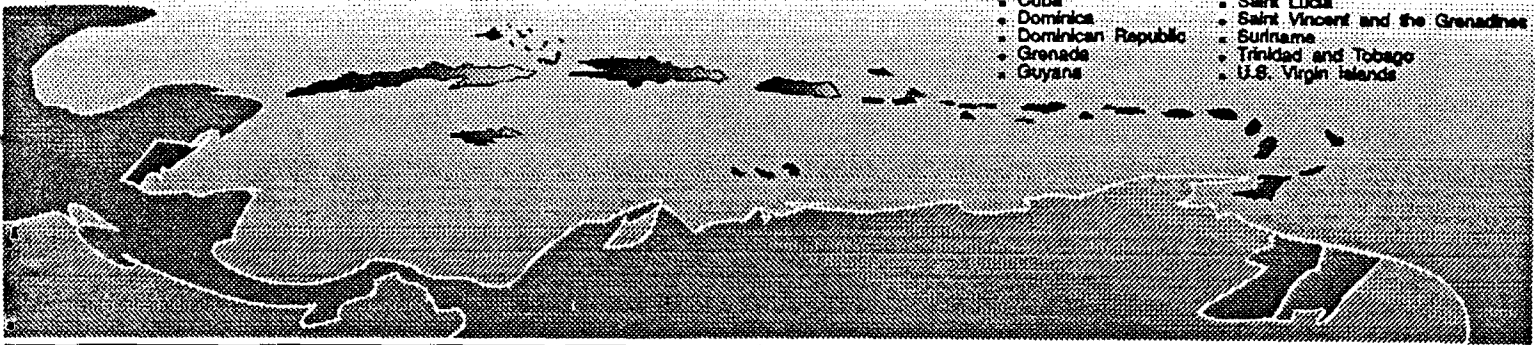


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- Antigua and Barbuda
- Aruba
- Bahamas
- Barbados
- Belize
- Br. Virgin Islands
- Cuba
- Dominica
- Dominican Republic
- Grenada
- Guyana
- Haiti
- Jamaica
- Montserrat
- Netherlands Antilles
- Puerto Rico
- Saint Kitts and Nevis
- Saint Lucia
- Saint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

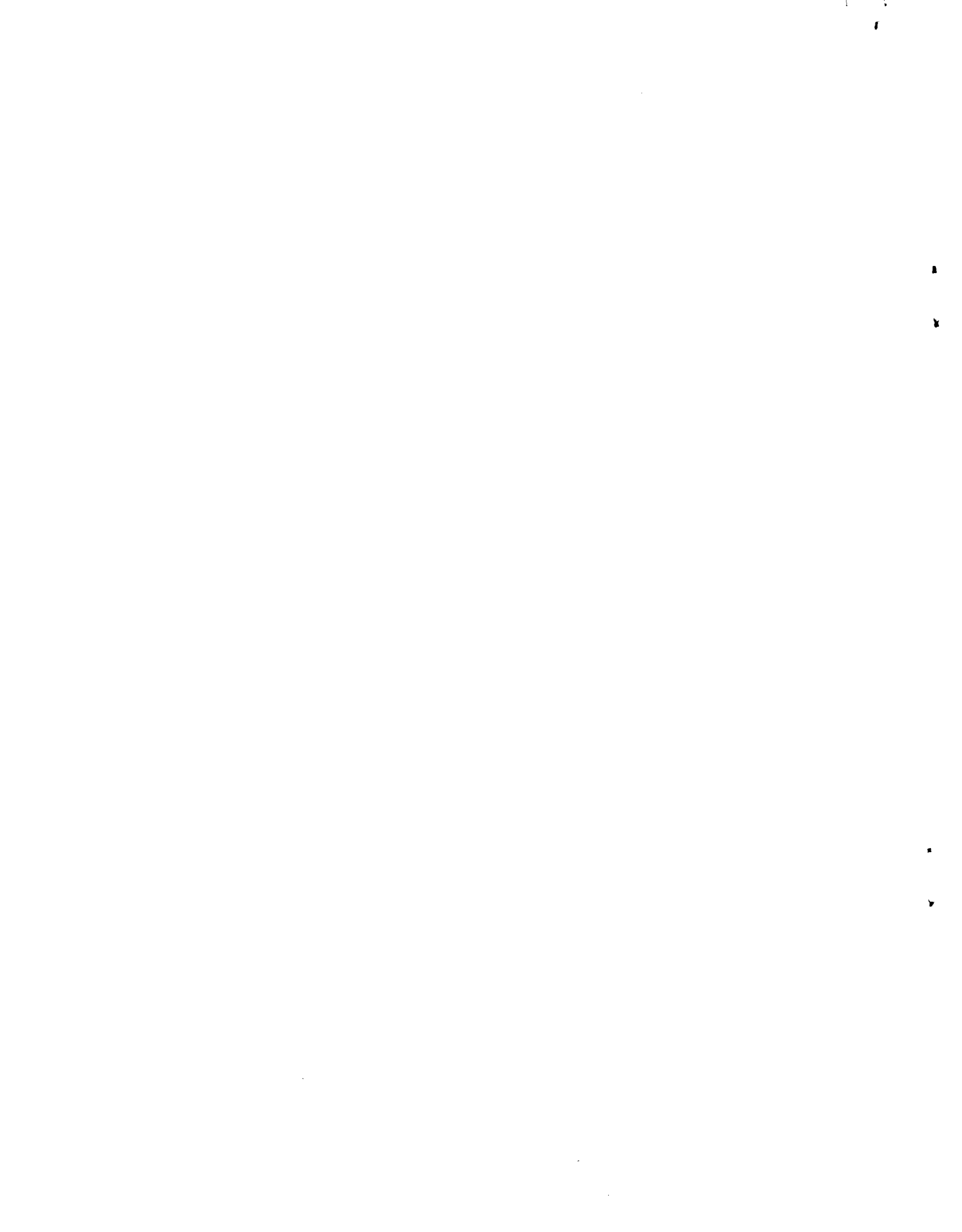


GENERAL  
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 31 March 1998  
 ORIGINAL: ENGLISH



**A REVIEW OF GLOBAL ECONOMIC DEVELOPMENTS**  
*With comments regarding their impact on Caribbean policies*  
 - 1997-





### **ABSTRACT**

The document discusses those global economic developments for the year under review which are deemed to be of interest to the Caribbean policy maker. It also tries to highlight their implications for Caribbean policy. The paper begins by describing patterns of growth and inflation in the industrial, developing and transition countries, outlining the salient macroeconomic and global factors/determinants of such developments. Special attention is given to the Asian crisis in 1997. It provides a brief overview of global trade focusing on the institutional arrangements being negotiated to conduct it via the WTO, FTAA and the EU. Developments towards the EMU are also given attention. The document concludes with a description of international capital flows.

**Key words** are: Asian crisis; CARICOM; developing regions; EU; EMU; FTAA; global capital flows; global output; global trade; industrial countries; integration; transition countries.

1. The first part of the document discusses the importance of maintaining accurate records of all transactions and activities. It emphasizes that proper record-keeping is essential for ensuring transparency and accountability in financial reporting.

2. The second part of the document outlines the various methods and techniques used to collect and analyze data. It highlights the need for consistent and reliable data collection processes to ensure the validity of the results.

3. The third part of the document focuses on the analysis and interpretation of the collected data. It discusses the various statistical and analytical tools used to identify trends, patterns, and relationships within the data.

4. The fourth part of the document discusses the importance of communicating the findings of the research. It emphasizes the need for clear and concise reporting that effectively conveys the key results and conclusions to the relevant stakeholders.

5. The fifth part of the document discusses the implications of the research findings and the potential for future research. It highlights the need for ongoing monitoring and evaluation to ensure the continued relevance and effectiveness of the research.

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## INTRODUCTION

The study of global developments reveals a rich tapestry to inspire Caribbean development responses. At the same time, it uncovers clear signposts to the emerging global framework and is replete with examples of success and failure in areas which the subregion cannot afford to ignore.

The small size of Caribbean economies and their dispersion over a small and circumscribed geographic space means that they have a limited range of production possibilities, some of which they must trade to obtain the full range of goods and services necessary for well-being and economic expansion. Accordingly, a large proportion of domestic production must be exportable, a fact which places a high premium on macro and microeconomic policies and domestic institutions which encourage the development and expansion of productive enterprises. It also means that items, whether they be destined as inputs for eventual exports or for immediate domestic consumption, should be sourced from the most efficient producers, for only in this way are the greatest welfare benefits to be derived. Caribbean countries are, therefore, amongst the most trade-dependent in the world, as is illustrated by the fact that the value of trade in goods and services exceeds the value of Gross Domestic Product in seven CARICOM countries.

Small size also means that Caribbean countries have limited scope to shape markets or to influence global trends, factors which put a premium on good information and rapid response. In the past, special arrangements were fashioned for countries perceived to be at a disadvantage, whether the disadvantage derived from small size or low levels of development. Accordingly, special preferences were granted, or derogations agreed from measures deemed to be the most onerous, for small or disadvantaged countries. While the record of such measures is mixed, the international mood has shifted towards the application of universal criteria and the elimination, wherever possible, of special and differential treatment for all countries whether they be small and underdeveloped, or not. The norm is now for reciprocity, most favoured nation (MFN) or full national treatment.

While the rationale for this shift is vigorously debated, two factors seem to stand out. The first is practical, and relates to the need for simplification and standardization in the face of the already complex task of creating a seamless global economic system. The second is conceptual and derives from doubt that preferences, aside from being costly to those granting them, are ever in the long-term interest of the so-called beneficiaries. The call for "trade and not aid" made by the developing countries in the 1970s, though they assumed preferential trade at the time, is now being taken seriously by many decision makers. Even the nature of trade itself has changed, since it is now underpinned by liberalization and openness, contestability of markets and the removal of impediments to the free flow of goods and services. The proponents believe that integrated global markets eventually lead to economic convergence among the participants and this is, ultimately, the only viable means of removing global inequities. As a corollary, aid flows have also declined.

Cited in support of this new view is the fact that countries granted preferences because of an inability to compete were seldom encouraged thereby to become competitive or to shift to more appropriate activities. Conversely, many poor countries which have not benefited from preferences have evolved to become the most formidable global competitors. It is believed by some that preferences smack of dependency and confer an anti-export bias. Several small countries at lower levels of development than many Caribbean countries in the 1960s have also emerged by the 1980s and after to be successful competitors on global markets with rapidly expanding economies. Finally, on a broader macroeconomic front there is a growing body of evidence to support the theory of convergence at the global level.

Others are less enthusiastic about the benefits of globalization which, by its very nature, means that countries become progressively more absorbed in global developments, sometimes by an insidious process over which they seem to have little control. Countries might benefit from the gains from international trade but, simultaneously, become more threatened by international competition. New investments are spawned by the flows of international capital but economies are destabilized by rapid capital movements. New technologies liberate increased efficiency but often engender uncomfortable social and organizational changes. People are enriched by cultural variety but can become more insecure by the adoption of hitherto alien habits. Finally, while convergence might be evident among those who participate effectively in global markets some are in danger of retreating from them and for those the prospect is not convergence but rather divergence as their economies get left behind.

Despite these differing views, the evidence provided over the last decade suggests that the project to integrate global markets is likely to prevail. While some regional initiatives are motivated by the objective of slowing or eroding the global project others are fashioned to accelerate it, that is to create a seamless economic, political and juridical environment in which to operate. Where initiatives are unlikely to go beyond the World Trade Organization (WTO) to liberalize the trade in goods, which is proceeding rapidly, the immediate focus might be on services, investment and competition policies and ultimately into issues such as corruption, regularizing property law and the legal framework in which such law will be adjudicated. The proposed Free Trade Area of the Americas (FTAA) incorporates all these elements under the rubric of economic integration and goes further into areas such as financial coordination, education, democratic governance and multilateral cooperation, which includes joint action on issues such as narcotic trafficking. If, as the FTAA states, its objective is to create an environment which is WTO plus, it is not beyond the bounds of possibility that several similar initiatives might resurface in the WTO itself, or in other of the regional arrangements being put into place in Asia and ultimately Africa. Several of these initiatives are already underway within the Organization for Economic Cooperation and Development (OECD) and a United States/European Union reopening is mooted. The pattern which seems to be emerging is for these disparate activities to merge into a seamless global environment, with a high level of commonality.

Given these emerging trends and given the limited scope for small countries to shift the rules of the game, it would seem that they must best deploy their limited resources to discern trends and to devise measures to respond effectively to them. Countries are engaged in a competitive game in which the best strategy is to apply sound economic policies and conform to best global practice, since countries which fail to do so will be penalized by global actors, directly or indirectly. This paper is a modest attempt to glean such information from global developments in 1997 and to assist the policy maker to identify areas where further study and policy adaptation might be necessary. Several such issues surface in the body of the text and are appropriately highlighted since the greatest challenge facing the Caribbean policy maker is to ensure that regional policies are consistent with global trends.



