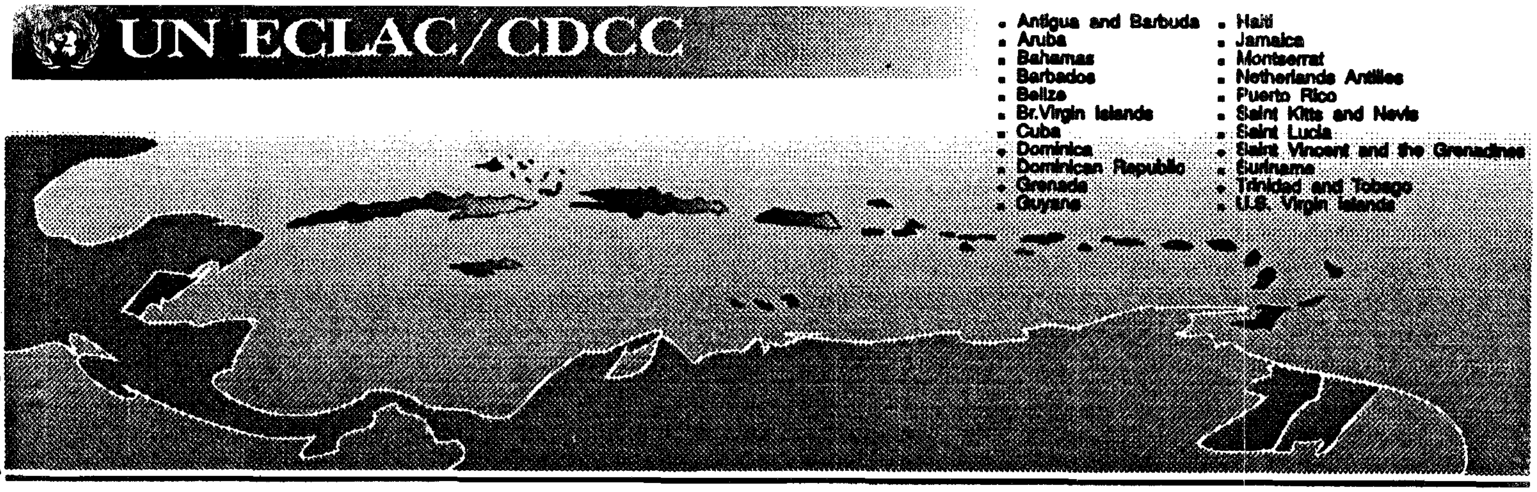

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SUMMARY OF GLOBAL ECONOMIC DEVELOPMENTS
-1996-

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

ABSTRACT

The document discusses selected global economic developments for the year under review which are deemed to be of interest to the Caribbean policy maker. It 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. It provides a brief overview of global trade focussing on the institutional arrangements being negotiated to conduct it. The document concludes with a description of international capital flows and trends in international debt, focussing on the most seriously indebted among them and recent measures being applied for the amelioration of debt in those countries.

Key words are: global output; global trade; integration; transition countries; developing regions; industrial countries; global capital flows; international debt.

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INTRODUCTION

This paper continues the practice, started in 1994, of discussing selected global economic developments of interest to the Caribbean policy maker. Its objective is to provide background information about the economic context in which the open island economies must operate, especially as they seek to integrate these economies globally. It also tries to identify, by way of comparative analysis, those policies which work and for whom. It is to be seen as a complement to the Survey of Caribbean Economic Performance, which is published in the second quarter of each year and, therefore, does not go into Caribbean developments in any depth.

Any current study of world trends cannot help but be struck by the rapid pace of global integration and the high degree of complementarity which is growing among the industrial, developing and transitional countries. All the macroeconomic indicators point in that direction, notably trade and capital flows which are both growing faster than global output while the unidirectional link, whereby industrial country growth provided the engine for the developing country economies, seems to be evolving into a more interdependent relationship. This has been made possible because the developing countries' economies have continued to expand faster than those of the industrial countries to develop some momentum of their own. It has also been made possible by growing trade and investment links among the developing countries themselves. Accordingly, it has been estimated that the economic slowdown between 1991-1993 would have degenerated into a full blown global recession had it not been for the strong performance of the developing countries (IMF, 1996). Similar comments might also be made about 1996, where developing country performance continued to outstrip that of the industrial countries. Despite the progress being made in global integration, misgivings remain as to some of the means being used to achieve it. Misgivings also arise as a result of some of the rationale being used to justify increased integration while opposition to it is often based on an incomplete understanding of its costs and benefits.

The institutional arrangements being developed to foster integration are in some instances unwieldy and becoming increasingly complex. According to the World Trade Organization (WTO), 76 FTAs were either created or modified since 1948, more than half of which came into being after 1990. In Latin America and the Caribbean, several integration schemes currently coexist; the North American Free Trade Arrangement (NAFTA) in the Northern hemisphere; the Caribbean Common Market (CARICOM) in the Caribbean; the Central American Common Market (CACM) in Central America; while bridging them is the Group of Three countries, comprising Colombia, Mexico and Venezuela. In South America the Andean Group and the Southern Common Market (MERCOSUR) operate jointly. Moreover, the Association of Caribbean States (ACS) was formed in 1994 to encompass 25 countries members of the CARICOM, CACM and Group of Three, as well as others in the Caribbean Basin not members of the aforementioned groups. Finally, between members of the Latin American Integration Association (LAIA), 32 bilateral economic agreements had been signed (ECLAC, 1996a). These arrangements are proliferating rapidly and comprise several overlapping and possibly redundant arrangements. Some of them have been accused of diverting trade and their complexity could greatly complicate proposals for creating a wider hemispheric arrangement, such as the proposed Free Trade Area of the Americas (FTAA) or for progressing towards a more transparent global system, under the WTO.

The proliferation of bilateral trading arrangements is exacerbated when a country seeks to create the biggest bloc around itself with the objective of increasing its attractiveness to investment and improving its competitive position in the group. Aggressive free-traders often justify such attempts at market opening with arguments of increasing jobs. More traditionally, blocs justify protectionist action to defend members and to build export capacity while protecting against imports.

Several popular misconceptions are contained in these conflicting positions. Professor Stiglitz, President of the Council of Economic Advisers, in his 1997 Report to the President of the United States, rebutted them with some universally applicable advice, as follows:

"In international, just as in domestic policy, two fundamentally different visions have long dominated the debate. At one extreme, countries interact atomistically in an undifferentiated world of free trade abroad and free markets at home. In this view international economic relations are just a matter of opening markets. The other perspective harks back to 18th century mercantilism, often supplemented with metaphors of the Cold War. It replaces ideological competition with economic competition and sees the gains of one side of the border as coming at the expense of losses on the other. The trade deficit, in this view, replaces the missile gap as the measure of national inadequacy."... "the new vision does not split the difference between these two views; rather it recognizes that the vision of trade as war is profoundly wrong. Trade is not a zero-sum game. It does not create a winner for every loser: all countries can gain". At the same time, "Defenders of free trade can do it a disservice by promoting it as a way to create more jobs or to reduce bilateral trade deficits. Jobs, the unemployment rate and the overall balance of payments are ultimately a consequence of macroeconomic policies, not of trade barriers. The real objective of free trade is to raise living standards by ensuring that (people) are working in areas where (they are) comparatively more productive than their trade partners" ... "trade has more impact on the distribution of jobs than on the quantity of jobs. Finally, he noted that "Markets function best within an institutional environment that makes rules to promote free competition while facilitating the cooperation necessary for a stable world economy. What is required is a general understanding of the issues and difficulties in international trade and mutual commitments, of the kind embodied in the GATT and the WTO, not to allow the pleadings of special interests to interfere with the gains that all enjoy from free international trade" (1997 Report of the Council of Economic Advisers to the President P 21-22).

