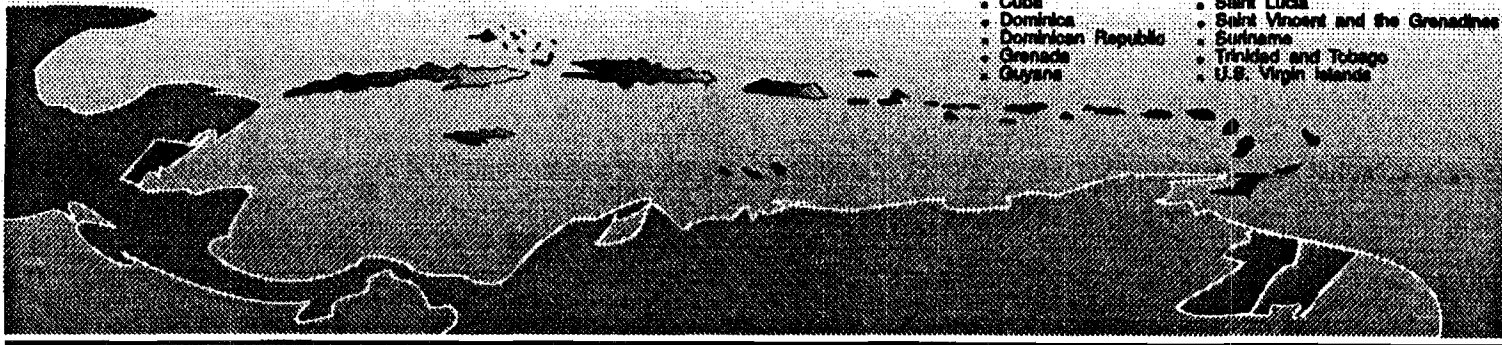


- Antigua and Barbuda
- Aruba
- Bahamas
- Barbados
- Belize
- Br. Virgin Islands
- Cuba
- Dominica
- Dominican Republic
- Grenada
- Guyana
- Haiti
- Jamaica
- Montserrat
- Netherlands Antilles
- Puerto Rico
- Saint Kitts and Nevis
- Saint Lucia
- Saint Vincent and the Grenadines
- Suriname
- Trinidad and Tobago
- U.S. Virgin Islands



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**SUMMARY OF GLOBAL ECONOMIC DEVELOPMENTS**  
**-1995-**

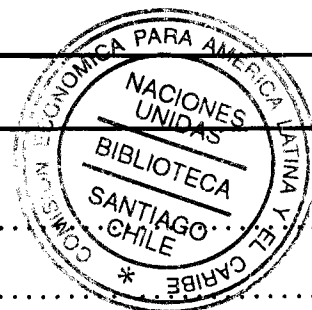
1996 JUN 20



**UNITED NATIONS**  
**ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN**  
Subregional Headquarters for the Caribbean  
**CARIBBEAN DEVELOPMENT AND COOPERATION COMMITTEE**



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1. The first step in the process of the scientific method is to make an observation or ask a question. For example, a scientist might observe that a plant grows better in one type of soil than another.

2. The second step is to form a hypothesis, which is a prediction or an educated guess about the outcome of an experiment. For example, a scientist might hypothesize that a plant will grow taller in soil A than in soil B.

3. The third step is to design an experiment to test the hypothesis. This involves setting up a controlled experiment where only one variable is changed at a time. For example, the scientist might plant the same type of plant in two different soils and measure the height of the plants over time.

4. The fourth step is to collect data and analyze the results. The scientist might measure the height of the plants in soil A and soil B at regular intervals and compare the results.

5. The fifth step is to draw a conclusion based on the data. If the data shows that the plants in soil A grew taller than the plants in soil B, the scientist might conclude that soil A is better for growing this type of plant.

6. The sixth step is to communicate the results of the experiment. The scientist might write a paper or give a presentation about the findings.

7. The seventh step is to repeat the experiment to verify the results. This is important to ensure that the findings are reliable and not just a one-time occurrence.

8. The eighth step is to apply the findings to other situations. For example, if the scientist finds that soil A is better for growing a certain type of plant, they might use that information to help farmers choose the best soil for their crops.

9. The ninth step is to share the findings with the scientific community. This allows other scientists to learn from the results and build on the work.

10. The tenth step is to continue to explore the topic. The scientist might want to know more about the properties of soil A and how it affects plant growth.

## INTRODUCTION

This is the third in the series of annual papers discussing external economic developments of potential interest to the Caribbean policy maker. It tries to paint a brief, broad-brush picture of global developments. Under this rubric, performance of the geographic groupings is discussed and country performance highlighted where this is judged to be of interest. It also tries to distill the most significant trends in the trade in goods and services and in the institutional arrangements which are evolving to facilitate it. Some comments are also made with respect to emerging public attitudes, including the protectionist backlash, which has been observed by those fearing the development of a "Fortress Europe" and which is becoming manifest via the political clout being exercised by the "Anxious Class", in the run-up to the 1996 United States election. Finally, developments in the flows of private capital and development assistance to the developing countries are summarized.

These developments are not academic for the Caribbean. As small open countries, survival or prosperity will depend on their capacity to discern and react appropriately to them. The major global development, which has been unfolding throughout the decade, is the rapidly integrating global market for trade in goods and services and for investment, which has in turn been made possible by the revolution in communications and computers and the adaptation of national policies to facilitate it. The development of a transparent global market holds enormous potential for all participants, but especially for the developing countries, since it allows them to break out of the constraints of small domestic markets, low savings rates, and weak technological development which they have traditionally faced. It, therefore, gives them the chance to contest markets for goods and services and improve their access to capital markets previously concentrated primarily on the industrial economies. These potentials can, however, only be realized if the developing countries adopt appropriate policies.

Yet these global developments are not without cost. The benefits to be derived from global markets are not evenly distributed and those unable or unwilling to access them will experience declines in their standards of living. Accordingly, they hold the potential to create major economic dislocations and insecurity, as several countries, both developed and developing, have found. Those unable or unwilling to participate in this process of change will naturally try to retard it, creating the risk that the society as a whole will be among the latecomers and the last beneficiaries from the process. Even countries initiating and consequently in the forefront of the process, must now grapple with such resistance to change.

The major challenge facing Caribbean countries, is to manage this transition with the minimum social and psychological cost. This can be assisted by familiarizing the public with the process, its costs and its benefits, and by progressively implementing policies which facilitate orderly change. Various institutional supports are also desirable, to assist citizens to build new competence and renew their confidence, if they are to sustain and accelerate the pace of adaptation to the new environment.

## OUTPUT, INFLATION AND REGIONAL PERFORMANCE

Table 1					
GLOBAL PRODUCT					
	1991	1992	1993	1994	1995
Global Output	1.3	2.0	2.5	3.6	3.7
Industrial countries	0.8	1.5	1.1	3.1	2.5
European Union	1.1	1.0	-0.6	2.8	2.9
Developing countries	4.9	5.9	6.1	6.2	6.0
Four Asian Newly Ind. Countries	7.8	5.7	5.9	7.5	8.1
Latin America	3.3	2.8	3.0	4.6	0.6
Debtors <1>	2.5	2.2	2.7	4.1	2.4
Countries in transition	-11.6	-15.2	-9.1	-9.5	-2.1
Russia	-13.0	-19.0	-12.0	-15.0	-4.0
Central and Eastern Europe	-11.1	-11.3	-6.1	-3.8	0.2
Source: I.M.F.; ECLAC.					
<1> Fifteen heavily indebted countries					

The global economy expanded at a slightly faster rate in 1995 than in 1994. This was the fourth consecutive year of accelerating growth since 1991. Steady growth was expected to continue, with a 4 per cent growth rate projected for 1996. Although growth slowed slightly in both industrial and developing countries in 1995, the rate of economic decline experienced by the countries in transition continued to slow from 1992. While output contracted slightly for the group as a whole in 1995, expansion of over 3 per cent was being predicted for 1996. Within the group, the countries of Eastern Europe experienced slight growth, although several of them expanded faster than the European Union (EU) average in 1995.

