GLOBAL ECONOMIC DEVELOPMENTS 2001-2003

ECLAC

ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN
Subregional Headquarters for the Caribbean

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CARIBBEAN DEVELOPMENT AND COOPERATION COMMITTEE

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EXECUTIVE SUMMARY

During 2001-2003, developed economies grew at a moderate and uneven pace. Expansionary monetary and fiscal policies facilitated the recovery of economic activity in the United States. Notwithstanding these policies, the United States still maintains important imbalances in its external account and a growing deficit in the government's finances that would probably widen after the Iraq conflict. For its part, European economic performance was affected by the prevalent geo-political tensions and the uncertainty surrounding the oil market. Latin America's growth was negative reflecting adverse international financial conditions, the lack of dynamism in the United States economy and the unfavourable evolution in the terms of trade.

The Argentine crisis culminated at the end of 2001 with external debt default, and the abandonment of the currency board arrangement. In 2002, the authorities opted for a floating exchange rate regime and implemented a set of restrictive measures geared towards restoring stability and credibility to the country's management of its economic affairs. However, Argentina's rate of growth plunged to –11% in 2002, registering one of the deepest troughs in GDP growth in the country's history. The unfolding of the Argentinean episode added another layer to the exchange rate regime debate while at the same highlighting the vulnerabilities of sovereign bond finance.

The Monterrey Conference and its aftermath, the follow-up of the Doha ministerial meeting and the implementation of new frameworks underlying preferential trade arrangements shaped international negotiations. The Monterrey Conference and its official document, the Monterrey Consensus, resulted in part from developing countries' efforts to change and shape the current international financial relations. The Consensus is divided into three parts (confronting the challenges of financing for development; leading actions; and staying engaged). The second and most substantive part of the document deals with policy orientation and implementation in six areas: mobilizing domestic and international financial resources; international trade; international financial cooperation; sustainable debt; and systemic issues. While the focus of the document is domestic reform rather than the creation of the adequate international conditions for growth, it incorporates some of the concerns of developing countries such as debt relief and the need to take into account the vulnerability of Small Island Developing States (SIDS).

At the Doha Ministerial Conference (November 2001), World Trade Organization (WTO) members agreed to grant a most favoured nation (MFN) waiver to the European Union (EU) allowing it to temporarily maintain its special regime for banana imports from African, Caribbean, Pacific (ACP) countries. In addition they granted an extension to developing countries' export subsidies to firms operating in export processing zones.

Finally, they requested a revised framework for agricultural negotiations and an examination by the trade and development committee of alternative approaches for the effective implementation of special and differential treatment provisions. At the end of 2002 and the beginning of 2003, both of these Doha mandates were still under negotiation among member countries.

INTRODUCTION

During 2001-2002 world economic growth prospects remained uncertain. In March 2001, the United States officially entered into the downward phase of the economic cycle that was confronted with expansionary fiscal and monetary policies. Since early 2001, the Federal Reserve lowered interest rates 12 times pushing the benchmark federal funds rate to reach its lowest level in the past 41 years. In addition, the United States Government engineered tax reductions to stimulate aggregate demand. These policy measures were carried out against a background of external disequilibrium and a widening fiscal imbalance due in part to lower than expected economic growth. In Europe economic performance remained weak as a result of increasing geo-political tensions and a volatile oil market. Japan recorded positive output growth in the third quarter of the year marking an inflexion point in its current deflationary path.

Developing economies registered a mixed record with an overall marginal improvement in 2002. Increased levels of consumption and export demand helped to fuel the rate of growth of East Asian economies. For its part South Asia maintained a moderate output expansion. Latin America's negative growth (-0.5% and –1.9% in terms of GDP per capita) is mainly attributed to a deterioration in the international financial conditions, the loss of dynamism in the United States economy, and the decline in the terms-of-trade for non-oil producing economies.

At the end of 2001, Argentina defaulted on its external debt and abandoned its currency board arrangement, which had been in place since 1991. Following the flotation of the peso beginning in January 2002, the authorities imposed a series of restrictive measures to bring about macroeconomic stability. Notwithstanding these policy measures, the decline in economic activity deepened in 2002 as GDP growth contracted by 11%.

The Argentine episode brought renewed interest in exchange rate regimes and in particular in the advantages and disadvantages of hard and soft pegs regimes. In this regard ECLAC maintains that the real exchange rate tends to return over time to a level compatible with the external competitive conditions of an economy. Furthermore, the Argentine case has underscored, once again, the importance of identifying the underlying causes of financial crises and has contributed to undermine sovereign debt as a reliable financing mechanism. Finally, it has highlighted the volatility of macroeconomic series in developing countries and the difficulty in predicting outcomes from parameters that are assumed to remain invariant over time.

The Monterrey Consensus (March 2002), its aftermath and the follow-up to the Doha ministerial meeting (November 2001) dominated the international negotiations arena. In both fronts progress has been achieved, albeit at a very slow pace.

With respect to the Monterrey Consensus, progress in some areas has been overshadowed by the lack of success in other areas. Among others, the key issues to be addressed are: the establishment of a deep commitment on the part of developed countries to liberalise all trade areas, including that of agricultural products; defining realistic macroeconomic targets for Highly Indebted Poor Countries (HIPCs); enhancing liquidity buffer stocks such as the Special Drawing

Rights (SDR) and guaranteeing the participation of developing countries in the decision-making processes.

The Doha follow-up has not yet produced tangible commitments on the part of member countries, and drafts in agricultural trade reform and strategies to make special and differential treatment effectively operational are currently under discussion. In other matters, the EU has reformulated its preferential trade arrangements with the ACP countries and Central America has initiated free trade agreement negotiations with the United States.

This document analyses selected global economic developments during 2001-2003. It is structured in six sections. The first and second sections deal with economic performance in developed and developing economies. The third section presents the different interpretations of the Argentine crisis. The fourth section examines the lessons of the Argentine episode for smaller economies and, more specifically, Caribbean countries. The fifth section centers on the Monterrey Conference, and its follow-up actions. This section also analyses the relationship between the Monterrey Consensus and the development needs of Caribbean economies. The last section focuses on the Doha ministerial conference follow-up and the current state of the trade negotiations between Central America and the United States.

1. THE PERFORMANCE OF DEVELOPED ECONOMIES

1.1. The United States economy

In 2002 the United States economy grew at an uneven pace. In the last quarter of 2001, real GDP growth registered a 2.7% growth, followed by 5%, 1.3%, 4% and 0.8% in the following four quarters of 2002. The overall rate of growth reached 2.4% while the rate of inflation was 1.6% and that of unemployment 6% (see Tables 1 and 2).

The performance of the United States economy has not dissipated the debate on whether the economic outcome of 2002 was part of the business cycle or revealed deeper imbalances in the United States economy.

A first line of argument asserts that the United States experienced a mild recession and as a result the pent-up demand to engineer an economic recovery is at best modest. In his monetary policy and economic outlook, the Federal Reserve Chairman, Alan Greenspan, stated that the economy's 2002 performance signaled the start of an economic recovery and that this was facilitated in part by a passive fiscal and monetary stance aided by productivity growth and unabashed household wealth. Labor productivity increased by 3.8% between the fourth quarters in 2002 and 2001.

Table 1
United States
Quarterly GDP growth (In percentages)
2001-2002

	2001				2002			
	I	II	III	IV	I	II	III	IV
Real GDP growth	-0.6	-1.59	-0.29	2.74	5.04	1.25	4.03	0.75
Final sales	2.67	-0.4	-0.2	4.13	2.44	-0.06	3.45	1.31
Change in inventory	-3.27	-1.14	-0.09	-1.39	2.6	1.31	0.58	-0.56
Consumption	1.53	0.92	0.97	4.05	2.22	1.22	2.93	0.67
Fixed investment	-0.38	-1.95	-0.72	-1.49	-0.07	-0.15	-0.03	0.46
Non residential	-0.71	-1.93	-0.73	-1.33	-0.66	-0.27	-0.08	0.16
Residential	0.34	-0.02	0.02	-0.16	0.6	0.12	0.05	0.3
Government	0.99	1	-0.21	1.85	1.04	0.27	0.56	0.86
Federal	0.54	0.36	0.07	0.8	0.47	0.47	0.29	0.65
State and Local	0.45	0.64	-0.28	1.05	0.56	-0.21	0.27	0.21
Net exports	0.53	-0.42	-0.24	-0.28	-0.75	-1.4	-0.01	-0.68
Exports	-0.69	-1.42	-1.94	-0.99	0.33	1.29	0.45	-0.17
Imports	1.22	1	1.7	0.7	-1.08	-2.69	-0.47	-0.51
Residual	0.45	0.5	0.06	0.42	-0.05	0.26	0.06	0.24

Source: The Federal Reserve Bank of St. Louis, February 2003.

Table 2
United States
Macroeconomic indicators
1999 – 2002

Years	Nominal GDP	Real GDP	Wages	Treasury Yields		Unemployment rate	Consumer price index	Consumer price index less food and energy
				3 months	10 years			
1999	5.6	4.1	3.4	4.64	5.64	4.2	2.2	1.8
2000	5.9	3.8	4.1	5.82	6.03	4	3.4	3.7
2001	2.6	0.3	3.7	3.39	5.02	4.8	2.8	2
2002	3.6	2.4	3.3	1.6	4.61	5.8	1.6	-1.3

Source: The Federal Reserve Bank of St. Louis, February 2003

The monetary authorities maintained the federal funds rate at 1-3/4% during most of the year and reduced it to 1-1/4% in November. The growth of monetary aggregates decreased from 12.8% in 2001 to 6.5% in 2002.

For its part, the federal budget result, which showed a fiscal surplus reaching US$127 billion in 2001, registered a deficit of US$158 billion in 2002. The fiscal outturn responded to lower tax earnings (-9%) due in part to the expansionary measures passed in 2001 and also to the increase in expenditure (8%). The government dissavings compensated for the increase in household and government savings, driving the savings-GDP ratio to 15% which according to the monetary authorities is the lowest since the 1940s.

The external performance of the economy continued to deteriorate as the increase in imports overpowered that of exports (5% and 9% for real exports and imports), which was reflected in the increase in the current account deficit. The deficit was amply financed by foreign official purchases of United States assets.

The projections for the current year, 2003, continue to be optimistic although economic signals remain mixed. The economy is expected to grow around 3% with price inflation below 1.5% and an unemployment rate between 5% and 6% (see Table 3).

Table 3
Projections for 2003

		2003 projections	
	2002	**Range**	**Central tendency**
Real GDP growth	2.8	3-3.75	3.25-3.5
Price index	1.9	1.25-1.75	1.25-1.50
Civilian unemployment rate	5.9	5.75--6	5.75-6

Source: Greenspan, Monetary Policy Report to the Congress, 11 February 2003

A second line of argument states that during the 1980s aggregate demand was maintained by budget deficits. As the United States economy started to grow and the budget deficit to narrow, a new source of demand, consumer demand financed by debt, became the new driving force of aggregate demand. The main message of this viewpoint can be stated through simple national accounts identities. In Eq. (1) below, income (Y) equals private consumption (C), plus investment (I), government spending minus taxes (G-T) and exports minus imports (X-M).