The rapid expansion of trade and investment has provided benefits to developing and industrial countries alike, the former from new industries and improved living conditions for those able to take advantage of global exposure, the latter from more diverse and robust sources of growth, with consequent mitigation of the wildest swings in the trade cycle. Yet while all countries benefit from globalization they have not benefited equally, neither have all people within countries been favoured by these gains. Disparities between and within countries have, therefore, become more evident. Discrimination between countries takes place on the basis of how they are perceived as places to do business, that is on their macroeconomic and other policies, especially those relating to properly functioning product and factor markets. Discrimination within the labour force tends to take place on the basis of worker productivity, which is in turn related to levels of individual skill and work attitudes. Policies at the national level and those relating to the development and training of people are, therefore, of the utmost importance in determining who will benefit most from global interaction (ECLAC, 1996).

Countries should not try to isolate themselves from the process of global transformation, since it provides the most promising means of increasing their own and also global welfare. Nevertheless, explicit policies will need to be applied to mitigate its worst disparities. At the national level, governments must accelerate their macroeconomic policy reforms so as to integrate effectively into the global economy. They should also increase training for their people and strengthen legal frameworks and social safety nets to help the disadvantaged. Internationally, technical assistance will need to be strengthened to encourage appropriate policies, while the secular decline in financial assistance must be reversed so as to help those countries which are unable to benefit from international capital flows.

OUTPUT INFLATION AND REGIONAL PERFORMANCE

Table I

GROWTH IN G.D.P.

	1992	1993	1994	1995	1996
Global Output	**2.4**	**2.4**	**3.7**	**3.5**	**3.8**
Industrial countries	**1.7**	**0.9**	**2.8**	**2.1**	**2.3**
European Union	1.0	-0.5	2.8	2.5	1.6
Developing countries	**6.4**	**6.3**	**6.6**	**5.9**	**6.3**
Africa	0.8	0.9	2.9	3.0	5.0
Asia	8.8	8.7	9.1	8.6	8.0
Middle East and Europe	6.2	4.2	0.5	3.6	3.9
Latin America	2.7	3.8	5.3	0.3	3.4
Countries in transition	**-14.7**	**-8.5**	**-8.8**	**-1.3**	**0.4**
Russia	-18.7	-11.7	-14.8	-4.1	-0.9
Central and Eastern Europe	-9.9	-4.9	-2.9	1.2	1.6

Source: I.M.F. World Economic Outlook; ECLAC.

The tempo of **global output** quickened in 1996, while further progress was made in containing inflation, especially in the developing and transitional countries. Inflation remained controlled in the industrial countries allowing a gradual reduction in interest rates to shore up flagging economic activity in these countries. Modest rates also made developing country markets more attractive to capital and helped to reduce the cost of imports from those countries. Continuing the trend evident over the past five years, the developing countries achieved a more sustained pace of expansion than the industrial countries, with the former averaging just over 6 per cent, as compared with the latter which averaged scarcely 2 per cent. The developing country average was flattered by the inclusion of strong Asian performance, which over the period averaged nearly 9 per cent. Nevertheless, even without the Asian contribution the developing country average, at 4 per cent, still exceeded that of the industrial countries. The persistence of differential rates seemed to signify to some that the causal relationship between prosperity in the industrial countries leading to prosperity in the developing countries was being modified and a more interdependent relationship was being established, particularly with the countries of Asia.

The rate of increase in global output was modest, but fairly broad-based. More rapid growth was evident in both the industrial and the developing countries. In the former group, several European countries continued to experience difficulty in removing structural and macroeconomic constraints which limited the expansion of their economies. The pace of economic activity in developing regions

Table II

INFLATION AND INTEREST RATES

	1992	1993	1994	1995	1996
Inflation <1>					
Industrial countries	**3.3**	**2.9**	**2.3**	**2.4**	**2.3**
European Union	4.5	3.7	2.9	2.9	2.6
Japan	1.7	1.2	0.7	-0.1	0.2
U.S.A.	3.0	3.0	2.6	2.8	2.8
Developing countries	**35.7**	**42.7**	**46.8**	**19.8**	**13.3**
Africa	31.7	29.5	36.8	32.1	21.3
Asia	6.9	9.6	13.4	10.9	7.9
Middle East and Europe	25.9	24.0	31.5	32.5	25.6
Latin America	418.0	887.4	336.8	25.5	19.3
Countries in transition	**681.2**	**614.3**	**264.8**	**128.0**	**41.3**
Interest rates <2>					
Major industrial countries	7.5	6.2	6.8	6.3	6.3
U.S.A.	7.0	5.9	7.1	6.6	6.6

Source: I.M.F. World Economic Outlook; ECLAC .

<1> Percentage change in consumer prices

<2> Long-term interest rates, in percent. 1996 relates to August 1996

Table III

UNEMPLOYMENT RATES (%)

	1992	1993	1994	1995	1995
Industrial countries	7.8	8.2	8.1	7.7	7.8
Seven major industrial	7.2	7.3	7.2	6.8	7.0
France	10.3	11.6	12.3	11.6	12.4
Germany	7.7	8.9	9.6	9.4	10.3
United States	7.5	6.9	6.1	5.6	5.6

Source: I.M.F

seemed to be moving to a converging path, with all the developing countries growing more rapidly with the exception of Asia, where economic activity moderated steadily from the frenzied pace experienced in 1994. The countries in transition also experienced modest growth for the first time since their adaptation to the global economy commenced at the beginning of the decade, as private actors increased their capacity to benefit from larger markets. Despite the fairly broadly based

Figure 1

OUTPUT GROWTH - 1996
Industrial countries

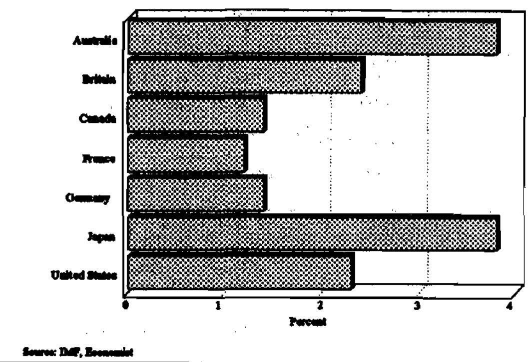


Figure 2

CONSUMER PRICES - 1996
Industrial countries

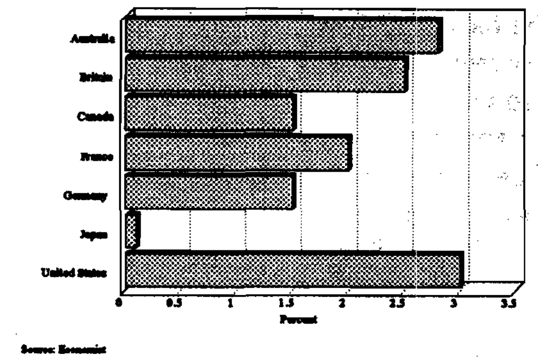


Figure 3

BUDGET BALANCE - 1996
Industrial countries

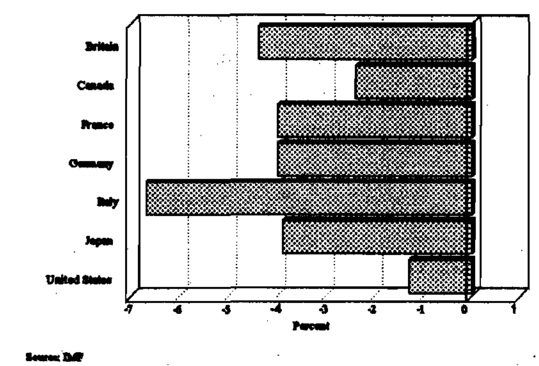
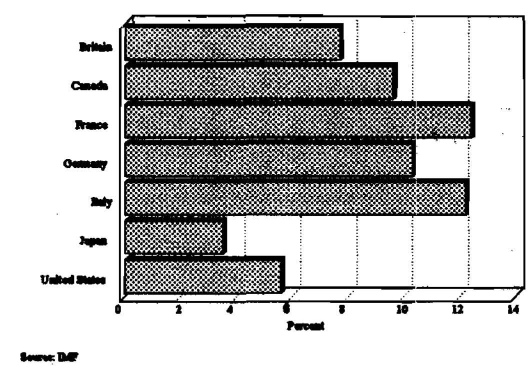


Figure 4

UNEMPLOYMENT - 1996
Industrial countries



expansion evident in the various geographic groupings variety was, nevertheless, evident within and among them.

