of the Hemisphere find themselves at quite different levels of readiness to travel the somewhat lengthy road required by the transition towards the ambitious goal of building a full-fledged free trade area. Furthermore, it can be safely assumed that this transition may at least take what is left of the decade.

Thus, the immediate task consists of patiently strengthening the groundwork and the building blocks to sustain and nurture the environment of mutual knowledge and trust required to undertake mutually beneficial negotiations. The requirements spelled out by the USTR as essential to negotiate can be summarized as follows: a stable macroeconomic environment and market oriented policies, as well as openness to foreign investment and trade with intellectual property protection. Besides these requirements, the governments should organize themselves internally and regionally to carry out lengthy negotiations, which will also demand a more active presence in Washington. For these purposes, it is better to ask the existing institutions to set up a joint effort to support the negotiations. As they have already done in the past, to implement the Alliance for Progress, the Organization of American States (OAS), the Inter-American Development Bank (IDB) and the Economic Commission for Latin America and the Caribbean (ECLAC) should be asked to set up, with their own resources, a "tripartite technical facility" to support the negotiations.

VIII. 2. IMPLEMENTING THE ACCESSION CLAUSE
(WDW/15/93 2 JUNE 1993)

The accession clause, which appears as Article 2205 of the North American Free Trade Agreement (NAFTA), reads as follows:

"1. Any country or group of countries may accede to this Agreement subject to such terms and conditions as may be agreed between such country or countries and the Commission and following approval in accordance with the applicable approval procedures of each country. 2. This Agreement shall not apply as between any Party and any acceding country or group of countries if, at the time of accession, either does not consent to such application."

The Commission mentioned is the supreme decision-making body created by article 2001 of the NAFTA, it is formed by "cabinet level representatives or their designees," to perform, among others, the following functions: "a) supervise the implementation of the agreement;" and "b) oversee its further elaboration."

A lot of praise should be shed on those negotiators of the NAFTA who insisted that the accession clause be left open. Although it is still too early to exactly know who took the initiative in these matters, rumor has it that the fact that there is an accession clause at all can be credited to the Canadian negotiators. However, the fact that the accession clause was left open to the participation of any country, without closing it geographically to include only those countries from the Western Hemisphere, is said to be due to the initiative of the Mexican delegation.

Be it as it may, that the NAFTA has an open accession clause protects it against the risk of its becoming another confirmation for those who already see the world split in three neat blocs. The openness of the NAFTA's accession clause disproves some of the inevitability attributed to this trend towards the formation of blocs, which can be found among some of the most anxious observers of the international scene, apparently nostalgic about the neatness of the bipolar world gone-by.

Other indicators from the Western Hemisphere which deny this allegedly ubiquitous trend towards the formation of a bloc in that part of the world can be found, for instance, in the recent creation at the Inter-American Development Bank (IDB) of a Multilateral Investment Fund (MIF), to improve the foreign investment climate in Latin America and the Caribbean. Sometimes it is overlooked that, among the principal contributors to the MIF, Japan has pledged \$500 million, an amount equivalent to the contribution of the United States. Additionally, the second largest contributor is Spain with \$50 million, followed by Germany and France with \$30 million each, Italy with \$20 million and Portugal with \$4 million.

Also in the Western Hemisphere, the accession clause as it appears in the NAFTA is a reflection of what can be characterized as an open regionalism. The days seem to be gone when the United States practiced the Monroe Doctrine to exclude extraneous influences from the Western Hemisphere. As gone seem to be the days when Latin America and the Caribbean practiced a "defensive nationalism," which manifested itself in attempts at economic integration oriented towards the protection of relatively meager internal markets.

However, it is not enough that the accession clause is written in a way which allows for the practice of an open regionalism, the appropriate signals must happen in order to conclude that this is the case. Among these signals, probably the most important must

come from the United States and it may come early, since it should happen with the process of approval of the implementing legislation of the NAFTA.

For the United States to become a credible partner in trade negotiations, the executive branch must obtain "fast track" authorization from the legislature. This reassures the negotiating partners of the United States that agreements will be approved or rejected by the legislature as negotiated.

The advantage of the "fast track" authorization was recently confirmed with the signature of the NAFTA. The new Administration requested the negotiation of additional agreements on the environment and labor standards, but the agreement itself will be submitted for approval as it was negotiated originally and it will have to be voted as it is.