Inflation remained moderate in the developed countries, though slightly higher than in 1994. The exception was Japan, where inflation was negative. For the developing countries as a whole, inflation declined significantly. Rates for the newly industrializing countries remained low, being only slightly more than the developed countries. Accordingly, this suppressed the rate for Asia as a whole, to about 12 per cent. For the other developing countries, however, rates seemed to be converging, clustering around 20-25 per cent. In Latin America, inflation fell sharply from about 890 per cent in 1993 to 25 per cent in 1995. The trend was consistent throughout the region, for in 17 of the 22 countries prices either fell or remained stable. However, the overall figure was greatly influenced by developments in Brazil, where inflation declined from 2489 per cent in 1993 to settle at 22 per cent for 1995. Mexico provided a notable exception to the downward trend, with inflation increasing to

**Table 2**  
**INFLATION AND INTEREST RATES**

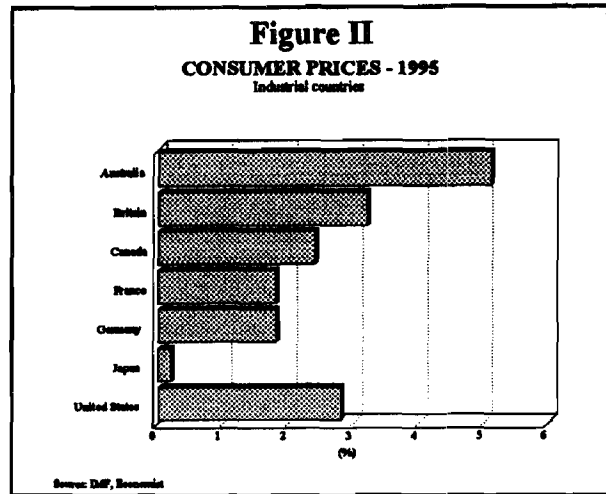
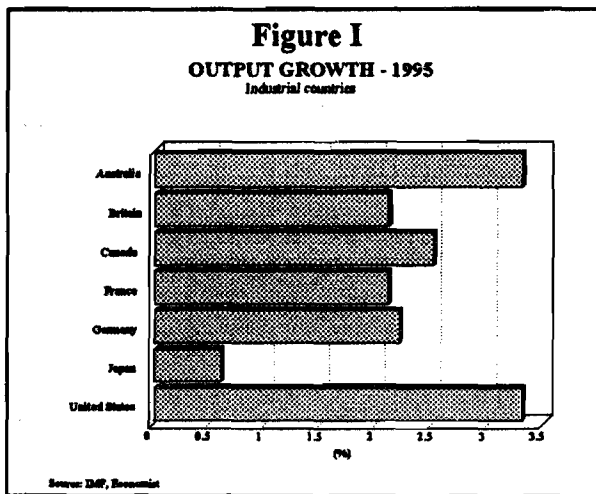
	1991	1992	1993	1994	1995
<b>Inflation &lt;1&gt;</b>					
Industrial countries	4.5	3.3	2.9	2.3	2.5
U.S.A.	4.2	3.0	3.0	2.6	3.0
European Union	5.1	4.5	3.8	3.0	3.1
Japan	3.3	1.7	1.3	0.7	-0.2
Developing countries	33.5	35.8	43.1	48.1	19.5
Newly Ind. countries	7.5	5.9	4.6	5.6	5.0
Latin America	199.7	418.9	887.6	337.3	25.0
Countries in transition	95.1	722.3	675.2	301.3	147.7
<b>Interest rates &lt;2&gt;</b>					
Major Industrial countries	8.3	7.5	6.2	6.8	6.2
U.S.A.	7.9	7.0	5.9	7.1	6.5

Source: I.M.F. ECLAC  
 <1> Change in consumer prices  
 <2> Long-term interest rates.

almost 50 per cent. The countries in transition also registered some success in the battle to contain inflation, the average for 1995 being about 150 per cent, compared with 675 per cent two years earlier. If countries in the former USSR were excluded, the figure would have been significantly lower.

In the industrial countries the rate of economic expansion slowed, the contraction being most notable in the major countries, as the smaller ones on the whole recorded faster growth. Early projections were for a slight increase for the European Union (EU), although end of year developments hinted that these expectations might be optimistic. Those countries furthest advanced in the economic cycle, such as the United States, Canada, Australia, and the United Kingdom, showed the greatest deceleration in growth as they attempted to restrain expansion to more sustainable levels. Tightening monetary policy, low real wage rates, and tax increases in some countries all contributed to dampen consumer spending.

Rapid growth in the United States in 1994 and consequent high levels of capacity utilization, especially in the labour market, prompted the Federal Reserve Board to fine-tune monetary policy in an attempt to moderate the rate of economic expansion. The strategy, to create a "soft landing"



**Table 3**  
**UNEMPLOYMENT RATES (%)**

	1991	1992	1993	1994	1995
Industrial countries	6.8	7.7	8.1	8.1	7.6
Seven major industrial	6.4	7.2	7.3	7.2	6.8
France	9.4	10.3	11.6	12.4	11.7
Germany	6.6	7.7	8.8	9.6	9.2
United States	6.7	7.4	6.8	5.7	5.1

Source: IMF; National data

and so prolong the duration of the business cycle, appeared to be successful. Inflation remained moderate, despite an economy near full stretch and moderate expansion was expected to continue into the 1996 election year. Since 1992, the fiscal deficit was reduced from 4.9 per cent of GDP to 2.3 per cent in 1995<sup>1</sup>. This in turn stabilized the debt to GDP ratio at 50 per cent since 1992, after steep and sustained rises from 27 per cent in 1980. Deficit reduction permitted interest rates to fall and consequent increased investment sustained economic performance and increased productivity. Continued reduction would ensure eventual balance in the external current account. Consensus seemed finally to have been reached as to the wisdom of eliminating the fiscal deficit. Yet, in their zeal, the contending parties were unable to agree on a budget so that, paradoxically, estimates of performance for 1996, an election year, were further clouded by uncertainty. These twin effects could impact adversely on investor confidence and economic performance.