In the **industrial countries** growth cycles varied, the rate of expansion quickening substantially in Japan while increasing more moderately in the United States, Australia and New Zealand. However, recent tentative growth in the European Union weakened further in 1996 while the rate of growth also weakened somewhat in Canada. Moreover, the capacity of the industrial economies to productively absorb their labour force varied widely. In the United States the labour market was operating against capacity constraints despite suffering massive restructuring and job market instability in recent years. Conversely, in several continental European countries, where the restructuring of industry had been constrained in the name of job security and job markets were subject to much greater stability, unemployment reached historically high rates.

The **United States of America** continued to experience output growth for the fifth consecutive year and despite operating against capacity constraints, notably in the labour market, it managed the expansion with only moderate price increases. Fiscal policy received much attention in an election year, previous years of high fiscal deficits prompting heated debate across party lines about appropriate policy options. Nevertheless, despite a seemingly inauspicious political environment the fiscal deficit was progressively reduced from about 4.4 per cent of GDP in 1992 to just over 1 per cent of GDP in 1996. Monetary policy was also prudent, largely being credited for the fairly long growth cycle with low inflation. Nevertheless, other factors contributed to containing inflation, notably the extensive restructuring of enterprises to release excess labour for expanding sectors. Openness to global trade, which forced insecure workers to moderate wage demands despite tight local job markets, and which encouraged cheap imports as the dollar appreciated were further contributing factors.

In **Japan**, four years of historically low growth were broken by a return to moderate growth in 1996. This was achieved initially by strong monetary and fiscal stimuli, with fiscal deficits being incurred from 1993 and reaching 4 per cent of GDP in 1996. While the steadily appreciating exchange rate had offset much of this stimulus, the change in trend in mid-1995 and significant depreciation into 1996, brought with it more favourable exchange rates and attractively priced exports, thus increasing the prospects for early fiscal correction and the resumption of a more sustainable expansion. Consumer prices were stable, as compared to slight deflation in 1995, in the face of still considerable unused capacity. Despite the favourable outcome in 1996 the rebound was deemed to be fragile since consumer confidence was low with savings increasing. Accordingly, domestic economic resurgence was not expected to move in tandem with external performance to bolster growth in the short run.

Output expanded more slowly in the **European Union** in 1996 than in the previous year and the expansion achieved was below the average for the Industrial Countries as a whole. Weak and declining economic activity was evident in almost all EU countries. Exceptions were to be found only in Ireland, which had averaged robust growth throughout the decade, driven by internal reform, strong inflows of foreign investment, declining unemployment and buoyant consumer spending, and in Greece where there was moderate expansion. Expansion was especially weak in Germany, France and Italy. Consumer confidence remained low with output falling in the major economies, while reduced exports from Britain, Italy, Spain and several of the smaller countries to the remainder of the EU further dampened economic activity.

Fiscal consolidation, as several members sought to meet Maastricht reference indicators for accession to the European Monetary Union (EMU), was given as one reason for sluggish activity. Consolidation might account for the dampening effect on domestic consumption, while high and growing unemployment might help to explain low consumer confidence. Nevertheless, the inability to direct unused capacity, calculated at 2-4 per cent of Product, to non-EU markets might say something about real exchange rates and the need to quicken structural change to increase productivity. In the face of these conditions, inflationary pressures were, as expected, low, inflation for the EU as a whole, falling from 2.9 per cent in 1995 to 2.6 per cent in 1996.

Economic activity in **Canada** was sluggish in 1996, the delayed effect of quite severe fiscal consolidation in 1995. Nevertheless, interest rate declines and strengthening consumer confidence had improved performance in the construction sector and reduced unemployment. The locomotive effect

Figure 5
OUTPUT GROWTH - 1996
Developing countries

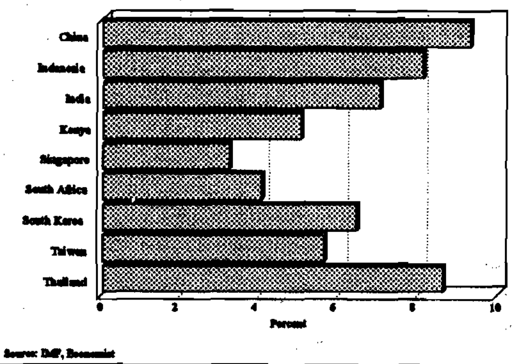


Figure 6
CONSUMER PRICES - 1996
Developing countries

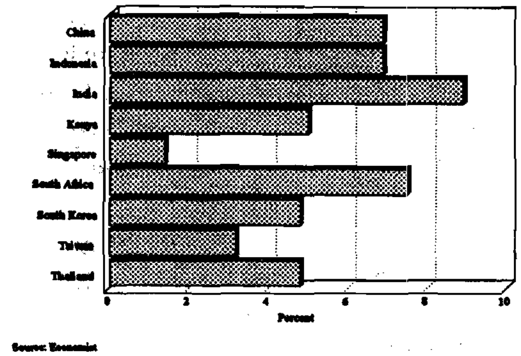
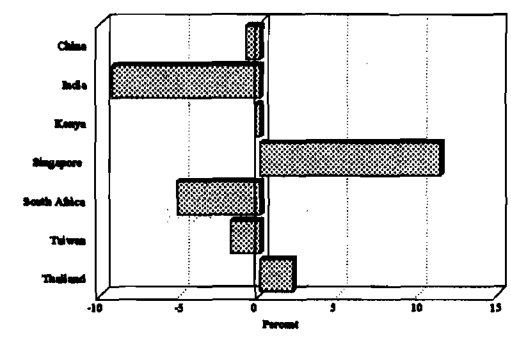


Figure 7
BUDGET BALANCE - 1996
Developing countries



of the expansion in the United States also exerted a positive influence and these factors taken together were expected to have a positive effect in 1997. Fiscal performance was positive, deficits which exceeded 7 per cent in 1992 and 1993 falling to 2.4 per cent of GDP in 1996. Price increases were moderate in 1996 and expected to remain so in 1997, given the trend to further fiscal consolidation and sizeable unutilized capacity, estimated at over 3 per cent of Product, still existing in the economy.

Capacity constraints, which had existed in **Australia and New Zealand** since 1994 and required a tightening of monetary policy, limited the rate of expansion in both countries as inflationary pressures persisted. In Australia, growth was, nevertheless, expected to be fairly strong, at just under 4 per cent. In New Zealand, expansion was expected to be just over 2 per cent, although even this moderate pace caused the economy to exceed the upper limit of the inflationary target band, set at 0-2 per cent. Tightness in the labour market and strong activity in construction were the main contributors to overheating.

For the **developing countries** the rate of growth increased in Africa, Latin America and in the Middle East and Europe. However, the heady rates of growth experienced in Asia moderated somewhat, in response to fears of overheating and increased inflation. The outcome was reduced growth and falling inflation, though growth rates in Asia continued to greatly outstrip all other regions. Overall, performance of the developing countries as a group was strong, in the context of improved fiscal performance and declining inflation.

In **Africa** the rate of growth of output increased for the fifth consecutive year and was projected to average 5 per cent in sub-Saharan Africa for the period 1996-1997. This strong performance contrasted with an average growth of 1 per cent for the period 1991-1993. Consumer prices also showed a tendency to moderate for the second consecutive year. The Communauté Française Africaine (CFA) countries showed an even more marked turnaround, since output per capita had contracted by 2 per cent per annum for the period 1991-1993, whereas in 1996 per capita output was expected to increase by a similar amount. Moreover, throughout Africa growth seemed to be based on more sustainable grounds. The commodity booms evident in 1995 were over and strong demand from the developed countries was not present in 1996, so that internal policies of restructuring and reform seemed to be the force unlocking current expansion.

The rate of growth of output in **Asia** moderated slightly in 1996, in response to fears of overheating, notably in China, Thailand, Malaysia and Indonesia. Nevertheless, the resulting rate of expansion for the region continued to outstrip that achieved by all other regions, while inflation remained lower than achieved by all other developing countries. Almost all countries achieved rates of growth in excess of 5 per cent, the sole exception being Bangladesh which recorded 4.8 per cent. The growth performance achieved by these countries was all the more remarkable because of the relative economic maturity currently achieved by several of them, a maturity which caused graduation by the International Monetary Fund (IMF) for these countries to industrial country status[1].