## OUTPUT, INFLATION AND REGIONAL PERFORMANCE

<b>Table I</b>					
<b>GROWTH IN G.D.P.</b>					
	1993	1994	1995	1996	1997
Global Output	2.6	3.9	3.6	4.0	4.1
Advanced economies	1.2	3.2	2.5	2.7	3.0
European Union	-0.5	2.9	2.5	1.7	2.6
Developing countries	6.5	6.8	5.9	6.4	5.9
Africa	1.0	2.6	2.9	5.3	3.4
Asia	9.3	9.6	8.9	8.1	6.8
Middle East and Europe	3.9	0.7	3.5	4.6	4.1
Latin America	3.9	5.4	0.2	3.5	5.3
Countries in transition	-6.7	-7.6	-1.3	0.1	1.9
Russia, Transcaucasus, & Central Asia	-9.0	-12.5	-3.9	-1.9	1.3
Central and Eastern Europe	-4.1	-2.6	1.3	1.5	2.4

Source: I.M.F. World Economic Outlook (Interim assessment, December 1997); ECLAC.

Global output increased slightly over the fairly solid performance achieved in 1996. The bulk of the increase came from the advanced countries and the countries in transition, for the developing countries recorded a 0.5 per cent decline over 1996. Nevertheless, while the advanced countries grew at a relatively slow pace of 3 per cent and the countries in transition as a group expanded on last year's barely positive growth, to record a figure just under two per cent, the developing countries continued to record strong performance of just under 6 per cent. Within the various categories performance remained uneven. Global output was also hampered by the economic crisis being experienced by the highest performers in Asia whose growth rate declined. Nevertheless, the full impact of the Asian crisis will not be evident until 1998 and beyond.

The performance of the advanced countries continued to be led by the United States, which posted its sixth year of sustained expansion and the highest rate achieved since 1984. In contrast, the E.U., while improving on its performance in 1996, still only achieved 2.6 per cent, while Japan suffered a further setback to its incipient economic recovery following the developments in Asia.

In the United States strong output growth was accompanied by vigorous job creation and falling inflation. Projections for 1997 were for 2 per cent GDP growth with an average unemployment rate of 5.3 per cent. The result at the end of 1997 was much above expectations, for output expanded by 3.9 per cent while unemployment and inflation both fell, to 4.9 per cent and 1.7 per cent, respectively. Moreover, private investment accounted for one third of the expansion and helped to create 3.2 million jobs. The high levels of new investment also served to increase productivity thus restraining inflation.

**Table II**  
**INFLATION AND INTEREST RATES**

	1993	1994	1995	1996	1997
<b>Inflation &lt;1&gt;</b>					
Advanced economies	3.1	2.6	2.5	2.4	2.2
European Union	3.8	3.0	2.9	2.5	1.9
Japan	1.2	0.7	-0.1	0.1	1.7
U.S.A.	3.0	2.6	2.8	2.9	2.4
Developing countries	46.6	51.0	22.7	13.3	9.0
Africa	29.3	39.3	32.9	25.2	14.1
Asia	10.3	14.8	11.9	6.8	4.1
Middle East and Europe	24.6	31.9	35.7	24.7	22.3
Latin America	882.2	335.1	25.9	18.4	10.5
<b>Countries in transition</b>					
Central and Eastern Europe	357.7	153.3	75.3	32.4	38.9
Russia	699.8	302.0	190.1	47.8	15.8
Transcaucasus and Central Asia	1224.2	1667.7	250.4	65.3	36.1
<b>Interest rates &lt;2&gt;</b>					
Major Industrial countries	6.6	7.1	6.8	6.1	5.8
U.S.A.	6.2	6.7	6.3	5.8	5.5

Source: I.M.F. World Economic Outlook (Interim assessment, December 1997); ECLAC.

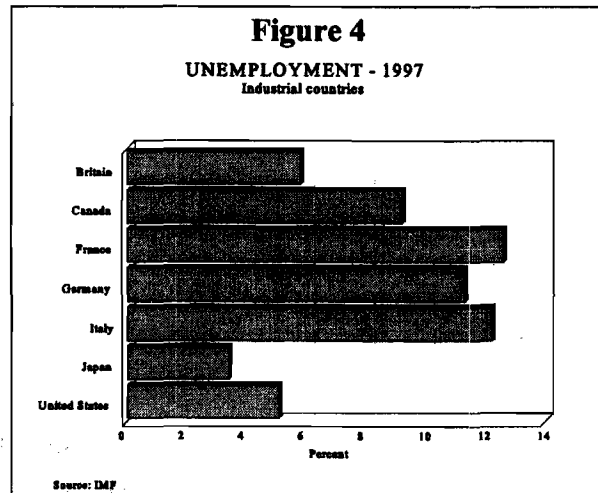
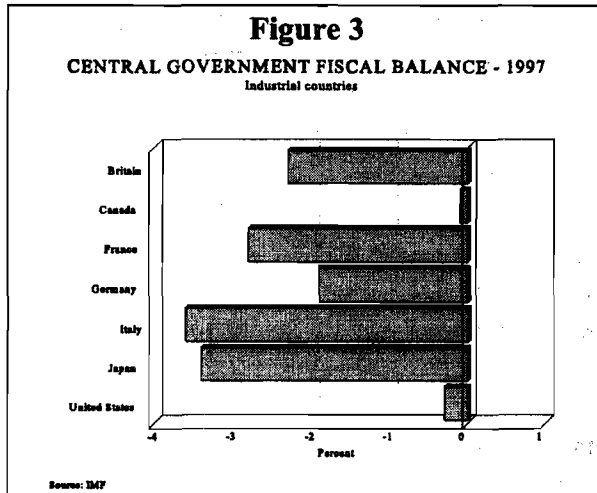
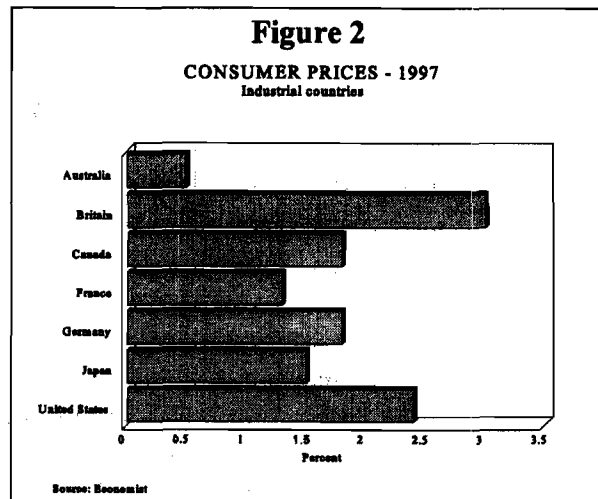
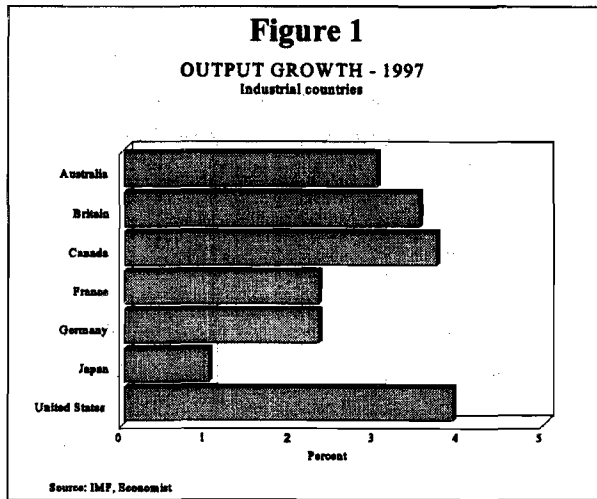
<1> Percentage change in consumer prices

<2> Long-term interest rates, in percent. Data for 1997 relates to August 1997

**Table III**  
**UNEMPLOYMENT RATES (%)**

	1993	1994	1995	1996	1997
Advanced economies	7.7	7.6	7.3	7.3	7.1
European Union	11.2	11.6	11.2	11.4	11.1
France	11.6	12.3	11.6	12.4	12.6
Germany	8.8	9.6	9.4	10.3	11.5
Japan	2.5	2.9	3.1	3.3	3.4
United Kingdom	10.3	9.3	8.2	7.5	5.7
United States	6.9	6.1	5.6	5.4	4.9

Source: I.M.F. World Economic Outlook (Interim assessment, December 1997); National data.



Restraint in public spending was reflected in the budget deficit which had contracted for five consecutive years, to rest at 0.3 per cent of Product in 1997. A balanced budget was projected for 1999. The stronger than expected fiscal performance was to be explained by the virtuous cycle created by a buoyant economy, with many more people and firms paying more taxes and with fewer persons seeking social benefits. Complacency with respect to the public finances was not yet warranted, however, given the major task which needed to be tackled, to adjust social services to the increased demands of an ageing population.

The strong overall performance came as a surprise, given that the economy was in its sixth year of expansion and was, therefore, on past performance expected to be at or beyond the peak of the business cycle. This was also underlined by the low level of unemployment which, on past performance, would have exceeded the non-accelerating inflation rate of unemployment (NAIRU) previously believed to be 5.5 per cent. Nevertheless, pressures were appearing, in the job market where unemployment fell to 4.6 per cent the end of the year, via extremely strong and growing domestic demand and evidenced by the growing external deficit and the strong performance in the

stock market. Developments in Asia might paradoxically benefit the economy by restraining an economy on the point of overheating. However, the uneven distribution of the gains from recent strong performance remained a concern. The very dynamism shown by the private sector has, in the short term, heightened wage differentials and, therefore, the income inequalities existing between those activities in the ascendancy and those in decline.

In **Canada**, the economic expansion which commenced in mid-1996 continued in 1997, with a slight reduction in unemployment while inflation remained within the target range of 1-3 per cent. The decline in interest rates, made possible by rapid fiscal consolidation, together with favourable exchange rates gave a significant fillip to business confidence and encouraged increased investment. As economic activity quickened modest interest rate increases became necessary in the second half of 1997. Nevertheless, with significant unutilized capacity the trend toward moderate expansion with low inflation is expected to continue in 1998.

In contrast, **European Union (EU)** performance was uneven. The **United Kingdom** economy has since 1993 managed to expand steadily towards its full potential, while reducing unemployment to relatively low levels in 1997. The steady appreciation of sterling has not restrained output since buoyant domestic demand has offset flagging export performance. Moreover, the spectre of overheating and increased inflation has been faced by the decision to give the Bank of England operational independence in monetary policy while inflationary targets have been set at 2.5 per cent. Monetary policy has, accordingly, been tightened and fiscal consolidation has been accelerated. While strong domestic demand remains a source of some unease, the prognosis is for further economic expansion in 1998 with only a minimal increase in inflation. Unemployment is expected to fall further, to about 5 per cent.

Several other small E.U. countries, are either approaching full capacity utilization or have started to move toward it. Ireland, Norway and the Netherlands fall into the former category, while Finland, Sweden, Spain and Portugal fall into the latter. Austria, Belgium and Switzerland continue to experience considerable unutilized capacity since their economies tend to be strongly influenced by France and Germany.

The other three major EU economies namely, **France Germany and Italy** experienced sluggish performance, in part because of the need to force their economies into the strictures of Maastricht fiscal targets. While domestic demand remained sluggish they have been trying to export themselves out of the doldrums. Construction activity was especially slow. Chronically high rates of domestic unemployment, caused by sluggish performance and rigid labour markets, served to accentuate consumer insecurity. Rigid labour markets further slowed the deep restructuring required for long-term growth.

The prognosis for 1998 was for only a slight increase in the economic tempo of these countries with minimal reduction in unemployment. The fiscal strictures will remain severe as they seek to qualify for the European Monetary Union (EMU) in May 1998, especially in Italy where the degree of consolidation necessary is still quite large and in France where some slippage is becoming

evident. Moreover, the external market was unlikely to be as propitious for them in 1998 so that export performance could not be relied upon to pull these economies out of their torpor.

Given the strong performance of Western Germany in preceding decades, current fiscal and labour imbalances need to be seen in the light of difficulties being experienced to reincorporate its eastern lander. This relates specifically to the need to absorb and restructure obsolete enterprises in the east and make the necessary public transfers, equivalent to US\$ 201 billion per annum. The adjustment of the eastern lander is further complicated since these transfers are to be phased out while simultaneously wages rates are to converge. Currently, unemployment in the eastern lander runs at over 19 per cent, but productivity lags behind the western lander. While wage rates are not yet equal to the west, unit labour costs in the east exceed those in the west by one third, making it among the most expensive in the world. High unit labour costs inhibit labour intensive investment to favour capital intensive plant. This, in turn, inhibits job creation generally and services industries particularly.

In **Japan** the economic recovery which appeared to be underway in late 1996 and early 1997 faltered in the second quarter of 1997. Growth, originally expected to be about 2.3 per cent achieved no more than 1 per cent in 1997, with scarcely any faster expansion anticipated for 1998. The underlying fragility of the Japanese economy resulted from the decline in asset prices in the early 1990s and the resulting problem loans for the financial system. While external performance, benefitting from the depreciation of the Yen vis à vis the United States dollar, was strong, domestic demand remained weak. Here low levels of consumer and business confidence were further depressed by a jump in consumption tax and reduced public investment, equivalent to 2 per cent of Product, which took effect in the second quarter of 1997.