The tempo of the Canadian economy, which was boosted in 1994 by buoyant exports to North American Free Trade Agreement (NAFTA) partners, slowed, consequent on reduced activity the United States and the collapse of exports to Mexico. Further economic expansion, justified by low capacity utilization and moderate inflation, was not forthcoming in the face of high interest rates, which reflected diminished confidence in Canadian policy. The high federal/provincial debt, at two-

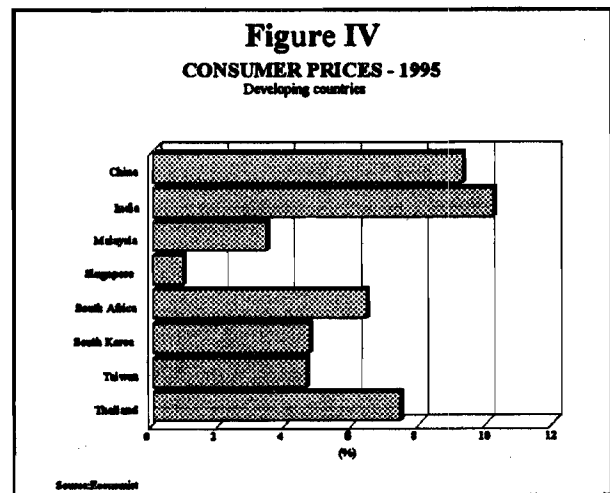
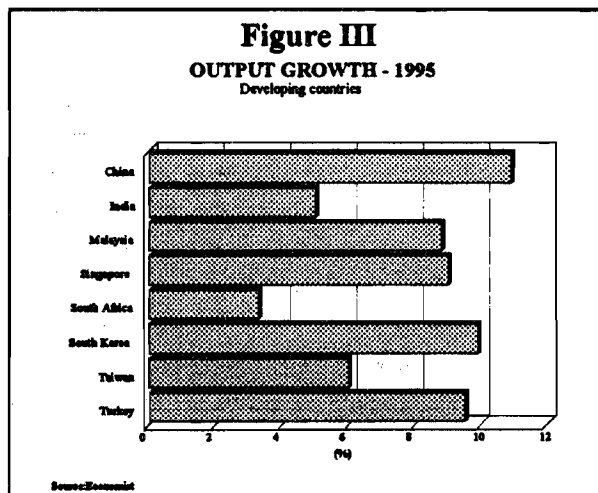
<sup>1</sup> In effect, a primary budget surplus, defined to exclude debt interest payments.



thirds of GDP, was in part responsible for investor doubt, but constitutional uncertainties also played their part.

Moderate growth was recorded in **Australia and the United Kingdom**, after both countries experienced rapid growth in 1994. Weak exchange rates and strong exports energized the United Kingdom economy, reducing unemployment rates to their lowest levels since 1991. Nevertheless, capacity limits were not being reached and continued fiscal moderation together with low inflation could reduce interest rate premiums and allow continued expansion in 1996. Other countries which were expected to grow more slowly were **Germany**, suffering the effects of an appreciating currency, high taxes and high labour costs and **France**, which had to react to currency speculation by increasing interest rates in the first half of 1995. Fiscal policy toward the end of the year resulted in widespread strikes, again eroding hard won confidence in the economy. **Italy** was expected to show an increased rate of output, driven by strong exports. The depreciating currency, the source of strong export performance, however, created inflationary expectations. This in turn necessitated a tightening of monetary policy which threatened to prematurely dampen the expansion.

**Japanese** economic performance was hampered by several factors operating in combination, especially low domestic demand consequent on the rapid contraction in asset prices, excess capital stocks and the appreciating exchange rate which constrained export performance. Subsequent depreciation of the Yen, together with fiscal and monetary stimuli were expected to provide a fillip for the economy in 1996, with growth in excess of 2 per cent being projected by the International Monetary Fund (IMF). Inflation was expected to continue to record minimal growth, the economy operating at an estimated six per cent below potential capacity.



The developing countries turned in a mixed performance. Asia continued to set the pace, with economic expansion averaging over 8 per cent for the fourth consecutive year. While this rate of growth raised the spectre of inflationary pressures, price increases in Asia, at about 12 per cent, were lower than for any of the other developing regions. Output expanded moderately in Africa, to

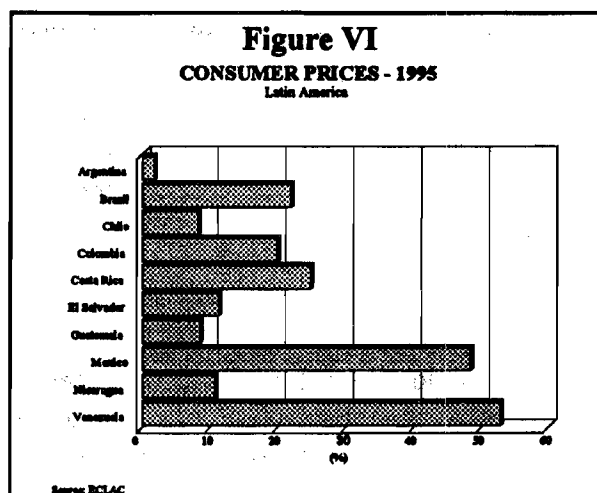
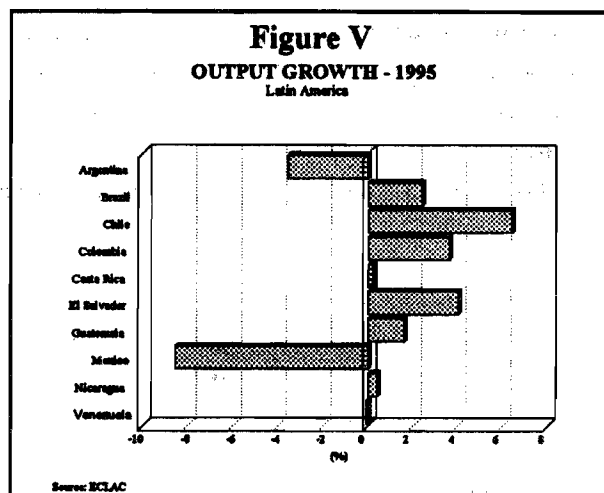
average about 3 per cent, while inflation decreased. Both factors were attributable to improved policies and consequently greater macroeconomic stability, but favourable weather conditions were also instrumental in increasing output. Similar trends were also evident in the Middle East and Europe, though performance was not projected to be as good as in Africa, in either output or inflation. The rate of increase in output fell in Latin America, to below one per cent, the average being influenced by declines in Mexico and Argentina. Inflation also fell significantly and was now not significantly out of line with most other developing countries.

Strong performance was registered in Asia, despite the difficulties being experienced in Japan. This provided some evidence to support the proposition that the developing countries were developing an economic dynamism of their own, facilitated by their growing purchasing power and liberalized trade between them. China continued to record double digit rates of economic expansion, driven by high rates of export growth and foreign direct investment. Strong performances were also registered by South Korea and Thailand, in both cases output expanded by 8-10 per cent. Despite strong export performance, exports benefiting from the strong Japanese currency, external imbalances were evident arising from a jump in capital and consumer goods imports. All other Asian countries were expecting growth to exceed 5 per cent, with the possible exception of Bangladesh. Inflation remained a concern throughout Asia, given its high rates of capacity utilization. It was of greatest concern in India and China, where it was almost 10 per cent.

In the Middle East, output was expected to increase at a faster pace than in 1994, although it remained moderate at 2.4 per cent. Strongest performance came from Jordan and Israel, though stagnating oil prices stifled the output of the petroleum exporters. Output was expected to fall in Kuwait and to expand by less than one per cent in Saudi Arabia, though Iran was expected to post a better performance, at about 3 per cent.

Africa was expected to record faster expansion in 1995 than in the previous year. Strong performance was expected from the Ivory Coast, Ghana, Kenya, Sudan and Uganda. South Africa was also expected to continue its steady expansion, benefiting from increased investment and stronger business and consumer confidence. Inflation was expected to moderate, especially in the Communauté Française Africaine (CFA) countries, following measures to contain the effects of the 1994 devaluation. In several other regions inflationary pressures were expected to dampen, consequent on favourable weather and increased food supplies. Long-term sustained development in Africa would depend, however, on increased agricultural productivity which in turn could only be sustained in the long run through increased investment in infrastructure and water resources, improved land tenure systems and the widespread use of modern technologies.