The highest rates of growth continued to be recorded by China and Vietnam, both countries in early stages of liberalization and modernization. This growth was also achieved with some moderation in inflation rates in 1996. The pace of adjustment in Vietnam, was especially notable, that country seemingly being poised for possible sustained growth. Factors in its favour were macroeconomic stability, achieved in part by a drastic reduction in subsidies to the public sector, high rates of saving and investment, an open trading system and skilled human resources. Vietnam was also poised to benefit from the buoyant markets and investment flows present in neighbouring countries. Nevertheless, working against longer-term development was the fact that although the household agricultural sector was strong, small and medium sized private enterprises were still almost non-existent. Moreover, the initial surge from agriculture was approaching its capacity limits and would need improvements in infrastructure, credits and extension services to further improve productivity. Debt management was also becoming a concern.

Policy challenges facing the Asian countries related essentially to the need for further adjustment to the fast changing global environment. Capital inflows to Asia presented a challenge to macroeconomic policy, since they had the effect of eroding the current account. They also proved taxing for the domestic banking system, rapid expansions of credit putting emphasis on prudential supervision and capital adequacy requirements. International financial innovation also put stresses on countries supervisory and regulatory skills. The ASEAN countries agreed[2] that they needed to

[1] In April 1997, Hong Kong, Korea, Singapore and Taiwan among the Asian countries and Israel from the Middle East, will cease to be considered developing countries by the IMF and will be graduated to industrial country status. The only other instance of graduation was for Japan.

[2] Policy decisions emanating from the meeting to discuss Macroeconomic Issues Facing ASEAN countries, held in Indonesia in November 1996.

accentuate several policies, for which they were already well known, such as the need to maintain macroeconomic stability and further reduce inflation, to increase the already high rates of public and private saving and to further liberalize markets, which should help to increase the pace of already strong total factor productivity growth. Productivity growth would also be assisted by measures to further strengthen human capital.

In the group of developing countries classified as the **Middle East and Europe** output expanded moderately for the second year, following virtual stagnation in 1994. Inflation also declined moderately, although at 26 per cent it exceeded that of all other developing country groups. Growth in excess of 4 per cent was experienced in Egypt, Iran, Israel, Jordan and Turkey. Inflation remained below 10 per cent for Egypt (7 per cent) and Jordan among the high growth countries, but was high in Iran (29 per cent) and Turkey (85 per cent) where the fiscal deficit had ballooned to over 9 per cent of Product. In Israel, where growth averaged over 6 per cent for the period 1994 to 1996, it moderated to 5 per cent in 1996. This declining growth was in part explained by falling domestic demand. However, it was accompanied by increasing inflation in the face of a growing budget deficit, which widened slightly from 3.4 to about 3.5 per cent of Product in 1996. Consistently high growth and a maturing economy meant that Israel was reclassified as an Industrial Country, to take effect from 1997.

Lower rates of expansion were experienced by Saudi Arabia, where output expanded by under 1 per cent with inflation of 1.8 per cent and Kuwait, where output grew by 1.6 per cent with inflation up by 2 per cent. In both instances, fiscal consolidation had a dampening effect on expansion. In Saudi Arabia, for example, the budget deficit averaged over 8 per cent for the years 1993-1995 but a small surplus was achieved in 1996. Nevertheless, buoyant oil prices toward the end of 1996 were expected to impact favourably on performance in both countries in 1997.

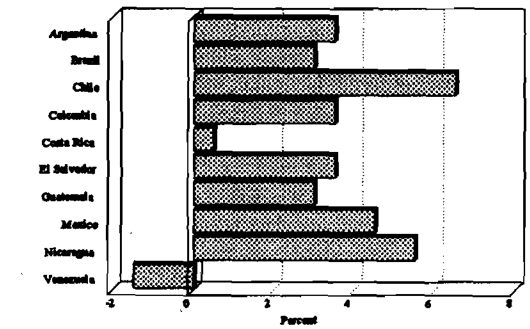
The trend towards moderate growth in **Latin America** resumed in 1996, with an average estimated growth rate of 3.4 per cent. This outcome followed the scant 0.3 per cent increase in output recorded in 1995, the average then being diminished by financial crises in Argentina and Mexico. With more normal growth rates in these countries the rates of expansion continued to converge, seven countries exceeded 5 per cent, 13 recorded increases of between 3-5 per cent, five had a growth rate of 2 per cent while in the other four, output either declined or stagnated. Of these, 20 countries were able to increase per capita incomes in 1996 (ECLAC 1996).

Sectoral performance was mixed, with agriculture and mining being positive while manufacturing stagnated. The Construction sector showed uneven results across countries, generally moving in rhythm with the economy as a whole. Services displayed moderate growth, in line with output generally. Total supply grew slightly faster than output, while domestic demand kept pace with it. At the regional level, gross capital formation recorded a moderate increase, although it manifested a significant upswing in Argentina and Mexico, both recovering from the previous year.

Consumer prices continued their steady fall, from a regional average of almost 900 per cent in 1993, to under 20 per cent in 1996. Convergence towards price stability was also noted, with inflation declining in 10 of 22 countries studied, while the index remained steady or increased only

Figure 8

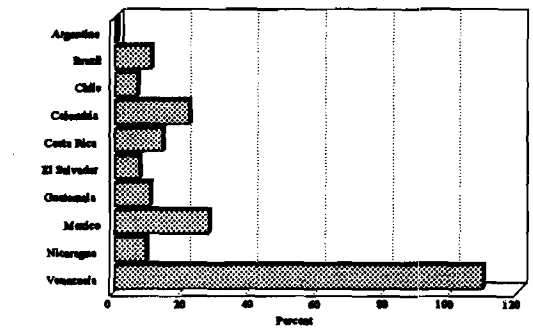
OUTPUT GROWTH - 1996
Latin America



Source: ECLAC

Figure 9

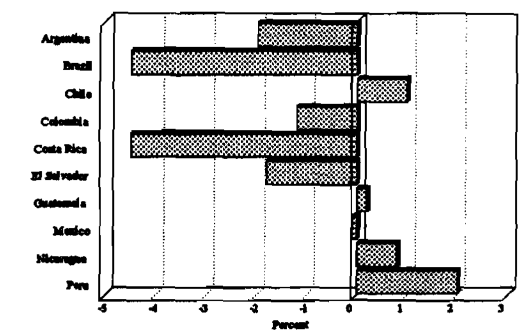
CONSUMER PRICES - 1996
Latin America



Source: ECLAC

Figure 10

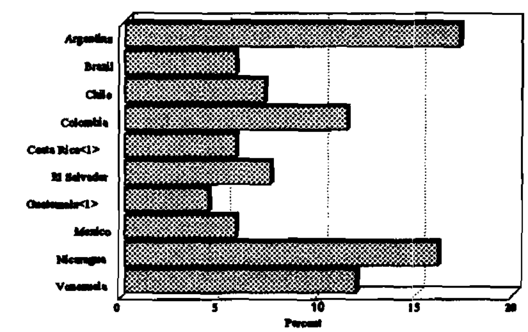
BUDGET BALANCE - 1996
Latin America



Source: ECLAC

Figure 11

UNEMPLOYMENT - 1996
Latin America



Source: ECLAC <1> Relates to 1995

moderately in another 11. Only in Venezuela was the increase significant. The decline in inflation reflected the priority given to it by most governments and was facilitated by tight fiscal and monetary policies and liberalization of the external account. Nevertheless, several countries entered 1996 with fiscal problems, notably Brazil, Costa Rica, Honduras, Uruguay and Venezuela. Changes in fiscal indicators in 1996 were limited to increased deficits in Argentina, up to 2 per cent of Product, while substantial budget balance was achieved in Venezuela.

Exports provided the motor for expansion, despite the less auspicious external environment. The appreciating terms of trade which were experienced between 1994-1995 came to an end in 1996, import prices rising marginally while the prices of several Latin American exports, such as coffee, copper, leather, cotton, steel, aluminum, sugar and meat fell. Offsetting these price declines, the prices of cereals, soybean, timber, bananas and hydrocarbons all increased. Benefits to the oil exporters in the region were offset by the regional importers, leaving the terms of trade unchanged over 1995. Simultaneously, the rate of expansion of global trade began to flag.