The same should be true of the possibility of extending the NAFTA to other interested parties, through the accession clause. For this possibility to enjoy any viability, the implementing legislation of the NAFTA will have to include a "fast track" authorization, guaranteeing that the accession agreements will only be approved or rejected as negotiated.

If the implementing legislation of the NAFTA in the United States does not contain a "fast track" authorization to apply the accession clause, the process of trade liberalization in the Hemisphere will be devoid of viability. Simply, because the biggest trading partner will not have the credible means to carry out the required negotiations.

Beyond this essential requirement, the concrete steps which will have to be given depend from two decisive factors. First, there is a need for leadership throughout a process which promises to be lengthy and protracted. Second, there is the need to enhance the "readiness to negotiate," by providing institutional support (WDW/14/93) to the governments and the private sectors of the acceding partners.

VIII. 3. THE NEED FOR LEADERSHIP
(WDW/17/93 16 JUNE 1993)

Now that the negotiations on the North American Free Trade Agreement (NAFTA) have entered into a decisive phase, focusing on the side agreements requested by the Clinton Administration, the need for leadership to complete this complex process has been widely confirmed. Even more so, when it is considered that a protracted and lengthy negotiation to extend the NAFTA throughout the Hemisphere can be expected to last at least for the rest of the present decade.

In normal times, leadership and an intense effort to maintain a presence in Washington, as the Mexican and the Canadian negotiators can verify, are two of the most essential ingredients to carry out successfully a protracted negotiation with the United States. In such normal circumstances, leadership should come from the United States. However, the turn towards the domestic in the United States will probably mean that

leadership, once the fast track authorization to implement the NAFTA's accession clause is approved (WDW/15/93), may have to come from somewhere else.

Some of the consequences of the present introversion in the United States are already being felt. First, there is the abrupt manner in which some external issues have literally disappeared from the agenda in Washington. Some of these external affairs cannot compete against the need to balance the budget or with the debate over health care. Second, relatively more intense efforts are consequently required to keep certain issues even at the bottom of the agenda. For instance, it has been estimated in The Journal of Commerce that Mexico spent in 1991 between \$75 and \$100 million to mobilize support for the NAFTA negotiations. Finally, as illustrated by the debate on the NAFTA, the focus is almost exclusively on the internal consequences, such as the alleged "job losses" and the flight of investments south of the border, which the NAFTA approval is supposed to precipitate. What Mr. Perot has more graphically described as a "sucking sound" of investment and jobs.

These are some of the arguments forcefully and quite effectively presented by the heterogeneous coalition where some strange bedfellows can be found, such as Mr. Ross Perot, several environmental organizations, Mr. Ralph Nader, as well as organized labor and MIT Professor Noam Chomsky.

Thus, leadership in these exceptional times of introversion in the United States will have to come from somewhere else, particularly from the other two members of NAFTA. For some time, Mexico will remain the least interested in NAFTA's extension to other trading partners, if only because it may want to enjoy for a while its newly obtained market access and build its market share.

The most viable alternative is for Canada to assume such leadership role during the forthcoming negotiations to extend the NAFTA. As characterized by University of British Columbia Professor Ivan Head, Canada's multilateral vocation comes from its inability "to protect its territory or its environment from its immediate neighbors," which has made "cooperation with others...the chosen route of Canadian foreign policy and Canadian diplomacy." Consequently, Canada "has long chosen to hone its skills and concentrate its efforts along multilateral paths."

There are indications that Canada is already assuming such a leading role. For instance, Canada's decision to join the NAFTA negotiations secured the multilateral character of the agreement. Also, one of the most important reasons for joining the NAFTA negotiations had to do with Canada's deliberate avoidance of the relatively more inefficient alternative represented by the emergence of the United States, through bilateral treaties, as "the hub of a rimless wheel."

Professor Ronald J. Wonnacott, of the University of Western Ontario, coined this phrase to describe the outcome represented by the "exclusive bilateral 'spoke' agreements" which the United States would "sign with any other countries individually." In Professor Wonnacott's terms, written before Canada decided to join the NAFTA negotiations, to prevent the "U.S.-centered rimless wheel" was "the most important reason for Canada to trilateralise the negotiations." Furthermore, for the same reasons, Professor Wonnacott suggested Canada "should also in the future similarly seek to ensure the

'trilateralising' of any succeeding negotiations between the United States and any other country."