The slowdown in the economy taken together with difficulties in Asia, to which the Japanese economy is closely tied, renewed doubts about the capacity of the financial institutions to strengthen their portfolios and grow out of their weakness, in the short run. Moreover, the failure of a major bank and later a securities firm, which exposed significant hidden losses and malfeasance in the regulatory apparatus, caused further concern as to the extent to which relevant information had been concealed from the public. These developments further eroded confidence and prompted the stock market to continue the downward spiral. Anxiety was further increased by the planned financial deregulation, the so called "Big-Bang" to take place in 1998 and the capacity of the financial institutions, given their current fragility, to face up to international competition and tighter regulatory standards.

Output in the **developing countries** continued to be strong, though not as strong as in 1996. All developing country regions recorded reduced performance, with the exception of Latin America. For the developing countries as a whole, the Asian crisis had a relatively modest effect in 1997, estimated to be a decline of 0.3 per cent in growth. The impact in 1998 is estimated to be more substantial, with a contraction of 1.3 per cent being projected at this stage, although the crisis might not have worked itself through. Even this modest estimate would mean the lowest rate of growth for the developing countries since 1990. In general, those dependent upon large international

financial flows were likely to be the most affected in 1998 since capital flows, especially longer-term development capital to the developing countries were likely to fall again. Asia and Latin America are, therefore, likely to be the most affected, with Africa and the Middle East being relatively immune since they are not significantly exposed to global capital flows.

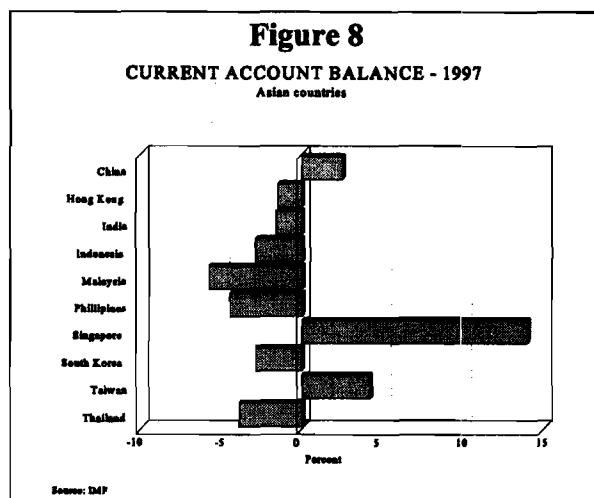
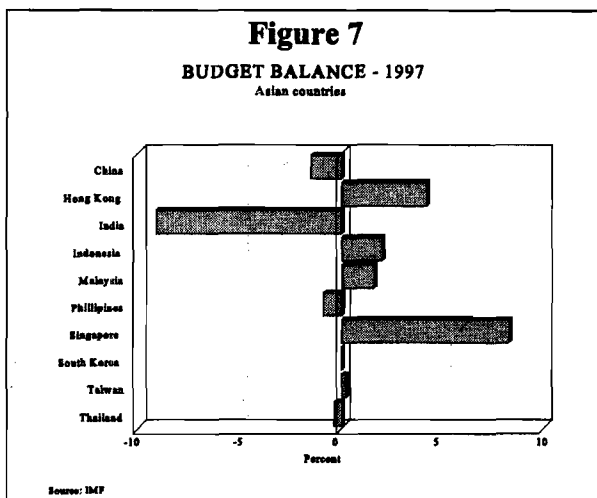
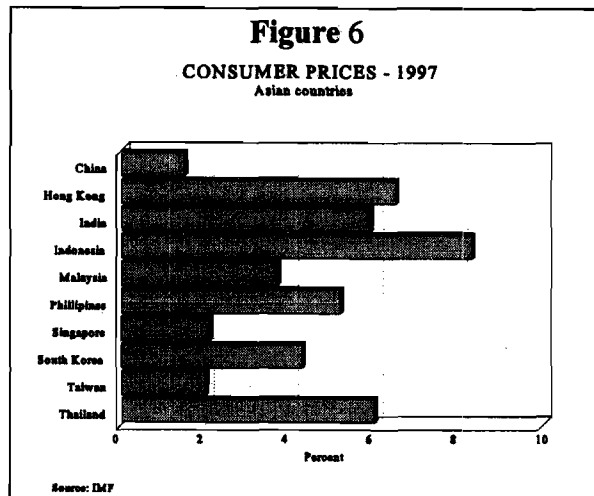
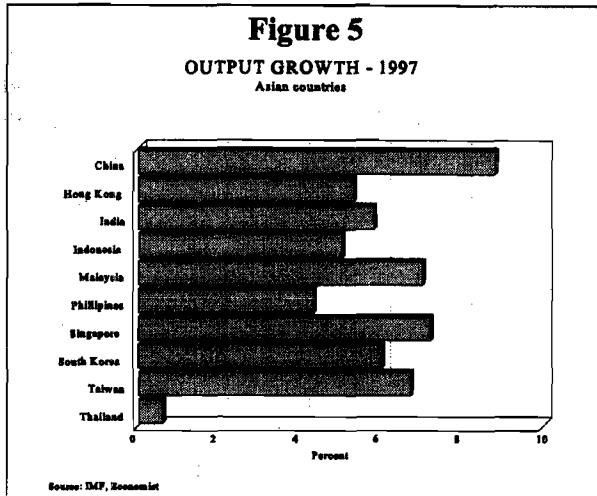
Performance varied for the developing countries in 1997. In **sub-Saharan Africa**, growth picked up in 1996 and was expected to remain in the region of 4-5 per cent in 1997-1998. Strong performance was also becoming more broad based. Whereas in 1994, 10 of the 47 countries recorded negative growth this applied to only one country in 1997. Moreover, whereas 26 countries achieved growth in excess of 3 per cent in 1994 no less than 35 did so in 1997. The average rate of inflation was also falling steadily, from 46 per cent in 1994 to about 19 per cent in 1997. Whereas 12 countries recorded inflation rates of less than 10 per cent in 1994, 33 managed to do so in 1997. Yet this improved performance is essentially a case of retrieving lost ground. If per capita income increased by 1 per cent per annum until 2006 it would return to the income per capita figure achieved in 1982 but still be 5 per cent below that achieved in 1974.

This performance was not achieved by buoyant raw material prices, since the terms of trade deteriorated steadily for the group as a whole over the period 1995-1997. Neither was expansion the result of large capital inflows, since private capital inflows averaged 1.1 per cent of Product in 1997, a decline from 2 per cent in 1996. In fact, domestic factors explained the good growth performance in this region, not the least of which was policy reform. Despite progress being made across several countries, in South Africa and Nigeria policy reform remains to be addressed if these economies are to approach their potential. Moreover, the group remains generally fragile and susceptible to external shocks and the challenge of mobilizing resources for strong future development remains to be met. The problem is complicated by the fact that the region is losing out on foreign capital, now merely 3.3 per cent of developing country flows and down from 6 per cent in the latter half of the 1980s.

While investor confidence in **South Africa** improved after the national elections in 1994 and the moderate economic policies followed immediately thereafter, unemployment remained high at over 30 per cent. However, this confidence was eroded by 1996, consequent on the deterioration of several macroeconomic indicators. This resulted in capital flight and steady erosion of the exchange rate<sup>1</sup>. The result was that growth slowed, investment declined and inflation increased in 1996. By 1997, investor confidence and capital inflows returned as the depreciation of the exchange rate, down by 8 per cent in real effective terms, contributed to an earlier than anticipated correction of the external current account. New fiscal policies, including a privatization programme, were also adopted to stabilize the economy. The new policies for equitable expansion and which emphasize growth, employment and redistribution and are entitled GEAR, have met with popular support but still remain to be fully elaborated.

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<sup>1</sup>For example, the deficit for fiscal year 1996/1997 exceeded 5 per cent of Product while the external deficit for 1995 was 2.1 per cent of Product. Inflation increased from 5.5 per cent for the period April 1995-1996 to 9.9 per cent for the corresponding period 1996-1997.



Developing countries in **North Africa, the Middle East and Europe** have recently been experiencing improved economic performance and were expected to continue to record growth in the range of 4-5 per cent in the period 1997-1998, despite the decline in oil prices. Strongest expansion, of between 5-7.5 per cent, was being experienced by Egypt, Iran, Jordan, Lebanon, Tunisia and the Republic of Yemen. Inflation is projected to fall below 9 per cent for the region as a whole, the lowest rate since the early 1980s. The majority of these countries achieved rates below 4 per cent, although Turkey went against the trend of falling inflation rates experiencing inflation of around 80 per cent. Aggregate debt and debt service ratios also declined in 1997.

The **Asian** crisis caused a reduction in the rate of growth in that region from over 8 per cent on average for the period 1992-1996 to under 7 per cent in 1997. A further reduction to under 6 per cent is projected for 1998. The impact is not expected to be evenly spread over the Asian countries, however, since the ASEAN 4, comprising Indonesia, Malaysia, the Philippines and Thailand showed the steepest declines, growth falling from 7.4 per cent in 1996 to 4 per cent in 1997 and this

is projected to fall further, to 1.7 per cent in 1998. The stock markets of these four, together with South Korea, declined in value by US\$6 billion. A comparison of estimates before the crisis and those made at the end of 1997 showed a downgrading of Asian output by almost 1 per cent for 1997 and 1.7 per cent for 1998. For the ASEAN 4 the impact of the crisis has been much more severe with projections for output to be downgraded by 1.6 per cent of GDP in 1997 and 3.7 per cent of GDP in 1998.

The survey of global economic developments for 1996 commented on the quickening integration of global markets. It also noted the fact that certain emerging markets, especially in Asia, had developed synergies and a virtuous cycle of their own, so that global activity was becoming less dependent upon the locomotive effect traditionally exerted by the advanced economies. Developments in 1997 were to confirm these interrelationships. This time, however, the evidence was perverse, the strong links manifesting themselves in the form of a vicious cycle which served to reduce the credibility and growth prospects of one after another of these economies.

The vicious cycle began when foreign investors lost confidence in the capacity of Thailand to take sufficiently rapid and determined action to deal with its growing external imbalance, which had moved steadily from a current account deficit equivalent to 5 per cent of Product in 1993 to 7.9 per cent in 1996<sup>2</sup>. This had been covered by capital inflows, the pegged exchange rate regime and low international interest rates continuing to encourage external borrowing and overexposure of domestic firms and financial institutions to exchange rate risk. Following the collapse of the Thai equity market and the inability of the Government to defend the currency against speculators convinced that the exchange rate could not hold, bond and currency markets began to see similar weaknesses throughout the region<sup>3</sup>. Loss of confidence and resultant capital outflows spread throughout the region causing already marginal currencies to collapse.

The resulting Asian financial crisis was perhaps the most noteworthy development in 1997. This was so, in part, because to the casual observer it was so unexpected, tarnishing what had been the seemingly invincible Asian economic performance. It was also noteworthy in that it provided a real life laboratory to study the interaction between national and integrating global markets and to observe the interplay between macroeconomic policies and business/entrepreneurial perceptions.

While worrying signs began to appear early in 1997, the tarnishing of the eastern miracle commenced in Thailand in mid-May but, because of the inter-linkages in these economies and because the economies manifested many common symptoms, the erosion had spread throughout the

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<sup>2</sup> Malaysia, and to a lesser extent, Indonesia, Korea and the Phillipines also suffered growing external current account deficits.

<sup>3</sup> These weaknesses included fixed exchange rates, with real exchange rate appreciation, slowdown in exports, persistent current account deficits financed by portfolio inflows and rising external debt. These factors exposed substantial unhedged foreign currency borrowing by the private sector, inflated domestic property markets, a weak overexposed and inadequately supervised banking system and a lack of transparency in business and financial affairs.



region by the end of the year. Initially the issues in Thailand spilled over into Malaysia and the Philippines, at first in the equity markets. By July, the contagion effect in the exchange markets was underway, following Thailand's inability to regain investor confidence with credible policies or to defend the Baht from the subsequent speculative attacks. By July 14, the Malaysian currency was set afloat, then the Singapore currency on July 17, the Indonesian currency on August 14 and by August 15 the Hong Kong dollar was under pressure. Subsequently, the crisis was also to spread further, to strike South Korea where the Won depreciated rapidly. It was ultimately to come to rest in Japan, the initial engine of the Asian miracle, where after currency depreciation the crisis struck home to the already hurting Japanese financial sector.