Developments in Latin America were overshadowed by the aftermath of the Mexican financial crisis, which began in late 1994, and fears of its contagion to the rest of the region. In effect the only other country directly affected was Argentina, although the decline in output in both these countries was sufficient to suppress the regional average to a mere 0.6 per cent growth in 1995, equivalent to a decline in per capita product of 1.1 per cent. If the performance of both countries was ignored the regional average was substantially the same as 1994, at just over 4 per cent. The other



notable development in Latin America was the success being recorded by Brazil in its stabilization programme, which was reflected in greatly reduced rates of inflation compared with previous years.

There were several positive developments. Overall, the region seemed to be tending toward modest though consistent growth rates with moderate and declining rates of inflation. Four countries, Chile, Peru, El Salvador and Colombia, recorded growth of over 5 per cent. Only three countries recorded declining output, Mexico and Argentina, and Uruguay suffering the effects of fiscal adjustment and reduced demand from adjacent Argentina. All remaining countries recorded positive rates of between 2-5 per cent. The average rate of inflation, at 25 per cent, was the lowest in 25 years. Most countries maintained or reduced inflation over the previous year, with the exception of Mexico. Also, Latin American debt was being contained, increasing by a modest 8 per cent in 1995, with the ratio of external debt to exports of goods and services falling slightly, from 250 per cent to 220 per cent. This was the lowest since the onset of the debt crisis.

As in previous years, growth was helped in several countries by strong capital inflows which were used to cover current deficits, and this continued in 1995. However, these flows complicated economic management and in some cases rendered the economies excessively vulnerable. Yet, despite the attention being paid to inflows, it was notable that the net transfer of resources to the region as a whole was negative for the first time since 1990. The main recipients of inflows in 1995 were Brazil, Peru and Colombia. In Brazil, inflows increased from \$US9 billion in 1994 to \$US28 billion in 1995, consequent on a new regime, the subsequent success of its stabilization programme and high rates of interest, but efforts to sterilize them later in the year damaged the fiscal balance. Chile, a traditional beneficiary of capital inflows, recorded only modest net inflows in 1995, in part because of a large debt repayment, but also because of its success in creating disincentives to short-term capital inflows. Similar measures were also being attempted by Brazil, Colombia and Peru, though initially with less success.

Conversely, Mexico and Argentina experienced significant private capital reversals. In the case of Mexico, average annual inflows of \$US27 billion between 1991-1993 and of \$US11 billion in 1994

were transformed to an outflow of \$US17 billion in 1995. Both Mexico and Argentina required massive emergency official inflows from bilateral and multilateral sources in an attempt to stabilize their economies, but even so both suffered precipitate declines in output. Capital also continued to flow out of Venezuela, a net outflow of US\$5.4 billion in 1995 following US\$6.6 billion in 1994. These experiences provided a reminder to the rest of the region about the skills they need to master if they are to cope with the new environment of rapid capital flows.

Several concerns remained about Latin American economic performance. Some countries showed limited growth in exports, and domestic savings rates remained inadequate throughout most of the region. Fiscal performance deteriorated significantly in Brazil, Colombia and Peru while imbalances remained in Venezuela and several Central American countries. Financial problems surfacing in the banking system in Bolivia, Costa Rica and Venezuela in 1994, spread to Mexico and Argentina in 1995, as would be expected after their financial crises, but also to Brazil, Ecuador, Paraguay and Nicaragua.

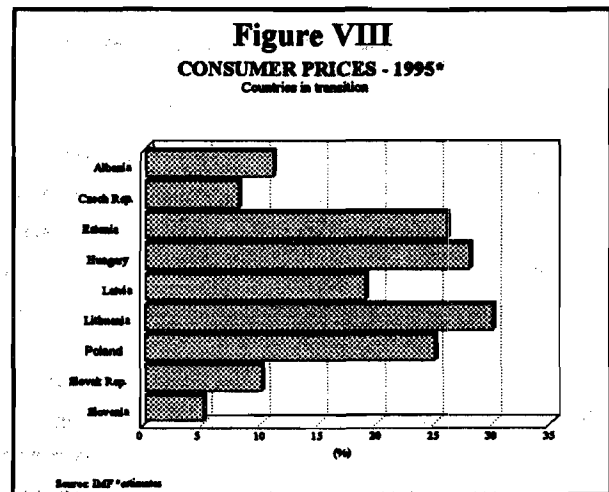
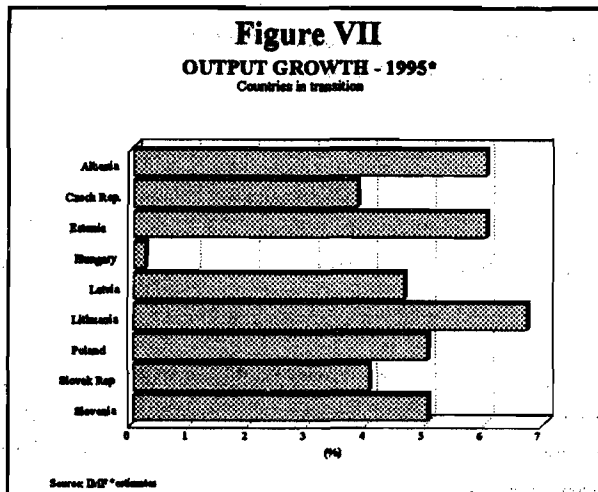
Several social concerns also remained. The most notable was that the rate of growth attained was insufficient to reduce the backlog of unmet social needs, while job creation lagged. The regional population - weighted rate of unemployment increased to 15 per cent, the largest deterioration since the beginning of the 1980s. Notable increases in unemployment were recorded in Mexico and Argentina, and also in Venezuela, Uruguay and Panama. Even in those countries recording rapid growth, job creation was slow, as growth was being achieved through greater productivity rather than by more extensive use of manpower.

The countries in transition continued to make substantial progress in transforming themselves into market oriented economic systems, though this progress was uneven and sometimes intermittent<sup>2</sup>. In general, greatest progress was made by those countries having quasi-independent economic institutions prior to the breakdown of the traditional arrangements, i.e. the countries of Eastern Europe, and which were able to embark on adjustment programmes early. Countries having to disentangle their economic arrangements with the dissolution of the USSR, including Russia itself and recreate economic institutions from scratch, experienced the greatest difficulties. The exceptions to this last category were the Baltic States of Estonia, Latvia and Lithuania, which had so far managed a rapid and effective adjustment programme. Other countries, such as Armenia, Bulgaria, the Kyrgyz Republic, Moldova and Romania, despite being later starters, were also expected to achieve economic expansion in 1995.

In the first category of countries, reforms were being implemented quickly and they were achieving rates of economic expansion at or above the average for the EU. In the Czech Republic,

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<sup>2</sup> The overview of global economic activities for 1994 identified three categories of transitional countries. The first category, which had achieved substantial progress in the various aspects of adjustment, included Albania, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia. The second category, which comprised Bulgaria, Kazakstan, Kyrgyz Republic, Macedonia, Moldova, Romania and Russia had achieved some progress towards liberalization, though somewhat less towards stabilization, and policy reversals were common. The third group, comprised the late or non-starters in the adjustment process and included, The Ukraine, Armenia, Georgia, Belarus and Uzbekistan.



for example, inflation had been reduced sharply and economic recovery was strong. Substantial reserves were being accumulated, fund programmes for balance of payments assistance had ceased and borrowings had been repaid ahead of schedule. The unemployment rate, at 3 per cent in 1994, was well below the Western European average. Budget surpluses were being accumulated, the privatization programme had been almost completed and its credit rating had been progressively uprated. Similarly, good progress was being made by the Baltic States despite their previously high level of integration into the Soviet economy, which required that they build institutions from scratch. The sharp change of policy required a rapid realignment between domestic and world prices, achieved through early price and trade liberalization. The new situation also required an insulation from inflationary impulses in the Soviet Union and the creation of their own currencies. This allowed independent monetary and exchange rate policies aimed at price stability. Finally, they had to become independent of the Soviet budget, with new and independent fiscal policies. Yet a new beginning did not guarantee success in the absence of appropriate policies. The Baltics managed to achieve both, simultaneously.