Finally, as part of what can be termed the "readiness to negotiate," certain conditions will be required by the United States to begin negotiations. As spelled by the Department of Commerce and the Office of the U. S. Trade Representative (USTR), these conditions comprise a stable macroeconomic environment and market-oriented policies; active participation in the GATT; openness to foreign investment and trade in services; and world class intellectual property protection. Briefly, these requirements basically include commonly agreed rules on the origin of products, safeguards, dispute settlement procedures and the conditions for future accession of non-members, as well as restraints on subsidies, state trading and the use of foreign exchange restrictions.

However, beyond the fulfillment of these requirements and of the "readiness to negotiate," there is also the readiness to carry out a deliberate effort in Washington, to keep the negotiations on the agenda. Otherwise, the issue will be overwhelmed by other relatively more salient and pressing matters.

IX. MULTILATERAL FINANCIAL INSTITUTIONS

IX. 1. SOUL-SEARCHING AT THE WORLD BANK (WDW/4/93 10 FEBRUARY 1993)

President Lewis T. Preston has taken another step in the path of adapting the World Bank to his management style. About a year ago, the organizational structure was "delayed" by eliminating the senior vice-presidencies and creating an inner circle of three Managing Directors. Second, poverty reduction was reaffirmed as the overriding objective of Bank's activities. Third, on January 1st. of this year, the three main components of the poverty reduction effort--human resource development, private sector development and environmentally sustainable development--were elevated to the rank of vice-president, to replace the Vice-Presidency for Sector Operations Policy. Finally, in October, the Board of Directors received a quite candid assessment of the management of the Bank's portfolio of projects. This last is the most inward-looking of all the steps. In President Preston's terms, it is "a frank and exceedingly useful report."

In February 1992, a task force on portfolio management was created under the chairmanship of Mr. Willi Wapenhans, one of the most experienced senior vice-presidents, who had decided to retire. The mandate for the task force was to conduct a review and to make recommendations for improving the Banks' portfolio management and evaluation process. Initially, the task force interpreted the scope of its inquiry as to analyze the "downstream" stages of the project cycle, from negotiations through impact evaluation. The scope was extended to include also those factors which affect the quality of projects when they enter the portfolio, the "upstream" stages of the project cycle, such as identification, preparation and appraisal, as well as others that influence the process of learning from experience.

The findings of the task force are quite impressive. First of all, just the dimension of the portfolio can serve as an indication of the magnitude of the Bank's impact. The lending commitments of the Bank and the International Development Association (IDA) amounted to close to \$140 billion, with annual disbursements against 113 country portfolios, containing about 1800 projects, reaching \$16.5 billion in FY92 and expected to increase to \$20.4 billion in FY93.

According to the task manager's memorandum of transmission, there is "no cause for alarm in the state of the portfolio." In FY91, "80 percent of the current portfolio was estimated to be performing well," while the rest "was incurring major difficulties." This last figure is not considered "excessively high," since a very low figure "could imply the Bank was not taking risks in a high-risk business." Some cause for concern is found in the 39 percent of borrowing countries with poorly performing portfolios, defined as countries in which "25 percent or more projects are problem projects."

However, the "main concern" is about the trend in portfolio performance, as revealed by the almost doubling of the share of problem projects, from 10 percent in FY79-

81 to 17 percent in FY89-91. This proportion is present in almost all sectors, with the exception of adjustment lending. By regions, Africa ranked last in projects' success rates with 59 percent, preceded by Latin America with 62 percent. Thus, in Mr. Preston's terms, the report "validates my initial concerns that all is not well with the results of Bank-financed projects and with the processes and procedures which affect lending, supervision and implementation."

The factors that are contributing to the decline in project performance are found at the global level, such as the oil shocks, the debt crisis, and declining terms of trade. At the country level operate other factors, such as deteriorating institutional, policy and macroeconomic environments.

Finally, Bank practices are also contributing to the decline, such as a "pervasive preoccupation with new lending," as part of an "approval culture" which emphasizes "timely loan approval." Mr. Preston recognizes that tension has "always existed" between "new commitments" and "effective implementation."

The problem is that this emphasis on loan approval "is not matched by equal emphasis on implementation planning and identification and assessment of major risks to project performance." Even "the Bank's role in supporting project implementation is inadequately defined." A project-by-project approach prevails in portfolio performance management, while country-wide implementation reviews still are far from being a standard practice. Also, the Bank's evaluation system gives inadequate attention to development impact.