Ripples were felt further afield, notably in Brazil in October, where the Sao Paulo stock exchange lost one third of its value and the authorities had to put a stabilization package in place to shore up the economy. Even so, the authorities lost 13 per cent of the foreign reserves to defend the Real from speculative attacks. But other countries in Latin America were not immune either, while the industrialized countries suffered severe turmoil in their stock markets. Moreover, they are still calculating the likely impact of these developments, which might not yet have been completely played out, on their economies. Finally, the severe currency depreciations have put a keener edge on the export performance of several Asian producers and left others, notably China, with an exposed currency. These changes will impact the current accounts and exchange rates of potential competitors in developing and advanced economies alike and could, conceivably, set off a new round of instability.

While the Asian crisis was in some senses a replay of the Mexican peso crisis, which commenced with declining economic fundamentals, the loss of investor confidence, capital flow reversals and spillover effects into various adjacent countries, there were also noteworthy differences. The Asian countries were not victims of public sector profligacy and they had a sustained track record of strong economic performance. Rather, funds were channelled into investment some of which was of dubious viability, including into property, in part because it was channelled to favoured family or institutional allies. This was possible because of influence peddling and lax prudential regulations which ultimately led to deteriorating loan portfolios. This together with the fact that Asian businesses held greater domestic debt impacted the banks more severely. Mexico was also closely tied to the United States via NAFTA at a time of expanding world trade so that the United States economy was able to assist in Mexico's recovery by absorbing its exports. Finally, Mexico encouraged by the IMF and the United States adopted a comprehensive recovery programme and immediately restructured its financial sector, whereas past successes in Asia have caused the authorities to be more cautious in changing what had been seen as the ideal model.

Asian businesses had become highly dependent upon foreign debt, some of it short term. As exchange rates collapsed and remedial measures in the form of increased interest rates were applied, domestic firms were unable to service the debt and consequently sank into insolvency. Increasing bad debts and non-performing assets adversely affected the balance sheets and, therefore, the solvency of banks. Accordingly, in Asia the currency crisis was linked to a banking crisis and both were much more severe than had been initially expected. The rapid contagion was evidence of both

the downside effect of global financial integration and of regional product and trade integration. Given a propitious global environment, these economies should be able to recommence growth, via keener export performance outside of the region, until regional demand is able to recommence the virtuous cycle from which they benefited up until recently. Nevertheless, the severity of the crisis should not be underestimated.

External developments were also a factor in the Asian crisis. The flow of funds to developing countries was, in recent years, prompted by the need to seek better returns than were available in the mature economies where interest rates were falling and economic activities were in the doldrums. After the Mexican crisis there was also a temporary shift away from Latin America to Asia though recently capital flows to Latin America have resumed. As economic activity increased, especially in the United States and as interest rates started to rise, investors turned their interest once again to the mature markets. A further factor was the linkage of several Asian currencies to the United States dollar. While the dollar depreciated in 1994-1995 these countries gained competitiveness but after mid 1995 as it began to appreciate, while the Japanese Yen fell, they were to suffer severe erosion in competitiveness, which was not counteracted by domestic exchange rate policy.

Several lessons can be learned from the Asian crisis. As was the case in Mexico, delay in taking action was the main culprit in Thailand. There, strong, consistent past performance lulled policy makers into a false sense of security and made them reluctant to tamper with a tried formula even when economic fundamentals had commenced their decline. Initial defense of the currency caused severe losses in reserves. Delay, together with financial sector problems and political uncertainties came together to shake investor confidence, which transformed the decline into a avalanche.

In contrast, in several other countries the stampede effect seemed to have a greater impact than the economic fundamentals seemed to warrant. This was in part to be explained by the fickleness of foreign investors, who initially thought the countries could do no wrong but with a reversal of sentiment sought rapidly to exit from the currency. By way of illustration, net capital flows to the Asian economies grew from US\$ 62 billion in 1994 to US\$ 101 billion in 1996 but the upward trend was reversed in 1997 as they received US\$ 34 billion. For the ASEAN 4 the trends were even more stark being US\$ 19 billion in 1994, US\$ 35 billion in 1996 and US\$-4.1 billion in 1997. Such capital reversals were inherent where investments were financed with borrowed money and where lenders based their decisions not on how the proceeds of loans were to be used but rather on the rates of return, hoping to minimize the risk with rapid response times. The lesson here was that while economic fundamentals remained paramount, they could for a time be obscured by other phenomena falling under the rubric of "confidence" which also exerted a significant effect.

Focus on economic fundamentals, therefore, needs to be unwavering (and indeed preemptive action might be necessary where contiguous or otherwise linked economies came under siege). One area of focus would seem to be on maintaining appropriate real exchange rates, and indeed on appropriate and credible exchange rate procedures. Few unambiguous lessons were to be learned from the Asian crisis. Nevertheless, it was clear that defense of the currency, in all cases where it

was attempted, with the exception of Hong Kong, was expensive and doomed to fail. Yet the currency board arrangements which (just) weathered the onslaught on the Hong Kong dollar, while seemingly appropriate for small economies like Hong Kong were not without cost. For example, that country had to maintain reserves in excess of US\$ 90 billion which exceeded all the currency in circulation and had to maintain impeccable macroeconomic fundamentals. The model is not universally applicable and is not deemed, at this time, to be appropriate for Indonesia which sought to establish a currency board of its own.

It was also essential that policies should be followed which were conducive to moderate market determined interest rates, which would not damage domestic economic activity, induce excessive amounts of short-term capital inflows or foreclose on policy tools intended to induce further monetary tightening, where this became necessary. This implied credible and consistent macroeconomic policies, stable and efficient financial institutions and a socio-political and psychological environment conducive to building confidence in local and foreign economic actors, alike. The need to raise interest rates to stem capital flight caused the market to focus on the debt profile and decimate several enterprises dependent on such debt which in turn weakened the financial sector. Overreaction by Malaysia, in the form of destabilizing political rhetoric and attempts to redirect blame and reimpose rigid currency controls, served to override other credible policies, exacerbate the mood of panic and accelerate the rate of capital flight in Malaysia and in adjacent countries.

Attention to other structural policies, such as better banking supervision and greater transparency to ensure sound financial systems was also necessary. Closer attention needs also to be paid to the timing of capital account liberalization and the adoption of measures to discourage and limit the frequency of movement of short-term speculative capital<sup>4</sup>. Lack of transparency and unreliable indicators were instrumental in eroding confidence in both Korea and Indonesia. When the external debt in Korea was discovered to be US\$100 billion, twice the previously thought figure, confidence in the capacity of that country to service the debt was severely eroded. Similarly, when the spotlight was placed in the murky corner of private sector debt of Indonesia, initially believed to be US\$ 55 billion but subsequently estimated to be as much as US\$50 billion more, a substantial portion of which was short-term debt, confidence collapsed to nullify the text book preemptive policies initially pursued.

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<sup>4</sup> Capital inflows can put severe upward pressure on the exchange rate which if allowed to float freely can reduce the competitiveness of domestic enterprises. If rates are held administratively, the flows can increase inflation or erode the current account of the balance of payments. Several approaches have been tried, the most obvious being for the Central Bank to sterilize the inflows but this can be expensive and counter-productive, others have raised statutory reserve requirements while some countries shift public sector deposits from commercial banks to the Central Bank. Another tool is to limit the open foreign currency positions of commercial banks through prudential regulations. Chile in 1992 allowed some appreciation of the rate while more recently it introduced selective capital controls to penalize short-term flows. This topic warrants much more detailed treatment than is possible in this paper if the costs and benefits of the various options are to be fully explored.

Moreover, issues of probity and governance were also brought to the fore. Where special groups were favoured, policies were distorted to serve narrow interest groups, such as the first family in Indonesia, or large enterprises in Korea<sup>5</sup>. Reports indicate a lack of evenhandedness in the treatment of family interests and a failure of will when the full impact on these interests became evident. Strong efforts from the highest level to establish a currency board in Indonesia, with a fixed (appreciated) exchange rate, which was contrary to the best international advice, was thought to be motivated by the need to protect those interests holding large external debts and to the detriment of those which had pursued more prudent policies. Issues of probity also surfaced in the financial sector in Japan, where bank regulators were accused of tipping off major institutions about inspections and where reports were rigged to protect them.

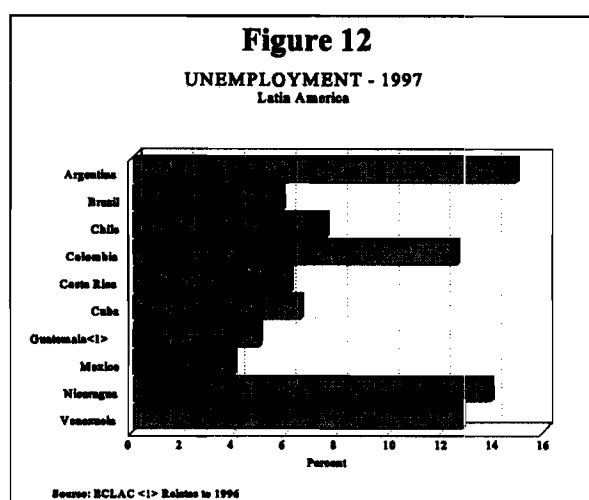
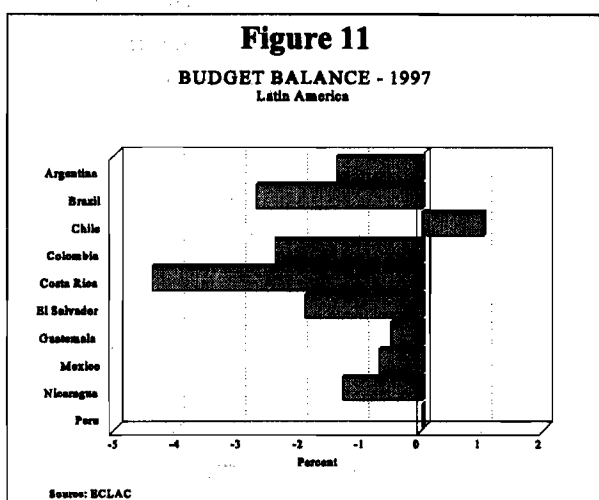
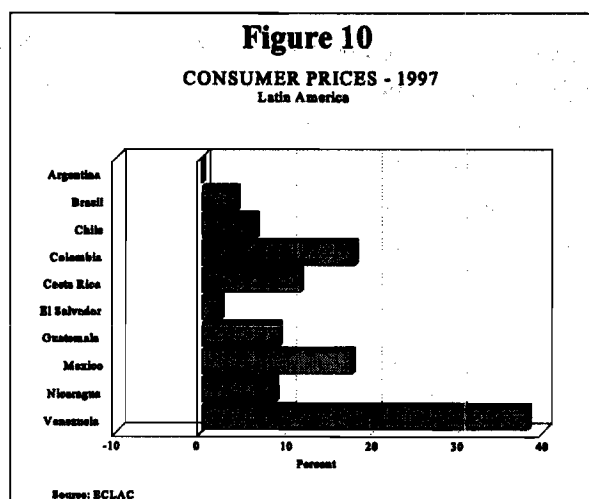
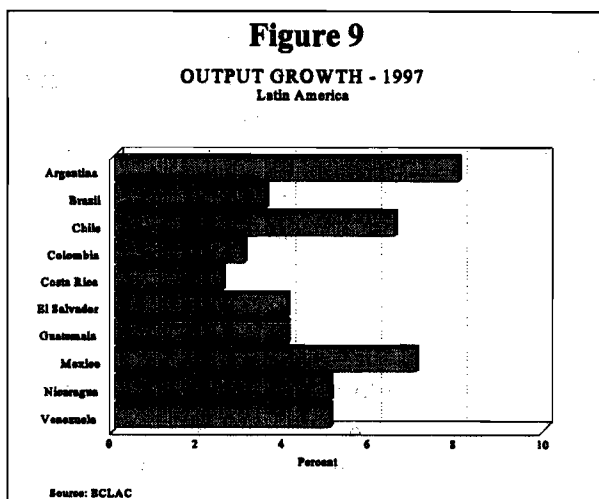
The Asian crisis brought home the fact that national economic agents operating in an open global environment had reduced scope for laxity at the macroeconomic and microeconomic levels. Greater attention, therefore, needed to be paid to economic fundamentals despite the seeming lack of attention given them by investors. Undue reliance on purely market signals as a guide to action could be extremely risky, as it often created over-confidence on the part of policy makers and entrepreneurs, alike. Since the market was usually governed by inertia, its initial slowness to react could encourage risk taking and even recklessness on the part of the recipients of capital inflows. Once potential dangers became evident to the investors of such capital, however, the corollary to inattention was stampede to exit the currency before erosion set in. The stampede, in turn, was self fulfilling in creating economic collapse.

The rapid contagion effects evident in Asia should also alert economically integrating regions to the need for better regional surveillance and the adoption of measures to bolster the efforts of partners to apply best practice at the national level. Loss of confidence in one country could damage others in a regional partnership with relatively sound economies. Efforts by CARICOM countries in the area of monetary policy surveillance should be strengthened. Innovative measures such as cross national banking surveillance arrangements might also be considered, while renewed efforts by the EU to agree upon a set of early warning arrangements to alert policy makers before speculators entered the market would also bear watching.