Hungary provided a contrasting approach to that adopted by the Baltics. Its traditionally market oriented approach to enterprise meant that it started early to develop and currently has, a vibrant private sector. Accordingly, it required less severe industrial restructuring after the collapse of the Council for Mutual Economic Assistance (CMEA) than most of its partners. Investor confidence had been built to the extent that foreign direct investment in Hungary currently accounted for more than half of such investment in the region. Nevertheless, despite starting from a better baseline, the effect of its gradualist approach was that it currently lagged more vigorous reformers in several areas. Hungary also faced difficulties with respect to its international debt, while the level of government intervention remained high and social expenditures were contributing to large fiscal and external imbalances. Output in 1995 stagnated, and inflation increased.

The most comprehensive task of adjustment was required of Russia. As the epicenter of the Soviet Union and the CMEA, it went furthest towards central planning and integrating its economy into the CMEA. The breakup of both entities accordingly impacted most severely upon Russia,

disrupting its trade and payments arrangements and leaving it with a monetary system not entirely under its control. It also had the huge fiscal burden of a military/industrial complex, based on strategic rather than on economic rationale which had to be downsized, dismantled and/or corporatized. Political problems, especially over the respective roles of the executive and legislative branches of government, further complicated the task of adjustment. Several structural changes were initiated, however, and the widely predicted hyper-inflation was avoided. Nevertheless, policy uncertainty was more in evidence than in other successfully adjusting countries and reversals were frequent. The adjustment programme remained in the balance.

Even for those countries furthest along in the adjustment process, several challenges remained. Inflation needed to fall to single digit rates, privatization had to be completed, private and efficient banking systems were still to be put into place, with portfolios stripped of doubtful loans and free markets for goods and services needed to be secured. As was the case in Western Europe, social security schemes also required overhaul to make them sustainable.

## GLOBAL TRADE AND MARKET ARRANGEMENTS

**Table 4**  
**GLOBAL TRADE INDICATORS**

	1991	1992	1993	1994	1995
World Trade Volume <1>	3.5	5.7	3.9	8.7	7.9
Export volumes					
Industrial countries	3.2	4.3	2.5	8.1	6.9
Developing countries	6.5	10.0	7.3	11.3	11.0
Import volumes					
Industrial countries	2.1	4.0	1.1	9.2	7.1
Developing countries	11.1	10.2	9.3	8.5	11.1
Terms of trade					
Industrial countries	0.7	0.5	1.1	0.4	0.3
Developing countries	-2.5	-1.7	0.8	0.2	-0.6
Fuel exporters	16.0	3.8	-1.5	4.3	-7.2
Non-Fuel exporters	-0.5	-0.3	1.1	0.1	0.7
Source: I.M.F. World Economic Outlook.					
<1> Annual percentage change in the volume of goods and services					

The volume of world trade in goods and services continued to increase rapidly in 1995, growing on average by almost 8 per cent. Developing country trade, both imports and exports, grew faster than the developed countries' with 11 per cent and 7 per cent, respectively. The persistent increase in trade was strengthening linkages between the developed and developing countries but also, increasingly, building a greater level of interaction between the developing countries themselves. These factors, assisted by increasing capital flows, were creating a more durable pattern of economic expansion for the developing countries. As competition increased in the markets of the developed countries, investment flowed into the developing countries with the highest productivity. Simultaneously, trade liberalization in the developing countries gave them access to these new and efficient producers increasing trade among themselves and diversifying their sources of expansion. As a consequence of greater trade among themselves, the wellsprings of growth in the South were being diversified and becoming less dependent on those in the North, than previously. For 1995, the terms of trade turned slightly against the developing countries, consequent on the unfavourable prices received by the fuel exporters among them. Conversely, the terms of trade of the non-fuel exporting developing countries were slightly favourable.

The growth in world trade was to be explained largely by the mushrooming growth in the trade in services which currently accounted for close to 25 per cent of trade and 60 per cent of Foreign Direct Investment (FDI) flows<sup>3</sup>. New technologies, essentially computer and communications technologies, were providing the catalyst for such growth, since they reduced geographical barriers and increased the range of services which could now be traded. Other contributory factors were the deregulation of services industries and the liberalization of services trade and investment regulations. These developments were creating new opportunities for developing countries to provide services via long distance to the markets with highest demand for them. A doubling of the current US\$180 billion earned by developing countries from commercial services was seen as feasible.

If developing countries were to be in a position to take advantage of this potential, however, several policy initiatives were required. The trade in services and concomitant payments regimes would need to be liberalized, intellectual property legislation would need to be internationally acceptable to potential providers and infrastructure, especially telecommunications infrastructure, would need to be internationally competitive, both in quality and in price. Most importantly, the tradable skills of local citizens would have to be diffused more widely, if a larger segment of the population was to benefit from these developments.

Several developments, such as the rate of increase in FDI moving into the developing countries, the rate of increase in trade and the formation of institutional arrangements to bind developed and developing countries in economic arrangements, suggested a trend to greater integration in the global economy. Among the institutional arrangements for increasing trade, the premier of which was the WTO, progress was uneven.

After one year in existence, the successor to the General Agreement on Tariffs and Trade (GATT), the **World Trade Organization (WTO)**, had 112 members. Some (16) countries, had still to convert their GATT membership to the WTO, while 27 other countries had applied to join. The aspirants, for the most part former CMEA members, although some, such as Hungary, Poland, the Czech and Slovak Republics, had already joined. Others, outside of the former CMEA, mainly Middle-Eastern countries, had also applied to join. Notable aspirants were China, Russia, Taiwan and Ukraine. Perceived benefits from membership were acceptance of a code of conduct which was likely to dissuade potential backsliders from returning to protectionist behaviour, defense against protectionist acts inflicted by other members and for smaller countries potential insulation against the greater muscle of larger traders. For some aspirants, membership was also seen as an imprimatur by the international economic community.

Yet despite the benefits which were seen to derive from universal membership, most of the aspirants faced difficulties in achieving quick entry, simply because they failed to meet the more stringent qualification criteria, following the Uruguay Round, than was originally required by the GATT. Aside from lowering tariff and non-tariff trade barriers, these criteria included commitments

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<sup>3</sup> The average annual rate of growth for commercial services was 7.7 per cent over the period 1980-1993, compared with 4.9 per cent for merchandise trade.



in services, agriculture and intellectual property. For several of the former CMEA countries the degree of State control was considered to be a further consideration, since it permitted a form of managed trade which could circumvent the spirit of the agreement. At the other extreme, several members of the WTO were impatient with the pace of global liberalization, as set by its slowest members in the international body and determined through regional arrangements to quicken this pace. Yet the regional arrangements were not immune from setbacks in 1995.