These are the major difficulties and the report presents six recommendations: 1) introduce country portfolio performance management; 2) allow country-portfolio restructuring, including reallocation of undisbursed balances; 3) improve the quality of projects entering the portfolio; 4) define the Bank's role in project performance management; 5) enhance the evaluations department's role as an instrument of accountability; and 6) create an internal environment, by reordering priorities and incentive systems, to ensure emphasis on portfolio performance management.

These recommendations, according to President Preston, are equivalent to a "cultural shift towards a better balance between work on new commitments and the effective use of previously approved operations." For President Preston the World Bank "must change the institutional values which determine our approach to new operations and supervision of the existing portfolio."

IX. 2. THE IMF-WORLD BANK SPRING MEETING (WDW/13/93 19 MAY 1993)

During this year's Fund-Bank spring meetings, almost everybody received a pat in the back. The sometimes acrimonious confrontations among the industrialized countries were conspicuously absent. Two issues were at the top of the agenda: first, a cooperative strategy for the restoration of non-inflationary growth among the industrialized economies

and second, aid to the former centrally planned economies. Both issues had been well prepared, by means of what Undersecretary of the U.S. Treasury Lawrence Summers characterized as "discrete, private communications," which contributed to a clear improvement in the tone of the discussions.

The substantive discussions took place in the Group of Seven (G-7), which includes the Finance Ministers and the Central Bank Governors of Canada, France, Germany, Italy, Japan, the United Kingdom and the United States, under the chairmanship of the new U.S. Treasury Secretary Lloyd Bentsen.

The "cooperative strategy for the restoration of non-inflationary growth" aims at "putting the world economy on the path to economic recovery and sustained growth," based on "sound macroeconomic policies, structural reforms and an open international trading system."

For this purpose, the G-7 welcomed the program for economic revitalization of the new Administration in Washington, whose "positive effects are already visible in a substantial reduction in long-term interest rates." In Europe, the G-7 recognized that there was "room for a further decline in interest rates that should make a substantial contribution to growth." Finally, the announcement of a substantial stimulus package by Japan was seen as "a welcome contribution toward the important goal of sustained non-inflationary growth based on increased domestic demand, which will contribute to reduce the large external imbalance."

On the economic assistance for the former centrally planned economies, the G-7 supported the results of the Russian referendum and the multilateral support package announced in Tokyo, as well as "the World Bank's Oil Rehabilitation Loan and the IMF's prompt action in establishing the new Systemic Transformation Facility."

For the first time in many years, the G-7 made reference to the need for "structural reforms," to strengthen long-term growth and bring down unemployment. Reflecting the changes in Washington, the G-7 listed the following measures: "labor market reforms and greater flexibility in markets; measures to increase savings and investment; the redirection of government spending toward investment in physical and human capital; curbing the burgeoning cost of health care; and addressing the economic effects of aging populations." Furthermore, a report on these "structural reforms" will be submitted by the Ministers of Finance to the Tokyo Summit.

Other issues which threatened to destroy the harmony were previously brought under control. For instance, the appreciation of the Japanese yen was becoming contentious, on April 28, when the yen hit a record low of 109.5 per dollar. However, on the same day, Secretary of the Treasury Bentsen in testimony before the Senate Appropriations Committee declared that "excessive volatility in exchange rates is counterproductive for growth." The Federal Reserve also began intervening, aggressively selling yen, which pushed it by the end of the day to 111.70. The same terms used by Secretary Bentsen appear in the G-7 communique, saying that "exchange rates should reflect economic fundamentals and that excessive volatility is undesirable." Finally, the G-7

confirmed that "a successful growth strategy requires prompt and appropriate conclusion of the Uruguay Round."

The meetings of the other committees essentially reflected the contents of the G-7 communique. For instance, the Group of Ten (G-10) dealt with a single issue, based on a report prepared by the deputies on "international capital movements and foreign exchange markets."

The same happened with the Development Committee meeting, dedicated as well to a single issue, the access by the developing countries to private capital flows. This meeting almost became an academic seminar. In an unusual step, the new Development Committee chairman, Minister of State and Head of CORDIPLAN of Venezuela, Ricardo Hausman, in addition to the documentation prepared by the Bank and the Fund, requested supplementary papers, both from members of the committee and from independent experts.

The Interim Committee issued a "declaration on cooperation for sustained global expansion," ratifying the decisions already adopted by the G-7 and by the IMF's Executive Board. Support was granted to the creation of the new Systemic Transformation Facility (STF), characterized by the IMF's Managing Director Michel Camdessus as a temporary facility, "designed to be a precursor." Also, the Interim Committee supported the IMF's Executive Board efforts to find a successor to the Enhanced Structural Adjustment Facility (ESAF), for low-income members.