(1) $Y = C + I + (G-T) + (X-M)$

Alternatively, Eq. (1) can be expressed stating that aggregate private savings (Y-C) equal government savings (G-T) plus foreign savings (X-M). That is,

(2) $Y-C = (G-T) + (X-M) \Leftrightarrow Sp = Sg + Sf$

Where,

Sg = government savings
Sf = foreign savings

In the United States, during the 1980s, government savings (Sg) and foreign savings (Sf) were negative and were compensated by the savings surplus in the private sector. In the next decade government savings (Sg) turned positive, foreign savings (Sf) remained negative and private savings (Sp) also turned negative. This can be seen in Table 4. Computation of the difference between gross savings and investment for the private and government sectors jointly with the foreign savings as a percentage of GDP shows that during 1995-2000, the private sector's dissaving was equivalent to 1.7% of GDP. For its part the government sector reached a position of equilibrium (-4.6% and –0.4% of GDP between 1990-1995 and 1995-2000). Finally, the result of the foreign account shows that foreign savings was equal to –0.9% in 1990-1995 and decreased to –2.4% between 1995-2000 (see also Figure 3 below).

Table 4
Difference between gross savings and investment as percentages of GDP
1960 – 2002

	1960-1970	1970-1980	1980-1990	1990-1995	1995-2002	2002
Private sector (Sp)	1.7	1.7	2.4	3.1	-1.7	1.5
Government sector (Sg)	-1.4	-2.5	-4.4	-4.6	-0.4	-3.6
Foreign sector (Sf)	0.6	0.2	-1.5	-0.9	-2.4	-4.7

Source: NIPA accounts (2003).

In addition, this interpretation sustains that the main agents responsible for the decline in savings are households. Business savings share has not experienced significant changes. However, the household share of savings has markedly declined since 1992 (see Figures 1 and 2). This has been financed mainly from debt. Two proponents of this interpretation (Godley, 2001 and Palley, 2002) argue, moreover, that the ratio of debt to disposable income has increased over time indicating that consumer debt has risen at a faster ratio than income. This in turn can generate the mechanics of an unsustainable debt process (see Table 5).

Finally, if this interpretation is accurate aggregate investment expansion should come to a slowdown. Indeed, it is generally the case that businesses are borrowers and households are net savers. In other words, businesses borrow from households and distribute profits to these. If businesses cannot borrow from households because these are, in turn, net debtors, then productivity and technological advance is driving investment or investment is being financed by non-distributed profits. If productivity is the driving force of the economy, this process could continue in the medium run. If, on the contrary, profit is the driving variable, then the process must reach a limit. In this last scenario higher profits mean lower real wages and incomes. But lower real wages and income mean a narrower base on which to sustain debt and aggregate demand.

Table 5
Household debt distribution by income
2000

Household type	Average income	Average debt	Debt share	Debt/income
<50 000 USD 66% of the total	23,090	68,918	46	2.98
>50 000 USD 34% of the total	112,232	157,681	55	1.40

Source: Palley (2002)

An important issue that remains to be addressed and that could provide fertile ground for further development of this interpretation is whether the pattern of growth followed by the United States is part of a more global phenomenon. There is some evidence, at least in the case of Mexico, that this country also followed a similar regime. In the case of Mexico, the growth during the later 1990s also coincided with an adjustment programme that reduced real wages. In fact, the most dynamic sectors such as, for example the assembly plant sector, registered the highest share of foreign direct investment and lower real wages pointing to an important increase in profits. If other economies besides the United States and Mexico have followed this growth pattern, an accurate assessment of the current economic situation would require a global rather than a national interpretation.

Figure 1
The United States
Personal savings as percentage of personal income
1959 - 2002

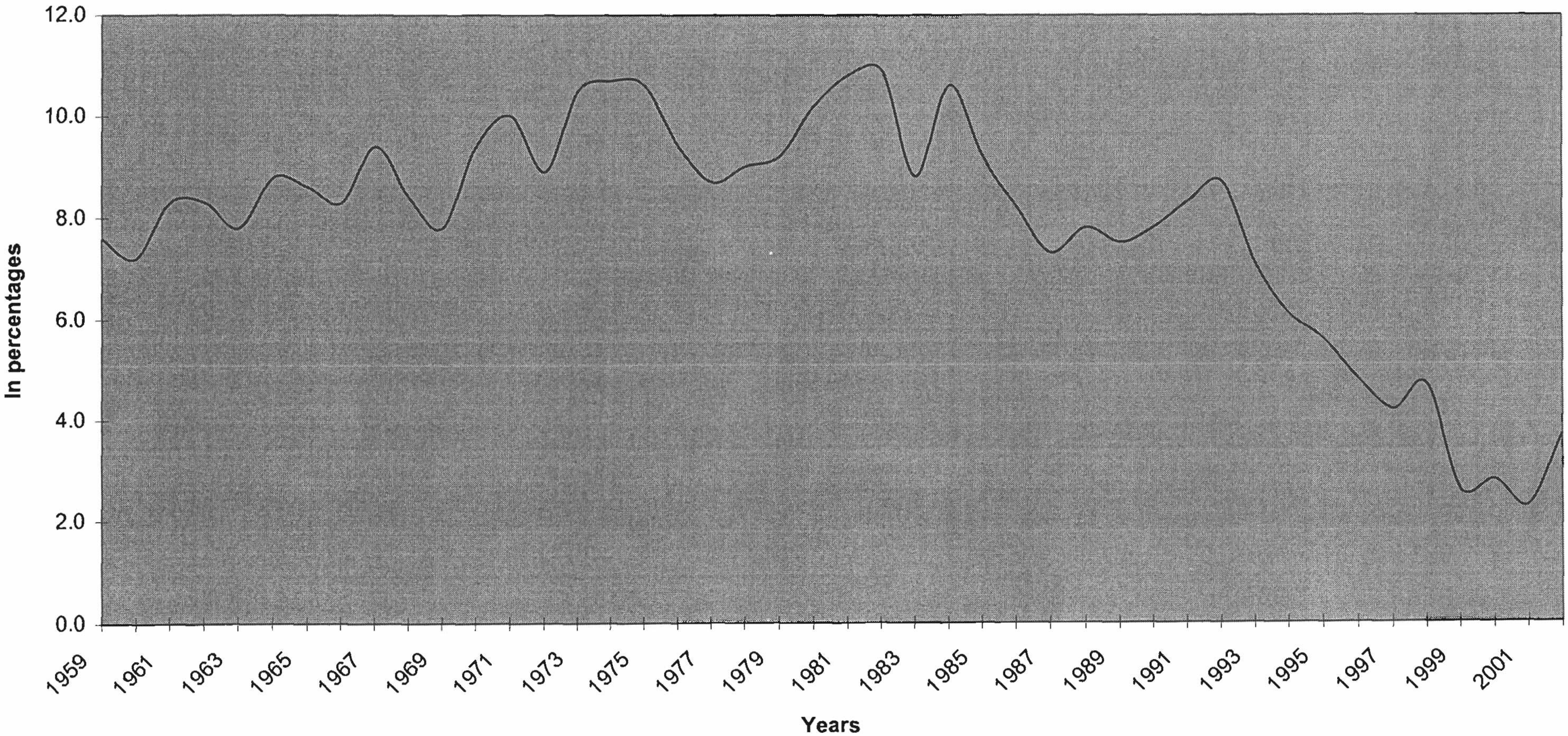


Figure 2
The United States
Personal consumption as percentage of personal disposable income