Following the Uruguay Round, three services sectors were earmarked for further negotiations, financial services, telecommunications and maritime transport. The greatest effort was initially placed on negotiations regarding financial services, but discussions also commenced on telecommunications in April 1994 and were scheduled to conclude by April 1996. Several WTO members (48) were currently in these discussions, 33 of which had submitted offers to liberalize the industry.

Intra North American Free Trade Agreement (NAFTA) trade received a setback in 1995, consequent on the economic and financial crisis experienced by Mexico. United States exports to the group fell, compared with 1994 when they had grown by 16 per cent, but remained higher than in 1993, before the agreement went into effect. While Mexico continued to honour its commitments to cut tariffs faced by its NAFTA partners, it increased them for several goods originating in non-NAFTA countries, by 15 per cent. Accordingly, Mexican imports from NAFTA increased from 69 per cent of total imports in the first 9 months of 1994 to 74 per cent in the corresponding period in 1995.

Negotiations for Chile's accession to NAFTA also commenced, but received a setback when fast-track negotiating status, which requires Congress to approve or reject an agreement within 90 days of its submission, was not granted by the United States Congress. In the circumstances, and given the election year climate which brought to the surface strong protectionist sentiments in several sectors of the country, Chile decided to postpone further discussions until after the elections. However, it agreed to continue bilateral discussions with Canada, already having concluded an agreement with Mexico. Despite this setback, the United States indicated its intention to use NAFTA as a model for future multilateral liberalization in areas such as investment. It saw Chilean inclusion in NAFTA as a means to gain access to its fast growing economy, as a means of denoting Chile an exemplar to the rest of the region and simultaneously providing a bridge to the FTAA.

After its inauguration in December 1994, the preparations for a Free Trade Area of the Americas (FTAA) commenced in earnest in June 1995, with the Denver ministerial meeting. The ministers agreed that hemispheric trade relations should be consistent with WTO principles and should be comprehensive in scope. They concluded the first meeting by establishing working groups in seven areas: tariff and non-tariff barriers; customs procedures and rules of origin; investment; standards and technical barriers; sanitary and phytosanitary measures; anti dumping and countervailing duties; and, smaller economies. The trade ministers met for the second time in Cartagena, Colombia, in March 1996, to review the progress of work over the previous nine months. They asked that the future work programme consider and report back to them, at the third ministerial meeting, approaches to the FTAA which would build on and bring together existing subregional and

bilateral arrangements; and consider the timing and means of launching negotiations to establish the FTAA. The ministers also designated four additional working groups, in government procurement; intellectual property rights; services; and, competition policy. The working group on smaller economies, in which the Caribbean countries had expressed a strong interest, convened three meetings prior to the ministerial meeting in Colombia, mainly to receive and review technical studies. The second ministerial meeting also recognized, "...the need for technical assistance in order to facilitate the full participation of the smaller economies in the entire process leading to the FTAA". The group was asked, as a matter of urgency, to make recommendations on measures, including technical assistance to facilitate the integration of smaller economies into the FTAA. Notwithstanding this conciliatory tone, indications were that the smaller countries could expect some of the larger countries to provide strong opposition for any special or preferential arrangements which they might seek in the agreement. The third ministerial meeting was scheduled for Brazil, in the second quarter of 1997.

In South America, **MERCOSUR** experienced a year of consolidation after inaugurating its customs union in 1 January 1995. The grouping, which comprised Argentina, Brazil, Uruguay and Paraguay, abolished tariffs on 95 per cent of the goods traded within the group. Currently, negotiations were well advanced to include Chile and Bolivia and the group proposed to extend the arrangement to the whole continent by the end of 1996. Indeed, Brazil regarded MERCOSUR as being a more acceptable model for hemispheric trade liberalization than the more comprehensive framework being created under the FTAA. At the end of the year MERCOSUR also entered into a framework agreement with the EU which was a major outlet for its exports.

The **European Union (EU)** was, however, preoccupied mainly with advancing its internal arrangements. In mid-December it sought to give renewed impetus to the European Monetary Union (EMU), by agreeing a name for the proposed common currency and a date for its introduction. The fillip came after years of doubt following currency instability and the eviction of Britain and Italy from the EU Exchange Rate Mechanism (ERM), in mid-1993. Doubts were compounded by the subsequent failure of potential members to meet the first deadline for a single currency in 1997. The common currency, the Euro, was scheduled to be launched in January 1999 and used by governments and banks of the countries that qualified for entry from that date. The public was expected to get bank notes and coins no later than the year 2002. New debts would be issued in the Euro from its starting date, while old debts would all be converted to the new currency by 2002. The new timetables did not, however, confer lasting credibility to the exercise, for although public statements continued to express strong support for the timetable, several of the same voices continued to question the pace and the rigour of the exercise, in private.

Currently only Luxembourg met the accession criteria, although it was expected that Germany, France, the Netherlands, Belgium, Austria and possibly Ireland and Finland might be able

to qualify when the economic indicators were reviewed in early 1998<sup>4</sup>. It was believed that Great Britain could also qualify, but had been traditionally skeptical of monetary union and was keeping its options open. Italy, another of the major EU economies, was not expected to qualify.

Strains were evident in some countries as they struggled to meet the qualification criteria. Labour unrest in France and Belgium in late 1995 reflected the tightening grip on fiscal policy necessary to meet criteria set out in the Maastricht Treaty. For France, this meant reducing its fiscal deficit from the current 5 per cent of Product and restructuring one of the main contributory causes, the social security deficit. The original French targets were now in doubt, however, since they rested on growth estimates which were not met for 1995 or projected for 1996. The social security deficit in France required stringent fiscal measures to reduce the "contribution gap" in its public pension scheme. This gap refers to the extra contribution needed to equate future benefits and contributions<sup>5</sup>. In France, this would require an extra inflow of 3 per cent of GDP per annum, although France was not unique in this respect, similar inflows being required for Japan and Germany<sup>6</sup>. Unless action was taken quickly these pension schemes were likely to create a significant extra debt burden for all the major industrial countries. Debt for the EU, as a whole, was expected to be 75 per cent of Product in 1995. The United Nations Economic Commission for Europe had warned, just prior to the December decision, that the timetable for accession should be relaxed, since the policies necessary for meeting the criteria risked choking off economic expansion and further increase the already high unemployment rate.

While the burden of meeting the criteria was, therefore, heavy for some, Germany was adamant that these criteria should not be relaxed. Currently, 66 per cent of the German people were opposed to giving up the strong and secure German Mark for the new Euro. Others feared the high cost of transfers which might become necessary to assist some to qualify initially and subsequently to remain within the EMU. Any relaxation of initial criteria would increase these fears and further reduce support for the EMU. Recent polls suggested that 84 per cent of the German public believed that the EMU should not commence in 1999.

Even if the single currency was successfully implemented in 1999 concerns remained about the potentially destabilizing relationship which might exist between those members qualifying for the EMU and those which were unable to do so initially. One major fear was that the "outs" could benefit

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<sup>4</sup> The criteria for monetary and fiscal convergence were, inter alia: cumulative public debt not to exceed 60 per cent of GDP; annual fiscal deficit not to exceed 3 per cent of GDP; inflation not to exceed the three states with the lowest rates of inflation by 1.5 percentage points; interest rates on long term government securities not to exceed the three states with the lowest rates of inflation by 2.0 percentage points; a country to have maintained its membership in the EMS for two years without having initiated a devaluation.

<sup>5</sup> The alternative calculation, that of unfunded liabilities, showed a gap of 1 per cent of 1995 GDP for the United Kingdom, 26 per cent for the United States and more than 100 per cent for Japan, Germany and France.