Even the communique issued by the G-24 of the developing countries was celebrated for its lack of confrontational language. For instance, on the creation of the STF the Ministers of the G-24 "noted that countries that qualify for Fund assistance under the systemic transformation facility (STF) are not restricted to one region, and called on the Fund to give due attention to the needs of all members that are experiencing balance of payments difficulties associated with systemic economic transformations."

IX. 3. 'GETTING RESULTS' AT THE WORLD BANK (WDW/22/93 28 JULY 1993)

This is the title of a brochure released by the World Bank describing the recent endorsement by the Board of Directors of an "agenda for improving development effectiveness," based on the recommendations of what is known as the "Wapenhans Report" (WDW/4/93).

Where and how the World Bank intends to put its money determines in effect the development agenda as a whole, on account of its relative weight. For instance, the Bank's portfolio contains 1800 projects, amounting to \$140 billion and generating around \$370 billion in investments, distributed in 113 individual country portfolios. Just in fiscal year (FY) 1993, new lending commitments to developing countries by both the Bank and the International Development Association (IDA) totalled a record \$23.7 billion, compared to

\$21.7 billion in FY92. Gross disbursements in FY93 from both IBRD/IDA amounted to \$18.0 billion, compared with \$16.5 billion a year earlier.

By regions, during FY93, Latin America and the Caribbean received the largest proportion of new commitments from both IBRD/IDA, amounting to \$6.2 billion, basically dedicated in the largest countries to institutional development, the environment and human resource development.

Also, contrary to common beliefs, adjustment lending has been decreasing, amounting in FY93 to 19 percent of total IBRD/IDA new commitments, compared to 27 percent for the previous fiscal year.

The decision of the Board of Directors adopting the recommendations of the Wapenhans report constitute "a wide-ranging action plan to improve the performance of the projects and programs" financed by the World Bank group. The action plan contains the following elements: 1) the management of country portfolios, instead of individual projects, will become the focus to evaluate effectiveness and future lending; 2) to restructure the entire portfolio, instead of only individual nonperforming projects; 3) to improve the quality of new operations entering the portfolio; 4) to increase the resources dedicated to supervision as a means to reinforce project and program implementation; 5) to enhance the evaluation of operations, focusing on whether benefits are sustainable; and 6) to change institutional behavior and attitudes, through changes in staff and in performance incentives, aimed at a better balance between approving new operations and ensuring the success of those in progress.

The implementation of this action plan entails the enactment of some profound changes in traditional Bank operating procedures, which will require leadership and determination to overcome the natural resistance to change ingrained in the inertia characteristic of a well-entrenched bureaucracy.

For instance, the whole portfolio of Bank-supported operations in a country will become "the 'unit of account' by which the Bank will measure its own effectiveness." This demands the utilization of at least two principal mechanisms. First, performance reviews will have to be carried out for the country as a whole, covering macroeconomic, as well as world economic conditions, including commodity prices and international interest rates. Second, since future lending will depend on the implementation of current operations, the Bank will have to assume a larger responsibility in implementing country assistance strategies.

The issue of nonperforming projects sometimes will be more effectively confronted by means of restructuring the country portfolio as a whole, particularly when specific remedies have proved unsuccessful. In some cases, this may lead to the cancellation of certain projects and to the restructuring or redesign of others, including substantial reductions in Bank financing.

To improve the quality of operations certain actions by the borrowers will have a much greater effect, such as a sense of ownership and commitment. However, this poses a challenge of delivering the assistance required by the borrowing countries, whose capacity to conceive, design and implement projects is often weak. As described by an

Executive Director, "the challenge for the Bank is to change the ways it interacts with borrowers, from a pattern dominated by prescription, imposition, condition-setting, and decisionmaking to one characterized by explanation, demonstration, facilitation and advice."

Loan supervision demands clear implementation plans, close monitoring and assessment of progress, through midterm reviews and the expansion of the number and role of field offices. Also, operations evaluation demands the performance of impact evaluations, focused on country portfolios, as well as diversified specific studies.