Reforms are likely in the policies of International Financial Institutions (IFIs) following the Asian crisis. Agencies such as the IMF are likely to become more aggressive in demanding information and in vetting the information for accuracy following accusations that it was tardy in predicting instability in some countries or indecisive regarding the policies of others. Some of the data provided to the Fund was also shown to be grossly inaccurate, sufficiently so to lead to misjudgements in policy. Greater emphasis is likely to be placed on short-term capital flows and on the policies governing the capital account generally. Greater focus is also likely to be put on the compliance of domestic financial institutions with international standards. Internal Fund policies are

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<sup>5</sup> This was a danger inherent in picking winners since governments could be held hostage to select enterprises in financial trouble.



also being reviewed with respect to the adoption of measures to slow capital movements in a crisis and to provide better funding for countries in difficulty.

Aside from the technical and policy lessons to be learned from the crisis, analysts are also trying to evaluate the consequences of it for the global economy. The initial prognosis is for a decline of between 0.3 to 0.6 per cent of GDP for the OECD countries in 1998 and of 0.6-1.2 per cent of GDP in 1999. While this seems to be manageable, it does not include the cost of a potential deflationary spiral which is a growing concern of some analysts. The fact is that with domestic demand falling in the affected countries they will need to export their way out of the crisis<sup>6</sup>.

Growth in **Latin America** in 1997 was stronger than achieved for 25 years, with 5.3 per cent recorded as compared with an average of 3.2 per cent for the period 1991-1996. Per capita GDP was

<sup>6</sup> The implications of this are further expanded in the section on capital flows.

estimated to have increased by 3.6 per cent, making a cumulative per capita increase of 13 per cent for the decade. The increased rate of economic expansion was evident throughout the region, few countries experiencing slower rates of growth than in 1996. Six countries, Argentina, Chile, the Dominican Republic, Mexico, Peru and Uruguay recorded growth of between 6-8 per cent while in seven others it was between 4-6 per cent. Nine countries had growth rates of around 3 per cent. Preliminary indications are that three Caribbean countries, namely, Haiti, Jamaica and Saint Lucia had little or no growth.

Inflation for the region fell from a high of 888 per cent in 1993 to 10.5 per cent in 1997, the lowest rate achieved in 50 years. In most countries it declined, while in 13 of the 22 countries surveyed inflation was now in single digits. The highest rate of inflation was in Venezuela which, nevertheless, managed to reduce it from 103 per cent in 1996 to 38 per cent in 1997. Brazil which as recently as 1993 experienced inflation of 2489 per cent, had managed to reduce it to 4.1 per cent in 1997. The sharp decrease in inflation in Latin America was to be explained in part because of structural changes in the global economy which tended to lower inflation and also to reward countries which achieved low inflation. As a consequence, domestic policies in Latin America had been geared to inflation fighting, with positive results.

The positive outcomes for growth and inflation were, however, accompanied by an increase in the current account deficit, moving from US\$35 billion in 1996 to US\$60 billion in 1997, or 3 per cent of Product. The increased deficit was fairly widespread, for in eight countries the deficit exceeded 4 per cent of Product while in Bolivia, Haiti, Nicaragua and Paraguay it exceeded 5 per cent. The overall average was also heavily weighted by deficits in Brazil (where it exceeded 4 per cent of Product) Argentina and Mexico.

The deficit was to be explained by an 18 per cent surge in the value of imports mainly to Brazil and Argentina and a reduced surplus in Mexico. More generally the reasons for increased imports were increased domestic demand, especially from investment in most countries, real currency appreciation in practically all the countries, especially Mexico and Venezuela, and the loosening of import restrictions or reduction in tariffs in Central America and Brazil. The prices of imports were lower for most countries.

Exports, which could not keep pace with the growth in imports, were, nevertheless, strong. For the region as a whole export volumes increased by 11 per cent, twice the rate of output and also in excess of the increase in world trade volumes. This was achieved despite widespread appreciation of the currency, although a high proportion of the exports was destined for other Latin American countries<sup>7</sup>.

Nevertheless, capital inflows estimated at US\$73 billion more than covered the deficit. Inflows were particularly strong in the first three quarters, although the flow slackened in the final

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<sup>7</sup> MERCOSUR increased its Common External Tariff by 3 per cent in November 1997.

quarter as a result of the Asian crisis. Foreign Direct Investment (FDI) amounted to US\$44 billion, the highest recorded, with particularly strong inflows being received by Brazil, the Dominican Republic, Mexico and Venezuela. FDI flows were encouraged by more liberal and deregulated economies and by greater macroeconomic stability. For the region as a whole the proceeds from privatization accounted for about one quarter of FDI flows, although for Brazil the proportion was higher. Bond placements, unlike FDI, were restricted to relatively few countries notably Argentina, Brazil and Mexico, placements being made primarily by governments. Equity investments continued to account for a small portion of the capital entering Latin America, being significant only in Argentina, Brazil, Chile and Mexico.

The external debt of Latin America increased by 2.5 per cent, a slower rate of increase than in 1996. The increases were confined primarily to Brazil, Chile and Colombia in the form of increased private sector borrowing and to Argentina where the increase was in public sector debt. In general, external debt indicators were improving, now being similar to those registered prior to the external debt crisis of the 1980s.

The prospects for 1998 remained fairly good, though growth is likely to return to the average achieved for the decade about 3.5 per cent. This Economic Commission for Latin America and the Caribbean (ECLAC) estimate, for a 1.8 per cent contraction compared with 1997, was based on an evaluation of likely global developments and likely internal macroeconomic policies. The IMF has also projected 3.5 per cent growth for the region, revised downward by 0.9 per cent after the Asian crisis. The World Bank has estimated that the Asian crisis will have a greater impact and be directly responsible in a 1.5 per cent contraction in Product in Latin America. Inflation was expected to continue to be moderate, while external current account deficits were expected to moderate in the face of concentrated efforts by the region to rebalance its economy in the face of reduced capital inflows. Unemployment was likely to contract only slowly.

An examination of first semester performance for **the Caribbean countries** provided scant hope for improved economic performance<sup>8</sup>. Preliminary indications suggested that output did not increase as quickly across the Caribbean as it did in the first semester of 1996. Moreover, fiscal deficits increased in most countries, mainly because of buoyant public spending. In the few instances where gains were made on recurrent account they were used to bolster capital formation. External performance was also generally weak, for the traditional export crops were facing new marketing constraints and depressed prices. Simultaneously, imports burgeoned in some cases because of disequilibria elsewhere in the economy. While tourist earnings were generally encouraging they were insufficient to offset declines elsewhere, so that several countries were running down their reserves. Prices remained moderate in all instances with the exception of Jamaica, which, nevertheless,

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<sup>8</sup> Further details about Caribbean economic developments are to be found in ECLAC/CDCC document entitled, "Review of Caribbean economic performance - 1997" (LC/CAR/G.512) which is based on data for the period January to June 1997 and from which this section is abstracted. The annual review entitled, "Overview of Caribbean economic performance - 1997" is forthcoming.

recorded a decline over the first semester of 1996. For the most part, unemployment which had been inching down in recent years of relatively strong growth showed signs of inching up again.

Policy focused on the two perennial problems, achieving and maintaining macroeconomic stability, on one hand, and expanding economic activity on the other. Most governments tried their hand at the second only after achieving some measure of success in the first. Where both goals were being pursued simultaneously, policy inconsistencies were evident which jeopardized success in both. Sub-themes were concerns about equity and the reorientation of production away from sectors which seemed to have declining future prospects. In only one instance did the policy maker have the luxury of being able to focus mainly on achieving higher levels of productivity to relieve the labour shortage faced by that economy.

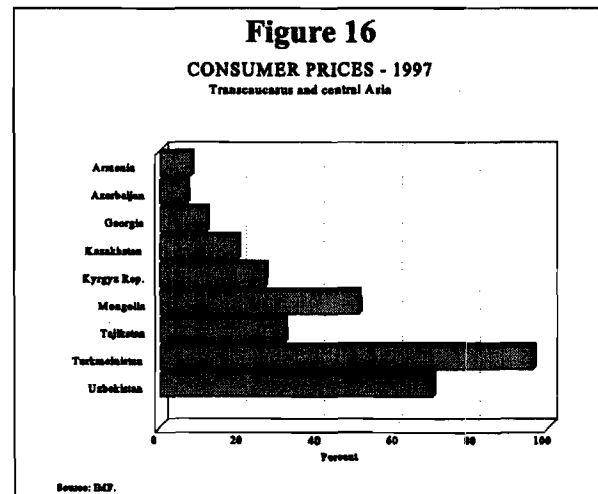
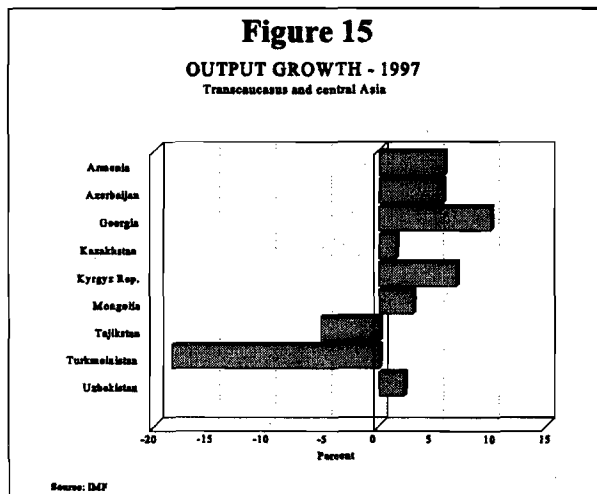
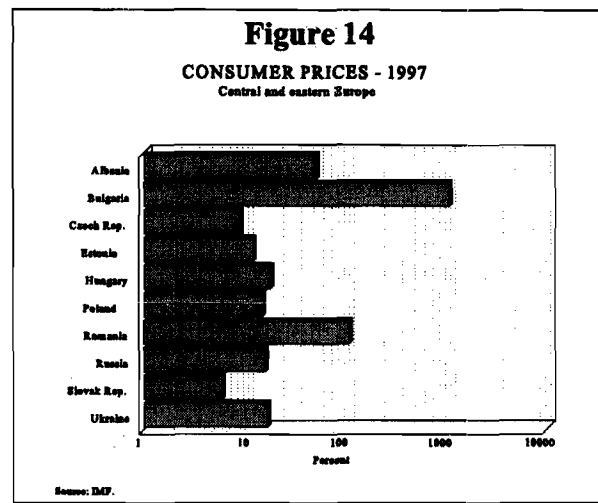
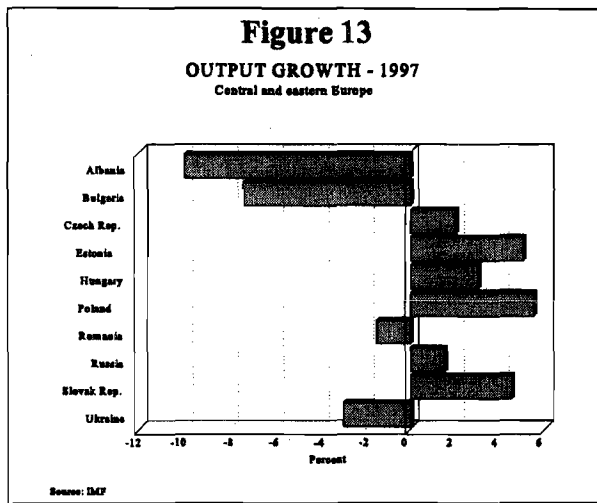
Throughout the region structural reforms continued, notably in the area of fiscal policy, to make tax regimes more transparent and to substitute consumption taxes for declining trade taxes, to improve compliance and tax collection mechanisms and to remove loss making and other business operations from the public accounts, through privatization. Reforms were also evident in response to continuing liberalization, especially in the areas of trade and the financial sector.

For the countries surveyed, only Trinidad and Tobago recorded faster rates of growth when compared with the first half of 1996. For the other countries experiencing growth, namely Aruba and Barbados, expansion slackened from the pace achieved in the previous year. Both Jamaica and the Netherlands Antilles continued to experience contracting output, while the Organization of Eastern Caribbean States (OECS) countries moved from expansion in 1996 to contraction in the first part of 1997. Anecdotal evidence suggests that the rate of expansion in the Bahamas and in Belize also slowed in 1997.

Fiscal performance deteriorated in all instances except Trinidad and Tobago, where a deteriorating recurrent account was salvaged by inflows from divestment proceeds. In Aruba and Barbados, gains on recurrent account were used to augment capital spending which served to increase the deficit. In Jamaica, both the recurrent account and the overall deficit widened significantly succumbing to pressure from debt servicing charges and the decision to support failing financial institutions.