Despite these external factors, several countries were able to increase export volumes sufficient to augment the export earnings of the region by 11 per cent. This was, however, a slower rate of expansion than the 19 per cent average growth rate recorded for 1994-1995. Imports increased by almost the same rate as exports, notable increases being recorded for Argentina and Mexico, recovering from import compression experienced in the previous year, while conversely the import boom evident in Brazil in 1995 abated. In several instances, imports rose with increasing output, with capital goods imports leading the increase.

The *current account* deficit, which remained stable from the previous year, was financed by capital inflows which doubled over the previous year. This was made possible because the region regained favourable access to international capital markets, as the perception of high regional risk waned, following recuperation in Mexico. International interest rates were also favourable, with stable interest rates in the United States and low rates in Germany and Japan. The quality of capital flows also improved, with a large inflow[3] of portfolio investments. These were mainly in seven-year bonds, especially to Mexico, Argentina and Brazil but also to Chile, Colombia and Venezuela. Foreign direct investment also recorded new peaks in Bolivia, Brazil, Chile, Colombia, the Dominican Republic and Peru. Equity investments, which were depressed following the developments in Mexico, were also showing signs of recovery.

The external debt increased moderately, a 3.4 per cent increase being the lowest since 1991. Argentina, Brazil and Colombia accounted for the bulk of the increase, the former consequent on government borrowing to restructure its debt, while in the latter two countries debt was incurred mainly by the private sector taking advantage of favourable external interest rates. Panama and Ecuador also increased their debt, the former in part as a result of the incorporation of interest arrears in its debt rescheduling exercise. In Mexico, the quantum of debt remained substantially unchanged. This was despite Mexico's major intervention on the bond market, intended to raise funds to repay US$ 7 billion of the special financing received from the United States, while simultaneously obtaining more favourable terms. The quantum of nominal debt fell in Nicaragua and Venezuela, in the former country consequent on debt forgiveness by Mexico, Germany and the Russian Federation amounting to US$ 4 billion. Debt burden indicators for the region continued the fairly steady improvement evident since 1985. More than half of the countries individually improved in 1996, consequent on moderate debt increases and increased rates of growth for exports of goods and services.

Despite these generally favourable indicators, *unemployment* continued to increase for the sixth consecutive year, the regional average moving up to 7.7 per cent, the highest in 10 years. While the labour supply remained stable, job creation was sluggish, such jobs as were created being concentrated in tertiary activities. Only in Mexico was there a significant growth in manufacturing jobs as the sector returned to normal. Argentina, Uruguay and Venezuela continued to experience difficulties in their labour markets, unable to reverse the adverse trends experienced in 1995. In Colombia, Brazil, Honduras and Panama unemployment grew in 1996 while in Chile, Nicaragua and Peru some progress was made to reduce unemployment. The quality of employment also fell in several instances, formal jobs declining in proportion to informal activities while even in formal employment contract work was making a growing presence in place of more permanent jobs.

[3] Amounting to about 50 per cent of developing country placements.

Figure 12

OUTPUT GROWTH - 1996

Countries in transition

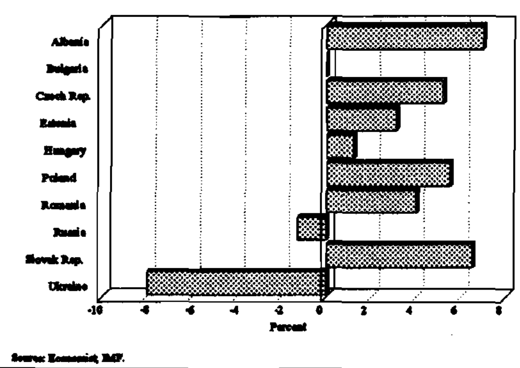


Figure 13

CONSUMER PRICES - 1996

Countries in transition

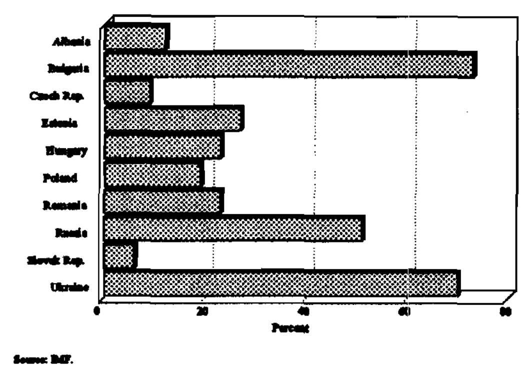
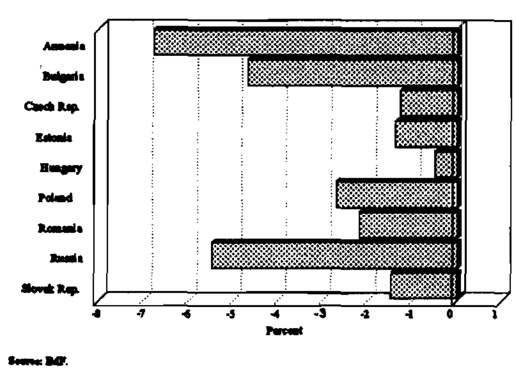


Figure 14

BUDGET BALANCE - 1996

Countries in transition



The countries in transition seemed finally to be emerging from the traumatic adjustment which they undertook at the commencement of the decade (IMF, 1996). While progress within the group was uneven, the overall aggregates showed steady progress from the nadir experienced in 1991-1992. The steep decline in output evident for these countries, which in 1992 averaged almost 15 per cent, had steadily abated, to show a projected slight increase in output of just under 1 per cent for the first time in 1996. Similarly, inflation had been falling steadily, from 681 per cent in 1992 to a projected 41 per cent in 1996. Government budget deficits, which still remained high, nevertheless showed steady progress, falling from an average of 7 per cent in 1993 to an expected deficit of just under 4 per cent by end 1996.

Despite the underlying generally favourable prognosis for the transitional countries as a whole, *significant differences in performance still existed within the group*[4]. By far the best performance was recorded by the Central and Eastern European group, where output expanded in almost all cases, the two exceptions being Belarus and the Ukraine. If these countries were excluded, the group was expected to turn in average growth of over 4 per cent. Strong growth, in excess of 5 per cent, was evident in Albania, Croatia, the Czech Republic, Poland and the Slovak Republic. Inflation for the group as a whole was contained to about 20 per cent, five members recording price increases of 10 per cent or less. Belarus and the Ukraine turned in a weaker performance than average, growth

[4] For the purposes of categorizing the countries in transition the IMF distinguished three groups: Central and Western Europe, Russia, and the Transcaucasus and Central Asia. The former category included, Albania, Belarus, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Poland, Rumania, the Slovak Republic, Slovenia and the Ukraine. In the latter category, were to be found Armenia, Azerbaijan, Georgia, Kazakstan, the Kyrgyz Republic, Mongolia, Tajikstan, Turkmenistan and Uzbekistan.

continuing to contract, by 5.5 per cent and 8 per cent, respectively, while inflation remained at about 70 per cent in both countries.

Performance in *Russia* showed steady improvement, although the pace of adjustment there remained behind most of the other transitional countries. The steep decline in output, which contracted by 15 per cent in 1994, improved somewhat to record a contraction of just over 1 per cent in 1996. During the same years inflation moved from 300 per cent to 51 per cent. Fiscal performance also showed signs of improvement during that period, moving from a deficit of over 10 per cent of Product to just over half that in 1996. The adjustment process was severely complicated and partially set back by the Presidential election, acute uncertainty as to the outcome and possible consequences for policy triggering financial market volatility, while the quest for votes may have helped to reverse the trend toward increased fiscal discipline, the deficit widening by one-half percentage point from 1995.

