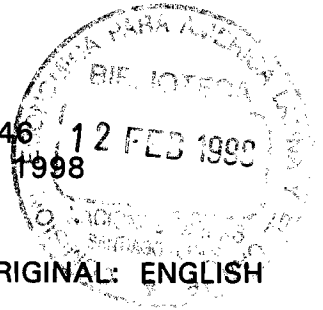


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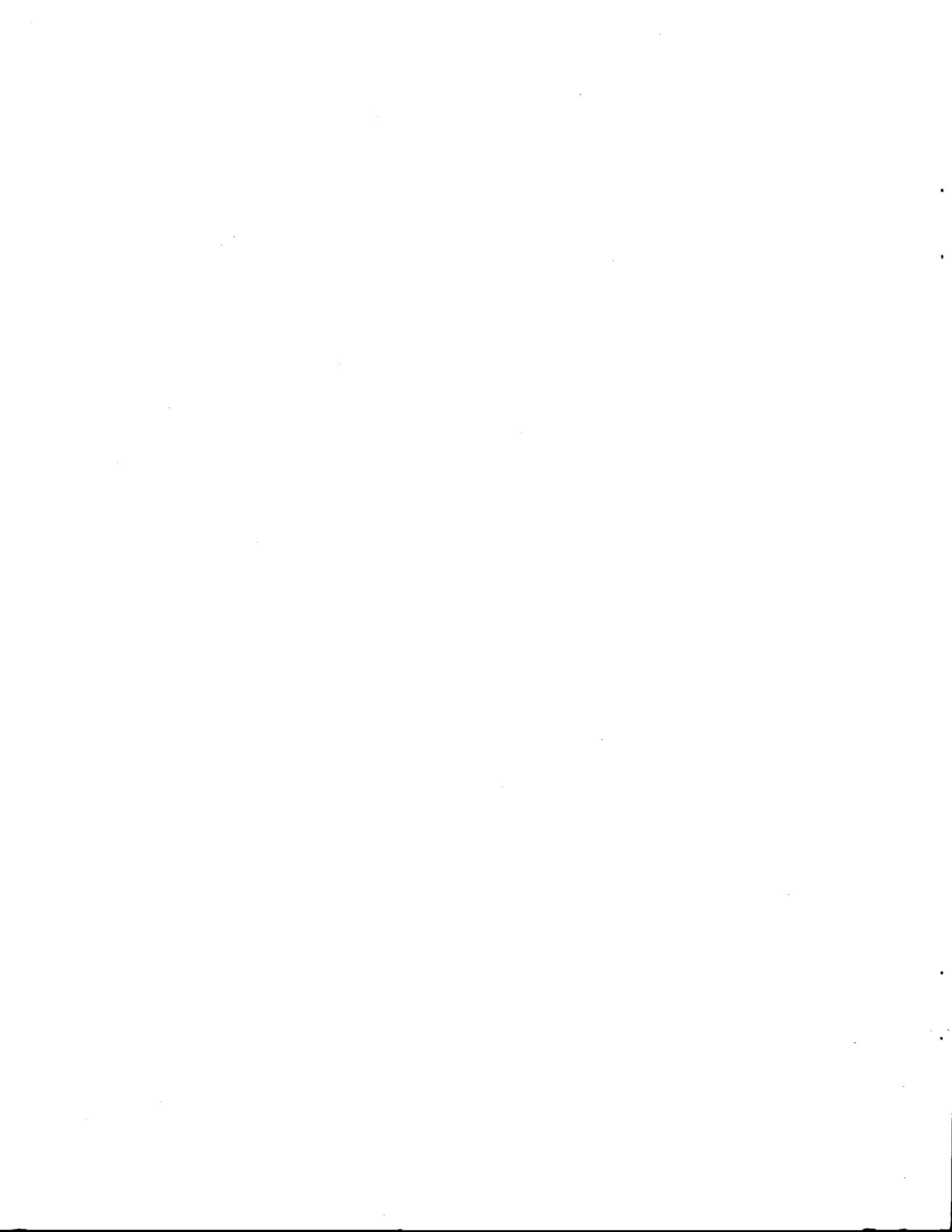


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INTERNATIONAL ECONOMIC HIGHLIGHTS

1997



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## PRESENTATION

This is the eleventh year that the weekly dispatches transmitted during a year from ECLAC Washington to ECLAC's headquarters and other subregional offices are gathered in a single document.<sup>1</sup>

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

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

1) The amazing performance of the U.S. economy persisted throughout the year. The present expansion of the U.S. economy, although in its eighth year, remains the third longest of the post-war, still short from the 92-month expansion of the Reagan years in the eighties, and the 106 month expansion of the Vietnam War in the sixties. What is amazing about the present expansion is that it is taking place with very low rates of inflation, of around 2.5 percent, and very low rates of unemployment, of less than 5 percent.

2) The instability and vulnerability experienced by the East Asian economies, during the second half of the year, took almost everybody by surprise. Some of the fastest growing economies in the world, such as Thailand, Indonesia and Korea, experienced instability and had to turn to the International Monetary Fund (IMF) for assistance. Perhaps most surprising was the speed with which the instability was transmitted to all the markets of the world. Some pessimists saw the instability and vulnerability of these economies as evidence that the so-called East Asian "miracle" is coming to an end.

3) Finally, the rejection by the U.S. House of Representatives, controlled by the Republican Party, of President Clinton's request for authorization to negotiate trade agreements on "fast track," caused shivers around the world. The main concern is that this rejection could be evidence that the specter of protectionism is gaining ground among both the Democratic and Republican parties in the United States.

These and other issues were described throughout the year in the regular transmissions of the weekly dispatch. The purpose of gathering these dispatches is to make them available for easier consultation in a single document, in case the Washington D.C. vantage point they present still has some testimonial value.

Those readers not familiarized with the dispatches should be reminded that they try to remain within a self-imposed limit of 750 words, because their purpose is to bring an issue to the reader's attention.

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<sup>1</sup> ECLAC Washington, International Economic Highlights (LC/WAS/L.2) 17 August 1988; (LC/WAS/L.4) 17 March 1989; (LC/WAS/L.8) 15 March 1990; (LC/WAS/L.11) 22 March 1991; (LC/WAS/L.14) 11 March 1992; (LC/WAS/L.17) 11 March 1993; (LC/WAS/L.23) 30 March 1994; (LC/WAS/L.27) 21 February 1995; (LC/WAS/L.33) 8 March 1996; (LC/WAS/L.39) 20 January 1997.

## I. THE WORLD ECONOMY

### I. 1. TECHNOLOGICAL UNCERTAINTIES (WDW/3/96 5 FEBRUARY 1997)

The Chairman of the Federal Reserve Board (FED), Alan Greenspan says that we are going through one of those rare periods of "radical transformations in what we produce in the way of goods and services and how we produce them."

Periods of radical transformation, according to Chairman Greenspan, "occur perhaps once or twice in a century, at most." He cites as examples the development of railroads and of the telegraph in the United States, after the Civil War, as decisive factors in the emergence of a national market. He also mentions the expansion of electricity, at the beginning of this century, as a revolution in productive capabilities.

Chairman Greenspan holds that the present transformation is characterized by "the displacement of human physical effort by ideas," under which "concepts and ideas . . . substitute for physical resources and human brawn in the production of goods and services."

However, the present transformation has yet to reflect itself in productivity data. This is caused, according to the FED Chairman, by the uncertainties that characterize the processes of adoption of new technologies. He also raises "a serious question about the quality of the data we employ to measure output in today's economy."

These uncertainties that characterize the adoption of new technologies have been described by Stanford University Professor Nathan Rosenberg in a paper titled Uncertainty and Technological Change, presented to the Federal Bank of Boston's Conference on Technology and Growth, held in Chatham, Massachusetts, on 5-7 June 1996. Professor Rosenberg describes at least five "sources of uncertainty," which make difficult to anticipate the impact of technological innovations.

First, technologies "often come into the world with properties and characteristics whose usefulness cannot be immediately appreciated." As examples, he offers the present slow process of using the laser and the several decades it took to discover the uses of electricity. Even aspirin, used for almost a century, was only recently discovered to be useful to reduce the risk of heart attacks.

Second, the "impact of an innovation depends, not only on improvements of the invention, but also upon improvements that take place in complementary inventions." For instance, it took a while before the link between the laser and telephones was discovered, because fiber optics were not yet available. Only the availability of both the laser and fiber optics has led to the transformation of telephone communication.

Third, "thinking about new technologies is likely to be severely handicapped by the tendency to think of them in terms of the old technologies that they eventually replace." There are many

examples of how such "path dependence" hinders thinking about the uses of new technologies. Railroads were first conceived as feeders to canal systems. The same is true of the telephone whose patent was titled by Bell as "improvements in telegraphy."

Fourth, "many major inventions had their origins in the attempt to solve very specific, and often very narrowly defined, problems." Therefore, it has been difficult to foresee the uses of the new technology. For example, the steam engine was invented as a pump and more than a century had to pass before it became a "generalizable source of power and had major applications in transportation."

Finally, "new technologies need to pass an economic test, not just a technological one." The radio was invented as a device for transmitting messages, but somebody else had the vision of using the radio to transmit entertainment and information to every household. The same with computers, invented for "the numerical solution of large sets of differential equations," it was not seen as a machine to serve as a cash register in department stores.

There are many cases of someone different from the inventor having the vision to discover a new use for an existing technology, or to combine several available technologies into a new product. The walkman and the VCR are good examples of products developed by the Japanese electronic industry based on products invented in the United States.

A main conclusion drawn by Professor Rosenberg is that uncertainty prevails not only in the process of invention, it is also present in the process of product design and development, in "the D of R&D."