External performance weakened in 1997. Merchandise exports were down or stagnating in all cases, except Barbados and Trinidad and Tobago, yet imports increased rapidly in most cases. The exception was the Netherlands Antilles which was able to record better performance on merchandise account, because of suppressed demand. Earnings from tourism increased in all cases but were insufficient to offset the deterioration carried forward from the merchandise account, so that current accounts deteriorated. Reserves were augmented in Barbados and Trinidad and Tobago, in the latter case because of privatization proceeds. While complete data were not available for Aruba and the Netherlands Antilles reserves were thought to have increased in the former but deteriorated by about 3 per cent over the first quarter of 1997 in the latter. The reserves fell by US\$130 million in Jamaica yielding to the twin effects of trade and exchange rate pressures.





The **transition countries** as a group recorded measurable growth for the first time since the collapse of the Council for Mutual Economic Assistance (CMEA). Concealed behind the overall average, however, performance was mixed since countries were at significantly different stages in the transition from centrally planned to market economies. Accordingly, some countries were attaining similar levels of growth and inflation to those prevailing in Western Europe, others were experiencing financial crises similar to those being experienced by the emerging economies of Asia, while some were still to achieve a measure of economic stabilization prior to sustained growth.

Countries such as Poland, the Baltic states, Estonia, Latvia and Lithuania, the Czech and Slovak Republics, Hungary and Slovenia had all been applying stabilization and reform programmes and had made substantial progress toward integrating their economies into the global economic and financial system. All had achieved in excess of 3 per cent growth and reduced inflation rates to under 15 per cent, the median figure for the group as a whole.

Nevertheless, like the other market driven economies this exposed them to hitherto unknown economic uncertainties. The Czech and Slovak currencies, in fact, came under speculative pressures at about the same time as Thailand, and for substantially the same reasons, namely, large external current account deficits following sluggish export growth, real exchange rate appreciation and doubts that the authorities could support the exchange rate with the appropriate macroeconomic policies. The speculative attacks showed rather the extent to which these economies had become integrated into the global financial system but also the need for caution as they exposed their still fragile economies and financial institutions to the rough and tumble of international finance. Nevertheless, the setback in these countries did not spill over into adjacent countries and was expected to be short-lived, provided appropriate policies were applied consistently.

Several other economies which had pursued tight financial policies and carried out the necessary reforms, such as Armenia, Azerbaijan, Georgia, Kazakhstan, and the Kyrgyz Republic had also started to achieve sustained growth with falling inflation.

At the other end of the spectrum, those encountering greater difficulty in applying the policy reforms, or which had resisted implementing them had lagged in economic performance. The two largest transitional economies suffered major contraction, 40 per cent in Russia and 60 per cent in the Ukraine between 1991 and 1996. Nevertheless, the Russian economy might have passed the worst and seems to have started to grow again. Moreover, it is estimated that growth might be underestimated since the official statistics might not have fully accounted for some of the emerging private informal activities. The Ukraine has only recently achieved a measure of stabilization with falling inflation but the economy continues to contract.

Major weaknesses were evident in the financial institutions of both countries while the restructuring of State enterprises still remained to be tackled. Three quarters of the State enterprises were believed to be in need of restructuring in Russia while one half were currently incurring losses and one-quarter of them would probably not be able to regain their solvency. The situation in the Ukraine is thought to be even worse. Farm productivity in both countries, suffering under the traditional management and incentive practices, continued to decline while government regulatory policies remained pervasive to distort the economy. Expenditure patterns needed reform while the tax system was complex and difficult to administer.

## GLOBAL TRADE AND MARKET ARRANGEMENTS

	GLOBAL TRADE INDICATORS				
	1993	1994	1995	1996	1997
World Trade Volume <1>	4.0	9.3	9.5	6.2	8.6
Export volumes					
Advanced economies	3.3	8.9	8.8	5.6	9.3
Developing countries	6.9	12.7	10.4	8.6	9.6
Import volumes					
Advanced economies	1.6	9.7	8.9	6.1	8.0
Developing countries	8.7	7.2	11.7	8.0	8.3
Terms of trade					
Advanced economies	0.8	-	-	0.1	-0.7
Developing countries	-2.1	-0.3	2.6	1.3	-0.8
Fuel exporters	-6.7	-1.5	-5.1	5.8	-
Non-Fuel exporters	-0.6	1.7	1.7	0.3	-
Source: I.M.F. World Economic Outlook (Interim assessment, December 1997); ECLAC.					
<1> Percentage annual changes in goods and services					

The volume of goods and services traded globally expanded at the pace set in 1994 and 1995 outstripping that of 1996. This quickened expansion was achieved by the increased volume of trade conducted by the advanced countries for the rate of increase achieved by the developing countries increased only marginally. Nevertheless, the rate of increase achieved by the developing countries remained marginally greater than for the advanced countries. For 1998 the rate of increase in trade is projected to decline by about 2.5 per cent to 6.2 per cent. Trade is projected to slow down more in the advanced countries than in the developing countries.

Whereas the terms of trade improved for all categories of exporters in 1996 they either declined or remained the same in 1997. This is in part to be explained by the general decline in real prices of most traded commodities and services as a result of increasingly competitive global markets. In United States dollar terms the price of manufactures declined most steeply by 7.3 per cent, oil prices declined by 5 per cent while non fuel primary commodities declined by 3.6 per cent. These declines were exaggerated by the fairly steep appreciation of the United States dollar vis à vis most major currencies in 1997. This is illustrated when trade is valued in Special Drawing Rights (SDR), where the price of manufactures still showed a decline of 2.3 per cent but oil prices showed a slight increase, of 0.1 per cent, while non-fuel primary commodities increased by 1.6 per cent.

While there was a fairly broad consensus about the need to increase trade, **the institutional arrangements** being developed to secure it continued to differ. The uneasy symbiosis between

global trading arrangements and those being fashioned at the regional or bilateral level remained. Yet in some instances, such as the FTAA, the intention was clearly to go beyond the WTO, which was making steady progress, to create a seamless economic and financial environment in the hemisphere which might eventually provide the model for a broader global framework. Similarly, the Asia-Pacific Economic Cooperation (APEC) seemed intended to pursue the same objective in Asia. It took its Information Technology Agreement into the WTO and was able to secure binding global agreements on it.

The WTO continued to make progress in resolving several of the issues which remained outstanding following the Uruguay Round and in advancing new issues for liberalization under the General Agreement on Trade in Services (GATS). In December 1996 the WTO held its first ministerial meeting and set the stage for future action. In 1997 the WTO, in its third year of operation, achieved several breakthroughs at the sectoral level. In the past the General Agreement on Tariffs and Trade (GATT) had conducted its business in comprehensive rounds where trade-offs across sectors were deemed to be the most effective way of liberalizing trade. The rapid succession of achievements at the sectoral level in 1997 was, however, unexpected and significant because it was achieved in sectors of great importance in achieving systemic economic efficiency and global integration.

The first was an agreement to liberalize international trade in basic telecommunications services, whereby 72 members representing 93 per cent of total domestic and international revenue from the sector agreed to open their markets to foreign competition. The services covered in the agreement included voice and data transmission, telex, telegraph, facsimile, private leased circuit services, fixed and mobile satellite services, cellular telephony, mobile data services, paging and personal telecommunications services. Eight CARICOM countries were party to the agreement, which came into effect on 5 February 1998.

The second major agreement was to cut tariffs on Information Technology Products. Accordingly, computers and telecommunications products were subject to tariff cuts commencing July 1997 and concluding with tariff free trade by 2000. These reductions will mean liberalizing 600 billion of world trade and give consumers access to cheaper information technology products.

Finally on 12 December 1997, 70 countries agreed to open their financial services sectors to greater competition<sup>9</sup>. In all, 102 countries have multilateral commitments in the sector. The agreement which will grant permanent and full most favoured nation status to the participants will come into force on 1 March 1999, at the latest. It covers more than 95 per cent of the trade in banking, insurance, securities and financial information. Potential benefits from the liberalization of financial services are greater efficiency in the sector, the provision of more diverse financial services at lower cost, better financial intermediation and investment opportunities and better means of managing risks. Countries remaining outside of the agreement are less likely to reap these benefits and are likely to be less favoured by foreign capital.

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<sup>9</sup> One of which was a CARICOM country.

A high level meeting was also convened in October to assist the least Developed Countries to increase their ability to trade. The initiative came out of the G7 Summit in June 1996, where it was noted that while the Uruguay Round had managed to incorporate several of the developing countries into the emerging global trading system some of the Least Developed Countries (LDCs) were in danger of being marginalized by fast changing events. The meeting agreed to provide a trade assistance programme and new and improved preferential market access measures to the LDCs as a temporary measure to speed their transition to global integration.

For the future the WTO has committed itself to several new issues, such as the relationship between trade and investment, the interaction between trade and competition policy and transparency in government procurement. It is also committed to studying the relationship between regional and multilateral trading arrangements. Outstanding issues remaining from the built-in agenda of the Uruguay Round were government procurement, where negotiations were scheduled to commence in January 1999, and agriculture where negotiations were scheduled to commence in January 2000.

In conclusion, the WTO has been pursuing its agenda with unexpected vigour. Initiatives being pursued via some of the regional negotiations will complement this work and build upon it, although the desire to go beyond the WTO is not universal in all the regional groups. Whatever the outcome of the tension being created by regional/multilateral initiatives, the agreements being reached within the WTO are themselves of great significance, and will have far reaching effects for all Caribbean countries despite the various provisions still extant to protect developing countries from the full force of globalization. The decision with respect to CARICOM bananas shows the extent to which these sentiments have changed. It is important that all developments in the WTO are followed with care so that governments can be kept fully apprised of their implications for national and regional policies.

The major issue overshadowing EU policy during 1997 was the run up to the EMU. This issue is of special interest to CARICOM countries since the EMU seems to be the favoured role model for their efforts to coordinate monetary policy. The need to meet the convergence criteria was overwhelmingly the most important consideration in the macroeconomic policies of most of the larger economies. The exception is the United Kingdom, which is not seeking membership in the first tier which will be selected in May 1998. While this meant fairly stringent deflationary policies throughout the EU, with scant hope of reducing unemployment via reflation, the disciplines required are generally thought to be in the longer-term interest of these countries.

The lead up to the EMU was conceived in three distinct stages, the first commenced in July 1990 when all restrictions on the movement of capital between EU members was abolished. The second stage commenced in January 1994, with the creation of the European Monetary Institute (EMI). At this time monetary financing of budgetary deficits was outlawed and governments were no longer allowed privileged access to domestic finance. EU institutions were also given increased power to monitor the economic policies of member countries. The third stage, which is to commence on 1 January 1999, will see the European Central Bank (ECB), already existing in embryo in the EMI, take responsibility for European monetary policy. All exchange rates will be locked in and a new currency, the Euro, will commence circulation among those qualifying to be members.

Since the commencement of the second stage, the international community has spent its time watching and speculating as to whether the Euro will come into being on schedule and if so which countries would qualify for membership. The issue was shrouded in doubt until about mid 1997 since it was believed that by any strict interpretation of the accession criteria several of the major economies would not qualify. However, the advocates of strict interpretation, led by the German Bundesbank, were vanquished by French pressure for a more political interpretation of the criteria and by a proposal by Germany to revalue its gold reserves. This was deemed by some to be a means of "cooking the books" and coming from the country backing the most strict interpretation of the criteria, undermined the position of the Bundesbank. With the relaxation of the criteria the timetable was now almost certain to be met, with all the interested members being able to qualify<sup>10</sup>.

After 1999 the design and implementation of monetary policy will shift from national jurisdiction to the European System of Central Banks (ESCB) led by the ECB. Considerable authority will also shift from the Bundesbank, which had exclusive control of the anchor currency of the exchange rate mechanism, the Deutsche mark, which it administered in accordance with German interests. In the third stage this anchor role will pass to the Euro where monetary policy will be influenced by all the central banks. Monetary policy decisions will be made by the Governing Council of the ECB which will provide instructions and guidelines to its Executive Board, to be responsible for its day to day administration. The primary task of the ESCB is to maintain price stability and it will be provided with a high degree of independence in order to do so. Nevertheless, these provisions have been subject to criticism, as to whether there is enough autonomy, for example, in its relations with non-EU currencies or, on the other hand, whether the ESCB is sufficiently accountable to member States for its actions.

While monetary policy will pass to central control, the same is not true of fiscal policy since the EU budget is scarcely over 1 per cent of EU GDP. Fiscal policy, therefore, remains the province of national governments. Since fiscal deficits can undermine the anti-inflationary goals of monetary policy, provisions were necessary to ensure that fiscal and monetary policies were made compatible. In practical terms this means essentially that fiscal deficits and debt needed to be kept in check, so as not to beleaguer EU partners. Two measures have been devised, targets and policy coordination. The target value was for the general government's fiscal deficit not to exceed 3 per cent of GDP, under normal circumstances, and for the general government's gross debt not to exceed 60 per cent of GDP<sup>11</sup>. In "special" circumstances a greater deficit might be allowed and a timetable provided for returning to the reference values. Countries incurring deficits outside of the guidelines, in times not

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<sup>10</sup> This is not to downplay the significant efforts made and progress achieved in meeting the criteria. For 1997, consumer price inflation was expected to be less than 2 per cent on average, with all members, except Greece, falling below the 3 per cent target. Fiscal deficits for the EU as a whole were expected to be 2¾ per cent of GDP, although France, Germany and Italy are likely to have difficulty in meeting it, if the criterion is strictly applied. This compares with an average fiscal deficit of 6.1 per cent in 1993. Interest rate differentials have also fallen to less than 1 per cent across the EU while market exchange rates had also converged. Gross government debt indicators continue to show fairly wide divergence, however.