For the cluster of transition countries in the *Transcaucasus and Central Asia*, Product was estimated to have increased by just under 1 per cent, as compared to a contraction of output averaging 14 per cent for the group in 1994. Inflation fell from 1600 per cent to about 70 per cent over the same period. Signs of economic vibrancy were also evident within the group, notably in Armenia and Georgia, where growth was 6.5 and 8 per cent, respectively, with almost all other countries recording more moderate growth. The exceptions were Azerbaijan and Tajikstan, where output continued to contract by 4 and 7 per cent, respectively. Inflation for the group would have been even lower but for high rates of inflation which continued in two members of the group, Tajikstan and Turkmenistan at 600 per cent and 900 per cent, respectively. Budget performance varied, with large deficits still being evident, for example, in Mongolia and Armenia, at nearly 11 per cent and 7 per cent of Product, respectively

In sum, output declines seemed to have bottomed out in most of the transitional countries, with inflation falling steadily. Nominal exchange rates seemed to have stabilized in the face of falling inflation rates, although, since inflation exceeded that of the industrial and most other developing countries, real rate appreciation continued. Nevertheless, previous depreciations were believed to continue to provide a competitive edge for many export products, although some, especially agricultural exports, faced barriers to enter the nearest Western markets. Budget deficits seemed to be under control although tax revenues remained depressed with non-payment of taxes and energy payments arrears being common in many public enterprises. Payments for wages and pensions were also in arrears in several countries.

Despite the considerable progress made in several areas, slippage was also evident in meeting targets and in implementing new policies, in areas such as land reform, privatization, trade policy and in restructuring social safety nets. Finally, the banking sector was weak in several countries, being hampered by a lack of staff with sufficient experience in the new economic environment, high risk endemic to the transition, the previous weakness of existing enterprises, directed lending to favoured, though often insolvent, entities and in some instances also by fraud.

GLOBAL TRADE AND MARKET ARRANGEMENTS

Table IV
GLOBAL TRADE INDICATORS

	1992	1993	1994	1995	1996
World Trade Volume <1>	4.7	3.9	8.8	8.9	5.7
Export volumes					
Industrial countries	4.3	2.4	8.3	7.3	4.3
Developing countries	9.9	8.1	11.1	11.5	10.3
Import volumes					
Industrial countries	3.8	0.7	9.3	7.8	5.3
Developing countries	9.8	8.9	8.1	11.6	11.3
Terms of trade					
Industrial countries	0.6	0.9	0.2	0.5	0.2
Developing countries	-1.3	-1.1	0.2	0.5	-0.2
Fuel exporters	4.6	-6.3	-0.5	-6.8	3.2
Non-Fuel exporters	-1.2	-0.2	0.6	-0.7	-1.0

Source: I.M.F. World Economic Outlook.
<1> Percentage annual changes in goods and services
<2> Valued in S.D.R.

World trade continued to outstrip world output as the process of global economic integration deepened[5]. While the pace of trade expansion did not match that achieved in 1995, it exceeded the average for the previous five years. This weaker performance was attributable mainly to slowing trade performance turned in by the industrial countries. At the same time, the volume of trade conducted by the developing countries continued to grow much more quickly than that of the industrial countries, though at a slightly reduced pace than they achieved in 1995. The terms of trade moved slightly in favour of the industrial countries, although the fuel exporters among the developing countries experienced a modest gain in their terms of trade over the fuel importers, reversing three years of substantial declines.

Trade provided another indication that the uni-directional relationship between prosperity in the industrial countries and that in the developing countries was being modified. The changed

[5] Global economic integration has been defined as "the widening and intensifying of international linkages in trade and finance". For the decade 1985-1994, the ratio of world trade to GDP increased three times as fast as in the preceding decade. During this period FDI doubled as a share of global GDP(IBRD).

relationship, considered by some to be structural with respect to Asia and possibly also in Latin America, was deemed to flow from policy changes which fostered the liberalization of trade to accelerate the imports of consumer and advanced capital goods to the developing countries. Policies also helped to reduce distortions in product and financial markets and provided a climate which encouraged long-term investment and output, to further stimulate the flow of exports to the industrial countries. This virtuous cycle also fostered diversification in output and export markets and served to reduce their vulnerability to external shocks. Reduced vulnerability was also achieved by a greater emphasis on Manufactures in the output mix of developing countries, since manufactures had a lower incidence of fluctuation in demand and price than the traditional primary product exports of the developing countries. In Asia, for example, manufactures accounted for 70 per cent of exports in 1990.

The diversification of export markets and the growth of intra-developing country trade was also fostered by the reduction of barriers to trade within regions and the growth of intraregional trade. Forty percent of Asia's exports were within Asia. In Latin America, intraregional trade did not show the same dynamism, activity being concentrated mainly in MERCOSUR. Intra LAIA trade actually fell by one per cent between 1995-1996, to 16 per cent. In the Andean Pact group intra zonal trade remained unchanged at about 11 per cent in 1996 and in the CACM it fell from nearly 24 per cent in 1994 to rest at about 20 per cent in 1996. Nevertheless, within MERCOSUR intra zonal trade expanded, from 14 per cent of total trade in 1992 to 21 per cent in 1996 (ECLAC, 1996). Diversification of markets was also limited, with almost 50 per cent of Latin America's exports being destined for North America while in Africa diversification was similarly limited, being concentrated on primary products, 50 per cent of which were destined for Europe.

Institutional developments in the field of trade.

The institutional landscape continued to be strewn with existing and emerging arrangements and groupings intended to liberalize trade. The most universal of them, the **World Trade Organization** (WTO) held its first ministerial meeting at the end of 1996 in Singapore. The meeting took place while the momentum developed by the Uruguay Round was still strong. It also benefited from the fact that its dispute panels, which were more rigorous than those which preceded them in the GATT, were working well[6]. More than 60 disputes had been registered, 15 had been completed, 10 of which had been settled without going before a panel. Membership in the organization was also rising. At the beginning of the Uruguay Round, the GATT had 92 members and this had grown to 114 by the end of the Round. Currently the WTO had 126 members and several more were queuing to join[7]. Finally, the summit took place in the context of rapidly growing world trade in goods and services, while cross border investment flows were booming (Economist, 1996).

[6] Under the GATT any member could veto the verdict of a panel, even if it was a party to the dispute. Under the WTO, panels must report within nine months and decisions can be overturned only by consensus. Parties found against must cease the practice or offer compensation, otherwise they might face sanctions.

[7] Thirty countries, including China and Russia, were seeking membership but were deemed not yet to have met WTO norms.

Of the uncompleted issues remaining from the Uruguay Round, which included financial services, shipping, the movement of persons to supply services on a temporary basis, progress was slow. Nevertheless, the meeting fixed a deadline by which the agreement to liberalize the telecommunications sector was to be signed. Future action would require progress on other outstanding issues, such as the liberalization of agricultural trade, talks on which begin in 1999 and Services, talks on which were scheduled to begin in 2000. Other issues which had to be resolved included foreign investment, competition policy, and labour standards. The WTO would also need to resolve issues surrounding new members, notably China, which although the eleventh largest exporter, retained a largely planned economy with a regulated trade regime. Several of these regulations, such as export taxes, import quotas and trade licences were not compatible with the norms of the WTO.

Frustration at the slow progress on several of the outstanding issues had prompted members to seek faster action through regional trading arrangements, such as the FTAA. Yet these agreements also held the potential to divert trade and distort investment decisions. The plethora of overlapping arrangements also held the prospect of greatly complicating national responses to them and regional efforts to liberalize trade[8]. Given this complexity, swifter progress on outstanding issues was not assured through regional FTAs which might end up being the most serious future problem for the WTO.

MERCOSUR gained two new members in 1996 with Chile joining the free trade area, comprising Argentina, Brazil, Uruguay and Paraguay, in June and Bolivia joining in mid-December. Chile's adherence took the form of an association agreement which commenced in October 1996 and provided for the liberalization of a substantial portion of goods traded, while sensitive products could be given protection for up to 18 years. The agreement with Bolivia would come into effect in April 1997 and provided for a free trade area to be phased in over a ten year period. Simultaneously, MERCOSUR stepped up its talks with the Andean Community with a view to establishing a free trade area between the two groups.

At its presidential meeting in mid-December MERCOSUR discussed measures to deepen the grouping, agreement being reached on procedures to protect against unplanned import surges from outside the group, such as those which caused Brazil to hastily increase tariffs on motor vehicle imports. Discussions also continued on issues such as the trade in services and improved customs procedures, while the formation of a MERCOSUR Development Bank was also discussed. On the investment side, strains were also becoming evident as provinces played each other off to secure foreign capital.