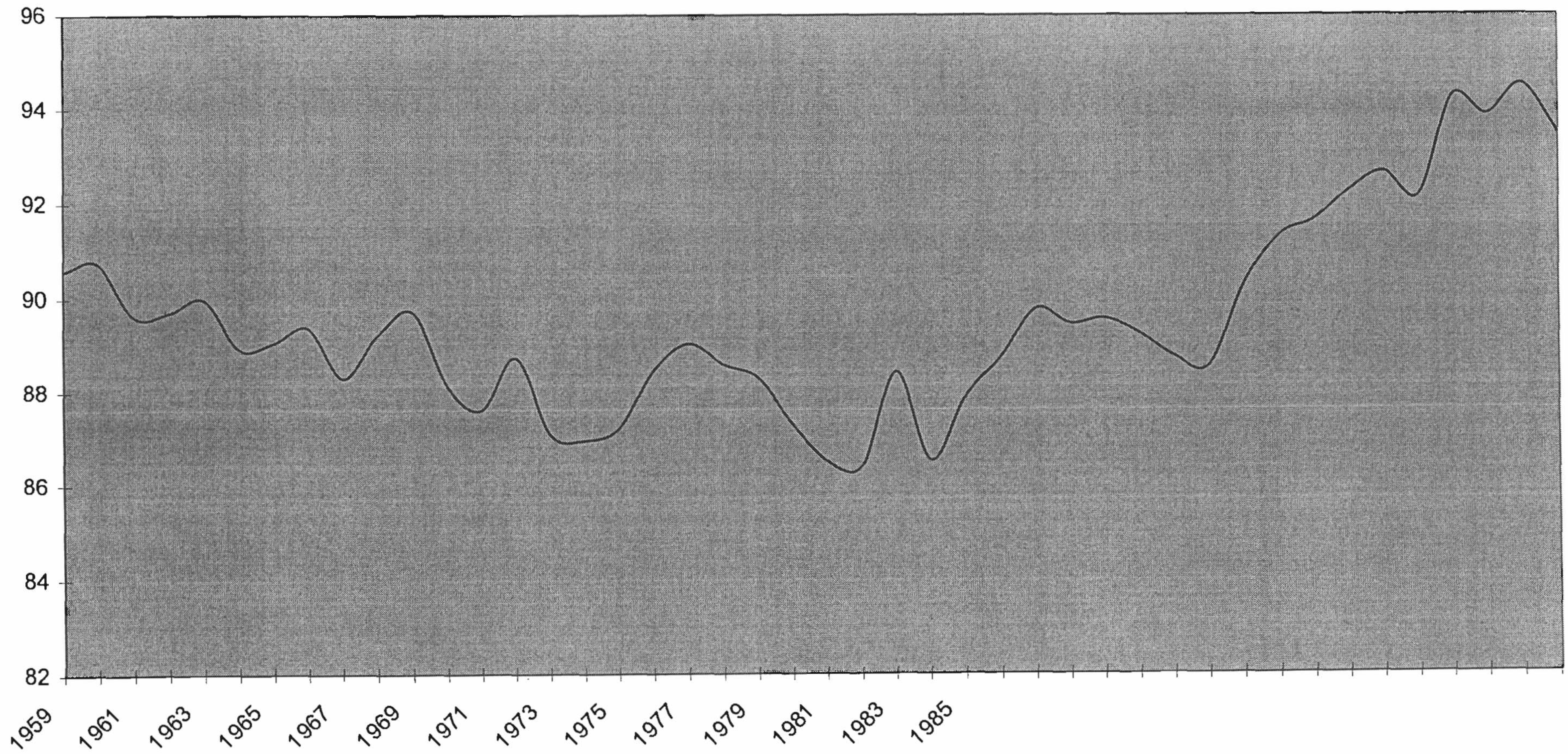
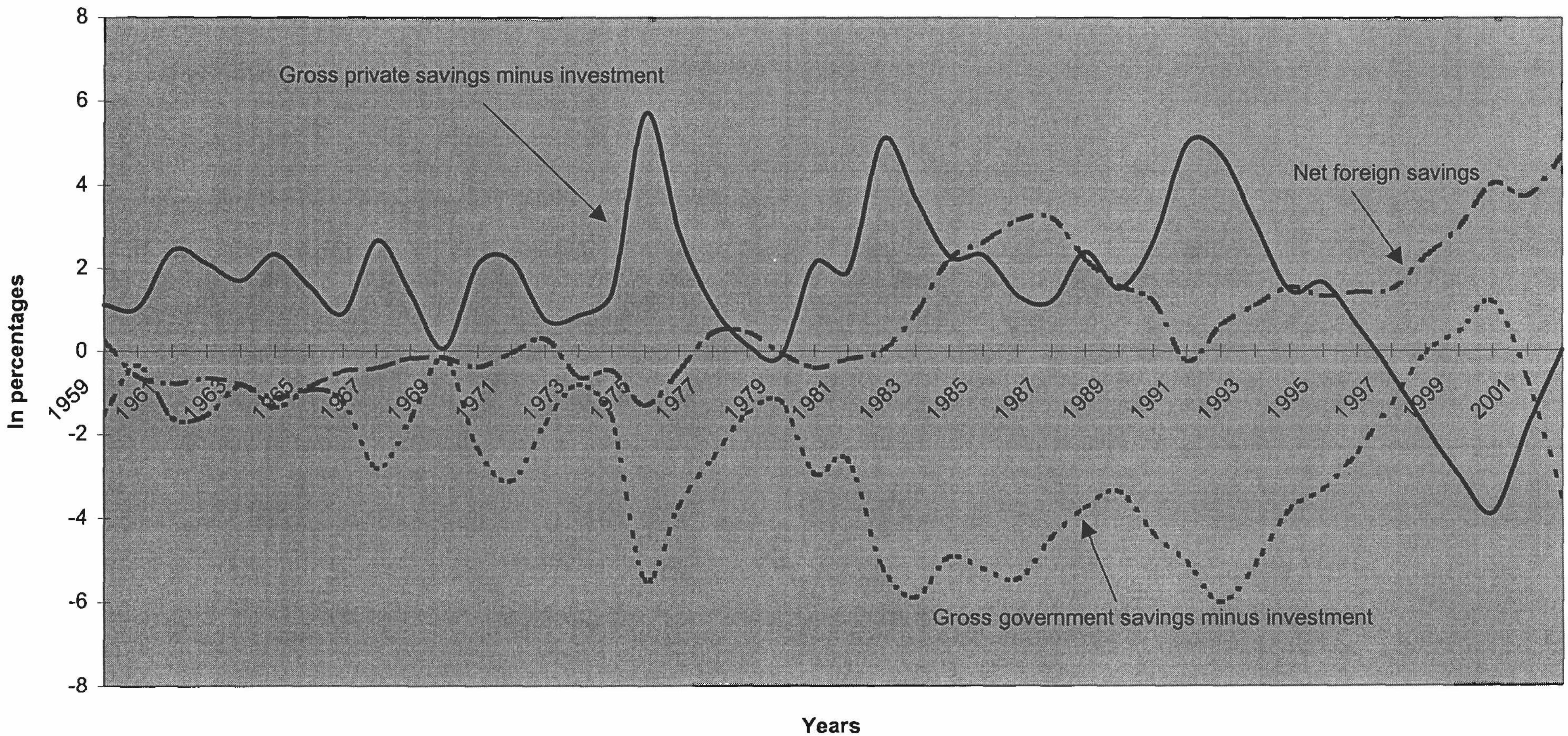


Figure 3
The United States
Private, government and foreign savings minus investment
1959 -2002



1.2. The economic effects of unforeseen events: 11 September 2001 and the Iraq conflict

During 2001-2003, the United States was faced with two unforeseen events, the 11 September terrorist attack on the World Trade Center and the armed conflict in Iraq. The events of 11 September had important financial effects on the city of New York.

Effects were measured both in terms of stocks (physical capital) and flows (labor). Physical capital was grouped into three categories: (i) the cost of the cleanup and restoration for rebuilding at the site; (ii) the cost of replacement of 14 million square feet of office and retail in the World Trade Center and repairing the buildings in "adjacent areas"; and (iii) the cost of repair of transportation and communications infrastructure damaged.

Table 6
Estimation of the costs of the events of 11 September
June 2002

Impact	Magnitude
Physical capital Cleanup and site restoration	1.5 billion
Destroyed buildings in World Trade Center complex Damaged buildings in World Trade Center Area Contents of buildings in World Trade	14 million square feet 6.7 billion to rebuild 15 million square feet 4.5 billion 5.2 billion
Public infrastructure	
Subway	850 million
PATH	550 million
Utilities	2.3 billion
Total capital loss	21.6 billion
Labor market Loss of Human Life	Estimated 2 780 workers 7.8 billion lifetime-earnings loss
Net job Losses	38,000-46,000 in October 2001 rising to 49,000-71,000 by February 2002, diminishing to 28,000-55,000 by June 2002
Net Earnings Losses	3.6 billion to 6.4 billion between September 2001 and June 2002.
Attack-related productivity effects	Increase in post-traumatic stress disorder and alcohol and drug use three months after attack.
Total labor loss	11.4 billion-14.2 billion
Total loss	33 billion-36 billion

Source: Federal Reserve Bank of New York (2002)

It is estimated that the capital loss amounted to US$22 billion or US$2,650 per resident. Most of the loss was concentrated in the destroyed and damaged buildings in the World Trade Center Complex and in the surrounding area (76% of the total) (see Table 6 above).[1] Damage in transportation and communications and basic services amounted to US$3.7 billion.

In terms of flow categories, the damage was computed for loss of life and employment disruptions. The 11 September attacks resulted in the death of 3,000 persons with an average earning of US$127,000 yearly income (for 2000). Assuming an average age of 40 and that the yearly rate of growth of the average income would equal that of inflation which in turn equaled the average discount rate, the loss in earnings was estimated at US$7.8 billion.

Employment disruptions included mainly net job losses and net earning losses. These affected, in particular, the financial services industry (losing 12,000 jobs in October 2001 and 6,000 additional posts from October 2001 to June 2002). Other affected sectors included the restaurant and hotels industries. Jobs declined by 6% in October 2001 in the former and by 15% between September 2001 and March 2002. Earning losses are due to the decline in wages and salaries as a result of job losses but also to lower tourist visits, lower customer traffic and shorter work hours, which were particularly visible in the restaurant and garment industry.

Table 7
Estimates of the cost of a potential war with Iraq
Costs of war (billions of US dollars)

	Low estimate For a short war favorable to the US	High estimate for a protracted war unfavorable to the US
Direct military spending	50	140
Follow-on Costs		
Occupation and peacekeeping	75	500
Reconstruction and nation building	25	100
Humanitarian assistance	1	10
Impact on oil markets	-30	500
Macroeconomic impact	0	345
Total	121	1 595

Source: Nordhaus (2002)

The reaction of the monetary authorities to the events of 11 September was anti-cyclical. The Federal Reserve increased liquidity through open market operations injecting $100 billion into the system and ensuring the safe financial position for the banking system as a whole.

[1] The estimations were undertaken using nominal gross replacement values and repair and not "explicitly account for the depreciation of the assets or any potential offsets from government rebuilding programmes or private-insurance proceeds". Federal Bank Reserve of New York, 2002, p. 11.

In assessing the overall economic effects of 11 September, it is important to distinguish between the effect of the disaster itself and the trend followed by the economy prior to the disaster. A recent study (Bram, 2003) indicates, that the effects are smaller than originally estimated. The explanation lies in the fact that prior to the disaster, private sector employment and equity markets had declined and that in general the economy was showing signs of an economic downturn. As a result, the attacks of 11 September did not cause a decline in economic activity but rather "exacerbated the downward phase of the cycle".

The effects of the Iraq conflict are more difficult to gauge and assess. Preliminary estimations have situated the cost between $100 and $1,595 billion (see Table 7). The President of the United States requested $87 billion to finance the war and the daily cost of the war is estimated at US$2.5 billion a day. The United States administration has stated that the tax cuts will increase economic growth and this will stimulate tax revenues and help finance the war. Alternatives include the imposition of a 'reparations payment' on Iraq, which will translate in practice, in financing the war bill and the cost of occupation as well as the humanitarian cost with Iraqi oil.

1.3. The European Union and Japan

The European Union's listless economic performance (0.7% in 2002) responded to a modest increase in consumption and decline in investment. All the major components of GDP recorded stagnant growth (see Tables 8 and 9). There was, however, in the third quarter of 2002 a change in the composition of GDP as the contributions of consumption and investment to GDP growth increased.

The growth performance is attributed to uncertain expectations shaped by the international geo-political situation, the volatile evolution in the price of oil and the 'macroeconomic imbalances in other developed economies'.

The behavior of European stock prices registered a downward movement since November 2002. Stock prices declined by 6% between the end of December and the beginning of February 2003 mirroring stock market behavior in the United States and Japan. In turn, the United States stock market reflected the weakness of the economy, the war prospects and the corporate scandals. In the case of Japan, the appreciation of the yen with respect to the dollar dampened the profitability expectations of exporter companies while the general global uncertainty asserted the risk adverse behavior of investors.

The European Central Bank also reported that the projections of economic activity for 2003 were not encouraging. In January 2003, the consumer confidence index declined. In a similar fashion, the European Commission's retail confidence indicator for January 2003 also forecasted a shadowy recovery for 2003.