Professor Rosenberg also suggests these uncertainties should persuade governments "to resist the temptation to play the role of a champion of any one technological alternative," as with nuclear power, or the fight against cancer. It is better to support "a deliberately diversified research portfolio" aimed at opening "many windows and to provide the private sector with financial incentives to explore" those windows. Additionally, the market "also provides strong incentives to terminate quickly and un sentimentally, directions of research whose once-rosy prospects have been unexpectedly dimmed."

To compound these uncertainties, Chairman Greenspan adds others emanating from the poor measurements available of productivity and of standards of living. For instance, if the unit of output is well defined, the price per unit will be known. However, Chairman Greenspan asks "what is the unit of software," or the unit of output of medical care, as in the removal of cataracts.

## I. 2. NEW ARRANGEMENTS TO BORROW (NAB) (WDW/5/97 19 FEBRUARY 1997)

Two years after the Mexican financial crisis signaled the insufficiency of financial resources available to respond to such crises, on January 27, the Executive Board of the International Monetary Fund (IMF) adopted the decision to create New Arrangements to Borrow (NAB).

The objectives of the new arrangements remain the same as those of their still available predecessor, the General Arrangements to Borrow (GAB). First, "to make loans to the IMF when supplementary resources are needed to forestall or cope with an impairment of the international monetary system." Second, to deal with an exceptional situation that poses a threat to the stability of the system."

Given these objectives, despite assertions to the contrary, the NAB constitute the institutionalized manifestation, or the formalized expression, of the will to carry out the essential task of lender of last resort. As the GAB, this is also a cooperative effort, which now involves twenty-five countries willing to assume collectively such responsibility.

The new mechanism does not replace the existent, both remain in force and amount together to \$74 billion. However, the NAB is "the facility of first and principal recourse in the event of a need to provide supplementary resources to the IMF."

The original participants in the GAB--the members of the Group of Ten industrial countries, Belgium, Canada, France, Germany, Italy, Netherlands, Sweden, United States, United Kingdom and Switzerland, in addition to Saudi Arabia as associate--remain the principal contributors to the new arrangements.

The newcomers together will contribute almost 15 percent of the total, with Australia and Spain as the largest contributors with 2.2 and 2 percent, respectively. All the others, including Austria, Denmark, Finland, Hong Kong, Korea, Kuwait, Luxembourg, Malaysia, Norway, Singapore, and Thailand, contribute each around 1 percent of the total.

However, in terms of relative participation, although the original members of the GAB have increased the amounts contributed to the new arrangement, their relative participation has decreased. For instance, the United States remains the largest contributor to both mechanisms, but its relative participation has gone down from 25 percent in the GAB to almost 20 percent in the NAB. The same with Japan and Germany, from 14 and 12.5 percent to 10.4 percent, while France and the United Kingdom have moved from 10 percent to 7.5 percent.

Therefore, the conclusion may be drawn that the new participants have come to alleviate the burden of the original members, with the responsibility now more widespread and shared among a larger group of countries.

With the admission of the mid-size industrialized economies of Europe, including Luxembourg, and the Asian Tigers, including Hong Kong, the new mechanism reflects more accurately the present stratification of the world economy.

The new arrangements can also be seen as the first step in the direction of adapting the existing institutional framework to the transformations of the world economy. More accurately than the Organization of Economic Cooperation and Development (OECD), sometimes characterized as "the club of the rich" with its more restricted and heterogeneous membership, the NAB represents today a meeting point for the most significant economies of the world.

Credits under the NAB can be granted to an IMF member that is a participant in the NAB, or



for the benefit of an IMF member that is not a participant in the new arrangements.

New members can be admitted at the time of renewal, with the agreement of participants representing 80 percent of total credit arrangements, or with the approval of 85 percent if admission is sought at other times.

The NAB will enter into force, for a renewable period of five years, when participants representing at least \$41 billion adhere to the decision, including the five members that contribute the largest proportions, the United States \$6.7 billion; Japan and Germany \$3.5 billion each; and France and the United Kingdom \$2.5 billion each.

Procedures for the functioning of the NAB are relatively simple. Participants will meet once a year, during the Annual Meetings of the Bretton Woods institutions and the chair will rotate annually in the English alphabetical order of the participants. Under the direction of the chair, staff from IMF headquarters will provide secretariat support for the functioning of the arrangements.

IMF Managing Director Michel Camdessus welcomed the creation of the NAB as "a milestone in the membership's efforts to strengthen the IMF." He also said that the agreement was "an important and timely reflection of ongoing changes in the world economy."

However, Managing Director Camdessus recalled that the members of the IMF Board also stated that "the NAB cannot be a substitute for the strengthening of quotas--which is the capital basis for the IMF." He said he was hopeful about accomplishing "rapid progress in reaching a conclusion on a significant increase in IMF quotas under the Eleventh General Review," which is under way.

A significant increase in IMF quotas, concluded Mr. Camdessus, will "further complete the effort of adapting the IMF's resources to the current world situation and risks."

### I. 3. THE IMF'S FIRST WORLD ECONOMIC OUTLOOK (WEO) (WDW/13/97 21 MAY 1997)

The advanced copy of the first WEO was released on April 23, as every year, just before the spring meetings of the International Monetary Fund (IMF) and the World Bank.

This year's single volume is dedicated to the challenges and opportunities of globalization and contains the following chapters: I) policy considerations and issues for discussion; II) world economic situation and short-term prospects; III) meeting the challenges of globalization in the advanced economies; IV) globalization and the opportunities for developing countries; V) integration of the transition economies into the global economy. Finally, a specific annex is dedicated to placing globalization in historical perspective.

After experiencing "widespread deceleration" in 1995, the rate of world economic growth "quickenened" in 1996, with positive prospects for continued expansion in 1997, due to "generally propitious" economic and financial conditions.

The IMF staff sees "few signs of the tensions and imbalances that usually foreshadow significant downturns in the business cycle." This positive outlook relies on the following indicators: "global inflation remains subdued, and commitments to reasonable price stability are perhaps stronger than at any other time in the postwar era; fiscal imbalances are being reduced with increasing determination in many countries, which should help contain real long-term interest rates and foster higher investment; and exchange rates among the major currencies appear to be generally consistent with broader policy objectives."

Therefore, world economic output is projected to increase slightly to 4.4 percent in 1997 and 1998, from 4.0 percent in 1996. This represents a slight upward revision of 0.2 percent of the projections for 1997, released last October.

For the developing countries of the Western Hemisphere, output is projected to increase to 4.4 percent in 1997 and to 5.1 percent in 1998, an upward revision of 0.5 percent of the October 1996 projections for 1997.

There remain, however, "a number of risks to the central scenario." First, in the European Union (EU) "unemployment has risen further to new postwar peaks, and neither prospective growth nor the progress made with labor market reforms gives reason to expect any significant decline in joblessness in the near future."

Second, recent declines in equity prices in the stock markets of the advanced economies "have underscored the risk of a more significant correction, especially if earnings expectations were to be downgraded or a reemergence of inflationary pressures were to require a marked rise in interest rates."

Third, "caution is warranted" on the persistence of capital flows to the so-called emerging markets, "since both global availability of these flows and their cost are vulnerable to higher global interest rates and to adverse developments affecting systemically important capital-importing countries."

Finally, "fragile banking systems are of concern in a broad spectrum of countries." Some of these difficulties have been caused by "excessive credit expansion in the past under conditions of inadequate prudential supervision." Consequently, "large portfolios of nonperforming loans, the erosion of banks' capital bases, and outright banking crises can affect countries' economic performance."

Among the "advanced economies," there remain contrasting differences in cyclical positions. For instance, the "favorable performance" of the United Kingdom and the United States contrasts with the "record levels" at which unemployment remains in France, Germany and Italy. Additionally, in Japan "uncertainty in financial markets" raises doubts about the persistence of the momentum of the economy's recovery.

In the developing countries growth reached 6.5 percent in 1996, with stronger activity in Africa, Latin America and the Middle East and a moderate slowdown in Asia.

Among the developing countries of the Western Hemisphere a better performance is expected for 1997, "as recoveries in several countries gain momentum, and inflation is projected to moderate further."

By contrast, growth in the developing economies of Asia registered a moderate slowdown in 1996, to 8.2 percent, and it is expected to decrease in the near future to a rate of 7.7 percent in 1998. Some of these economies, such as Indonesia, Malaysia and Thailand, are experiencing an export slowdown, which coincided with tighter domestic policies aimed at reducing overheating.

Among the transition economies contrasting performances have become more pronounced among the early, relatively successful reformers and those that started adjustment and reform later. After a disappointing average growth of 0.1 percent for 1996, the transition economies are expected to grow at three and 4.8 percent in 1997 and 1998, respectively.

Finally, notice is given that starting with this issue, the term "industrialized economies" will no longer be used in the WEO. With the addition of several newly industrialized economies of Asia, such as Hong Kong, Korea, Singapore, and Taiwan, Province of China, and Israel, the expanded group of countries will be labeled the "advanced economies." This is in recognition, says the WEO, "of the declining share of employment in manufacturing common to all these economies."

#### I. 4. GLOBALIZATION IN THE ADVANCED ECONOMIES (WDW/15/97 4 JUNE 1997)

As notified by the last World Economic Outlook (WEO), the term "industrialized economies" will no longer be used by the staff of the International Monetary Fund (IMF), because of the "declining share of manufacturing in these economies" (WDW/13/97, p.4). This new term allows for the inclusion of several newly industrialized economies, such as Hong Kong, Israel, Korea, Singapore, and Taiwan, Province of China, which are also experiencing deindustrialization.