<sup>11</sup> Achieving the target for fiscal deficits now seems possible but whether it is sustainable is another matter. Italy, for instance, will need to achieve a continuous fiscal surplus of 3 per cent of Product if it is to meet the debt target of 60 per cent of Product by the year 2007.

deemed to be special, could be subject to financial sanctions but the decision to impose sanctions will be politically determined, by a vote. Aside from fiscal targets, policy will also be coordinated by the Council which issues broad economic guidelines to members.

Another area of concern surfacing with the formation of the EMU was whether countries would reduce their resilience to shocks if they lost their independence in monetary policy, for example, if they were unable to vary the exchange rate or to increase fiscal deficits for that purpose. In the event that a shock impacted all members to more or less the same extent, that is, if the shock was symmetrical, the general consensus was that little or nothing would be lost by the application of a common monetary response. The one caveat was placed on the possibility where policies were transmitted through to countries at different rates or with different degrees of efficiency, such as would allow one country to respond more quickly or more completely to the policies. In those circumstances outcomes could differ significantly.

The second instance was where shocks impacted countries in significantly different ways, so that they were asymmetric<sup>12</sup>. Here independent monetary policy was seen to be of greater potential benefit. Nevertheless, the outcome would depend on whether the shocks were permanent or temporary and whether other compensating mechanisms were available to the central authorities, such as tax transfers. Another relevant factor was the mobility of resources. Could labour and capital move easily from depressed to booming areas? In general, asymmetric shocks required a greater level of independence or integration for their successful treatment. In the absence of exchange rate flexibility and easy labour mobility, which in Europe is less than in the United States for cultural and linguistic reasons, real wage flexibility would be necessary to effect an adjustment to permanent asymmetric shocks. Given the lack of such wage rate flexibility in Europe, EMU signals the need for its early adoption if that economy is to adapt to its current and future economic difficulties.

Another issue of importance was the widening of the EU. The group being considered comprised 10 from the former eastern Europe, plus Cyprus. Turkey, another aspirant, was not currently being considered. Three issues militated against her. The first was fear that Turkish workers would flood into Germany, where unemployment was high. The second was fear of the resurgence of Muslim fundamentalism in Turkey, which would not sit well with European political norms. The third fear was that the current severe economic imbalance, which Turkey was not seen to be tackling with sufficient vigour, would strengthen the likelihood of the other two fears being realized.

In the first rank of countries to be considered for membership were Poland, Hungary, the Czech Republic, Slovenia and Estonia. Membership might be forthcoming to these countries by 2005, if all went smoothly. Deferred for later consideration until their economic policies qualified were Bulgaria, Latvia, Lithuania and Romania. Slovakia would need to improve its human rights record before being considered for entry. Several issues, revolving around financing, need to be resolved before accession, not the least of which was the Common Agricultural Policy (CAP) which

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<sup>12</sup> For example, a significant change in the price of oil would impact producers and consumers in a common monetary arrangement in significantly different ways.

would be destabilized by the accession of several new agricultural producers. Another issue in contention related to transfers to the less developed regions, the main current beneficiaries, namely Italy, Spain and Portugal, resisting any diversion of regional funds to the new entrants. Net contributors, such as Germany, were also wary about the need for increased payments. Several of the original members, led by France, were also concerned that their influence would be diluted by the accession of new members and wanted constitutional reforms to secure their status. Finally, the entry of Cyprus was complicated by its divided status, several members believing that this issue needed resolution prior to accession. Resolution of the divided status of Cyprus would require the cooperation of Turkey, while Greece indicated that if the decision to admit Cyprus was deferred it would veto the whole issue of new membership.

Finally the EU was reviving the issue of EU/US trade talks. While the bulk of trade has been liberalized several issues remained outstanding, notably agricultural products, audiovisual products, shipping and textiles, the first two being protected by the EU, especially France, while the last two were specially protected by the United States. The idea of new talks had been approved by the European Commission, but must receive approval by member States, while the United States is yet to demonstrate a sense of urgency for beginning these talks. While fast track authority was turned down in November of 1997 it was believed by some to have a better chance of being passed for negotiations with Europe, especially since labour rates were more closely compatible with the EU than with Latin America or with Asia. Moreover, with the financial difficulties in Asia and what is perceived to be a reduction of interest in the FTAA by some Latin American countries, especially Brazil, observers on both sides are coming to the view that the time for revitalizing EU/US talks is right.

Developments in the EU hold significance for the region. Efforts to consolidate the single market and the EMU provide useful lessons for those seeing the EU as a prototype for Caribbean initiatives. The process of widening also invites some parallels, while global initiatives raise questions about how the common market aspects of the Union will interface with global developments. But the parallels between the two groups can be over-drawn. The European project is proceeding with enormous effort and the application of considerable human and material resources, in part because of a common desire to contain the extremely destructive tensions and enmities of the past. The issue of widening involves some of these same concerns, as well as others made more pointed by the cold war period. The rationale for Caribbean integration is quite different and derives from people of similar historic circumstances having a strong affinity and desire to assist each other to do better. The Caribbean effort is, therefore, driven by different motives and has at its disposal significantly more modest resources to draw upon. It is also by its nature a more modest proposal and much less likely to achieve critical mass in global terms. Yet the desire to strengthen its functional cooperation activities can provide significant functional and psychic benefits for its members.

The negotiations leading to the FTAA have reached a major turning point. Since its inception participants had spent their time gathering information and identifying the various issues for negotiation. At the second Summit of the Americas, held in Santiago, Chile from 18-19 April 1998, the 34 participating countries agreed to commence the negotiations with the agreement scheduled to come into effect in January 2005.



At the second summit the structure of the negotiations were also set, with the Trade Negotiating Committee (TNC) scheduled to convene no later than 30 June 1998. The TNC would oversee the tempo and organizational arrangements of the working groups. The site of the negotiations, which would rotate between Miami, Panama and Mexico City, was also agreed and the supporting administrative arrangements based on the previous tripartite arrangements confirmed. The latter remained a fairly light structure, mandated simply to provide logistical and administrative support, translation services, and secure, publish and distribute official documents. The chairmanship of the process was also selected to rotate between Canada, Argentina and Ecuador, with a joint chairmanship comprising Brazil and the United States to cover the last phase, from 2002 to the end of the negotiation. The consultative group on smaller economies was also created to follow the FTAA process. It could bring to the attention of the TNC issues of concern and it could also make recommendations to it. A civil society committee was also created, to deal comprehensively with growing concerns about globalization. The committee will include representatives of the environmental movement, labour unions, consumer groups and business interests. Several initiatives in areas other than trade were also unveiled, with respect to education, poverty reduction, governance and drugs.

Despite the progress made in the interim the mood of participants had changed significantly since the first summit in December 1994. At that time the United States took the initiative to broaden the arrangements, recently agreed under NAFTA, to quicken the pace of trade liberalization which was believed to be too cumbersome when conducted via the GATT/WTO route. Simultaneously, potential members were anxious to join the FTAA so as not to be denied benefits which were perceived to be flowing to Mexico. The model envisaged at that time was a docking arrangement to NAFTA with Chile being first in the queue to dock.

Since then the WTO came into being and has made perceptible movement on the multilateral front. MERCOSUR has developed a momentum of its own and widened its membership to include Chile and Bolivia as associate members, the former being the candidate most favoured, but subsequently ignored, by the United States for membership in NAFTA. Since its inception, trade has increased rapidly within MERCOSUR and together with better macroeconomic performance fostered increased self confidence amongst its members. Just prior to the second summit, MERCOSUR signed a framework agreement with the Andean community comprising Venezuela, Colombia, Ecuador, Peru and Bolivia to create a South American Free Trade Area (SAFTA) by the year 2000. It also plans a wide ranging FTAA type negotiation with the EU commencing in 1999.

The United States administration, for its part, ran into persistent difficulties receiving fast track negotiating mandate. Several issues mitigated against fast track, including the Mexican peso crisis and fears of widened financial obligations, reduced enthusiasm for free trade agreements and the opposition of labour and environmental groups. While fast track authority is not essential for the negotiations to proceed, failure to achieve it has been interpreted by some as signifying a possible diminution of interest in hemispheric trade liberalization and might lose the United States the momentum in defining the pace and shape of the negotiations. Greater familiarity with the workings of NAFTA also led some to question the desirability of embracing so comprehensive a relationship. Smaller countries, especially, fear that they will be virtually without a voice during the negotiations

and subsequently, when it becomes necessary to defend their interests in what is expected to be labyrinthine trade arrangements.

Finally, the financial difficulties in Asia will impinge on hemispheric initiatives. Reduced capital inflows will require a new round of austerity in several Latin American countries and will create new uncertainties for their business interests. A new more intense phase of global competition is expected to commence in 1998, as the adjusting economies in Asia and Latin America jockey for limited global markets. Given the overvaluation of some Latin American currencies, their relatively low productivity and the dynamism which they have enjoyed within the confines of MERCOSUR, they may be hesitant about opening their markets further to global competition, at least in the short term. This is thought to be one of the reasons for Brazil's early effort to control the pace of the trade negotiations and for the seeming coalition of forces into two negotiating groups, with NAFTA on one side and MERCOSUR on the other. It might also help to explain the urgency in transforming MERCOSUR into SAFTA. Currently, NAFTA comprises 392 million people with GDP of US\$8.6 trillion, and inter group trade of US\$44 billion. Mercosur for its part comprises a population of 204 million, GDP of US\$1.2 trillion with inter group trade of US\$19 billion. Chile adds 12 million people to MERCOSUR while the Andean group adds a further 100 million.

Despite these complications, the FTAA remains a comprehensive project which reaches far beyond the issues of trade. Areas such as financial flows, investment and competition policies, democratic governance, property rights, education, the judiciary and multilateral cooperation are being included in the negotiations. The formation of a civil society committee to include several of the proponents and opponents of globalization is a timely development which is necessary if the process is to proceed with a broad consensus. While this comprehensive agenda will complicate the negotiating process, it also broadens the constituency of interest in the FTAA. If successful, the resulting agreement would represent a new kind of relationship in the hemisphere and a possible template for future multilateral initiatives.

CARICOM's integration efforts are evolving in a complex web of activities intended to integrate their economies at the subregional level and into the wider hemisphere. These include measures to complete the deepening and widening of CARICOM itself, secure the consolidation of the Association of Caribbean States (ACS) and fashion a place for its members in the comprehensive FTAA by 2005. These initiatives must also pay due attention to existing relationships with the EU and prepare for new ones that are compatible with hemispheric initiatives. Finally, they must all be made compatible with developments at the global level, especially as they evolve in the WTO.

Within CARICOM, work continued in the survey year to consolidate the single market and economy (CSME), the major elements of which were to be in place by 1999. The CET entered in its fourth and final phase in 1998, although the degree of compliance varied from country to country, either as a result of slippages in administrative procedures or, as in the case of Belize, derogations which allowed that country to implement the provisions two years behind the agreed schedule. Moreover, the coverage of the CET was not universal, since several products remained exempt through the various lists, as a result of lobbying from interested parties.

Other institutional arrangements were being put into place to establish the single market and economy within CARICOM. Rather than replacing the original Treaty of Chaguaramas, which came into effect in 1973, the governments decided to enact a series of protocols to the Treaty to effect the necessary changes. The first of these, relating to the new institutional structures for decision-making and implementation was signed in February 1997. It confirmed the status of the Community as an association of sovereign States, reaffirmed the Conference as the supreme organ of the Community and established more efficient and flexible procedures for decision-making while also rationalizing the organizational structure of the Community. The Common Market Council (CMC) was superseded by the Community Council of Ministers comprising ministers of CARICOM affairs, while four other councils were created, namely the Council for Trade and Economic Development, the Council for Foreign and Community Relations, the Council for Human and Social Development and the Council for Finance and Planning.

Several governments had already put into place arrangements for national consultations on CARICOM matters. Simultaneously, the Charter of Civil Society was brought into effect. It is declaratory but emphasizes the obligation of CARICOM States to good governance and to respect civil, political and economic rights and the rule of law.

A second protocol which allowed CARICOM nationals to establish business enterprises, provide services and move capital without restriction within the common market was also signed by 11 of the 13 members eligible to do so. Measures to facilitate production integration within CARICOM were also being developed while legal provisions were adopted by eight members so far to allow the free movement of certain skilled personnel. Protocols relating to disadvantaged countries regions and sectors, agricultural policy, industrial policy, trade policy, dispute settlement, competition policy and transportation are scheduled for completion by the next meeting of the Conference of Heads of Governments in July 1998.