Table 8
The European Union
Composition of Real GDP
1999-2002
Annual and quarterly data

	1999	2000	2001	2001 Q3	2001 Q4	2002 Q1	2002 Q2	2002 Q3
GDP	2.8	3.5	1.4	1.3	0.5	0.3	0.7	0.8
Domestic demand	3.5	2.9	0.9	0.7	-0.2	-0.3	-0.2	0.2
Private Consumption	3.5	2.5	1.8	1.8	1.7	0.6	0.4	0.7
Government Consumption	2.0	1.9	1.9	2.2	1.6	2.2	2.5	2.3
Gross Fixed Capital Formation	6.0	4.8	-0.7	-1.6	-2.5	-.31	-3.6	-2.9
Changes in inventories	-0.2	0.0	-0.4	-0.4	-0.8	-0.4	-0.1	-0.1
Net exports	-0.6	0.6	0.5	0.6	0.6	0.6	0.9	0.7
Exports	5.3	12.6	2.7	1.4	-2.6	-1.8	0.8	1.2
Goods	5.0	12.5	2.6	1.3	-2.8	-4.2	-1.9	1.8
Imports	7.4	11.3	1.4	-0.3	-4.4	-4.2	-1.9	1.2
Goods	7.1	11.3	0.6	-1.4	-5.6	-4.1	-2.2	1.8
Agriculture and fishing	2.8	-0.8	-1.2	-1.1	-0.6	1.1	1.1	0.2
Industry	1.3	3.7	0.7	0.5	-1.5	-1.8	-0.6	-0.2
Services	3.3	3.9	2.3	2.2	1.7	1.4	1.5	1.3

Note: Q= quarter.
Source: European Central Bank (2003).

In consonance with the prevailing economic conditions, the unemployment rate remained at 9% in December 2002. As reported by the European Central Bank at the end of 2002, "the average monthly rise in the number of unemployed in the fourth quarter (70,000) was twice as large as that in the third quarter".

For their part, prices declined slightly by 0.3 percentage points (from 2.5% to 2.2%) reflecting mainly weak demand conditions. The most important declines were registered in the price index for goods, which decreased from 2.5% to 1.7% as the price index for services increased from 2.5% to 3.1%. The latest figure available is for the month of January and shows a decrease to 2.1% from 2.3% in December. This behavior is explained by a concatenation of factors including higher oil prices and increases in indirect costs that were compensated by the appreciation of the nominal exchange rate.

Slack demand conditions and a climate shaped by uncertainty has significantly increased the preference for liquidity, which is reflected in the robust growth of the broad measure of money supply (M3) (7% from September to November 2003). In order to maintain the underlying economic conditions for economic recovery, interest rates have remained stable and exhibited a declining trend. Retail bank interest rates decreased in December 2002 with larger declines in the deposit (20 basis points for one-year deposits) than in the loan rates of interest (10 basis points). Money market rates of interest that started to decrease in May 2002 continued the downward movement in January 2003. For its part the overnight interest rate remained below 3%.

Table 9
Industrialized country indicators
2000 – 2002 (in percentages)

	2000		2001		2002	
	Ist Quarter	4th Quarter	1st Quarter	4th Quarter	1st Quarter	4th Quarter
	GDP growth					
Canada	5.2	3.53	2.64	0.83	2.14	4.03
Euro Area	3.85	2.74	2.37	0.45	0.35	0.83
France	4.58	3.78	2.96	0.31	0.53	0.82
Germany	2.93	1.92	1.78	0.08	-0.23	0.4
Italy	3.18	2.61	2.59	0.59	0	0.48
Japan	3.63	2.33	1.35	-2.3	-3.08	1.5
United Kingdom	3.43	2.25	2.47	1.56	1.13	2.08
United States	4.17	2.25	1.46	0.05	1.44	3.26
	Inflation					
Canada	2.71	3.09	2.81	1.1	1.55	....
Euro Area	2.15	2.68	2.28	2.23	2.59	2.27
France	1.59	2.04	1.46	1.52	2.19	2.06
Germany	1.95	2.45	2.38	1.72	1.95	1.12
Italy	2.45	2.77	2.1	2.25	2.49	2.84
Japan	-0.62	-0.76	-0.45	-0.99	-1.41	....
United Kingdom	2.32	3.08	2.55	1.05	1.21	....
United States	3.22	3.38	3.41	1.89	1.25	2.25
	Unemployment					
Canada	6.77	6.87	6.95	7.66	7.82	7.6
Euro Area	8.8	8.1	8	8	8.1	8.3
France	9.77	8.78	8.57	8.54	8.62	8.77
Germany	7.94	7.58	7.63	7.89	7.98	8.27
Italy	10.9	9.92	9.7	9.2	9.05	8.99
Japan	4.8	4.78	4.74	5.43	5.28	5.43
United Kingdom	5.68	5.16	5.02	5.08	5.07	5.19
United States	4.02	3.97	4.19	5.61	5.62	5.74
	Broad money					
Canada	5.92	7.29	5.75	5.75	5.91	....
Euro Area	6.99	4.1	6.59	11.17	7.23	....
Japan	1.93	1.95	2.51	3.37	3.69	....
United Kingdom	5.47	8.46	8.35	6.45	5.81	....
United States	6.04	6.1	7.09	10.32	9.16	6.97
	Short term interest rates					
Canada	5.28	5.81	5.1	2.39	2.11	2.84
Euro Area	3.54	5.02	4.75	3.44	3.36	....
Japan	0.11	0.54	0.36	0.04	0.12	0.04
United Kingdom	6.12	5.99	5.64	4.09	4.01	....
United States	6.03	6.59	5.26	2.06	1.82	1.49

Source: The Federal Reserve Bank of St. Louis (February 2003)

The Euro reported an appreciation relative to the currencies of its major trading partners. From 1999 to the last quarter of 2000 the Euro showed a marked depreciation. This tendency was reversed starting in the second quarter of 2001 and has continued throughout 2002. During this period, the effective exchange rate of the Euro has appreciated by 15%. The appreciation has had a negative effect on exports, which have declined by 3%. However, the effect of declining exports on the balance of payments has been offset by the decline in imports (-5%). As a result, the current account posted a surplus of 10 billion Euros, three times that registered in 2001 (3 billion Euros).

For its part, Japan registered a positive rate of growth in 2002 following a contraction in GDP during the previous year and increasing financial distress in the financial and corporate sectors (see Table 9 above). Recession and deflation aggravated the fragility of the balance sheets of banks and firms increasing the probability of loss making. At the same time, Japan was unable to export its way out of the crisis due in part to the slowdown of the United States economy. In 2002 despite an appreciating currency, Japanese exports profited from relatively better demand conditions and contributed to strengthening industrial production. According to the United Nations World Economic Situation and Prospects, 2003, corporate profits and business sentiment also showed signs of improvement which, however, were not enough to stimulate non-residential business investment (-6%).

A recent business survey shows that businesses still perceive a lack of demand as the main problem and are seeking to reduce costs as a way to maintain profitability. The decline in costs will translate into lower incomes and demand increasing excess capacity and causing further financial imbalances. Government finances remained in low profile due to a large budget deficit and a domestic debt that is 127% of GDP. Within this scenario, monetary policy has remained passive. In 2002, the Bank of Japan took several measures to provide liquidity and debt relief. Among others, the bank announced a plan to buy shares from those banks that have excessive holdings of equity in order to reduce bank exposure to stock market variations, increase purchases of long-term government bonds and widen the options for collateral in market operations.

2. THE PERFORMANCE OF DEVELOPING ECONOMIES

During the year Asian-developing economies registered a mixed performance. East Asian economies increased their rates of growth propelled by consumption and export demand. Nonetheless, these economies did experience constraints to domestic investment as stock prices plummeted and business confidence dimmed. The rate of growth of GDP for these economies increased from 3.5% to 5.3% in 2002 and is expected to remain at 5.5% for 2003.

GDP in Southern Asia remained for the second year in a row at 4.6% and is projected to increase to 5.8% in 2003. The dynamism of Southern East Asian economies is explained mainly by expansionary fiscal policies since agricultural performance, one of the main contributors to growth, was somewhat volatile and sectoral performance remained uneven. For 2003, the growth projection is based on export growth and on the stability of agricultural output.

Latin American economies and the Caribbean continued on a stagnant growth path. The rate of growth for 2002 was -0.5% on average for the region (see Table 10 below) and declined even further in terms of per capita income (-1.9%). The bigger economies of the region, Argentina, Brazil, Mexico and Venezuela experienced low rates of growth.

Table 10
GDP real growth in Latin America
1993-2002 (selected years)
In percentages

	1993	1995	1997	1999	2001	2002
Latin America and the Caribbean	3.3	1.1	5.1	0.5	0.3	-0.5
Argentina	5.9	-2.9	8.0	-3.4	-4.4	-11.0
Bolivia	4.3	4.7	4.9	0.3	1.3	2.0
Brazil	4.5	4.2	3.1	1.0	1.5	1.5
Chile	6.9	9.0	6.8	-0.7	2.8	1.8
Colombia	4.4	4.9	3.3	-3.8	1.4	1.6
Costa Rica	7.1	3.9	5.4	8.0	1.0	2.8
Cuba	-16.0	3.4	3.3	6.8	2.5	1.4
Ecuador	2.2	3.0	3.9	-7.9	6.0	3.4
El Salvador	6.4	6.2	4.2	3.4	1.9	2.3
Guatemala	4.0	5.0	4.4	3.9	2.4	1.9
Haiti	-8.0	9.5	3.2	2.9	-0.7	-1.5
Honduras	7.1	3.7	4.9	-1.5	2.7	2.0
Mexico	1.8	-6.2	6.8	3.7	-0.4	1.2
Nicaragua	-0.4	4.4	5.4	7.4	3.0	0.5
Panama	5.3	1.9	4.7	3.5	0.4	0.4
Paraguay	4.0	4.5	2.4	-0.1	2.4	-3.0
Peru	4.8	8.6	6.8	0.9	0.2	4.5
Dominican Republic	3.0	4.3	8.2	7.8	2.7	4.0
Uruguay	3.5	-2.3	5.4	-3.4	-3.4	-10.5
Venezuela	-0.4	5.9	7.4	-5.8	2.9	-7.0

Source: ECLAC (2002)

Latin America's economic performance was shaped by adverse external conditions. These included the deterioration in the international financial markets, the slowdown of the United States economy and the decline in the terms of trade of non-producing oil economies.

The first factor materialized in a significant level of net resource transfer abroad (2.4% of GDP) half of which is explained by Argentina and in higher sovereign bond spreads which reached a 200% basis point level towards the end of the year. Leaving aside the Argentine case, the countries that were most affected by these factors were Brazil, Uruguay and Venezuela.

The slow growth of the United States economy had a negative impact on neighboring countries such as Mexico, Central America and the Dominican Republic. Within these economies, only three (Costa Rica, El Salvador and the Dominican Republic) registered positive GDP per capita growth.

For its part the decline in the terms of trade, which is a prevalent phenomenon for Latin American economies since 1998, was particularly harmful to some economies of the Southern Cone and of Central America. When viewed from a five-year perspective the most significant terms of trade losses have been sustained by Peru (-21%), Chile (-19%) and Brazil (-16%).

In accordance with these economic conditions the rate of unemployment increased from 8.4% to 9.1% between 2001 and 2002 and real wages declined on average 1.5%. The regional inflation rate showed an upward tendency and reached 12% (6% in 2001). Its behavior is explained by the exchange rate devaluations (depreciations) in Argentina, Uruguay, and Venezuela and, to a lesser extent, Brazil.

In most countries, pro-cyclical monetary and fiscal policies aggravated the economic downturn. The monetary policy stance responded to the pressures exerted in the foreign exchange market. In the case of fiscal policy, the authorities aimed to maintain a balanced and sustainable trajectory of government revenues and expenditures over time.