Dedicated to the issue of "globalization," the last WEO examines the effects that this process is having on the advanced economies. It comes out against the common perception that "deindustrialization" in the advanced economies is caused by the globalization of world markets. Two relevant questions come under scrutiny. First, if globalization has affected wages, employment and income distribution. Second, if globalization has reduced national sovereignty.

To address these issues the WEO focuses on the causes and consequences of deindustrialization, how factor mobility is affecting labor markets, and how capital market integration is affecting national autonomy in the conduct of monetary and fiscal policy.

Globalization is defined as "the growing economic interdependence of countries worldwide through the increasing volume and variety of cross-border transactions in goods and services and of international capital flows, and also through the more rapid and widespread diffusion of technology."

The welfare benefits of globalization are compared to those of specialization and to those of technological progress, as sources of economic growth and structural change. Also, the process is compared to the integration that existed between the mid-1800s and the First World War.

However, the contemporary process is different in many ways, because of the number of

countries involved and the reduction of transportation, telecommunication and computation costs. Additionally, through trade, direct investment flows and technology transfers, "the world economy is becoming, more and more, the relevant context for economic decisions."

It is in this context that has to be evaluated the deindustrialization of the advanced economies. For the United States, the European Union and Japan "the share of manufacturing employment declined from 28 percent in 1970 to 18 percent in 1994." But this has little to do with increased openness and trade, it reflects mainly "the impact of unequal rates of productivity growth in manufacturing and services."

For this reason, deindustrialization is not negative, because it is associated with rising living standards. It is comparable to the drastic reduction experienced in the share of employment in agriculture.

To be sure, since not all sectors benefit, the most efficient policy option is to provide assistance to those affected by the process, instead of trying to restrict globalization.

The same conclusion is drawn about the increasing interdependence of financial markets. Evidence of capital market integration can be found in several indicators. For instance, "cross border transactions in bonds and equities in the major advanced countries were less than 10 percent of GDP in 1980 but were generally well over 100 percent of GDP in 1995."

Another indicator can be found in the average daily turnover of the foreign exchange market, which has "grown from \$200 billion in the mid-1980s to around \$1.2 trillion." Those concerned about the capacity of central banks, "to influence exchange rates," are reminded that the daily turnover in the foreign exchange market amounts to "approximately 85 percent of all countries' foreign exchange reserves."

This has limited the policy options that are available in this context of vertiginous and intense capital flows. For instance, it is no longer possible to pursue simultaneously the following three policy objectives: an independent monetary policy, fixed exchange rates, and open capital markets. No more than two of these policy objectives can be pursued simultaneously.

Also, in the present context of high capital mobility, as evidenced by the Mexican crisis, the third option of having fixed-but-adjustable exchange rates has become unsustainable. The only options left are either permanently fixed exchange rates, as in a monetary union or through a currency board, or fully flexible exchange rates.

To conclude, the main effect of globalization on economic policy is to limit the possibility of adopting policies that are "incompatible with medium term financial stability." In this sense, increased financial market integration will contribute to discipline domestic financial policies. Such policies will be rewarded positively, because increased capital flows will contribute to easing financing constraints.

However, if such inflows of resources relax domestic discipline and generate imbalances, "markets will eventually exert their own discipline, in such a way that the time period for adjustment may be brutally shortened." Therefore, international financial markets may encourage "the adoption of appropriate policies," and ultimately reward good policies.

I. 5. THE DENVER SUMMIT  
(WDW/20/97 9 JULY 1997)

Against the background provided by the U.S. economy's outstanding performance, President Clinton hosted the Summit of the Eight in Denver, Colorado, from Friday, June 20 until Sunday, June 22.

"We host our partners," President Clinton declared on the eve of the Summit, "at a time when America's economy is the healthiest in a generation and the strongest in the world." Using stronger language, Deputy Treasury Secretary Lawrence Summers described the United States as "the world's only economic superpower" and "the world's most flexible and dynamic economy." U.S. Treasury Secretary agreed, saying "today, the United States is once again the most respected economy in the world."

Several academics also contributed laudatory remarks. For instance, Harvard University Professor Robert Z. Lawrence said "Clinton is presiding over an economy that is doing fantastically well in those areas where other countries have great problems, especially unemployment and budget deficits." According to Professor Lawrence, "Germany, France and, to some extent, Japan, are all in deep denial."

Reactions from other participants in the Summit did not make themselves wait. President Chirac said "to each his own model," adding that "we have our own model, and we plan to stick to it." An unidentified "senior European Union official" said "it's a bit arrogant of the Americans to assume that what works in Illinois will work in Frankfurt." Sir Leon Brittan, the European trade commissioner was more direct, he said "I don't think you have to spend a long time in the inner cities of the United States to see that all is not a paradise."

Beyond the celebration, President Clinton's assistant for international economic policy Daniel Tarullo said that during the meetings the leaders did not dwell in "comparisons." The final communiqué issued by the Group of Seven recognized that the participants' "circumstances and priorities differ." In relatively more balanced terms, the G-7 communiqué said in the United States, "with a long recovery and successful job creation, it is important to remain vigilant against a resurgence of inflation, to achieve the full promise of the agreement to balance the federal budget, and to promote savings."

However, the center of attention in Denver was not the performance of the U.S. economy. The presence of President Boris Yeltsin as a full participant, in what became known as the Summit of the Eight, dominated the scene. President Yeltsin's participation was viewed as a payoff for his recent acceptance of North Atlantic Treaty Organization (NATO) expansion.

With President Yeltsin present, henceforward, these annual rituals will now be known as the Summit of the Eight. The meetings of the heads of state and government of the Seven most advanced economies took only one half-day session, on Saturday afternoon, and their communiqué dealt almost exclusively with economic issues.

By contrast, the communiqué issued by the Denver Summit of the Eight "marks a new and deeper participation by Russia" and it contains an impressive number of issues, to the point that it was characterized in THE NEW YORK TIMES as a "long wish list."

instance, "global inflation remains subdued," while "fiscal imbalances are being reduced," and exchange rates among the major currencies "appear to be consistent with medium-term fundamentals."

Second, among the advanced economies, "cyclical divergences have remained sizable," with considerable "margins of slack" in Japan and Europe. This will sustain the present expansion, when the slowdown comes to those economies that have been expanding, such as the United Kingdom and the United States.

Finally, the recovery of the economies in transition and the strength of some developing economies are "providing both new markets and increased production capacities."

In the medium term, the WEO concludes, "the sustainable rate of world output growth may now in fact be somewhat stronger than in the quarter century since the first oil shock." This positive scenario "points to a trend growth of world GDP of about 4 1/2 percent between 1996 and 2002 compared with an average rate of expansion of 3 1/4 percent since 1970."

Still, "a wide range of risks and fragilities" remain in the following "areas of concern": 1) risks of overheating; 2) uncertainties about the Economic and Monetary Union (EMU) in Europe; and 3) questions about the sustainability of capital flows to emerging market economies.

In the performance of the advanced economies the United States and the United Kingdom "are operating at relatively high levels of resource use." The U.S. economy is in its seventh year of expansion, combining "solid growth of output and employment with low inflation and a diminishing fiscal imbalance."

By contrast, the three major continental European economies, France, Germany, and Italy, exhibit an "unsatisfactory performance" which "cannot be blamed on the external environment."

Finally, Japan's recovery has been "quite hesitant," with growth for 1997 estimated at 1 to 1 1/4 percent, "substantially weaker than projected in the May 1997 WEO."

In the developing economies, real GDP growth "is expected to remain relatively buoyant at slightly over 6 percent in 1997" and in 1998. In the Western Hemisphere, Argentina and Mexico continue recovering, with Venezuela experiencing "a welcome turnaround." In Brazil, inflation has "continued to abate," but with an increasing external deficit the economy still requires further tightening. By contrast, Chile "remains the strongest among the developing countries of the Western Hemisphere."

The rapid expansion in Asia is "projected to moderate somewhat further," due to "recently experienced financial market pressures linked to concerns about large external deficits." For instance, growth in Thailand will "slow significantly in the short run" by almost four percentage points, with spill overs into Indonesia, Malaysia and the Philippines.

China's impressive "soft landing," by contrast, has meant reducing consumer price inflation to 4 1/2 percent, from 22 percent in 1994, while maintaining a rate of growth of 9 percent.

Finally, in the transition economies there is "evidence of an end to the decline in output, and perhaps of a beginning of growth in Russia" and in all the other countries as a group.

The projections are that world output growth will increase at 4 1/2 percent in 1998, a "slight downward revision" from the rate projected in May (WDW/13/97, p.4). The major downward revision of growth prospects among the advanced economies is in Japan, about one percentage point for 1998.

For the developing countries as a whole, "slight downward revisions" to the May projections leave prospective growth in 1998 above 6 percent.

Among the developing countries of the Western Hemisphere, in 1998, "the recovery of growth is still expected to continue" but at 4.4 percent, a lesser pace from the May projections. This is mainly due to "main downward revisions" for Brazil and Colombia, because "less sanguine assumptions have been made about fiscal adjustment." By contrast, projected growth for Argentina has been revised upwards by 2 1/2 percent, to 7 1/2 percent, due to "continuing progress in reforms, the environment of stable prices, and associated gains in private sector confidence."

Despite downward revisions in the projections, because of recent currency turmoil, Asia "is projected to remain the fastest growing region in the developing world," at a rate of 7 1/2 percent for 1997 and 1998.

Finally, in 1997, the economies in transition are projected to experience an increase in output of 1 1/2 to 2 percent, "still the first significant positive growth rate in eight years, despite a downward revision of over 1 percentage point of the May 1997 projections."

#### I. 7. WHITHER EAST ASIA? (WDW/35/97 26 NOVEMBER 1997)

When the Thai baht started plunging, on July 2, nobody anticipated that the contagion would spread with such intensity. After almost five months of incessant turbulence, with markets and currencies falling like "dominoes," to borrow a metaphor from the sixties, there are enough reasons for concern.