Trade between the original four members was estimated to have grown by 12 per cent in 1996, a four-fold increase since 1990, raising questions as to whether the Agreement was trade diverting. A recent study noted that, "The most dynamic products in MERCOSUR's intra-trade generally are highly capital intensive products which members have not been able to export

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[8] Seventy-six FTA's were either created or modified since 1948, more than half of which came into being after 1990, according to the WTO.

competitively to outside markets"[9]. Furthermore, they "have very low comparative advantage indices" and export indices show "that MERCOSUR countries are not competitive for these goods in third countries". The study claimed further that, "MERCOSUR's own trade barriers are responsible," since "tariffs are well above the average for all imports and provide MERCOSUR members with preferences that may exceed 70 per cent" while "over 80 per cent of non-member country exports .... encounter quantity reducing or price raising non-tariff restrictions". Denials followed from several regional institutions, to point out that the sector studied, essentially relating to automobiles, was not covered by MERCOSUR rules for the period of the study, and that the agreement was in fact reducing tariffs quite significantly even though the CET would not be fully in place before the year 2000.

Nevertheless, arguments persisted about the trade diverting effects of some regional arrangements, the latest being the trade diverting effects of NAFTA, where Caribbean Basin countries were expected to lose a significant portion of their exports to the United States unless they were granted parity in access conditions with Mexico.

Such parity could eventually be granted through the **Free Trade Area of the Americas**, for which discussions continued throughout Latin America and the Caribbean with a view to its establishment by 2005. Preparations, which proceeded in 11 working groups established to examine various issues crucial to its establishment, had compiled a comprehensive body of information on legal and institutional practices at the national level in each of the issues covered by the working groups. While necessary, data collection seemed to proceed in a policy vacuum as the United States leadership for the process flagged in an election year where free trade was not universally supported. Subsequent events suggested a desire to revitalize the process in time for the Ministerial meeting in Belo Horizonte, Brazil, in May 1997.

The next major outstanding issue which needed to be clarified was the process of accession to the FTAA. Ministers had previously agreed that the FTAA should take account of all the integration schemes and agreements currently in existence in the hemisphere. Yet, adherence to this principle would greatly complicate the accession process, since integration schemes already existed in the Northern hemisphere (NAFTA), the Caribbean (CARICOM), in Central America (CACM), the Group of Three, the Andean Group and MERCOSUR. Moreover, the ACS was formed in 1994 to encompass 25 countries in the CARICOM, CACM and Group of Three countries, comprising Colombia, Mexico and Venezuela, as well as others in the Caribbean Basin not members of the aforementioned groups. Finally, 32 bilateral economic agreements had been signed between members of the LAIA (ECLAC 1996a). These arrangements envisaged different levels of association and covered varying issues.

In Western Europe the Dublin Summit held in December 1996 saw decisions taken which kept the EMU on schedule and kept the further widening of the **European Union** to the East on the agenda. Yet policy attention remained concentrated on the EMU, with a compromise being reached

[9] Yeats, Alexander; "Does MERCOSUR's Trade Performance Justify Concerns About the Global Welfare Reducing of Regional Trade Arrangements? YES!" The World Bank, 1996. (Unpublished)

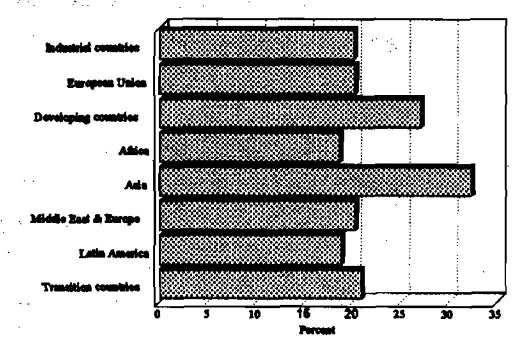
between France and Germany about the "strength" of the new currency. While the level of indicators was not in question the issue surfaced about the automaticity of punishment for countries not able to maintain budget deficits below the agreed 3 per cent of Product. Initially the Germans had proposed that penalties would be levied automatically except in severe recessions, defined as a contraction of over 2 per cent of Product. While the principle of automaticity was accepted, it applied only at the outer limits, that is to those with recessions of 2 per cent of Product or more. At the instigation of the French, discretionary powers were to be given to the Council of Ministers to waive punishments for the 3 per cent fiscal deficit infringement, to any country facing a contraction of Product of any size. Essentially, the decision to punish would become a political decision. Similarly, the character of the European Central Bank was still to be determined. The Germans, in line with their desire for a strong Euro, sought a technocratic independent Central Bank, while the French wanted a more flexible institution, answerable to some political authority. Despite these differences, both France and Germany stressed the inevitability of the EMU, which they were determined to see come into effect on 1 January 1999. What remained to be seen was the slate of countries which qualified for inaugural membership or alternatively how the criteria for entry might be further blurred. The softening of entry criteria could be prompted by real fears about the creation of a two-class Europe. These fears were fanned further by the French and Germans who sought greater flexibility to allow smaller groups who wished to integrate faster than the full membership to do so.

Other issues remaining to be dealt with in the near future included the widening of the EU to the East, common immigration and drug policy, changes in weighting of votes to give bigger countries greater clout, the expansion of majority voting and measures to reduce the size of the European Commission.

The range of issues to be tackled and the diversity of forums through which initiatives for global integration were being pursued, presented developing countries, and especially the smallest among them, with a daunting task. This was particularly true since they sought to tailor accession terms and timetables to coincide with regional and sub regional agendas. The task was made more onerous since the negotiating process was sometimes being asked to secure objectives which could only be secured by domestic macroeconomic policy. Accordingly, they ran the risk of diverting scarce resources, especially policy attention, away from the internal processes of adaptation to global integration, directing them instead to the futile task of changing the pace and direction of global events. Accordingly, multilateral action seemed to hold out the best prospect for efficiently using resources. Countries with common interests could benefit from multilateral action in pooling resources to formulate and negotiate their positions. They could also benefit by seeking integration through the most universal forums, thus circumventing the danger of duplication through several parallel negotiations.

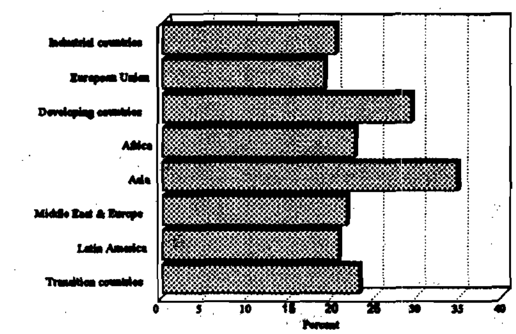
DEVELOPMENT FINANCE

Figure 15
SAVINGS - 1996
In percent of GDP



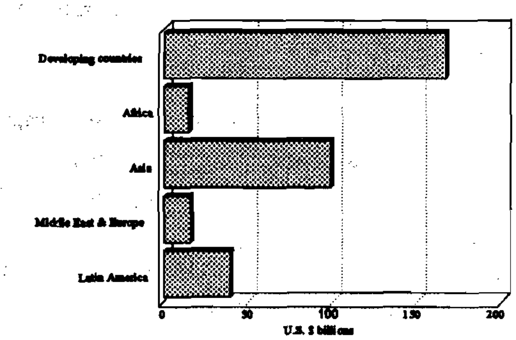
Source: IMF

Figure 16
INVESTMENT - 1996
In percent of GDP



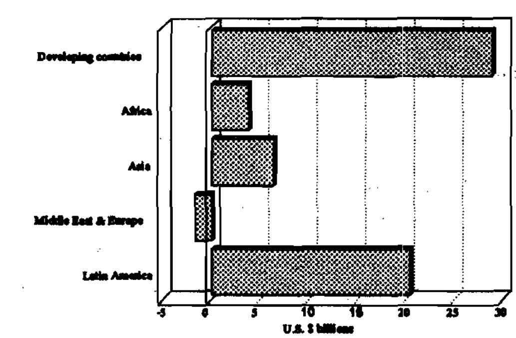
Source: IMF

Figure 17
PRIVATE CAPITAL FLOWS<1>
In billions of US dollars



Source: IMF <1>Relates to 1995

Figure 18
OFFICIAL CAPITAL FLOWS<1>
In billions of US dollars



Source: IMF <1>Relates to 1995

Local and foreign savings provide the resources for investment. Since the correlation between investment and growth is high, it is not surprising to note that the biggest savers among the developing countries were also the fastest growing. Notable also was the fact that those countries with the highest rates of domestic saving received the greatest proportion of foreign inflows. The linkage between these factors seemed once again to be explained by the ubiquitous issue of domestic macroeconomic policy. Fiscal policy also played a key role, for fiscal deficits reduce savings destined for productive investment. Nevertheless, care must be exercised to ensure that social expenditure is efficient and adequate to meet social objectives. Factors influencing the inflows of foreign savings included liberalization of the foreign account and the opening of domestic markets to foreign entrants.