Argentina was without doubt the economy that experienced the largest decline in real GDP growth. GDP contracted by 4% in 2001 and 11% in 2002. The country's performance marked the height of a series of unfavorable events that shook Argentina's quasi currency board arrangement since the crisis of the Mexican peso in December 1994 (see Table 13). Argentina received substantial financial aid from multilateral organizations ($7 billion to surf through the Tequila effect and $39.7 billion to overcome the effects of the Brazil and Russian crisis). However, the country defaulted on its external debt and abandoned the currency board in December 2001 after the domestic currency lost most of its value and the sovereign bond spreads increased to more than 7,000 basis points.

Table 11
Argentina
Financial indicators
1992 – 2001

	1992	1994	1996	1999	2001
Dollar deposits	10	24	28	47	48
Peso deposits	......	....	26	34	19
Credit in dollars as % of the total	54.2	59	63	......	......
Credit in dollars to the private sector	15.5	27.3	31.7	......	......
Credit in dollars to the public sector	4.0	3.4	4.4	....	......
Average money market rate, pesos (%)	15	8	6.2	6.99	24.9
Average money market rate, dollars (%)	.....	.....	5.9	6.07	12.76
Average lending rate, pesos	.....	10.0	10.5	11.04	28.6
Average lending rate, US$	......	8.0	9.12	9.07	17.5
Country risk premium	....	.....	4.9	5.3	43.7

Note: dollar and peso deposits and credit to the public and private sectors are in billions.
..... Denotes not available.
Source: Bonilla and Schamis (2001) and Schuler (2002)

Table 12
Argentina
Macroeconomic programming
2003

	Quarters				Year
	I	II	III	IV	
GDP	4.6	1.6	2.9	1.5	2.6
Consumption	3.9	1.3	3.6	2.0	2.6
Investment	8.0	3.2	5.0	4.4	5.0
Exports	17.4	16.8	10.0	2.7	11.7
Imports	28.5	38.3	31.6	15.1	27.9
Inflation (average)	35.8	20.6	16.0	19.8	22.3
Nominal exchange rate (end of period)	3.5	3.45	3.4	3.35	3.35
Real exchange rate (end of period)	2.39	2.24	2.09	1.96	1.96

Source: Central Bank of Argentina (2003)

Following the abandonment of the currency board, the banking system was in a fragile situation and ready to become insolvent due to the effects of a weak currency, recession and the government's debt default (see Table 11). The measures that followed, such as the forced conversion of the banks' dollar denominated assets and liabilities into domestic currency, did not improve the situation and the authorities defaulted again on their debt in late 2002 and at the beginning of 2003. As it now stands the authorities have managed to reach an agreement with the International Monetary Fund (IMF) involving a short-term loan programme of $6.6 billion. The authorities expect that the growth rate will reach 2.6% in 2003 propelled by export and investment growth.

Table 13
Argentina
Macroeconomic indicators
1989 – 2001

Year	GDP (1)	Inflation (2)	Fiscal deficit (3)	Current Account deficit (4)	External debt (5)	RER (6)	FDI (7)	Unemployment rate (8)	Real wage (9)
1989	-6.6	3,079.5	-2.7	-1.7	....	....	...	7.7	....
1990	-0.5	2,315.5	-1.6	3.3	....	.....	.....	7.4	103.2
1991	10.0	172.1	-0.3	-0.2	32.3	....	....	6.5	94.6
1992	9.5	24.9	0.9	-0.1	27.4	103.5	3218	7.0	98.6
1993	5.7	10.7	-0.3	1.5	28.0	95.4	2059	9.6	100.0
1994	7.5	4.1	-1.4	-0.3	30.4	94.6	2480	11.5	101.9
1995	-5.0	3.4	-2.2	-0.6	35.2	100.0	3756	17.5	96.8
1996	5.5	0.1	-1.4	-1.9	36.9	101.9	4937	17.2	97.1
1997	8.1	0.3	-1.2	-1.5	42.6	98.6	4924	14.2	93.6
1998	3.8	0.7	-1.6	-1.4	47.1	95.7	4175	12.9	92.6
1999	-3.4	-1.8	-1.7	-4.4	51.5	89.1	22633	14.2	97.5
2000	-0.8	-0.7	-2.4	-3.1	51.8	89.6	10553	15.0	94.5
2001	-4.5	-1.1	-3.5	-1.6	....	87.1	3500	17.4	....

Note: (3), (4) and (5) are expressed as percentages of GDP.(3) refers to the result of the non-financial public sector.(7) is expressed in millions of US dollars. (1), (2) and (8) are expressed in percentages.(6) refers to the real exchange rate of imports. In (9) the base year is 1990.
... denotes not available.
Source: ECLAC (2001-2002); Bauer (2001); Cavallo (1996); IMF Financial Statistics. Several Issues.

3. THE ARGENTINE CRISIS AND ITS POSSIBLE INTERPRETATIONS

The Argentine episode has renewed economists' interest in the nature and causes of financial and economic crises. There are different interpretations to the Argentine crisis. This section will center on three: the economic policy options approach; the structural view of the crisis; and the political economy approach.

Table 14
Chronology of selected events in Argentina 1999- 2001
From convertibility to devaluation

Date	Event
December 1999	Country risk premium is equal to 6.10 percentage points.
January 2000	Increase in tax rates.
December 2000	IMF aid package of US$40 billion to Argentina.
March 2001	Succession of three finance ministers. Proposal to impose a financial transactions tax and increase tariffs.
April	Peso is partly delinked from the dollar through the adoption of a basket of currencies (Euro and Dollar) to determine the peso exchange rate.
June	Adoption of a dual exchange rate system (preferential exchange rate for exports).
July	Country risk increases above 13 percentage points. Congress approves the zero deficit law.
August-September	Increase in the IMF stand-by loan from US$14 to US$22 billion.
November	Debt swap for a greater par of the US$132 billion public debt. Interest rates exceed 689%. Bank run
December 2001	Imposition of restrictions on deposit withdrawals and on transfer funds abroad. IMF announces it unwillingness to disburse US$1.3 billion in aid to Argentina. Country premium exceeds 40 percentage points. Imposition of high reserve requirements on new deposits. Argentina defaults on its external debt.
January 2002	Law of public emergency and reform of the exchange rate. The peso is devalued.

Source: Schuler (2002)

The first type of interpretation highlights different factors including the alleged overvaluation of the Argentinean domestic currency, the peso, the government debt and discretionary policy measures that proved to be an obstacle to the adjustment of the currency board. The opinions are divided as to which was the most destabilizing factor.

The overvaluation of the peso is linked to the fact that the United States dollar was, in turn, overvalued. The overvaluation had a negative impact on export performance contributing to a current account imbalance that had to be financed with capital flows in the form of foreign direct investment and, in its absence, external loans. The overvaluation of the peso and its negative effect on the balance of payments was aggravated by Brazil's devaluation of its own currency.

The existence of inflexible labor laws, an overstaffed bureaucracy and the inefficiency of government institutions explain the high levels of government indebtedness. Other contributing factors include the need to maintain a strong political coalition and the interests paid on the debt, which reached 50% of GDP in the last years of the currency board's existence (see Table 15). According to Schuler (2002):

> Starting in 1994, the federal budget was in deficit continuously, even in years of good economic growth. New debt was added to old, year after year, and debt plus interest grew much faster than the economy. At the end of 1994, the federal government's gross debt was about US$70 billion...GDP had grown fast and was US$257 billion. By the third quarter of 2001, the debt was twice as large, at US$141 billion, while GDP was US$271 billion – only 5% bigger than 1994 in nominal terms and smaller in real terms per person.

The discretionary policy measures undertaken to correct the impending imbalances made the situation worse. These measures included tax increases at a time when what was needed were measures to stimulate an economic recovery. Tax increases took effect in January 2000 and were applied to income, wealth, consumption, and retirement benefits. In April 2001, the authorities passed a competitiveness law, which included a tax on financial transactions. The tax rate was established at 0.25 and increased to 0.6 in August 2001.

In addition to the tax measures, proponents of this interpretation also refer to the interventions in the foreign exchange market to change the determination of the peso parity from March 2001. These were undertaken as last resort measures to salvage the currency board regime and comprised changing the anchor currency from the dollar to a basket of currencies made up of the United States dollar and the Euro. Also a preferential exchange rate was established for exporters. Finally, in an effort to boost export competitiveness the authorities established a preferential exchange rate for exports. These measures failed to restore the required confidence for economic growth. At the end of 2001, agents' confidence in the economy was finally shattered by the freeze imposed on banks' deposits.

Table 15
Argentina
Current and capital expenditures (as percentage of the corresponding total)
1993 – 1999

	1993	1994	1995	1996	1997	1998	1999
Current expenditures	90.6	92.0	91.8	91.1	91.3	91.5	92.5
Consumption	20.9	22.1	22.6	21.8	20.9	20.1	19.5
Remuneration	15.1	15.9	16.8	16.5	15.4	14.6	14.7
Goods and services	5.8	6.2	5.9	5.1	5.4	5.5	4.8
Interest	6.8	7.7	9.9	9.5	12.5	14.3	16.8
Social Security	37.6	40.2	37.3	39.0	38.3	37.3	35.7
Current transfers	25.2	21.9	21.9	20.7	19.6	19.8	19.9
To private sector	8.5	9.2	11.2	10.4	9.8	10.3	10.4
To public sector	16.4	12.4	10.5	10.0	9.5	9.3	9.3
Abroad	0.4	0.3	0.1	0.3	0.3	0.2	0.2
Capital expenditure	9.4	8.0	8.2	8.9	8.7	8.5	7.5
Direct investment	2.5	2.55	1.5	1.5	1.6	1.8	1.1
Capital transfers	5.0	4.9	6.4	6.9	6.6	6.4	4.8
Financial investment	1.9	0.6	0.4	0.6	0.4	0.3	1.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Baer et al. (2000)

The structural approach has two variants. According to the first, Latin American countries were able to overcome their external debt overhang through the market reforms that accompanied the 1980s stabilization programmes. Privatization and outward-oriented policies provided the basis for attracting foreign capital flows financing their external debt positions. However, countries were not able to achieve fiscal balances and external imbalances remained a fundamental obstacle to long-term growth. As a result, the level of indebtedness did not improve and Latin American countries remained dependent on capital flows. In the words of Kregel (2003, p.19):

> The persistence of large stocks of external debt, meant that domestic policy remained constrained by external shocks, and in particular by the necessity to maintain flows of external finance and the impact of international capital market interest rates on the carrying cost of the outstanding debt. The failure of domestic producers to become major competitors in international markets in the short period in which this liberalization of domestic markets to foreign competition took place meant that when growth occurred it was not led by expanding demand via higher net exports, but rather via higher foreign capital inflows. This has been characterized as 'debt-led' growth, in contrast to 'export-led' growth, and has meant that any given level of economic growth has meant a higher

share of imports creating a vicious circle of external financing crises that replaces the 'stop-go' cycles of the 1960's balance of payments crises.