Finally, the changes in staffing and resources demand a different mix of skills, focused on "institutional building, public sector management, and social sciences other than economics," as well as changes in promotion policies to reward portfolio management, rather than project approval. As recalled in May 1993 by President Lewis Preston, "the Bank's objective in lending is to reduce poverty. On-the-ground benefits--rather than loan approvals--should be the measure of our success." To accomplish such a purpose, he concluded, "we are changing our processes and we are changing our incentive system."

IX. 4. THE IMF'S ANNUAL REPORT (WDW/24/93 15 SEPTEMBER 1993)

As every year, before the annual meetings of the Board of Governors, the Executive Board releases the Annual Report reviewing the International Monetary Fund's performance in the financial year ending on April 30.

The first part of the Report contains a description of the main developments that took place in the world economy during 1992 and early 1993. It reviews the most recent trade policy developments and a summary of three discussions of the World Economic Outlook (WEO). The second part contains a description of policies and activities, including surveillance activities; financial support for members' policies; technical assistance and financial operations.

Against the background of a world economy experiencing a recovery "below expectations," the Fund carried out the surveillance of the members' policies and performance. This is done by means of yearly individual consultations and multilaterally through two regular discussions in the Board of the world economic outlook, on September 1992 and April 1993 (WDW/13/93), and an additional discussion held in December 1992 (WDW/7/93).

Several major changes are testing the IMF's role of overseeing the functioning of the international monetary system. This "time of almost unprecedented changes in the international economy" has led to what is characterized as "the most significant set of developments to have faced the IMF in recent years." Among these changes, the enlarged membership is "foremost," since it has made the IMF a "near-universal institution." Second, several members are "undergoing the difficult transition to market-oriented

economies." Third, the "record number of countries which are being assisted by the IMF." Fourth, "the number of countries that have taken steps to remove restrictions . . . and open up their economies." And finally, "the major efforts in regional integration that are under way."

This expansion in membership during the last financial year, from 157 to 177, and the quota increases due to the Ninth General Review, in effect since November 1992, raised total IMF quotas by almost 60 percent, from SDR 91.2 billion at the end of April 1992 to SDR 144.6 billion at the end of April 1993. Only the initial quotas of the new members who joined the IMF during the same period amounted to SDR 6.2 billion of the quota increase. Additionally, both the quota subscriptions by the new members and the quota increases more than doubled the Fund's liquid resources. Thus, as of the end of April 1993, IMF's liquidity reached record levels, since "adjustable and uncommitted usable resources totaled SDR 52.2 billion, compared to SDR 20.9 billion a year earlier."

A temporary Systemic Transformation Facility was created "to extend financial assistance to members experiencing severe disruptions in their trade and payments arrangements due to a shift from significant reliance on trading at nonmarket prices to multilateral, market-based trade."

Additionally, in August 1992, a Technical Assistance Secretariat was created within the Fund "to provide a focal point" for responding to the demands of the new members.

Yet, only 11 stand-by arrangements totaling SDR 2.0 billion, and 3 extended arrangements totaling SDR 1.2 billion were approved in 1992/93. Of these eleven stand-by arrangements, 4 were in Central Europe (Albania, the Czech Republic, Poland and Romania); 3 were to the Baltic States (Estonia, Latvia and Lithuania); one was for Russia; and the remaining three went to the Western Hemisphere (Costa Rica, Guatemala, and Uruguay).

The amount of these stand-by arrangements was almost half the total level of commitments approved in the previous year, amounting to SDR 8.1 billion. The explanation for this decrease in activities is "the improved economic performance of many developing countries, particularly in the Western Hemisphere, while the expected large demand for use of IMF resources from many of the IMF's new members had not yet materialized."

During financial year 1992/93, members' purchases (drawings) remained the same as the previous year, amounting to SDR 5.3 billion, while repurchases (repayments) decreased to SDR 4.1 billion, from SDR 4.8 billion. In all, in 1992/93, the net resource transfer to the member countries increased from SDR 0.5 billion of the last financial year, to SDR 1.2 billion.

The overdue financial obligations to the Fund "remained high in 1992/93." However, "for the first time in a decade" there was a decline in the amount of arrears, from SDR 3.5 billion at the end of April 1992 to SDR 3.0 billion at the end of April 1993.

Also, Peru eliminated its arrears with the successful completion of its program of rights accumulation; thus, its ineligibility to use the Fund's general resources was lifted on

March 13, 1993. As a consequence, at the end of financial year 1992/93, no countries in the Western Hemisphere were in arrears with the Fund.