Some already see the end of what the World Bank in 1993 described as the East Asian "miracle." According to the New York Times, the "miracle" has turned into a "mirage." For others, the so-called East Asian "tigers" have been "declawed" and they are "growling," as they turn into "paper tigers."

Not so fast, says the World Bank Chief Economist Joseph Stiglitz, in a New York Times op-ed. "East Asia's amazing economic transformation in the last few decades has been real." Stiglitz mentions how Malaysia and Thailand "virtually eliminated absolute poverty (defined as people living on less than a dollar a day)." Also, in Indonesia poverty decreased from 64 percent of the population in 1975 to 11 percent in 1995.

However, by contrast with the Mexican crisis of 1994, present turbulence is showing that in today's international system, or "nonsystem," even the fastest growing economies are liable to become victims of instability. Also evident, but unexplained, is the vertiginous contagion that has

spread throughout the world. Therefore, key decision makers have stepped forward to reassure anxious markets.

The Chairperson of the Federal Reserve Alan Greenspan, on October 29, examined the impact of events in East Asia on the U.S. economy and offered an explanation that appears already as the accepted wisdom. First, Chairman Greenspan said that "the direct impact of these developments on the American economy has been modest, but it can be expected not to be negligible." The main indicator used to gauge this impact is that U.S. exports to Indonesia, Malaysia, the Philippines and Thailand were about four percent of total U.S. exports in 1996. Additionally, around 12 percent of U.S. exports went to Hong Kong, Korea, Singapore and Taiwan. Finally, "there may be indirect effects on the U.S. real economy from countries such as Japan that compete even more extensively with the economies in the Asian region."

To explain present instability, Chairman Greenspan focuses on the spectacular growth of foreign net capital inflows into these fast growing economies, from a negligible \$25 billion in 1990 to more than \$110 billion in 1996.

The search for higher yields, in the global stock market boom of the 1990s, is identified by Chairman Greenspan as the "major impetus behind this rapid expansion." Moreover, he sees as "inevitable" that much of these capital flows "moved into the real estate sector," which, "in turn, ended up as collateral for a significant proportion of assets of domestic financial systems." However, many of these financial systems "were less than robust, beset with problems of lax lending standards, weak supervisory regimes, and inadequate capital."

Two external events hastened the crisis. First, a slowdown in exports from East Asia, without a slowdown in overall rates of growth. Additionally, East Asian currencies pegged to the U.S. dollar, appreciated by more than 50 percent against the Japanese yen. Consequently, "unsustainable current account deficits" exercised mounting pressure on fixed exchange rates.

According to Deputy Secretary of the Treasury Lawrence Summers, in testimony presented on November 13 to the House Committee on Banking and Financial Services, "the attempt to maintain a fixed nominal exchange rate without concomitant monetary policy commitments--against a backdrop of mounting current account deficits and weak and over-extended financial systems--was an invitation for trouble."

The purpose of U.S. policy, Deputy Secretary Summers said, is to restore stability "as soon as possible--both to limit the long term impact in the countries concerned and, critically, to limit the risk of further contagion across Asia, and across other emerging markets."

The response to the crisis consists in generating a "strong domestic policy response," by means of the "careful provision of international assistance" and preventing other crises through "improved transparency and surveillance."

Deeper questions raised by the East Asian crisis derive from an ongoing debate in the United States, among young luminaries of the economics profession.

On one side, MIT Professor Paul Krugman said in 1994 that East Asian growth was vulnerable because it was like "Communist growth." Both "miracles," Krugman said, were "based



largely on one time changes that cannot be repeated" such as heavy investment spending rather than productivity growth.

No way, says Harvard Professor Jeffrey Sachs in a paper co-authored with Steven Radelet published in the November/December issue of Foreign Affairs. Their conclusion is that "the Southeast Asian currency crises of 1997 are not a sign of the end of Asian growth but rather a recurring--if difficult to predict--pattern of financial instability that often accompanies rapid economic growth."

Professor Krugman admitted in the Wall Street Journal that "the fact that this came on so suddenly and with so much drama, suggests that it isn't the long-term slowdown" that he anticipated. Only time can tell.

## II. THE U.S. ECONOMY

### II. 1. OPTIMISM IN 1997 MEANS 'MORE OF THE SAME' (WDW/1/96 22 JANUARY 1997)

With the U.S. economy heading into the seventh year of sustained expansion, way past the 50-month average of postwar expansions, most forecasts for 1997 ask for "more of the same." The present expansion is the third longest of the postwar, after the Reagan years' 92-month expansion of the eighties and the Vietnam war's 106 month expansion of the sixties.

There is almost no contention among forecasters that in 1997 the U.S. economy will keep moving at the present slow and steady pace. There is agreement among 57 economists, who participate in the WALL STREET JOURNAL's semiannual survey, that the U.S. economy will experience a modest slowdown in GDP growth to an annualized rate of 2 percent.

One key variable to observe is the prevailing low level of inflation, which despite a surge to 3.3 percent in the consumer price index for 1996, remained at the lowest level in thirty years. Further, without food and energy prices, what is known as the "core rate," rose only to 2.6 percent, the same as in 1994 and the lowest annual figure since 1965.

Since prices do not seem to offer much guidance, the other closely watched indicator is the unemployment rate. The labor market appears tight at around 5.3 percent, the lowest point in 23 years. Some observers believe that it is already half a percentage under the level consistent with stable inflation. However, others point out that labor costs are still rising at the slowest pace in fifty years.

Other indicators have become less reliable. For instance, George Melloan in the Wall Street Journal, says that the misery index, or the combination of inflation and unemployment rates, is at the lowest point in years. Also, Melloan holds that "the old Phillips Curve theory," based on the tradeoff between employment and inflation, "has by now been laid to rest," given the prevailing low inflation levels accompanied by low unemployment. The same happened to the "natural rate of unemployment, set at 6 percent, it was "breached months ago, and nothing happened," said Louis Uchitelle in the New York Times.

The signals from the FED are usually enigmatic. For instance, Robert Perry, president of the Federal Reserve Bank of San Francisco, told the Washington Post, "I didn't think we would get through 1996 as comfortably as we did . . . It may have been good luck. I am still not sure we can keep the economy at this level of resource utilization without some added inflation. We at the Fed have to remain vigilant about this."

As expected, some of the most positive comments are from the Administration. Janet Yellen, the new head of President Clinton's Council of Economic Advisers, who comes from the Federal Reserve Board, told the Washington Post, "The fundamentals look very, very solid, the economy is

and 5.4 percent, respectively. These are the lowest inflation rates since 1967 and the lowest annual rate of unemployment since 1988 and previously since 1973.

From the White House, Vice President Al Gore declared, "the American economy is growing and a land of new promise is emerging." As described by Laurence H. Meyer, member of the Federal Reserve Board of Governors (FED), the "surprise" consists in "a decline in measures of core inflation for consumer and producer goods and in the inflation rate for the GDP price index during a year when the unemployment rate declined and averaged more than 1/2 percentage point below levels that in the past had been associated with stable inflation."

Perhaps even more surprising was the performance of the economy in the last quarter of 1996, because despite a vigorous 4.7 percent rate of growth, inflation remained subdued, by one measurement, at the lowest point in thirty years. The implicit price deflator, in the last quarter increased only 1.4 percent, the smallest increase since 1967. Therefore, most surprising was that such a spurt in growth did not push the inflation rate higher, because unemployment at 5.3 percent is indicating that the labor market, particularly for qualified workers, is already very tight and hourly compensation is edging upward.

At least two casualties, among analytic tools, can be claimed by these very impressive numbers. First, the nonaccelerating inflation rate of unemployment (NAIRU), or the lowest rate of unemployment that can be reached without generating inflation. It used to be that 6 percent unemployment was perceived as such a threshold. Second, the related equation between inflation and unemployment, known as the Phillips Curve, has been recently "over-predicting inflation."

Several explanations have been offered about why these tools are presently not performing adequately. Norbert Walter, chief economist of the Deutsche Bank, said in the New York Times that the problem with the NAIRU is that it "does not look beyond national borders." According to Norbert, "the NAIRU concept may have been destroyed by the creation of global labor pools," which have "created a work force that is solving many of America's NAIRU-related worries from afar."

In defense of the Phillips Curve came out Laurence H. Meyer, member of the Federal Reserve Board. In a speech at the Charlotte Economics Club, on January 16, Meyer criticized those who claim that the Phillips Curve "was long ago theoretically discredited and historically repudiated." Such criticism must come from someone, Meyer said, who has "not bothered to look at the data and probably has never estimated a Phillips Curve nor tried his or her hand at forecasting inflation."

One explanation for the present "systematic overprediction errors," that have characterized recent estimates of the Phillips Curve, is that the NAIRU has declined, from 6 to 5.5 percent. Therefore, what demands an explanation is why inflation has performed better compared with unemployment.

The decline in core inflation can be explained, first, by a set of supply shocks in the last two years. According to Meyer, "the key is that these supply shocks are generally not included in estimated Phillips Curves, so that Phillips Curves missed their effects and over-predicted inflation." Recent supply shocks have taken the form of declines in the prices of health care, computers, and imports.

Another factor contributing to moderate inflationary pressures is worker insecurity. First,

there is evidence that "the proportion of workers who have suffered a permanent job loss in recent years looks high relative to the 1980s." Second, "workers appear reluctant to voluntarily leave their jobs because of an increased apprehension about the difficulty of finding a comparable new job."