<sup>6</sup> The United States and the United Kingdom were somewhat better off, requiring a one per cent per annum inflow to close the contribution gap.

from flexible exchange rates to win market share from those tied to more rigid policies required by the EMU. These questions were currently being studied and the conclusions would also have a strong bearing on the pace of widening the EU to the 10 Central and Eastern European countries being considered for entry. Widening, in turn, was reopening the question of the EU decision making process, with France and Germany seeking a revision in voting powers to reflect their economic power, together with the implementation of more majority voting so as to reduce the use of the veto.

Another development, involving the European Union and the United States, got off the ground in December 1995, with the **Transatlantic Trade and Investment Initiative**. More modest than originally intended by the United States, which had hoped for a wide ranging free-trade agreement comparable with the other proposed blocs, the initiative included a commitment to foster a transatlantic marketplace, where both parties pledged to seek agreements on mutual recognition of testing data and standards certification, to cooperate on customs procedures, to work towards a comprehensive agreement on cooperation in science and technology and to initiate a joint study on market barriers impeding transatlantic trade.

In May 1995, the OECD countries agreed to begin negotiations toward the **OECD Multilateral Agreement on Investment**, which they hoped to complete by 1997. Broad consensus was reached at its first meeting in September to work toward full national and Most Favoured Nation (MFN) treatment of foreign investment among members. It was hoped to establish international legal standards governing expropriation, freedom from performance requirements, guaranteed access to binding international arbitration of disputes between private investors and national governments and the right to unrestricted investment-related transfers across borders. It was assumed that once the agreement was concluded, it would provide the template for investment relations between OECD members but also in their relations with the developing countries as well.

The **Asia-Pacific Economic Cooperation (APEC)** made a commitment in November 1994, at its meeting in Indonesia, to achieve free and open trade and investment among its members by the year 2020. This commitment was advanced at its Osaka meeting in November 1995, with the agreement of an Action Agenda covering 15 broad areas for liberalization, including issues relating to market access, services, intellectual property rights, investment, competition policy and deregulation. It identified 135 specific actions that members should take to open their markets and reduce the costs of doing business. In each of the broad areas the Action Agenda set out key objectives, benchmarks, time-frames and specific actions to be taken. It also embodied principles to ensure that liberalization would be comprehensive, covering all products, services, and investment and require each country to achieve results that were balanced and comparable with those of other APEC members. Members were expected to start detailing their specific offers by the Manila meeting in 1996, with implementation possibly starting in January 1997.

Several "down payments" were made to start the process. Japan promised to accelerate, by 50 per cent, its Uruguay Round commitments for industrial tariff cuts, China promised to cut a number of its tariffs by 30 per cent, while Indonesia and several other developing members promised to sharply reduce tariffs. Several countries had also agreed to accelerate Uruguay Round

commitments relating to intellectual property. In general, APEC initiatives were based on unilateral concessions, voluntary acts based on enlightened self-interest and peer pressure. This approach differed significantly from the familiar negotiations conducted in the West, where formal adversarial negotiations lead inexorably to the presumption that any benefit obtained by one must mean a concomitant loss by another. Such instincts, which are widespread, are at variance with the tenets of international trade.

APEC had three economic goals, to maintain the momentum of liberalization in the face of uncertainty in the global trading system, to counter inward-looking regionalism elsewhere, mainly in Europe but also in North America, and to provide a better forum for resolving economic conflicts in Asia itself.

In early March 1996 the first Asia-Europe meeting, the so called ASEM, was held in Bangkok. It took place at a time when Asia-Europe trade seemed to be in the doldrums. Trade between the United States and Asia was double that of Asia-Europe. Moreover, the EU share in Asian imports fell from 25 per cent in 1970, to 15 per cent in 1994. The picture was somewhat different, however, when trade with emerging Asia, that is, Asia excluding Japan was examined. Two-way trade between the EU and emerging Asia more than doubled since 1988, to rest at US\$212 billion in 1994. This trade was growing faster and was not substantially less than the almost US \$250 billion trade between United States and emerging Asia and the roughly similar amount between Japan and emerging Asia. Yet the EU exported more to the group than the United States, US\$99 billion in 1994 compared with US\$92 billion from the United States. Moreover, EU trade was likely to grow with less potential friction in the near future, since its trade was substantially in balance with emerging Asia, whereas the United States had a large trade deficit with the group while Japan had a substantial surplus.

There were several other potential motives for the meeting. The EU may have had concerns that APEC, which included the United States, was coordinating a common trade policy against it. They might also have been concerned at the inside track which the United States seemed to be developing in several policy areas with Asia. The Asians in turn might have been concerned by the unilateral trade sanctions threatened against them by the United States, on the one hand, and growing protectionism there, on the other. The EU and Asia could, accordingly, work together to strengthen the WTO, which seemed to be less favoured by the United States. There was also a rich political agenda to be addressed by the EU and Asia. Many of the issues of concern to the EU would coincide with United States positions, but not all, and even so, the EU would doubtless wish to put its own nuance on them. Asia, for its part, would seek a more accommodating stance from the EU on human rights questions, than it had been able to obtain from the United States.

The pattern of global trading blocs which was emerging seemed, for the moment, to have placed the WTO in the background, with several complex geographically defined multilateral groupings radiating out from the United States. This was to be explained in part by the fact that the United States had taken the initiative in most of them, to knit itself into an overall global pattern. Only in its relations with Europe, which seemed preoccupied with its internal arrangements, was this

strategy lagging. The rationale given for the bloc as opposed to the global approach, via the WTO, seemed to be that logistically negotiations were more manageable within smaller groups having similar interests and approaches than in the more geographically and culturally diverse WTO. This approach also tended to isolate the EU, which was perceived by some to be less convinced about the benefits to be derived from liberalized trade.

The United States had, therefore, played a pivotal role in knitting countries together, through trading blocs, having virtually identical conditions and cross-linked by MFN. Nevertheless, the emergence of protectionist sentiments on to the center stage in the United States, as the 1996 elections approached, raised a question as to the durability of their regional bloc approach. More specifically, several countries, including some in the Caribbean might question the soundness of the investment which they had made so far in the FTAA.

The growth of protectionist sentiments in the United States prior to the 1992 election was explained as being consequent on a protracted period of recession. Despite strong economic performance since then, these sentiments seemed to have grown, a fact which might be explained, in part, by the severe dislocations and insecurity experienced throughout the society, as it restructured to face increased global competition. Despite strong growth over the past four years, it was estimated that 3.3 million people lost their jobs in each year between 1992-1994 and the pace of job losses might have quickened in 1995. While the economy was able to reemploy in excess of this number each year and so reduce the rate of unemployment to levels which were close to the minimum Non-Accelerating-Inflation Rate of Unemployment (NAIRU), many of the jobs created were not as remunerative or as secure as those lost. For example, substantial numbers of white collar jobs, especially in middle management, were replaced by less secure work, either in services or through some form of temporary arrangement. And while many remunerative jobs were being created elsewhere in the economy, the white collar losers were unlikely to qualify for them<sup>7</sup>. Accordingly, a large pool of disgruntled workers was being created and insecurity engendered even among those fortunate enough to retain steady employment. These forces, which constituted a new, "Anxious Class", seemed to be developing sufficient critical mass to influence trade policy. Yet, others saw the global restructuring as an inexorable ongoing process and feared that hesitance or postponement would jeopardize late-comers more severely than those leading the process.