Finally, for the performance of these duties the Fund's regular staff increased from 1861 persons from 107 countries in 1991/92 to more than 2,100 from 114 countries in 1992/93. Consequently, the total administrative budget increased in 1992/93 from US \$338 million in the previous financial year to US \$ 389 million.

IX. 5. THE WORLD BANK'S ANNUAL REPORT (WDW/25/93 22 SEPTEMBER 1993)

Covering the fiscal year (FY) from 1 July 1992 to 30 June 1993, the World Bank's Annual Report contains the following sections: 1) The Executive Board's activities; 2) a global perspective of the economic scene; 3) the Bank's operations in FY 93; 4) the Bank's finances; 5) the activities of the members of the World Bank Group, 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, with a special segment dedicated to Latin America and the Caribbean; and 7) a summary of the projects approved during FY 93.

The admission of sixteen new members, among them eleven republics of the former Soviet Union and two remaining Baltic states, brought total membership to 176, which brings the Bank close to universality. Action was pending on membership for Bosnia-Herzegovina, Eritrea, Macedonia and the Federal Republic of Yugoslavia.

Total new lending commitments by the World Bank Group in FY 93 amounted to \$23.7 billion, of which \$16.9 billion for 122 projects from the Bank and \$6.8 billion for 123 projects from the International Development Agency (IDA). These figures represented an increase from FY 92, from \$15.2 billion for 112 Bank projects and \$6.6 billion for 110 IDA projects. Net disbursements by the Bank increased in FY 93 to \$2.4 billion, from \$1.8 billion in FY 92. IDA's net disbursements also increased from \$4.4 billion in FY 92 to \$4.5 in FY 93.

By sectors, structural adjustment lending operations experienced an impressive decrease from 27 percent of total lending in FY 92, to 17 percent of new commitments in FY 93. By contrast, lending for human-resource development, comprising education, population, health and nutrition, accounted for 16 percent of total Bank lending in FY 93. Still, agriculture and rural development received the largest percentage of commitments in FY 93, with 13.8 percent, followed closely by transportation with 13.4 percent. With the increase in lending for human-resource development, the Bank is approaching rapidly the goal stated by President Lewis Preston that "poverty reduction must be the benchmark against which (the Bank's) performance must be judged."

The segment dedicated to Latin America and the Caribbean describes the economic recovery experienced by the region, with the notable exception of Brazil which influences heavily regional averages. Even so, it is noted that "the economic recovery of the region is

even more remarkable in the context of an international environment that has provided limited opportunities for export growth."

Other bright spots highlighted from the region's evolution are first, the sharp decline in inflation, which was particularly noticeable in Argentina, Nicaragua and Peru. Second, the "strong stabilization programs in the region, combined with relatively low interest rates in the United States, have provided an environment that has attracted a substantial inflow of capital to the more successful adjusting countries (Argentina, Colombia, Chile, Mexico and Venezuela)." Finally, "the establishment of stable economies with low tariffs has laid the basis for renewed discussions on regional integration."

In FY 93, Bank activities in Latin America and the Caribbean can be summarized as follows: 1) total new commitments increased to \$6.1 billion from \$5.6 billion in FY 92; 2) gross disbursements of \$5.1 billion were higher than the \$3.9 billion of FY 92, while repayments of almost \$4.4 billion yielded positive net disbursements of \$769 million; 3) however, interest and charges of \$3.1 billion led to a negative net transfer of \$2.3 billion.

In the near future, considering "the revival of capital flows" into Latin America and the Caribbean, "the Bank's accent today in the larger countries of the region is less on resource transfers and more on institutional development, human-resource development, the environment, and natural-resource management." In the other countries of the region the Bank will continue operating "consultative groups and other mechanisms to mobilize external assistance."

Finally, during FY 93, particular attention was given to the issue of portfolio management, after an internal task force led by former vice-president Wapenhans revealed that the quality of the Bank's portfolio had declined (WDW/4,22/93). Also, the creation of three new vice-presidencies "to provide enhanced support and leadership in critical-poverty related areas: human resource development, finance and private sector development and environmentally sustainable development."

At the end of FY 93, the Bank employed 6,197 regular and fixed term staff, of whom 4,005 were higher-level staff from 121 nations, 58 percent from industrialized countries and the remaining 42 percent from developing countries. During FY 93, the Bank hired 239 new higher-level staff, of whom 140 were to support Bank's activities in the republics of the former Soviet Union. The proportion of women employed as higher-level staff during FY 93 increased from 27.4 percent of the total to 28.4 percent. The Bank's administrative budget increased by 11 percent, to \$1.38 billion for FY 94, from \$1.25 billion in FY 92.