Alan Greenspan, Chairman of the Federal Reserve, testifying in the Senate illustrated such "heightened job insecurity" quoting a recent survey of workers' perceptions. Chairman Greenspan declared, "in 1991, at the bottom of the recession, a survey of workers at large firms indicated that 25 percent feared being laid off. In 1996, despite the sharply lower unemployment rate and the demonstrably tighter labor market, the same survey organization found that 46 percent were fearful of job layoff."

Finally, another factor that explains the "surprising inflation performance," according to Meyer, is an absence of "pricing leverage" among firms. This is a consequence of a "perception of increased competition," which makes companies afraid of increasing prices first, to avoid losing market share.

The conclusion drawn by Meyer is that the economy's "excellent" performance in 1996, characterized by an "impressive combination of low core inflation and low unemployment," does not justify the conclusion that "the business cycle is dead or that the Phillips Curve is no longer relevant."

From this conclusion, Meyer recommends "a prudent monetary policy . . . based on a working assumption that the underlying trend of inflation has been stabilized in the past couple of years." Consequently, the FED will "have to maintain a close watch for signs that inflationary pressures are mounting."

### II. 3. THE ECONOMIC STATE OF THE UNION (WDW/6/97 26 FEBRUARY 1997)

On February 10, President Clinton transmitted to the Congress the first Economic Report of his second mandate. The Report focuses on the "present state of the economy," draws a balance of the last four years, and glimpses into the prospects at the beginning of the 21st century.

In his message of transmission to Congress, looking back, President Clinton describes the challenge of January 1993 as "to put the economy on a new course of fiscal responsibility while continuing to invest in our future." The record of the past four years reveals that unemployment is "down by nearly a third," from 7.5 percent to 5.4 percent, through the creation of 11.2 million jobs. Inflation, at an average of 2.8 percent, is "lower than in any Administration since John F. Kennedy was President," while "the combination of unemployment and inflation is the lowest it has been in three decades."

Finally, the President highlights a better distribution of the benefits, since "between 1993 and 1995 the poverty rate fell from 15.1 percent to 13.8 percent--the largest 2-year drop in over 20 years."

These accomplishments, according to President Clinton, are the consequence of the application of a "comprehensive economic agenda," which includes historic deficit reduction,

complement markets."

An example of market failure is found in the Great Depression, when "one out of four workers was without a job--clearly the market was not performing well."

In some cases, "competition may be imperfect, market participants may lack needed information, or markets may be missing." In still others, "would-be innovators and entrepreneurs may fail to capture enough of the benefits of their activity, or the users of resources, such as clean air and water, may escape the full costs of their use, degrading the resources for all."

Accordingly, the conclusion is drawn that "government should focus its attention on those areas in which markets will not perform adequately on their own."

### III. THE DEVELOPING ECONOMIES

#### III. 1. CAN TECHNOCRATS BECOME POLITICIANS? (WDW/8/97 12 MARCH 1997)

Since Plato's philosopher-kings, there have been utopias based on claims to legitimacy other than the will of the people, be it the "mandate from Heaven" of the Chinese bureaucracy, or the Communist Party as vanguard of the people. As it is also well known, these claims to legitimacy sometimes have led to ugly and costly authoritarian experiments.

Latin America has been a fertile ground for some of these legitimating ideologies. However, Harvard Professor Jorge Domínguez, a prominent Latin Americanist, has edited a book on the present generation of Latin American technocrats claiming that this time it may be different.

The book's title is Technopols: Freeing Politics and Markets in Latin America in the 1990s (Pennsylvania University Press, 1997). The book's main thesis is that these policy makers are not common "technocrats," because they do not fit traditional definitions. Besides the claim to political power based on rationality and expertise, they are also political leaders dedicated to opening politics and markets.

Therefore, we are told in the foreword by Richard Feinberg the former president of the Inter-American Dialogue, he and Jorge Domínguez had to invent the term "technopols," to describe these new "variant of technocrats."

Professor Domínguez offers several reasons to explain why he believes Latin American "technopols" are different. First, they are more political than technocratic, because they have made economics "political." Second, they have built "their own teams and institutional bases" and consequently "they are not the marionettes of other politicians." Third, for them "a rational policy is not just technically correct but also politically enduring." Finally and above all, "technopols" are "bearers of a 'passion' for open politics and open markets."

According to this description, the transition to democracy in Latin America may have given birth to a rare breed, a technocrat able to transform his expertise into a political asset, contributing in the process to freer politics and freer markets.

However, looked at more closely, only one out of the five cases has been rewarded with the highest office. The others' attempts to obtain this reward for their performance as slayers of inflation have failed, until now.

After a successful performance as Finance Minister, Alejandro Foxley has become president of the Christian Democratic Party of Chile. Shedding the mantle of technocrat, Foxley calls his present position "the highest form of public service."

After five years of successful performance and a sixth year that now looks as a dismal failure,

Pedro Aspe contended for the presidency within the Mexican official party. Bypassed twice for the nomination by then President Salinas, Aspe has now returned to the anonymity that befalls, in the Mexican political system, those who contend unsuccessfully for the highest office.

Domingo Cavallo has now returned to private life, after it was feared that his separation would bring down the successful, though painful, fixed exchange rate policy he applied in Argentina. He is now running for president in the next elections.

Evelyn Mattei, after an unsuccessful attempt to become presidential candidate from the opposition in Chile, may run for the Senate in the next elections.

Fernando Henrique Cardoso is the most successful case. He became president of Brazil after the enforcement of a stabilization plan that slayed hyperinflation. But Cardoso is the most atypical of all the cases. He is not an economist, but a sociologist who surrounded himself with a team of brilliant economists, such as Pedro Malan and Edmar Bacha. Also, when he became minister of finance, he was already a successful politician, as founder of a political party he was elected to the Senate.

These are some reasons that perhaps explain why Cardoso's bid for the presidency was the only one that was successful of all the cases studied. Another explanation may be found elsewhere. Commenting on Cardoso's election, Albert Hirschman declared to the Brazilian magazine VEJA, "intellectuals do not seize power frequently. This only happens in countries where elites are very small."

Still, the fate of the other "technopols" is not a setback, it reveals a certain strength in these young Latin American democracies. It is good for democracy that the successful execution of a set of economic policies, to control inflation, was not enough to turn the executioners into successful politicians, propelling them to the highest positions.

In conclusion, with the exception of Cardoso who was not a technocrat, the "technopols" described in this book have been successful as technocrats but have failed, thus far, in their attempts as politicians. Therefore, instead of trying to transform their successful performances into bids for the highest office, technocrats should remember one message that comes out of this book, better expressed by the wisdom of the old Spanish saying, "cobbler, stick to your shoes."

### III. 2. GLOBALIZATION IN THE DEVELOPING ECONOMIES (WDW/16/97 11 JUNE 1997)

A separate chapter is dedicated in the last WEO (WDW/13/97, p.4) to analyze the impact of globalization on the developing economies. As with the chapter on the advanced economies, dedicated to the same topic (WDW/15/97, p.6), the focus is on the opportunities and challenges generated by the globalization process.

The first consequence highlighted is that instead of convergence of income levels between the economies of the world, increasing polarization has prevailed. Despite some spectacular successes achieved in some developing economies, such as Chile, Malaysia and Thailand, on average, real per

capita incomes have doubled, which is roughly similar to the performance of the advanced economies. Therefore, there has been no convergence among both groups of economies. On the contrary, the finding is that, in absolute terms, the distance has widened between the developing and the advanced economies, while additionally there is increased polarization among the developing economies.

The "key lesson" drawn from this contrasting performance is that "countries that align themselves with the forces of globalization and embrace the reforms needed to do so, liberalizing markets and pursuing disciplined macroeconomic policies, are likely to put themselves on a path of convergence with the advanced economies, following the successful Asian newly industrialized economies (NIEs)."

The next question is what factors are necessary to achieve faster per capita income growth. To answer this question the WEO describes the forces of integration and the "policies to boost growth and promote convergence." Among the main forces contributing to integration are trade, capital markets, and movements of people.

On trade, "except for countries in Asia and some in Latin America, integration with the world economy has been rather slow." Except for the newly industrialized economies of East Asia and the so-called "rapidly industrializing economies"--Chile, Malaysia, Indonesia and Thailand--the conclusion is that "the shares of most other developing country regions have been roughly flat or have declined."

In the nineties, there has been an increase in net private capital flows to developing countries, at a yearly average of \$150 billion and close to \$200 billion in 1996. However, these "flowed overwhelmingly" to about a dozen emerging market countries. Meanwhile, the flow of people across national borders "remains relatively small."

Therefore, these differences in the impact of integration forces account for the lack of convergence in the per capita incomes of the developing and the advanced economies. True, the WEO mentions some spectacular success stories among the developing countries, such as Korea's tenfold rise in per capita income between 1965 and 1995; Thailand's fivefold; and Malaysia's fourfold.

However, in the Western Hemisphere the developing economies "average per capita incomes doubled between 1965 and 1980 before stagnating over the next 15 years." Thus, the success stories, do not preclude the conclusion that "many countries regrettably are not realizing their potential."

Beyond this falling behind or stagnation in almost all the developing economies, "there has also been a sharp decline in upward mobility of developing countries within the international distribution of average per capita incomes and an increased tendency of countries to become polarized into high- and low-income clusters."

The number of countries ranked in the lowest income quintile has almost doubled, from 52 countries in 1965 to 84 countries in 1995. By contrast, "the middle income fell rapidly," from 49 countries placed in the second and third income quintiles in 1965, the number had dipped dramatically to just 21 countries by 1995."

Because of this "thinning of the middle," the conclusion is that "there are now fewer middle-income developing countries, and upward mobility of countries seems to have fallen over time." The evidence also reveals that this downward mobility has become accentuated lately. Therefore, "while



there was some tendency for countries to move to higher brackets and to progress relative to the advanced economies over the 1965-75 period, the forces of polarization seem to have become stronger since the early 1980s."