The other variant views the Argentine crises as a process driven by instability. From this perspective Argentina is an unstable economy. Two main features of this instability are structural changes and volatility (Fanelli, 2002). Structural changes refer to unforeseen and sudden changes in the parameters that define the structure of an economy and are, to some extent, unique. They also modify the context within which the economy functions forcing agents to engage in a learning process. This increases the difficulty of forming expectations as well as the probability of making mistakes and can lead to a climate of uncertainty and a loss of faith in the current economic model.

The third type of interpretation of the Argentinean case is the political economy approach. In essence, it views events in Argentina as a manifestation of the 'fight for shares' and thus maintains that the stability of a regime depends on whether it is capable of making acceptable 'the distributional status quo of agents' (Baer et al.). In the case of Argentina the periods of stability and instability can be explained by the ability of the party holding power to build and sustain a consensus among economic agents. This view distinguishes three stages in the evolution of its currency board arrangement. The first (1990-1995) is characterized by an agreement among economic agents to end inflation instability leading to the 1989 high inflation episodes.

During this stage economic agents have a positive opinion of the change in regime even though some political and economic groups are not favored by the change in monetary regime. In the particular case of Argentina, price stability restored confidence in allocation and trading mechanisms such as relative prices and contracts. At the same time, market reforms, including privatization which provided important flows of funds to the economy, permitted the government to make unilateral transfers to the provinces and certain agents to guarantee the success of the convertibility plan.

The second stage (1995-1997) is characterized by an external shock, the Mexican peso devaluation of 1994-1995, which had a devastating effect on Latin American capital flows and, in some countries, on economic growth. In the case of Argentina, the price of stocks and bonds showed a marked decline. According to Mishkin and Savastano (2000), the banking system lost 17% of its deposits and the Central Bank 33% of its international reserves. Unemployment reached 18% and real GDP declined by 3%. In spite of these effects, the authorities managed to use the crisis to consolidate the currency board regime. According to Bauer et al., the crisis was a means to introduce banking reform, prudential regulation and opponents of the regime were persuaded to support and back the monetary regime.

The third stage (1997-2001) was marked by the realization that the currency board had negative social outcomes. Since its inception, the rate of unemployment increased steadily, real wages started to decline from 1997 onwards and income distribution became more concentrated (see Table 16). As a result, the consensus that supported the currency board regime started to break down. Some groups, market-oriented groups and corporate interests, demanded more reforms. Others, namely union and provincial governments, asked the central government to focus on social issues. The fragmentation of political and economic interests became more prevalent as some provincial governments were allowed to stop or slow down the implementation of reforms in return for their political support.

Table 16
Argentina
Social indicators
1990-2000

	Gini Coefficient in Urban Areas	Income Share of Upper 20%	Income Share of Lower 20%	Poverty rates in Buenos Aires
1990	0.438	4.8	50.4	41.2
1991	0.441	4.6	50.4	26.4
1992	0.432	4.3	48.7	18.7
1993	0.432	4.3	48.8	16.9
1994	0.433	4.5	49.4	17.0
1995	0.454	4.2	51.5	22.6
1996	0.448	4.4	51.1	25.5
1997	0.447	4.3	50.7	25.2
1998	0.460	4.2	52.2	24.9
1999	0.447	4.4	51.0	....
2000	0.455	4.1	51.4	....

Source: Bauer et. Al (2001)

4. THE ARGENTINE EPISODE: LESSONS FOR CARIBBEAN ECONOMIES

The Argentine currency board experiment can provide useful lessons for other economies in Latin America and the Caribbean and especially for smaller economies.

The first important lesson to be drawn from the Argentine case is that a distinction should be made between currency risk and country risk. Country risk refers to property risks, tax policies, government regulation and/or commercial policies. On the contrary, currency risk refers exclusively to a risk due to an expected variation in the exchange rate. This distinction can be further clarified by stating that the backing of a currency does not necessarily mean making a hard peg currency arrangement credible. Backing depends on reserves, the willingness of multilateral institutions to provide liquidity when needed. Credibility is related to the set of factors that determine country risk.

Currency and country risks are not necessarily interrelated and indeed the suppression of currency risk does not automatically imply the elimination of country risk. Dollarization, such as in the cases of Argentina and El Salvador, is a way to eliminate exchange rate risk but this does not mean that these countries are free from country risk. Panama is a case in point as in that country sovereign bond spreads have exceeded those of most Latin American countries with independent currencies.

Second, hard pegs exchange rate regimes do not necessarily guarantee fiscal discipline. That is, a monetary rule does not imply that agents will follow a fiscal rule. As shown in Hanke (2001) most countries that have adopted hard peg regimes of the currency board type have, for the most part, increased their fiscal deficit and, in some cases, their external debt levels.

Third, a hard peg exchange rate regime, such as the Argentinean currency board type, necessarily imposes a trade-off between monetary discipline and the provision of liquidity, and indeed the solvency of the financial system. Under adverse external conditions, the financial system may require an expansion of liquidity, which can undermine the very foundations of the hard peg regime. This trade-off between flexibility and stability is less relevant for smaller countries where the financial system is not highly sophisticated, for countries with a limited number of financial institutions or in cases where multilateral organizations can act as international lenders of last resort (Eichengreen, 1996, p.184).

Finally, the Argentinean episode illustrates that the structure of the domestic financial market is also an important determinant of the feasibility of a currency board. The absence of capital market significantly reduces the probability of failure of a hard peg regime. In the absence of alternative abodes for purchasing power, agents maintain their liquid balances in commercial banks while, at the same time, borrowing from the same institutions. Thus the finance that comes out of the banking system returns to the banking system via new deposits. Within this framework, the financial institutions cannot experience a balance-sheet imbalance since there are no leaks in the financial circuit.

5. FINANCING FOR DEVELOPMENT

5.1. The Monterrey Consensus

In 2002, United Nations member countries adopted the Monterrey Consensus at the Conference on Financing for Development (Monterrey, Mexico). The conference formally originated in resolution 54/196 of the United Nations General Assembly, by which it was decided to convene, in the year 2001 a high-level international intergovernmental event on financing for development. The General Assembly's resolution was the result of members' dissatisfaction with the framework governing international financial relations. It also responded to the need to ensure the effective mobilization of resources to enhance economic development.

The Monterrey Consensus comprises three sections (confronting the challenges of financing for development: a global response; leading actions; and staying engaged). The first section states that financing for development requires a holistic and interconnected approach and the full participation of all its stakeholders.

The second part is in turn subdivided into four sections. These four sections deal with mobilizing domestic and international financial resources for development, the role of international trade in development, international cooperation, sustainable debt financing and systemic issues.

The first section describes the conditions required to achieve growth, poverty eradication and sustainable development. These are improved domestic governance, sound macroeconomic policies, fiscal sustainability, the creation of social security and safety nets, financial sector strengthening and capacity building. Improved domestic governance refers to fighting corruption and creating the appropriate policy and regulatory frameworks to encourage the business sector, while at the same time improving the distribution of income and "empowering women and protecting labor rights and the environment".

Sound macroeconomic policies achieve a sustainable growth path without spurring inflation and creating an atmosphere prone to economic instability. Sustainable macroeconomic policy also involves maintaining fiscal and external equilibrium over time. Fiscal sustainability means creating and managing equitable and efficient tax systems while at the same time improving public expenditure and avoiding the crowding out of private investment. The creation of social security and safety nets comprise making investments in basic economic infrastructure and social services (education, health, nutrition, and social security programs).

Financial sector strengthening refers to the strengthening and development of capital markets using domestic institutions to channel savings for investment purposes. In this regard the Consensus calls for a strong central bank and a transparent and effective system of financial intermediation. Other important elements include micro-finance and credit for small and medium sized firms, development banks, and pension schemes that combine their dual role of social protection with that of source of savings.

The second section states that national efforts must be complemented by long-term private capital flows, which has become the most important international source of finance for developing economies. The Consensus asserts that foreign direct investment has the main benefit of "contributing toward financing development in the long term, in a more stable orderly fashion than portfolio investment. In addition foreign direct investment is an important vehicle for the transfer of knowledge, skills, technology, the creation of jobs, to increase productivity, enhance competitiveness and entrepreneurship and to reduce poverty. As a result countries must step-up efforts to attract foreign direct investment". As part of these efforts, countries must concentrate on creating the adequate macroeconomic environment and the appropriate regulatory framework to allow foreign direct investment to operate efficiently. Long-term capital inflows should also be complemented with other types of flows as, for example, remittances and official aid. In addition international organizations should provide support through "the provision of export credits, risk guarantees, co-financing, and leverage of aid resources and venture capital, as well as provision of information on investment opportunities".

The third section focuses on international trade and encourages countries to liberalise and adopt free market oriented policies as these provide a foundation for industrial growth and development. These policies should promote exports and encourage the adoption of a rule based and a non-discriminatory multilateral trading system. The Consensus encourages countries to strengthen the rules and disciplines of the WTO, to liberalize trade in agricultural products and in services, accelerate the elimination of barriers to manufactures, reduce tariff peaks, eliminate tariff escalation, and make operational special and differential provisions in trade agreements. Developed countries should assist in these efforts by taking the necessary steps to benefit least developed countries and support the New Partnership for African Development and the small island, landlocked, and transition developing economies. Multilateral help to stabilize the export revenues of countries that are to a greater extent dependent on commodity exports can complement these efforts. In turn, less developed and developing economies should increase and strengthen their participation in the multilateral trade negotiations.

The fourth section focuses on the need to increase international financial cooperation through official development assistance. Official development assistance can improve export performance and competitiveness especially in the case of countries that have little capacity to attract foreign direct investment. These include the least developed economies as well as small-island and landlocked developing economies. The consensus recommends that overall official development aid should be increased to the equivalent of 0.7% of GNP.

In order to make official development assistance more effective, multilateral and bilateral financial and development institutions should strive to: "(i) harmonize their operational policies and procedures, reduce transaction costs, and make official development assistance disbursement and delivery more flexible; (ii) avoid burdensome restrictions such as aid tying, and shift from project-based to budget support mechanisms for aid delivery; (iii) increase the concessionality of development financing, including greater use of grants, while ensuring full additionality of resources; (iv) give recipient countries more influence over the design of technical assistance programs and more control over the use of technical assistance resources; (v) deepen triangular cooperation, including South-South cooperation, as a delivery tool for assistance".

The fifth section addresses the problem of sustainable debt financing and external debt relief. Efficient strategies to manage and monitor external liabilities are needed to reduce national vulnerabilities and to avoid mismatches between financing needs and repayment capacity. The Consensus approves the Highly Indebted Poor Countries' Initiative (HIPC) to strengthen economic prospects and reduce poverty levels. In addition the Consensus urged the main funding multilateral organizations (IMF and the World Bank) to propose debt relief for small island and landlocked developing countries and low-income countries with difficulties in servicing their debt.