IX. 6. THE IMF-WORLD BANK ANNUAL MEETINGS (WDW/27/93 6 OCTOBER 1993)

A world economy undergoing, what the IMF's World Economic Outlook (WEO) (WDW/26/93) described as, its "fourth consecutive year of sub-par growth performance"

furnished the background for the annual meetings of the World Bank and the IMF, held in Washington on September 24-30.

Several changes in the style of conducting the meetings were noticeable, with some of these changes probably resulting from the new Administration in Washington. For instance, from the cryptic communiques issued by the G-Seven and particularly by the G-Ten, the center of gravity of the meetings displaced itself to the Interim and Development Committees. Second, open manifestations of disagreement, if there were any, were kept within closed quarters. Third, by contrast with the Reagan and Bush Administrations, the President of the United States did not participate in the inauguration ceremonies.

Still, one of the high points of this year's meetings was contained in the communique issued by the G-Seven Finance Ministers after meeting with their colleague Boris Fedorov from Russia. The G-Seven "praised president Yeltsin's commitment to pursue the path of market-oriented reform" and "reaffirmed their commitment to the program of support agreed on in Tokyo in April."

However, it was the Interim Committee that expressed "concern" about the continued weak growth performance in industrial countries and the high and rising rates of unemployment and persistent protectionist pressures." Also, the Interim Committee stressed "the need for Fund members to continue action to promote a robust recovery and a sustained expansion."

Another high point, briefly mentioned in the communique of the Development Committee, "welcomed the outstanding contribution to the Middle East Peace Process made by the World Bank in preparing the ground for a coordinated program of financial support for Gaza and the West Bank."

Finally, the return of South Africa to the international financial community was marked by the vote in the U.S. Senate that rescinded a ban on IMF lending to that country. This was followed by a meeting between African National Congress (ANC) leader Nelson Mandela and the IMF's Managing Director Michel Camdessus. Upon the conclusion of this meeting, the IMF announced the preparation of the first disbursement for South Africa of an \$850 million credit to compensate for a dramatic drop in exports.

No specific mention appeared in the communiques about Latin America, particularly because the much expected results of the conversations between the Brazilian Finance Minister Fernando Henrique Cardoso and the IMF Managing Director Camdessus never happened. The communique of the Development Committee only registered the assumption of the chair by Mr. Rudolf Hommes, Minister of Finance of Colombia, to replace the retiring chairperson, Minister Ricardo Hausmann of Venezuela.

Other highlights that took place during the meetings had to do more with decisions that should be adopted, rather than with more positive outcomes. For instance, the Director General of GATT, the President of the World Bank and the Managing Director of the IMF issued a joint declaration demanding the successful conclusion of the Uruguay Round.

Among the main points, the tripartite declaration said that "uncertainty about industrial nations' commitment to the multilateral trading system puts at risk the success of many countries that have unilaterally liberalized their trading regimes in recent years and discourages others from following in their footsteps."

The three chief executives conclude their statement saying that "with so much at stake, political hesitations and vested interests must be put aside." Consequently, "courageous and visionary decisions need to be made quickly to conclude the Uruguay Round and thereby contribute to a return to substantial and sustainable economic growth."

Finally, one promise and one non-decision may be more illustrative of what happened at the meetings. First, there is agreement about the establishment of a successor facility to the IMF's Enhanced Structural Adjustment Facility (ESAF), created in December 1987, "to provide concessional financing to back adjustment by the poorest countries." The last new lending commitments from the ESAF must be done by the end of November 1993 and the successor facility will operate by making commitments until 1996, to be disbursed through 1999.

The non-decision had to do with the global need for a new allocation of SDRs. In response to a decision adopted last April by the Interim Committee, the IMF's management has come out in support of an allocation of SDR 36 billion. This is considered "reasonable to attain the modest objective of beginning to reverse the declining importance of the SDR in members' international reserves." Such an increase would raise "the present share of SDRs in world international reserves to the average of the last two decades, or 5.3 percent."

The reaction by the Interim Committee did not close the door to a new SDR allocation soon. The Committee requested that the IMF's Executive Board "continue its work on these issues--having particularly in mind the situation of the many new members that have not participated in previous SDR allocations--and to report to the Committee at its next meeting, to be held in Washington, D.C. on April 25, 1994."