The policy prescription "to boost growth and promote convergence" consists of the following elements: 1) macroeconomic stability, to encourage domestic investment and the flow of foreign capital; 2) openness, because the fastest growing developing countries had the highest ratios of imports and exports to GDP; 3) limit state intervention "to areas of genuine market failure (such as health, education, and infrastructure)" and reduce involvement in state-owned enterprises; 4) "financial liberalization needs to be accompanied by strengthened regulation and supervision of financial institutions"; 5) increase the quality of governance against the lack of transparency and accountability; 6) invest in human capital and restrain population growth.

Finally, "the key lesson that emerges is that no policy by itself is sufficient," therefore, "good policies tend to be mutually reinforcing and policy complementarities are important."

### III. 3. BRINGING THE STATE BACK IN (WDW/21/97 16 JULY 1997)

Almost twelve years ago, Peter Evans, Dietrich Rueschemeyer and Theda Skocpol edited a book with this title (Cambridge University Press, 1985). They said that, despite prevailing ideological fads, state autonomy and capabilities remained a relevant subject of study. It took the World Bank the same amount of time to accept this conclusion, thus getting rid of the ideological grip of those who claimed that the best that could be done with the state was to dismantle it.

Better late, seems to say the recently released World Development Report (WDR), titled The State in a Changing World. The portentous nature of this change in perspective is recognized at the Bank. Therefore, those in charge of presenting the Report in public have deemed it necessary to offer an explanation.

For instance, at the press conference where the WDR was presented, the new Bank's Chief Economist and Vice-president for Research Joseph Stiglitz was asked to explain the reason for the change. Known for his writings on the role of government in development, Professor Stiglitz candidly answered that perhaps part of the explanation was that he had not been at the Bank before.

In the same vein, Ajjay Chhibber, head of the staff that prepares the WDR, clarified the objective of this year's Report as to dispel the perception that the Bank was committed to dismantling the state. Chhibber added that the main explanation for the change was the influence exercised by those in charge of Bank's operations. Therefore, the ideologues apparently have lost to the doers. The change is so obvious that it is necessary to read it to believe it. Here are some assertions made in the Report, which should be contrasted with the previous stance.

First, the world has changed. The command and control economies have collapsed, the welfare state is in fiscal crisis, the East Asian miracle cannot be understood without the state, and

where states collapsed humanitarian emergencies have emerged.

The "determining factor" behind all these changes is the effectiveness of the state. Without an effective state--remember the eighties--sustainable development is "impossible." Sounds like fifty years ago, the Report admits, but this is only apparent, because then the state was seen as "direct provider." By contrast, now, the state is seen as a "partner, catalyst, and facilitator," no longer as "villain," it could be added.

Neither is there a single state model, applicable everywhere, because diversity makes every state "unique." As President Chirac said in Denver, "to each his own model" (WDW/20/97, p.7). One wonders about the reaction of those policy-makers who in the past implored self-righteous World Bank missions to be aware of diversity and local conditions. The Report admits, with outstanding modesty, "no one-size-fits-all recipe for an effective state is suggested here."

Another difference with the past is that the prevailing development vision was too "simplistic," because what was seen as necessary then were good advisers and technical experts. Consequently, there was not enough accountability for technocrats, through checks and balances.

Even so, despite all the anti-statist rhetoric, governments expanded incessantly. This was the case particularly in the most advanced economies, where state spending, on average, represents almost half of total income, while in the developing economies it represents only one fourth.

The question may be legitimately asked if this is not a hint that there may be a correlation between development and government size. The Report only says that the question about state influence has shifted from "the quantitative to the qualitative." This deserves a full quotation, because the shift is "from the sheer size of the state and the scope of its interventions to its effectiveness in meeting people's needs."

However, the Report admits that this has now turned into a "clamor for greater government effectiveness," which the Bank intends to attend by means of a "two-part strategy." First, get the following five "fundamentals right": strengthen the rule of law; maintain an environment without distortions, including macroeconomic stability; invest in social services and infrastructure; protect the vulnerable and the environment. Second, build state capability and contribute to "reinvigorating public institutions," through effective rules and restraints; greater competition; increased citizen voice.

Finally, globalization also threatens "weak or capriciously governed states." It "sharpen the need for effective international cooperation," to deal with "at least five major concerns that transcend national borders": managing regional crises; promoting global economic stability; protecting the environment; fostering basic research and the production of knowledge; and making international development assistance more effective.

Even international agencies have a role to play, providing technical advice; cross country experience; financial assistance, "to endure the early painful period of reform."

Unveiling this major departure from its ideological past, the World Bank wants it to be known that they should no longer be perceived as encouraging the dismantling of the state. Now the conclusion is that "good government is not a luxury--it is a vital necessity for development."

### III. 4. PROSPECTS FOR THE DEVELOPING ECONOMIES (WDW/31/97 29 OCTOBER 1997)

This year's Global Economic Prospects and the Developing Countries 1997, released by the World Bank on September 9, predicts that the next 25 years will see "an unprecedented boost in the prominence of developing countries in the world economy." These projections are based on the following assumptions: 1) policy reforms in the developing countries will be sustained, and 2) the presently favorable international economic environment will prevail.

Therefore, the World Bank projects growth rates of between 5-6 percent a year that will raise the share of developing countries in world output, from the present one sixth to around one third by 2020.

According to Joseph Stiglitz, World Bank Senior Vice President and Chief Economist, "the potential rewards of this expansion will be very large, both in terms of growth of important export markets and as a source of imports." Stiglitz admits that "although there will be transition costs, there is little evidence to justify two of the most common fears, namely downward pressure on unskilled wages in industrial and other developing countries and higher prices for food and energy."

Among the report's main conclusions, which justify the optimistic projections, is that "the global environment for developing countries remains broadly favorable." Given a continuation in the advanced economies of the pattern of modest growth, with low inflation and moderate real interest rates, faster growth in trade and capital flows will also be sustained.

Consequently, "aggregate annual growth in developing countries is expected to rise to 5.4 percent in 1997-2006 from only 2.6 percent in the previous decade." According to Milan Brahmbhatt, principal author of this year's Prospects, "the outlook for developing countries looks much more favorable over the next ten years than in the previous decade."

Except for East Asia, almost every region in the developing world will benefit from the expansion. For instance, "three regions where per capita incomes fell in the past ten years--Sub-Saharan Africa, the Middle East and North Africa--are expected to see a reversal of the trend."

Also, in South Asia poverty is expected to "decline significantly as a result of more rapid economic growth," at an average rate of 5.9 percent in the next decade.

In East Asia, despite the recent slowdown in economic growth and monetary instability, the Bank still projects that growth will remain high, at an average of 7.6 percent for the next decade, but down from the average of 10 percent of the first half of the 1990s.

With most countries in Latin America and the Caribbean "moving ahead with reforms," growth is projected to be over 4 percent for the decade 1997-2006. This represents an increase of 2.5 percent in per capita growth, which contrasts with the average 0.5 percent of the previous decade.

"On balance," the Bank concludes, "the favorable external environment assumed in the projections implies that the growth performance of individual countries will be largely determined by domestic factors, especially policy developments."

Despite this favorable outlook, the Bank says "it would be imprudent to count on recent exceptional conditions continuing in all respects." For instance, the report describes a "modest boom-bust" scenario for the advanced economies, under which stronger growth in 1998-1999 in the United States can lead to a sharp corrective tightening that would precipitate a recession.

Given the relative weakness of the European and Japanese economies, it is unlikely that they would follow the tightening in the United States. Therefore, it is projected that the consequences of such tightening will not be amplified to the other advanced economies.

However, private capital flows to the developing countries would decrease, affecting particularly interest-sensitive portfolio bond flows. In this scenario, the most vulnerable developing countries are those that are financing high current account deficits with external resource flows and that have weak banking systems, burdened with bad debt.

Departing from its focus on how trends in the world economy influence the performance of the developing economies, this year's Prospects examines how the world economy will be influenced by the participation of "the Big 5" developing countries--China, India, Indonesia, Brazil and Russia.

Today, these economies account for half of the world's labor force but for only 8-10 percent of world output and trade. Assuming an average rate of growth of 5-6 percent, the relative weight of these economies is projected to double by 2020. This is expected to generate large net benefits for the world economy and it "will likely redraw the economic map of the world over the next quarter century."

The report also examines two additional topics. First, how "global production networks established by multinational enterprises provide developing countries with new means to enhance their economic performance by accessing global know-how and expanding their integration into world markets."

Second, how to overcome "concerns about job losses and other adjustment costs" that are inhibiting "many developing countries from undertaking or extending trade liberalization."

#### IV. EMERGING MARKETS

##### IV. 1. WHY MEXICO PAID BACK (WDW/2/97 29 JANUARY 1997)

Do not underestimate the significance of the Mexican government decision of paying, more than three years ahead of schedule, its debt to the United States and the International Monetary Fund (IMF). The underlying circumstances of such a decision are as extraordinary as the events of two years ago, which led to the Mexican bailout, but without the agitation and the sense of urgency.

For instance, recall how both Chairman Greenspan and Managing Director Camdessus pointed to the extraordinary nature of the crisis. Chairman Greenspan saw a challenge to Mexico's "exemplar" role, since it was approaching "near-first-world status." Managing Director Camdessus saw a risk of spreading the perception that "the market-based approach to development had failed."

Two years after, in the announcement made at the White House of Mexico's payment, President Clinton recalled how "some said that we should not get involved, that the money would never be repaid, that Mexico should fend for itself. They were wrong."

Therefore, it is useful to examine more closely the factors that are behind Mexico's payment, to avoid reaching the facile conclusion that the advanced payment was only a symbolic gesture.