Growing protectionism might also have been encouraged by the confrontational approach to trade negotiations adopted by the current administration and its trade representative. In adopting the stance of a trade warrior, he might have reinforced the false perception that trade was a zero-sum game, in which gains obtained by one side were inevitably at the expense of the other. In failing to meet many of the unrealistic and sometimes unlawful objectives set for his negotiations the domestic audience might have concluded that they were losers in these negotiations and were being unfairly treated by foreign trading partners. In effect, it was impossible to isolate a dubious negotiating

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<sup>7</sup> Over 50 per cent of job growth in the private sector during 1995 were in "high wage" industries, defined as those having an average wage above the employment-weighted median of all industries in 1993. (Council of Economic Advisers, February 1996.)

position from a receptive domestic audience, for while the argument was rejected by unconvinced negotiating partners it was accepted at home<sup>8</sup>. ("Kantor's Cant": Foreign Affairs, March-April, 1996).

The United States had invested considerable effort to lead the process of transformation and global restructuring. Trade was also assuming increased importance in its economy. In 1960, the sum of imports and exports accounted for 9 per cent of GDP, but by 1995 this had grown to 23 per cent. In the last three years, exports of goods and services grew by 20 per cent, accounting disproportionately for one-third of real GDP growth. Currently, 12 million workers owed their jobs to international trade. Trade to the developing countries was also increasing as a proportion of the total, rising from 29 per cent in 1970 to 41 per cent in 1995. These markets were also projected to be the main growth markets into the next century. (Economic Report of the President, 1996).

The Council of Economic Advisers to the President of the United States continued to stress to him the dangers to the economy if protectionism was allowed to prevail. These arguments warranted repetition, since they applied to the Caribbean policy maker, in equal measure. The advisers underscored that international trade promoted the welfare of all countries that engaged in it and proffered four main reasons. The first was that trade furthered domestic comparative advantage, allowing each country to devote more of its resources to producing those goods and services that it could produce most efficiently. Trade also increased competitive pressures, stimulating the search for increased productivity. Trade diffused technology and ideas, allowing countries to learn from each other and finally, it increased the variety of inputs and final goods available to producers and consumers alike, boosting efficiency and standards of living. Research showed a strong correlation between openness and growth. Simulations also showed that trade restrictions, even when used to defend a country against unfair foreign trade practices, hurt the country applying them the most. Despite the pressures from a growing protectionist lobby in the United States, which was sustained by growing insecurity and dislocation arising from restructuring to face foreign competition, it was expected that the fundamental economic arguments, together with the demonstrated benefits for the society as a whole were likely to prevail. Accordingly, it was likely that the push to open markets, through multilateral and regional arrangements, would resurface after the election.

Simultaneously, several areas of redundancy seemed to be forming to continue the push to open markets in the event of flagging commitment in the United States. Notable among these was the loose voluntary framework adopted by the APEC members, where group interaction would stimulate the process of unilateral liberalization. Chile's decision to continue bilateral negotiations with two of the NAFTA partners, in the absence of fast track negotiating powers being obtained by the United States delegation, was another example. Yet these initiatives continued, because of prior conviction about the benefits of liberalized trade among the parties. They were less likely to be replicated by less committed traders.

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<sup>8</sup> This risk of this type of negative feedback is greatly increased in small Caribbean societies.

## PRIVATE CAPITAL FLOWS AND DEVELOPMENT FINANCE

Developing country capital markets suffered a setback following the Mexican crisis in December 1994. From late December into early 1995 there was a massive shift out of developing country equities while new issues for bonds and equities virtually ceased. These developments led many to fear that the period of rapidly improving developing country access to international capital was at an end.

Yet markets rebounded soon thereafter, beginning in Asia where pressures to sell soon abated and portfolio capital returned. By the second quarter, even Latin American markets had started to pick up. Similarly, bond markets resuscitated in the second quarter, led once again by Asia, but by mid-year even Mexico had successfully re-entered the market.

Initial lack of confidence in the prospects of the developing countries, which was reflected in the flat financial market, returned quickly with the recognition that economic fundamentals in the Asian countries did not justify the retreat. Moreover, as adjustment policies in Argentina, Brazil and Mexico were seen to be credible, confidence quickly returned.

Nevertheless, some new trends were evident in the market. Of the almost US\$40 billion in bond placements made in the first nine months of 1995, about 50 per cent went to Asia, a further 30 per cent going to Latin America. In Asia, bond issues were made predominantly by private firms, while in Latin America issues were made primarily by the governments of Argentina, Brazil and Mexico. The Asian private issues, which were considered to be better risks, were made in United States dollars. Public issues were, however, shifting into other currencies, notably the Yen, whose bonds offered better terms than those denominated in United States dollars. It was speculated that more favourable terms were available in Yen denominated bonds because low domestic interest rates increased Japanese investor interest in foreign issues, less exposure to previous instability and the more benign approach taken by Japanese rating agencies, when compared with their United States counterparts. Finally, there was a trend toward higher yield spreads and shorter maturities on new bond issues, reflecting the residual nervousness in the market.

It was expected that continuing globalization of capital markets and the desire on the part of investors to diversify their investment portfolios would continue to work in favour of developing countries. It was also expected that the initial presence of official borrowers in Latin America was a precursor to the return of private borrowers, following the market re-entry pattern evident in the late 1980s and early 1990s. The prospects for private capital flows to developing country markets, nevertheless, remained uncertain and could be impeded by uncertainties in some of the major market economies as well as concerns about the future path of global interest rates. (IMF Survey, February 1996).



**Net Official development financing<sup>9</sup>** to the developing countries declined in 1994, by 5 per cent, in nominal terms, over 1993. (IMF Survey, January 1996). Compared with its peak in 1990, flows in 1994 represented a real decline, after inflation, of 16 per cent. Official Development Assistance (ODA), rose slightly in 1994 to US\$58 billion. The real value of ODA, however, declined by 2 per cent, representing 0.29 per cent of the GDP of the Development Assistance Committee (DAC) countries. This was the lowest proportion since 1973 and the decline was expected to continue because of the budgetary constraints facing the donor countries and increased demand for assistance from the countries in transition. Bilateral assistance declined to North Africa and the Middle East, but increased to Asia, Europe and sub-Saharan Africa. Surprisingly, aid also increased to the middle income countries in these regions at the expense of the low-income countries.

New ways were also being sought by DAC countries to increase the efficiency of and responsiveness to aid programmes. Governments of the poorest countries which pursued sound policies to reduce poverty and create employment were favoured, while governments which could benefit from private flows were being graduated from concessional bilateral flows. Traditional projects, focusing on areas such as infrastructure, were being downplayed in favour of projects designed to bolster human capital formation. The end of the cold war also motivated a shift away from the ideological determinants for assistance, to a focus on building legal and political institutions conducive to growth and which would permit widespread participation in economic and political life.

Official disbursements from multilateral institutions fell by US\$3 billion since 1990, to less than US\$21 billion in 1994. According to the IMF, this was to be explained by the growing role of private flows, as opposed to non-concessional bilateral arrangements, in meeting the financing needs of those countries able to access capital markets. Focus was being placed on heavily indebted poor countries which continued to receive positive net disbursements in 1994. Regionally, net disbursements increased to North Africa, sub-Saharan Africa and the Middle East, by US\$1 billion, while gross disbursements to Latin America fell by US\$3 billion.

Export credits to developing countries had increased steadily, by 275 per cent between 1988-1994. Credits, which amounted to US\$90 billion in 1994, were to be explained by aggressive export efforts by the industrial countries and increased import demand in many developing countries.

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<sup>9</sup> Defined to include funds from bilateral and multilateral sources but to exclude official export credits.