Significant differences continued to be evident in the relative rates of savings and investment shown by the respective regions. The highest saving rates were posted by Asia, which had a modest fiscal deficit of 1.8 per cent of Product. However the highest savers in Asia, the newly industrializing members have consistently achieved fiscal surpluses. Fiscal performance for the other regions closely mirrored savings and investment performance. Africa had a fiscal deficit estimated at 3.4 per cent of Product in 1996, the sub-Saharan grouping having a deficit of 5.2 per cent. The Middle-East averaged deficits of just under 4 per cent of Product, while Latin America averaged fiscal deficits of under 1 per cent for the period 1990-1994, though these increased to 1.1 per cent in 1995 and 1.3 per cent in 1996.

Capital flows illustrated one of the more dramatic areas of new interaction between the industrial and developing countries. The recent flood of capital moving from the North to the South was to be explained by similar developments to those which fostered the flow of goods and services, namely, new policies to integrate developing country economies into the global economy and which concomitantly increased the confidence of foreign investors in developing countries and their policies. Especially conducive to the flow of capital were domestic financial liberalization and fewer restrictions to the acquisition of assets by foreigners, which provided greater incentives for direct and portfolio investment. Shorter-term capital flows were also induced by financial liberalization, though also by fewer investment opportunities and lower interest rates in the industrial countries, the latter factors, nevertheless, underlining the growing complementarity between both groups. These capital flows, especially via Foreign Direct Investment (FDI), had in turn increased the exposure of developing countries to advanced technologies and industrial country markets, factors redounding favorably on the production of goods and services for export.

The recovery of net capital flows to the developing countries was evident, following the setback caused by the Mexican peso crisis although the disparities between developing country regions continued. Of the total private net capital flows moving to developing countries in 1995 almost 60 per cent went to Asia, 23 per cent of the remainder going to Latin America with a scant 9 per cent going to Africa and the Middle East. While the trend of flows to Asia was steadily upward, Latin America had not fully recovered from the Peso crisis, 1995 flows being less than in 1994 when it received 36 per cent. Preliminary indications were that the recovery was not complete in 1996 (ECLAC, 1996). In all regions direct investment exceeded portfolio investment. The picture with respect to official capital flows was somewhat different, with 70 per cent going to Latin America, 22 per cent going to Asia, with the remainder going to Africa. In the Middle East repayments exceeded inflows, the net account thereby being negative.

The countries in transition received increased capital flows in 1995, falling somewhat below Asia and Latin America, but above Africa and the Middle East in overall magnitude. Certain countries, however, such as the Czech Republic and Hungary received massive inflows, which as a percentage of GDP, 18 and 14 per cent respectively, exceeded even the strong inflows received in Asia. Yet the magnitude of flows in these countries severely complicated economic management and were expected to be significantly lower in 1996.

DEBT

A review of the debt situation facing the poorest countries, conducted by the IMF, identified 41 "Heavily Indebted Poor Countries", approximately 80 per cent of which were from Africa. From Latin America and the Caribbean four countries were identified, namely Bolivia, Guyana, Honduras and Nicaragua, while two Asian countries, Vietnam and Myanmar, made the list. The criteria for qualification were, debt service payments in the range of 20 - 25 per cent of export earnings or a Net Present Value (NPV) of all claims on the country not exceeding 200 - 250 per cent of export earnings[10]. To these criteria were added several vulnerability factors such as the country's reserve position, its vulnerability to shocks, its dependence on a single or small basket of commodity exports and the impact of debt service charges on the fiscal accounts.

The 41 countries identified were further sub-divided into three categories, namely "Sustainable" with 18 countries including Honduras, 12 were deemed to be "Possibly Stressed", including Bolivia and Guyana, while 8 were assessed to have "Unsustainable" debt burdens, including Nicaragua. Three countries' positions were undetermined, namely, Sudan, Somalia and Liberia, because of internal instability and an inability by these countries to adopt appropriate economic reform programmes. The group categorized as sustainable was deemed to be covered by existing arrangements such as the Naples terms, so that new arrangements were being evaluated for the remaining 20. Nevertheless, countries would be considered on a case-by-case basis, since their categorization could either improve or worsen, while debt profiles varied widely.

Relief proposed included writing-off some or all of the debt by those creditors able to do so. Paris Club and other bilateral creditors were asked to reduce the stock of debt by 90 per cent at the end of the prescribed adjustment period, instead of the previously targeted 67 per cent. For the multilateral agencies not having the option of debt write-off, debt service relief would be provided in the form of more concessional lending. The IMF, for example, would provide softer terms than those provided under its Enhanced Structural Adjustment Facility (ESAF). The initiative would be linked to credible adjustment efforts by the respective countries. The World Bank was also considering supplemental flows via the International Development Association (IDA).

At the same time that it moved to address the debt problems of the poorest countries, the IMF signaled that the debt profiles of the richest and transitional countries were becoming unsustainable. Contrary to the views of some economists the international organization believed that the debt resulted in higher interest rates, lower investment and slower growth in living standards. For the industrial countries as a group, public debt had grown from 40 per cent of Product in 1980 to 70 per cent of Product in 1995, while in Greece and Italy debt was at or near 100 per cent of Product in

[10] The Net Present Value of debt was defined as the sum of all future debt service obligations on existing debt, discounted at the market interest rate. The definition, therefore, took into account the degree of concessionality of a country's debt.

1995. Several countries, notably Belgium, Canada, Denmark, France, Germany, Japan, the Netherlands, Sweden and the United States, had experienced a doubling of their debt over the period.

Examination of industrial country fiscal positions had shown a shift in the mid-1970s following the first oil-price shock, where accounts previously in balance went into deficit, a deficit which began to widen dramatically after 1980. Imbalance seemed not to be caused by reduced revenues but rather a jump in expenditures directed to transfers, notably pensions, subsidies and interest payments. Expenditures directed to transfers and subsidies currently accounted for one-third of Product in France, Italy, Norway and Sweden. Budget performance was even worse than it appeared if the unfunded liabilities of public pensions were taken into account.

Policy proposals were based on recent research which showed that, contrary to the prevailing wisdom, several countries experienced growth while undertaking fiscal contraction since it permitted lower long-term interest rates. Moreover, such consolidation in the face of growth would contribute to a declining ratio of debt to GDP (IMF, 1996b). The studies also showed that robust fiscal reform measures were more likely to be effective than modest ones and that consolidation should emphasize spending cuts, especially in the government wage bill, consumption and transfers, rather than tax increases. It was also desirable that caps should be placed on expenditure to ensure permanent decreases and that fiscal consolidation be undertaken in the context of a buoyant global environment. Nevertheless, the external environment did not appear to figure prominently in determining the success of the consolidation. Finally, real exchange rate movements seemed not to be significant in consolidation efforts.

These findings were of interest to the developing countries, since an apparent double standard in policy was in the process of being removed. Up until now, stimulative fiscal policy was justified by several economists to spur output, while conversely the poor were admonished by agencies such as the IMF to pursue rigorous fiscal consolidation, if sustained growth was to be achieved. While increasing evidence pointed to the wisdom of the latter position, policy makers in the developing countries were often perplexed, looking enviously at the softer options which seemed to be at the disposal of those richer countries not subject to IMF dictates.

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