First, Mexico's capacity to pay is based on its renewed access to world financial markets. The payment was made possible by the issuance of bonds for \$1 billion in global bonds; \$ 1 billion in German marks; \$650 million in Japan's Samurai market; even \$330 million denominated in Italian lire. Additionally, several other smaller operations enabled the Mexican government to come up with the additional \$2 billion to pay the final \$3.5 billion owed to the U.S. Treasury and \$1.5 billion for the IMF.

Second, such renewed access to world capital markets would be inconceivable, if Mexico would not be experiencing a most extraordinary turnaround in its external accounts. For obvious reasons, this comes out most clearly in the evolution of Mexico's trading relationship with the United States.

Under the terms of the North American Free Trade Agreement (NAFTA), trade between Mexico and the United States increased in 1996, both ways, at an average yearly rate of almost 20 percent. This impressive rate of growth was accomplished despite the steep fall in Mexico's rate of growth.

Those who look at trade balances as a measure of successful trading relationships--to be sure, a mercantilist perspective--will point out to Mexico's surplus with the United States amounting to \$15.3 billion in 1995 and an estimated \$18 billion in 1996.

However, such a measure reveals only one side of the picture, since Mexico's imports from

the United States, despite falling by almost 9 percent in 1995 to \$46.3 billion, were still above the \$41.6 billion of 1993, before NAFTA. More impressive still is that Mexico's imports from the U.S. in 1996 will be around \$56 billion, which represents an annual increase of more than 20 percent.

This reveals that trade interdependence between these neighboring North American economies is proceeding at an intense pace, despite the major adjustment experienced by the Mexican economy. To illustrate the intensity of such trade interdependence, it should be recognized that Mexico today is trading more with the United States than all of Latin America and the Caribbean.

This was already the case before the NAFTA, but the difference was not significant. In 1993, Latin American and Caribbean trade both ways with the United States amounted to almost \$70 billion, while Mexico's total trade with the United States, in the same year, amounted to more than \$80 billion.

In 1995, the year of the Mexican recession, the corresponding figures were \$81 billion for Latin America and the Caribbean and \$107 billion for Mexico. In 1996, the distance will increase, since it is estimated that total trade between Mexico and the United States will exceed \$120 billion.

Finally, because of the drastic reduction in the rate of growth, enormous domestic sacrifices have been experienced by everybody in Mexico, particularly by the salaried sectors. As a consequence of the reduction in 1995 of almost 7 percent of GDP, average real wages decreased 13.6 and 11.4 in 1995 and 1996, respectively.

As described by U.S. Treasury Secretary Robert Rubin, in the New York Times, "this experience has been enormously painful for the Mexican people." These sacrifices have led to the reduction of inflation, as measured by the consumer price index, from 52.1 percent in 1995 to 27.8 in 1996. Therefore, the reactivation of growth in 1996, at around 4 percent, still has to reach most of the population, particularly the salaried sectors.

Additionally, it does not help to experience such a profound correction in the middle of a process of convulsive transition, from an authoritarian, single party system, to a pluralist and democratic polity, yet undefined and uncertain. What is puzzling is that such a profound adjustment has not generated greater instability.

If all these factors are considered, Mexico's payment of its debts to the United States and the IMF, ahead of schedule, represents more than a political gesture.

#### IV. 2. FINANCIAL STABILITY IN EMERGING MARKET ECONOMIES (WDW/18/97 25 JUNE 1997)

This is the title of a recently released report by a working party of experts from the member governments of the Group of Ten (G-10) and from some emerging market economies. Two of the experts were from Argentina and Mexico, the only Latin American governments represented.

Be it as it may, that the G-10 is interested in the financial stability of the so-called emerging

market economies, at the specific request of the last Lyon Summit, is a reflection of the increasing flows of private capital going to these economies. It is also an indicator of relevance that the topic was included in the agenda of the Denver Summit.

According to the working party, macroeconomic instability has been increasingly "associated with serious problems in the financial sector." This trend appears not only in emerging market economies, but also in some advanced economies. It is also becoming common for the public sector to assume the "resolution costs" of such banking crises.

In some cases the costs borne by the public sector have been staggering. The following are some of the examples cited in the study of "cumulative fiscal and quasi-fiscal outlays associated with systemic bank restructuring": Chile in 1981-1987, 20 percent of GDP and Venezuela from 1994 to the present, 20 percent of GDP. Other cases have amounted to 10-15 percent of GDP, such as Spain in 1977-1985, or Mexico from 1994 to the present. Just the estimated fiscal cost of what in the United States, in the 1980s, came to be known as the Savings and Loans (S&L) crisis amounted to almost 3 percent of GDP.

The main reason, offered to explain this propensity of macroeconomic instability to transform itself into banking crises, is found in the fact that "banks remain the dominant channel of financial intermediation in emerging market economies." For instance, "in most Asian and Latin American countries, banks still account for more than 80 percent of financial intermediation."

However, the study remarks, "the experience of many countries also indicates that, in a financial sector crisis, causality between the macroeconomic framework and financial sector soundness runs in both directions." This circular causation is described as follows: "while macroeconomic instability weakens financial institutions, an unsound financial sector, in turn, undermines macroeconomic performance and magnifies the effects of shocks and disturbances in the economy."

The study identifies some of the main sources of vulnerability to which are exposed the banks and financial sectors of emerging markets.

First, macroeconomic instability is described as "the most obvious and direct," because of "its adverse effect on asset price volatility and the allocation of financial resources."

Second, inflation also generates vulnerability because it "distorts incentives for both borrowers and creditors." However, while banks are capable of adjusting to inflationary environments, weaknesses are more pronounced "during the transition to lower inflation." Therefore, "a significant reduction in the rate of inflation appears to have been a factor in a number of financial crises since 1980."

Third, financial liberalization, including capital account liberalization, can also increase vulnerability during the transition, "by increasing the exposure to credit and foreign exchange risks." Additionally, an "improper sequencing of reforms" may contribute to vulnerability of the banking sector.

Fourth, taxation of financial institutions may "undermine financial intermediation," as the "choice of monetary policy instruments and central bank facilities can affect the soundness and vulnerability of the banking system."

the total. Finally, other regions came in far behind, with the Middle East and Europe receiving \$22.2 billion; the transition economies \$19.4 billion; and Africa \$9.0 billion.

Moreover, present levels of concentration in these flows can be further illustrated by the fact that, throughout the 1990s, only ten countries received "almost three-quarters" of total capital flows to emerging market economies.

Three factors are identified in the report as decisive in stimulating such record flows. First, emerging markets are benefitting from the search for higher yields by investors. Second, institutional investors are looking for greater diversification. Third, a recognition by investors that economic fundamentals have improved in emerging markets.

Impressive changes have also taken place in the composition of these flows. Since 1995, foreign direct investment (FDI) has become the largest component, reaching 45 percent of total private flows in 1996. The same in Latin America and the Caribbean, where more than two-thirds of the \$77.7 billion of total net private capital flows in 1996, almost \$30 billion, was FDI and \$27 billion was portfolio investment.

About half of the \$1.2 trillion in net capital flows to emerging markets, between 1990-1996, has been accumulated as foreign exchange reserves. In Asia, 70 percent of these inflows became foreign exchange reserves, while in Latin America the proportion was 37 percent. Therefore, emerging market central bank reserve assets by the end of 1996, amounted to \$822 billion, "a more than threefold increase since 1989."

By contrast, official flows have "declined significantly as a source of emerging market external finance, falling from 29 percent of total flows in 1990 to 6 percent in 1994." Because of the Mexican financial crisis, official flows in 1995 increased sharply to almost \$40 billion, or one fifth of total flows. However, in 1996 they fell again, for the first time in the 1990s, to negative \$13.2 billion. In Latin America, official flows were negative by \$11.2 billion in 1996, reflecting the substantial payments made by Mexico of official credits (WDW/2/97 p.27). Only in Africa, official flows remain the largest source of external finance, representing more than 40 percent of total flows in 1996.

A most remarkable development in emerging markets was the "increased reliance on bond issuance as opposed to bank lending," almost doubling, from \$58 billion in 1995 to \$102 billion in 1996. This was mainly a consequence of the improved access to global financial markets enjoyed by borrowers from emerging markets.

For instance, the number of countries rated by international credit agencies has increased from 11 in 1989 to 46 in 1996. Also, sovereign issues were launched to restructure existing liabilities, in the form of Brady bond buybacks and Mexico's repayment of obligations to the United States and partial repayment to the IMF. Also, in June 1997, Brazil sold \$3 billion of 30-year bonds with \$2.3 billion exchanged for Brady bonds. Even Century (100 year maturity) bonds made their appearance, from the People's Republic of China, the Israel Electric Corporation, India's Reliance Industries, and Endesa Chile Overseas Company.

The IMF offers an interpretation of this spectacular increase in "the scale of inflows and the broadening of market access" of the 1990s. This is evidence, the Fund says, of "a restoration of the



Other sources of vulnerability are "sector-specific," such as faulty corporate governance and management, due to "a lack of appropriate incentives to act prudently;" weak legal and judicial infrastructure; and lax supervision and regulation.

These deficiencies point to what the study characterizes as the "key elements of robust financial systems." For instance, it is necessary to create "an institutional setting and financial infrastructure" that contribute to a "sound credit culture and effective market functioning." Also, while markets should allow close supervision by stakeholders of financial institutions, it is necessary to complement "market discipline" with adequate regulatory and supervisory arrangements.

The study identifies several activities where "sound principles and practices" should be enforced: accounting; payments and settlements; banking supervision; securities market supervision; insurance supervision; and adequate supervision of conglomerates.