The last section is on systemic issues and stresses the need to reform the world's financial architecture including enhancing the coordination of macroeconomic policies and to reduce exchange rate volatility. The key to a strong and healthy international financial system is to provide the IMF with the adequate financial resources to provide assistance, where needed, and to promote the role of regional and subregional stabilization funds. Finally, the Consensus emphasizes the need to improve global governance, which needs a broad base of support by incorporating the participation of developing countries in multilateral forums in order to enhance their role in decision-making processes.

The last part of the Monterrey Consensus, 'Staying Engaged', states the need for a follow-up to the conference. It also describes the preparations for "the rededication of the existing United Nations General Assembly's high level development dialogue as a forum for the highest economic authorities, open to the participation of all public and private stakeholders associated with the Monterrey Conference".

5.2. The follow-up actions to the conference

Following the adoption of the Monterrey Consensus by United Nations member countries and institutions, the World Bank and the IMF convened meetings in the course of the year 2002 which gave support to the provisions of the Monterrey Consensus and highlighted the need to achieve the millennium development goals. In these meetings, the said multilateral institutions prepared a report describing the progress of the Monterrey Consensus by listing the domestic actions undertaken by developing countries to achieve millennium goals and by assessing the progress in delivering global commitments included in the Monterrey Consensus. As stated in the previous sections, some of these aspects include debt relief, debt restructuring, surveillance, crisis prevention, institutional coherence, SDR allocation and the enhancement of the participation of developing countries in international forums.

The United Nations also convened high-level international meetings, where participants supported the Monterrey Consensus and expressed the need to proceed to a quick implementation of its main provisions. Also financing for development was the subject of three reports, which were part of the official documentation for the specific consideration of the United Nations Second Committee. These reports are: the Report of the International Conference on Financing for Development; Report of the Secretary-General on the outcome of the International Conference on Financing for Development; and the Report of the Secretary-General on follow-up efforts to the International Conference on Financing for Development.

In its deliberations, the United Nations has decided to hold a high-level dialogue at the ministerial level with the theme: The Monterrey Consensus: Status of implementation and tasks ahead. The General Assembly also reached a complementary solution to "ensure effective secretariat support for sustained follow-up to the outcome of the International Conference on Financing for Development". In this resolution, the Secretariat states that it will commit resources for the follow-up and implementation of the provisions agreed to at the conference.

Prior to the Monterrey Conference on Financing for Development, European countries pledged to increase their official aid to developing countries. However, since the conference, international organizations have raised some areas of concern regarding the implementation of the provisions of the Consensus.

These included the limited amount of resources of the IMF to confront financial crises, the need to strengthen developing countries' participation in international forums, the inaction regarding the provision of safety nets and buffer stocks for developing economies, and the fact that the accompanying macroeconomic parameters to the HIPC initiatives have not corresponded to the realities of the debt relief receiving countries. Two other important factors are the failure of some developed countries to deliver tariff reductions and the inadequate coordination of industrialized countries' macroeconomic policies

In terms of trade liberalization, the industrialized countries have in some cases increased trade barriers or postponed to a later date trade liberalization policies. As an example, starting in the year 2006 the European Union has decided to reduce import tariffs by 36%, export subsidies by 45% and trade distorting domestic farm support by 55 % within a six-year period.

Finally, the necessity to coordinate macroeconomic policies is hampered by the internal and external disequilibrium in the United States. The United States has registered a trade deficit and a fiscal disequilibrium that is predicted to reach US$300 billion in 2003 and 2004. In addition economies are suffering from a general climate of uncertainty driven by increased geopolitical tension, an uncertain outcome in the oil market as a result of the present conflict with Iraq, and lingering growth prospects.

5.3. The Monterrey Consensus: A Caribbean perspective

From a Caribbean perspective the Monterrey Consensus is an incomplete document. The agreed draft text takes into account some of the issues raised by Caribbean economies regarding financing for development. However, key concerns relating to the constraints on development imposed by the small size of some developing economies, such as those of the Caribbean, and the need to address their vulnerability (as defined in the Preamble, paragraph 3 of the Programme of Action for the Sustainable Development of Small Island Developing States, 1994) in an increasingly integrated world are not subject to any analysis in the document.

The focus is on domestic reform and the required adjustment that developing economies must undertake rather than on the conditions that developed countries and the international community should create for development. Domestic reform and adjustment are presented as prerequisites to provide the necessary funding for development through increased savings and by creating the 'right' climate for international investors. But the document does not provide a more balanced approach to the financing for development issue.

In this regard, it should emphasize the commensurate responsibilities of countries at the domestic and international levels. In addition it should state that domestic reform is important but a favorable international context is a sine qua non condition for growth and development. Trade is an engine for growth and development. Trade performance depends on developed countries' increase of their import demand. Export diversification is a way of attracting foreign direct investment. Special and differential treatment is a framework for enhancing export diversification.

Caribbean exports remain concentrated on a few commodities and as a result their performance is vulnerable to external shocks such as variations in the terms of trade or natural phenomena. This contributes to the volatility of income. Combined with high import growth this leads to external imbalances and places important restrictions on fiscal and monetary policy management.

Also the performance of the services sector (tourism, off-shore banking) has partly compensated the need for foreign exchange but, at the same time, has experienced some saturation in the case of tourism earnings and a lack of a clear regulation framework in the case of offshore banking.

Export diversification constitutes a fundamental means to attract foreign direct investment and constitutes a basis to enhance economic growth. At the same time, export diversification and trade liberalisation require finance and adequate transitional periods to carry out the necessary adjustment and restructuring. Export diversification can be developed from special and differential treatment provisions applicable to sectors that have strong linkages with the rest of the economy, in particular with dynamic sectors such as the services sectors. This would allow special and differential treatment to be based on the production possibilities and the comparative advantage of Caribbean economies.

The Monterrey Consensus would gain in relevance by avoiding compartmentalizing issues such as capital and official flows, destination of official aid assistance, and domestic and international measures to attract foreign direct investment. These should be integrated under a comprehensive development perspective. External financing should not rely solely on private capital flows but on a combination of private and public financial flows. Public flows are complementary to private flows, which are subject to market failures and may not allocate resources in an optimal fashion.

The international flow of financial resources takes two forms: private flows such as foreign direct investment (FDI), portfolio investment and sovereign debt and official flows such as grants and concessionary finance from bilateral and multilateral sources. Less developed countries in the Caribbean tended to rely more on official flows because of their relatively small size but these flows have declined significantly during the 1990s. Official flows have shifted to other geopolitical regions, notably in Eastern Europe, and Caribbean countries have increasingly relied on private flows to finance development projects. Data for the 1990s reveal that private flows now exceed official flows by a margin of 5 to 1 whereas in 1990 official flows were more than twice that of private flows.

Foreign direct investment has become the predominant form of foreign investment in the Caribbean. Caribbean countries have opted for alternative options to attract finance for development including the issue of sovereign bonds and offshore financial services.

Despite the fact that in the agreed draft text foreign direct investment is viewed as a vital component of national and international strategy, private international intermediation flows are not a 'panacea' for development. Private flows are pro-cyclical (they vary with the fluctuations in the trade cycle) and are subject to discontinuities (the supply of private flows may not respond to reforms and adjustments undertaken by developing countries). Most important, there is no market mechanism that ensures that foreign direct investment flows are directed to those sectors and countries that would derive most benefit.

In particular, Caribbean economies and especially the smaller economies of the Caribbean do not possess the structural features to develop and market goods and services at an international competitive price and this may constitute an obstacle for the attraction of foreign direct investment. As a result private flows should be complemented with other types of flows.

Public international flows can be used to provide counter-cyclical funding and an international mechanism (such as Special Drawing Rights) should be set up for the provision of liquidity to developing economies. This is particularly important for the smaller economies in the Caribbean – SIDS- which have limited access to private capital flows.

Finally in relation to the issue of *financing for development*, it is to be recalled that *Agenda 21* which was adopted at the United Nations Conference on Environment and Development (UNCED) as *the blueprint for global sustainable development* highlighted, in its Chapter 33, the need for major efforts on the part of the international community to provide adequate financing for sustainable development. The document recognized the need for increased and predictable financing for medium and long-term objectives and for the provision of new and additional financial resources to developing countries. In this regard, preliminary estimates of the costs of implementation for developing countries and the requirements for grants or other concessional financing needed from the international community represented one of the more significant features of the document.

Already at Rio+5, which convened in 1997 for the "*Five-year Review*" of the implementation of *Agenda 21*, the issue of *financing* was highlighted as a major constraint. On the eve of the Monterrey Summit and also of the World Summit on Sustainable Development (WSSD), a similar observation is appropriate since very little progress has been recorded towards confronting the challenges of financing, including investment, for sustainable development, by reference to the financial goals that were adopted by the international community in *Agenda 21*. In the context of Monterrey, it is also to be noted that *Agenda 21* also envisaged durable solutions to the external debt problems of low and middle-income developing countries.

Within the SIDS Programme of Action which, for SIDS, is the most concrete expression of Agenda 21, it is provided in part two of the Declaration of Barbados (Global Conference on the Sustainable Development of Small Island Developing States, 1994), *inter alia,* that:

> *The international community should cooperate with small island developing States in the implementation of the Programme of Action for the Sustainable Development of Small Island Developing States by providing effective means, including adequate, predictable new and additional financial resources in accordance with chapter 33 of Agenda 21.*

Since the adoption of the SIDS Programme of Action in 1994, concerns relating to the financing of sustainable development have been the hallmark of strategies developed by the SIDS as they seek to overcome the unique range of vulnerabilities that are characteristic of these geo-social entities. According to the Draft Monterrey Consensus, the Summit will address, in the main, a range of issues relating to, *inter alia*, finance (resource mobilization, official development assistance (ODA), international debt); trade (access to markets) and certain issues relating to the coherence of global and regional, financial arrangements.

6. TRADE POLICY NEGOTIATIONS

6.1. The Doha Ministerial Conference

The Doha ministerial conference (Qatar, 9-14 November 2001) signaled the continuation of another round of multilateral trade negotiations. Doha recognized that trade was an engine for development and placed development objectives at the forefront of these trade negotiations.

The ministerial conference gave the WTO a broad negotiation mandate including, among others, negotiations on agriculture, services, trade-related aspects of intellectual property rights, dispute settlement, trade and environment and electronic commerce. Among the issues in the work programme that will affect, in particular, small developing economies are: i) the implementation and design of special and differential treatment; ii) the need to examine issues related to the trade of small economies; iii) acknowledgement of the specific problems confronted by least developed countries; iv) the possible extension of export subsidies; and v) the waivers granted to the European Union to extend the regime of preferential tariff treatment for products which originate in ACP countries. The Doha ongoing negotiations and the work programme are to conclude by January 2005.