The Council of Central Bank Governors was also developing a macroeconomic policy framework to facilitate macroeconomic convergence by the members of the common market. Initially convergence is being sought via the 3-12-36-15 criteria, which targets three months foreign exchange cover for 12 months, 36 months of exchange rate stability and a debt service ratio of under 15 per cent. The ultimate objective of this exercise is to create a Caribbean Monetary Union, modeled closely on that of the EU. This is a complex project which will suffer many of the conceptual uncertainties, costs and benefits as outlined in the section dealing with the EMU.

Whether the project can proceed with despatch to monetary union remains to be seen. Attempts to secure uniform policies in the medium term in some areas are likely to emphasize the differing economic tempos and policy orientations among members. Lessons can, however, be learned from past experience in the Caribbean or recent developments in Asia, in areas such as exchange rate policy and the extent and sequencing of events leading to the liberalization of the capital account. Nevertheless, there is clear advantage to be gained from regular meetings of CARICOM central bankers, working toward the application of best practices in their respective countries. Monitoring national performance and the development of an early warning mechanism to alert on errant behaviour can only be to the benefit of the countries. By itself the adoption of sound policies will ultimately lead to the convergence of economic indicators within CARICOM

and, of far greater importance, it will allow CARICOM members to converge with best practice globally. Increasingly, best practice criteria will determine the extent to which outsiders interact with CARICOM countries.

The free movement of goods within CARICOM has been substantially achieved, with unauthorized barriers being applicable only to five commodities and three countries. Yet this achievement is, in effect, a transitional arrangement to the regime being negotiated for the FTAA and that evolving via the WTO. Similarly, with attempts to achieve the free movement of capital within CARICOM, since similar elements will be included in the FTAA and are already widely practiced globally. Similar comments apply also to the double taxation treaty which is currently in operation among the seven signatories and the Social Security Agreement which has come into effect among the four countries that have so far signed the agreement.

The widening of the common market was also being pursued, Suriname was admitted to full membership while observer and associate member status was accorded to the Dominican Republic, Puerto Rico, the British Virgin Islands, and the Turks and Caicos islands. Haiti was provisionally accepted to full membership of the Community in July 1997, with the terms and conditions of membership to be resolved before July 1998.

CARICOM has also advanced the structure whereby it will coordinate and execute its external negotiations in those areas where it needs to negotiate as a group. A chief negotiator has been appointed who will oversee and coordinate these negotiations. Four specialized negotiating groups have been established, to cover Lomé/Europe; Western Hemisphere; Summit of the Americas, non-economic issues; and, global trade and economic issues including the WTO. The issues clustering under the Western Hemisphere group include, Summit of the Americas economic issues leading to the FTAA, NAFTA, NAFTA parity proposals and Caribbean Basin trade expansion initiatives.

Uncertainty surrounds some elements of the CARICOM single market and economy. The uncertainty derives from the pace and extent of several parallel actions being pursued at the global level. The global project is rapidly moving toward the free movement of goods, services and factors, with the exception of unskilled labour at the global level. At worst the CARICOM project, if completed before the main functional elements of the global project, will serve as a transition to it. Nevertheless, the several areas of functional cooperation, including the coordination of foreign policy, which have served the membership well in the past will remain valuable whatever the future scenario.

## DEVELOPMENT FINANCE

<b>Table V</b>					
<b>NET CAPITAL FLOWS</b>					
In billions of US dollars					
	1993	1994	1995	1996	1997
<b>Total</b>					
Net private capital flows	162.4	147.2	191.5	259.3	181.5
Net official flows	21.2	8.4	40.6	-25.5	1.6
Change in reserves <1>	-74.5	-72.7	-112.6	-114.6	-98.8
<b>Developing countries</b>					
Net private capital flows	142.0	116.2	149.4	216.3	144.6
Net official flows	20.0	19.7	32.8	-16.1	-2.4
Change in reserves <1>	-40.7	-42.9	-63.5	-100.6	-58.3
<b>Africa</b>					
Net private capital flows	2.8	9.0	10.9	12.9	6.8
Net official flows	5.9	7.5	6.9	0.9	1.2
Change in reserves <1>	0.0	-5.1	-0.5	-6.9	-6.6
<b>Asia</b>					
Net private capital flows	53.4	62.4	89.2	101.2	34.2
Net official flows	9.9	5.9	5.6	4.5	12.4
Change in reserves <1>	-26.1	-39.9	-28.2	-50.2	-22.3
<b>Middle East and Europe</b>					
Net private capital flows	22.6	-1.0	12.2	19.1	15.7
Net official flows	4.3	10.5	-1.6	-6.9	-7.9
Change in reserves <1>	6.7	-1.9	-8.9	-16.1	-10.2
<b>Latin America and the Caribbean</b>					
Net private capital flows	63.3	45.8	37.1	83.1	87.9
Net official flows	-0.1	-4.3	21.9	-14.7	-8.1
Change in reserves <1>	-21.3	4.0	-25.8	-27.4	-19.1
<b>Countries in transition</b>					
Net private capital flows	12.1	17.3	29.5	28.6	30.0
Net official flows	3.0	-11.0	8.5	-8.8	4.4
Change in reserves <1>	-12.4	-8.7	-34.7	-0.4	-16.9
<b>Newly industrialized economies &lt;2&gt;</b>					
Net private capital flows	8.3	13.6	12.6	14.3	6.8
Net official flows	-1.9	-0.3	-0.7	-0.6	-0.5
Change in reserves <1>	-21.4	-21.1	-14.5	-13.6	-23.6

Source: I.M.F. World Economic Outlook (Interim assessment, December 1997).  
 <1> A minus sign indicates an increase.  
 <2> Group comprises Hong Kong, South Korea, Singapore, Taiwan and Israel.

Net private capital flows to the developing, transitional and newly industrializing countries declined by almost one third in 1997. Several factors contributed to the change, most notably the

increased interest rates and economic activity in the advanced economies, which increased the attractiveness of investment in those countries, and the perception of increased risk in the developing countries, following macroeconomic instability and capital flight in Asia. While the flow of private capital to most regions contracted, its retreat was not universal. Private capital flows to Latin America actually increased by just over 5 per cent, while flows to the countries in transition increased by just under 5 per cent. Not surprisingly, the greatest decrease in private capital flows was to Asia which received 66 per cent less than in 1996, but flows to Africa also declined by over 47 per cent, while flows to the Middle East and southern Europe declined by a more modest 18 per cent.

In Asia the main decline in private capital flows took place in *short term finance* which grew rapidly from just over US\$2 billion in 1992 to US\$34.4 billion in 1996. The trend was severely reversed in 1997 with a net outflow of US\$17 billion. The countries most affected by the reversal in short term capital were Thailand US\$-12.6 billion, Taiwan, US\$-2.6, China US\$-0.8 and Malaysia US\$-0.6. Net *direct investment* to Asia also declined by 13 per cent. The countries showing the greatest contraction in direct investment were China, Indonesia and the Philippines while net *portfolio investment* declined from US\$7.9 billion in 1996 to just US\$0.2 billion in 1997, the largest reversals being evident in Thailand and the Philippines although large outflows were evident from Singapore, for the second year running.

Net *official flows* were barely positive in 1997, as compared with outflows of 25.5 billion in 1996. For the developing countries as a group, however, the outflows continued although the rate of repatriation contracted from US\$16 billion in 1996 to US\$2.4 billion in 1997. The one-third increase in official flows to Africa, was easily understood especially as it represented a relatively modest jump from US\$0.9 to US\$1.2 billion. Latin America also suffered net outflows of official capital although the rate of outflow was less than in 1996. The bulk of official inflows, representing a 175 per cent increase, however, went to assist the distressed Asian countries to regain their economic stability.

The magnitude of flows to Asia is illustrated by the fact that World Bank disbursements for 1998 have been projected upward from the US\$2 billion allocated at the end of 1997 to US\$11 billion, to accommodate financial packages negotiated for Asia and the emerging economies. Disbursements are expected to rise further to US\$14 billion in 1999. Some observers are concerned that the increased exposure of the World Bank comes at the expense of aid to the poorest countries, debt relief efforts and provisions to countries facing natural disasters and other emergencies. The increased exposure has also raised questions about Bank profitability and the future cost of money to the middle income countries.

The decline in both official and private capital flows to developing countries means that compensatory adjustments will need to be made by them to reduce imports and to increase exports in sum equivalent to the decline in capital flows. The two other options are less feasible. Running down the reserves is only a short-term option until more permanent measures can be put into place. Delay in such circumstances would be expensive. Private borrowing abroad would be more

expensive in view of the trend to increased interest rates and the heightened perception of risk. Institutional borrowing is likely to be increased hence the efforts by the IMF to increase its resources, but would be limited to those countries in greatest need<sup>13</sup>. It would only be approved on evidence of credible domestic adjustment efforts.

For many countries adjustment will mean reduced domestic demand and reduced rates of economic expansion as imports are compressed and domestic production is diverted to export markets. This is the most plausible option, which has already been exercised by Brazil and Chile outside of Asia. Delay in making these adjustments can be expensive. As more of these countries try to export their way out of the necessary domestic contraction they are likely to face increased competition for limited export markets. A new round of currency depreciations is possible in Latin America where some currencies are overvalued. Hopefully this adjustment can be contained without setting off further depreciations in Asia, especially in China<sup>14</sup>.

Any hope of a rapid adjustment for these countries will depend upon the level of demand in the developed countries. The main markets which would need to increase imports are the United States, the EU and Japan. This raises the perennial problem of the Japanese surplus and the United States deficit. At the end of 1997 the United States current account deficit stood at US\$178 billion and was projected to rise to US\$230 billion in 1998. Any effort by the United States to increase its imports sufficient to absorb the excess supply will be sure to spark incipient protectionist sentiments in that country, despite the fact that imports could help to reduce inflationary tendencies in an economy running at full steam.

Hopes of significant Japanese reflation are receding as that country continues its cautious fiscal policy, which in turn continues to fuel the increase in its current account surplus. The option of a fiscal deficit could be beneficial to Japan and the other Asian economies in the short run and unlikely to damage the Japanese economy in the longer run since it could borrow money currently at 1.9 per cent. Japan also had a modest net public debt, 18 per cent of GDP at the end of 1997.

Members of the third potential market, the introspective EU are mostly preoccupied with deflationary policies in order to qualify for membership in the EMU in May 1998. They have planned for some domestic deflation and have themselves sought to overcome weak domestic demand via exports. Currently they seem to be less concerned at this stage with global developments than about qualifying for the EMU. Issues, such as this, will probably be the subject of internal negotiations within the G7.

The decline in official flows which has been evident in the Caribbean for some time has not been significantly compensated by private flows to many countries. Some, such as Jamaica, have

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<sup>13</sup> By the end of 1997 the IMF had committed US\$36 billion to Asian economies in difficulty.

<sup>14</sup> China, which is currently being investigated to ascertain whether it qualifies for membership in the WTO, has pointed to its restraint in this regard as a factor justifying membership.

been the beneficiaries of short-term capital inflows taking advantage of interest rate differentials, although these flows have been induced as a result of macroeconomic imbalance and have not made any significant impact on long-term investment. On the contrary, they have inflated the money supply and increased fiscal spending to sterilize it, put pressure on the exchange rate, financed imports to erode the current account of the balance of payments and generally complicated macroeconomic management. Ways will, nevertheless, need to be found for Caribbean countries to derive lasting benefits from international capital flows since the traditional flows from official and multilateral sources are likely to become even more scarce. Mention has been made elsewhere of the need to pursue macroeconomic policies which will sustain interest rates at only a small premium over global rates, so that domestic firms can borrow at rates which do not differ significantly from those of their international competitors. Other measures to induce private foreign investment or joint ventures are also needed to supplement macro policies and include attention to infrastructure, transparent and well functioning markets and appropriate labour market policies.



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1. The first part of the document discusses the importance of maintaining accurate records of all transactions. This is essential for ensuring the integrity of the financial statements and for providing a clear audit trail. The records should be kept in a secure and accessible location, and should be updated regularly.

2. The second part of the document discusses the importance of maintaining accurate records of all assets and liabilities. This is essential for ensuring the accuracy of the balance sheet and for providing a clear picture of the organization's financial position. The records should be kept in a secure and accessible location, and should be updated regularly.

3. The third part of the document discusses the importance of maintaining accurate records of all income and expenses. This is essential for ensuring the accuracy of the income statement and for providing a clear picture of the organization's financial performance. The records should be kept in a secure and accessible location, and should be updated regularly.

4. The fourth part of the document discusses the importance of maintaining accurate records of all cash flows. This is essential for ensuring the accuracy of the cash flow statement and for providing a clear picture of the organization's liquidity. The records should be kept in a secure and accessible location, and should be updated regularly.

5. The fifth part of the document discusses the importance of maintaining accurate records of all taxes. This is essential for ensuring the accuracy of the tax return and for providing a clear picture of the organization's tax liability. The records should be kept in a secure and accessible location, and should be updated regularly.