In 2002-2003, one of the most important achievements within the Doha objectives was the adoption of modalities for the treatment of autonomous liberalization measures in the services sector. According to the WTO, an 'autonomous liberalization measure' is a measure "subject to scheduling under part III of GATS; leading to the termination of a most favored nation (MFN) exemption which is compatible with the MFN principle, undertaken by the liberalizing member unilaterally in accordance with article XIX of the GATS and applicable to all services sectors". Other developments relate to agriculture where countries have yet to agree on a framework for future agriculture trade reform.

The most recent document of the WTO on trade negotiations published by the Committee on Agriculture (18 December 2002, TN/AG/6) that was to provide the basis for an agreement on the modalities for agriculture trade reform identified key remaining areas of disagreement among member countries. These included in particular the level of trade reform implied in the ministerial declaration at Doha; at what level should the targets be set for tariff reduction; and what is the most appropriate tariff form. There was also a lack of counter-proposals in areas such as market access, export competition and domestic support. Moreover, there was a lack of agreement on the specifics of special and differential treatment and the modalities to incorporate non-trade issues such as food security, livelihood, poverty alleviation, rural development, environmental protection, food safety and animal welfare.

Some of the obstacles in achieving consensus on agricultural reform are due to developed countries' increase in agricultural trade barriers. As stated by Khor: "..the US Farm Bill 2002 was announced, representing an increase in almost 80% of the subsidies allocated to agriculture, at US$ 180 billion over ten years. Recently, a summit of EU leaders concluded that the Common Agriculture Policy subsidy levels would be maintained at least until 2013. It seems clear that both the US and the EU have decided to maintain or increase their agriculture subsidy levels, probably with more changes in the direction away from the 'amber box' to the 'blue and green box' subsidies, but with the same damaging effects on developing countries."

6.2. Special and differential treatment

The Doha Ministerial Declaration stated that WTO members "reaffirm that provisions for special and differential treatment are an integral part of the WTO Agreements. We note the concerns expressed regarding their operation in addressing specific constraints faced by developing countries, particularly least-developed countries. In that connection, we also note that some Members have proposed a Framework Agreement on Special and Differential Treatment (WT/GC/W/442). We therefore agree that all special and differential treatment provisions should be reviewed with a view to strengthening them and making them more precise, effective and operational".

The Doha Ministerial directed the Committee on Trade and Development to identify special and differential trade provisions that are mandatory, those that are non-binding and to consider transforming the consequences of the non-binding measures into mandatory provisions. The Committee was also charged with the task of making the special and mandatory provisions more effective and to "consider how special and differential treatment provisions can be incorporated into the World Trade Organization architecture".

The Committee held its first meeting on March 2002 and has since received a number of suggestions for special and differential treatment. These suggestions touched upon a number of crucial issues such as the principles underlying special and differential treatment provisions; the length of transition periods; the effectiveness of special and differential treatment; the validity and role of the enabling clause; the necessity to generate a monitoring mechanism; the creation of a Doha Trust fund; and the outline of proposals for technical assistance and training.

Initially, the country ministers mandated the Committee on Trade and Development to draft a report by July 2002 to the General Council with clear recommendations on special and differential treatment. The period was extended to December 2002 but definite resolutions have not yet been drafted.

6.3. The Cotonou Agreements and the Generalised System of Preferences

In 2000, the ACP-EC Partnership Agreement was signed in Cotonou, Benin. Fifty-five of the 77 signatory countries are members of the WTO and 40 are Least Developed Countries. The Cotonou Agreement differs from its predecessor, the Lomé Conventions, in that it seeks reciprocity in the dismantling of trade barriers. The shift from non-reciprocal trade barriers was to be negotiated starting in September 2002 and would enter in force on 1 January 2008. As it stands, the European Union still grants duty-free access to ACP industrial and processed agricultural and fishery products. It was also granted a MFN waiver during the Doha ministerial meeting.

For the period from 1 January 2002 to 31 December 2004, the European Union has put in place a Generalized System of Preferences (GSP) incorporating the "Everything-But-Arms" initiative for Least Developed Countries. With a few exceptions (rice, bananas and sugar) this regime grants duty-free treatment for all products. The GSP benefits 143 independent countries and 36 dependent countries and territories.

6.4. The Central American-United States Trade Negotiations

6.4.1. The general economic context

The main trading partner of Central America is the United States. Table 18 shows the evolution of the composition of Central American exports to the main export markets, and more specifically to the United States. During the 1990s, apparel and textiles became the main export product. At the country level in 2000, it represented, 21%, 55%, 81% and 83%, respectively, of the total exported to the United States for Costa Rica, Guatemala, Honduras and El Salvador, respectively. Central American countries, as well as the Dominican Republic, and some other Caribbean Community (CARICOM) economies, have granted export subsidies in the form of tax holidays to further promote the development of free trade zone exports to the United States. The exemptions include the exoneration from the obligation to pay income taxes which, depending on the cases, may be granted for a specific or an indefinite period of time (see Table 19 below).[2]

[2] The World Trade Organization considers this preferential fiscal treatment an export subsidy and according to the WTO-GATT texts forbids it under Articles 1 and 3 of the Agreement on Subsidies and Countervailing Measures (WTO, 1999c, pp.231-233 and pp.265-267). However due to the granting of longer periods for implementing

Some products enter the United States through special trading arrangements such as the Caribbean Basin Initiative (CBI). Exports entering the United States through CBI preferences represent a smaller percentage of the total relative to other developing countries such as Caribbean countries, with a maximum of 22% and a minimum of 8% for Costa Rica and Honduras, respectively. With the enactment of the Caribbean Basin Trade Partnership Act in 2000, these ratios are 33%, 48%, 27%, 52% and 22% for Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.

Central American exports also benefit from other trading arrangements with their main trading partners. Exports are beneficiaries of the Generalized System of Preferences granted by Western Europe, Canada and Japan. The products included in these arrangements comprise among others, bananas, tobacco, coffee, fish, plants, sugar cane, alcohol and soap. As shown in Table 17 in 1999, the share of GSP exports as percentages of the total stood at 21%.

Notwithstanding these trading arrangements Central American countries have, in order to enhance their competitiveness and export market potential, decided to begin negotiations with the United States in order to sign a free trade agreement.

Table 17
Central America
Share of SGP exports as a percentage of the total
1995 – 1999

	1995	1996	1997	1998	1999
Costa Rica	41	37	26	20	15
El Salvador	24	21	24	16	11
Guatemala	34.0	32.7	33.5	29.8	28.2
Nicaragua	....	.....	.....	22	28.5

Note: ... denotes not available.
Source: Ministerio de Comercio Exterior de Costa Rica; Ministerio de Economía de Guatemala; Ministerio de Economía de El Salvador; Ministerio de Comercio Industria y Comercio de Nicaragua.

obligations to developing countries, a period until the year 2003 was set to dismantle these subsidies. The exception was the group of countries whose GNP was below US$1,000 per capita (see, the Agreement on Subsidies and Countervailing Measures, Annex VII, WTO, 1999c, p. 274). The Doha Ministerial Conference (November 2001) extended the time derogations and the per capita threshold. These developments indicate the degree to which developing countries have become dependent on this foreign exchange earning activity. In fact, it is market-based policies at the national level that ultimately create and accentuate this dependency while at the same time their implementation at the international level demands their banishment in order to comply with WTO free trade rules.

Table 18 Central America Main export products as a percentage of the total 1990 – 2000					
Countries	**Products**	**Years**			
		1990	**1993**	**1996**	**2000**
Costa Rica	Machinery	4.6	5.7	8.1	43.9
	Fruits and nuts	22.8	22.4	20.0	13.0
	Textiles and apparel	**37.4**	41.2	35.5	**20.8**
	Subtotal	64.8	69.3	63.6	77.7
El Salvador	**Textiles and apparel**	**22.8**	51.5	67.2	**82.8**
	Coffee and tea	36.1	20.2	4.9	4.2
	Electrical machinery	10.3	6.5	3.1	1.9
	Fish and mollusks	5.2	4.3	3.7	1.7
	Subtotal	74.4	82.5	78.9	90.6
Guatemala	**Textiles and apparel**	**24.0**	45.8	47.7	**54.9**
	Coffee	23.7	12.9	15.6	13.4
	Fruits and nuts	15.3	11.6	10.8	8.6
	Fossil fuels	2.9	2.0	3.6	4.2
	Subtotal	65.9	72.3	77.7	81.1
Honduras	**Textiles and apparel**	**22.9**	55.6	69.0	**80.9**
	Fish and mollusks	12.6	9.9	5.7	4.0
	Fruits and nuts	12.0	14.6	10.9	1.9
	Coffee and tea	9.5	3.2	2.2	1.9
	Subtotal	57.0	83.3	87.8	88.7
Source: MAGIC (2001)					

Table 19 Latin America and the Caribbean Income tax exemption for firms operating in free trade zones (2000)		
Country	**Percentage of income tax exoneration**	**Years of exemption**
Costa Rica	100/50	8-12/4-6
El Salvador	100	Indefinite
Guatemala	100	5-15
Honduras	100	Indefinite
Nicaragua	100/60	10/11
Dominican Republic	100	15-20
Brazil	100	3-10
Chile	0	0
Mexico	0	0
Source: On the basis of national legislation.		

6.4.2 The current state of the negotiations

In January 2003, Central America began trade negotiations with the United States with the objective of signing a free trade agreement. To this date, Central American countries and the United States have concluded two negotiation rounds.

During the second round of negotiations, the United States presented its proposal for a trade agreement covering different areas. In market access, the United States proposed a five-year transition period for export processing zones which established that firms could continue to receive special tax concessions. In textiles, the United States proposed a text covering the specific rules (including safeguards and rules of origin) governing trade in these products. Regarding trade in services, the United States presented compulsory provisions to enhance the development of trade between bordering countries on the basis of a normative, clear and precise framework. Other proposals included government purchases, dispute settlement, institutional provisions and environmental provisions.

Central American countries viewed these proposals as protectionist and as favoring, in particular, United States textiles, and pharmaceutical and chemical products. In addition, Central American authorities would like improved market access to the United States market for a series of products such as, textiles, sugar, poultry and milk products. El Salvador is the first Central American country to present a trade-negotiating proposal, which will become part of the trade agreement. The proposal covers 35 sectors. Among these, the strongest proposals are those pertaining to the apparel and agricultural sectors. The apparel sector seeks to gain duty free access to the United States while maintaining the existing subsidies for its producers. The agricultural sector considers that tariff harmonization must be a necessary pre-condition to any free trade agreement negotiation. Manufacturers of products, such as marmalade, juice and beverages believe that under the present conditions they cannot compete with United States producers.

The third round of negotiations is scheduled to take place from 31 March to 4 April 2003. Central American countries are expected to present their trade negotiating proposals and have agreed to harmonize all tariff lines prior to the free trade agreement negotiations with the United States. Initially, the proposals may not include agriculture, textiles and labor. The negotiations pertaining to these areas will prove to be among the most challenging and Central America wants to have a complete, clear and definite assessment of the situation before proceeding any further in the current trade negotiations.

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