In each one of these areas the primary responsibility corresponds to the following "international groupings": the International Accounting Standards Committee; the Committee on Payment and Settlement Systems of the G-10 central bank governors; the Basle Committee on Banking Supervision of the G-10 central bank governors; the International Organization of Securities Commissions (IOSCO); and the International Association of Insurance Supervisors.

Finally, the IMF, the World Bank and the regional development banks should promote actively the adoption of these measures.

#### IV. 3. DEVELOPMENTS AND PROSPECTS IN EMERGING MARKETS (WDW/32/97 5 NOVEMBER 1997)

The latest issue of the yearly on International Capital Markets was released in Hong Kong, in late September, by the International Monetary Fund (IMF).

Private capital flows to emerging markets in 1996, according to the report, "marked a new milestone in the ongoing integration of these economies into global financial markets." Net private capital flows to emerging markets, last year, reached "a new record level of \$235 billion--a 22 percent increase over 1995."

At these rates, in the 1990s, these flows have already exceeded the levels attained with the recycling of petro-dollars, in the 1970s. Present record levels are one indicator, among others, of the "dramatic improvement" in the terms and conditions under which emerging markets are gaining access to world financial markets. Additionally, "interest rate spreads fell sharply, average bond maturities more than doubled, lending covenants weakened, and four times as many countries now have access to international markets as in 1990."

Still, these flows remain highly concentrated in Asia, Latin America and a few transition economies, while Africa and the Middle East lag behind. In 1996, Asia remained the largest recipient of net private capital flows, with \$106.8 billion, almost half of the total. The developing countries of the Western Hemisphere, as classified by the IMF, followed with \$77.7 billion, around one third of



trend toward global financial market integration that had been evident in the gold standard period and the 1920s but was disrupted by the Great Depression and World War II, as well as by the capital controls systems of the post World War II period."

This may be only the beginning. Presently, institutional investors, who manage over \$20 trillion, have not even placed 1 per cent of their assets in emerging markets.

## V. CAPITAL FLOWS

### V. 1. GLOBAL DEVELOPMENT FINANCE (WDW/10/97 26 MARCH 1997)

This is the new title of what formerly was known as the World Debt Tables, the most important document dedicated to monitor the debt crisis of the developing economies, the issue that demanded more attention in the eighties.

It is a sign of the times that the World Bank finally decided to release this document with a new title, reflecting the lesser saliency of indebtedness and the spectacular increase in private investment flows to the developing countries.

The document is still divided in two volumes. The first volume, of analysis and summary tables, contains the following chapters: 1) advances in global markets; 2) project finance for infrastructure; 3) foreign direct investment and global integration; 4) the changing face of aid; and finally only one chapter is dedicated to 5) removing the debt overhang of the heavily indebted poor countries.

Most of the topics related to the debt issue appear in the following appendixes also included in the first volume: 1) debt burden indicators and country classifications; 2) external debt trends in 1995; 3) official external debt restructuring; 4) commercial debt restructuring; 5) portfolio investment in developing countries; 6) progress in privatization; and 7) regional trends in debt and flows.

The second volume contains statistical tables on the external debt and flows of the 136 countries that report public and publicly guaranteed debt under the World Bank's Debtor Reporting System (DRS).

In 1996, the main highlight in development finance was the continued surge in private capital flows and the contrasting stagnation of official flows. Total net long term resource flows to the developing countries, in 1996, amounted to \$284.6 billion, an increase of \$45 billion, or 20 percent, from 1995.

Out of this total, private flows accounted for almost 86 percent, while the rest were official development finance flows. The increase in private flows amounted to \$60 billion, by contrast to a decrease of \$12 billion in official flows.

The bulk of private flows was in foreign direct investment, which amounted to \$109.5 billion in 1996, almost 40 percent of total flows and \$14 billion more than in 1995. Even the commercial banks are staging a comeback, mainly in lending for infrastructure projects, which increased by \$8 billion from 1995.

All regions registered increasing net flows of resources in 1996, with Latin America experiencing the most modest increase of \$2 billion, as opposed to East Asia, which registered the

largest increase of \$20 billion increase in net flows.

Despite a persistent concentration of private flows in twelve developing countries, the share of this group is declining, from 87 percent in 1992 to 73 percent in 1996.

Four Latin American countries appear among the twelve most important recipients of net private flows, as follows: Mexico (\$28.1 billion); Brazil (\$14.7 billion); Argentina (\$11.3 billion); and Chile (\$4.6 billion). The other recipient countries are mostly in East Asia, including China at the top (\$52.0 billion); followed by Indonesia (\$17.9 billion); Malaysia (\$16.0 billion) and Thailand (\$13.3 billion). The rest are countries from Eastern Europe and Central Asia, such as India (\$8.0 billion); Turkey (\$4.7 billion); Russia (\$3.6 billion) and Hungary (\$2.5 billion).

Despite this persistent concentration, the share of the rest of developing countries is increasing, even for countries that do not have access to world capital markets. For instance, the countries of Sub-Saharan Africa, in 1996, received \$11.8 billion in net private capital flows, equivalent to ten times the amount registered in 1990.

Still, Joseph Stiglitz recently appointed World Bank Chief Economist and Vice President for Development Economics said "the share of private capital flows in the 1990s should continue as more developing countries improve macroeconomic management and open their markets to competition from the rest of the world. But the stakes become higher for those countries that fail to undertake these reforms."

The disappointing figures are for official flows, which stagnated in 1996, since concessional development assistance, mainly to low income countries, experienced a "serious decline" of almost \$1 billion. In nominal terms, this is equivalent to the level of 1990 and 3 percent lower in real terms from 1995.

The Report also notes "a marked shift in official concessional flows in the 1990s to funding refugee relief and other emergency aid, including peacekeeping efforts in Haiti, Rwanda, the former Yugoslav republics, and elsewhere." According to the Organization for Economic Cooperation and Development (OECD), "about 12 percent of all official development assistance (including technical cooperation grants) is now devoted to emergency aid, compared with less than 2 percent in 1990."

On the debt front, the Report describes recent debt buybacks of collateralized Brady bonds by Mexico and the Philippines and debt restructuring operations by Panama and Peru, amounting to \$3.9 and \$8.0 billion, respectively. Finally, there is a description of the recently agreed framework for resolving the debt problems of the heavily indebted poor countries (HIPC), which moved into the implementation stage.

## V. 2. CAPITAL FLOWS TO EMERGING MARKET ECONOMIES (WDW/17/97 18 JUNE 1997)

According to Charles Dallara, Managing Director of the Washington-based Institute of International Finance (IIF), "private capital has been flowing to emerging market economies at a record pace."

It should be recalled that the IIF was created in 1983, in the midst of the debt crisis and it includes in its membership almost 200 commercial banks from all over the world. It has now become a tradition that the IIF's Managing Director releases a letter addressed to the Chairman of the Interim Committee, commenting on the issues that concern the Spring Meetings of the Bretton Woods institutions.

This year's IIF letter is dedicated to addressing the "major challenge facing the global financial community," described as "how to sustain, broaden and deepen" private flows to the emerging market economies.

The letter reveals the magnitude of these flows, which reached \$255 billion in 1996, up from \$57 billion in 1990. By contrast, official flows to these economies are dwindling, from \$37 billion in 1990 to \$10 billion in 1996.

Nearly half of these flows were in the form of equity, which last year amounted to \$113 billion. Additionally, also in 1996 non-bank flows, mainly bonds, amounted to \$94 billion. Around half of these flows, \$131 billion, went to Asia, while Latin America was a distant second with almost \$65 billion.

Finally, according to the IIF, the buoyancy of emerging markets finance can also be seen in lengthening maturities and shrinking spreads. The average maturity of emerging-markets bonds increased from 5.8 years in 1995 to 8.3 in 1996.

Stanley Fischer, First Deputy Managing Director of the International Monetary Fund (IMF), commenting on the IIF's letter, said "the performance of the last two years, including the rapid recovery from the Mexican crisis, is so impressive as to raise the question of whether it's too good to last." The IIF predicts that in 1997 these flows will remain at the same level as last year, and the IMF agrees with this optimism. However, both Fischer and Dallara recognize that there are risks to the forecast.

To analyze those risks, Fischer says, it is useful to look at the factors that explain why private capital flows to emerging markets have increased so rapidly. Summarizing those described in the IIF letter, Fischer singles out the following six major factors:

1) "an increase in expected returns in emerging markets, due to structural reforms, increases in the supply of assets via privatization, and enhanced macroeconomic stability";

2) "improvements in emerging market financial markets and banking systems, and other aspects of the economies, have reduced risks and made investments in these countries more attractive";

3) "liberalization of capital controls in emerging market countries, removals of restrictions in institutional investors in industrial countries, and technological advances in communications";

4) "portfolio diversification by investors in advanced countries, with the number of emerging market mutual funds having increased from 30 to 1500 in a decade, and with the flows to emerging markets fueled in part by the capital gains in advanced country stock markets";

5) "improvements in information flows about emerging markets, both in the provision of data by emerging market countries and companies, and in the vastly improved quality of research on emerging markets in recent years;" and

6) "low interest rates in the advanced economies."

According to the IIF, the following are among the "possible risks to the sustainability of these flows: uneven industrial country performance; a slackening of reforms in emerging market economies; diminishing influence of multilateral institutions; and injudicious lending."

Fischer identifies "at least three elements that do present risks. First, there are emerging market countries where large current account deficits have to be watched, and some in which banking sector problems need to be dealt with rapidly. Second, capital flows to emerging markets show some signs of the "exuberance" that has been detected in other asset markets. In particular, spreads have become remarkably low. Third, interest rates in the United States have begun to raise."

Finally, the IIF also recalls that "while access to foreign capital contributes to growth," in emerging market economies "strong flows have three potentially harmful effects. They can: (1) weaken external competitiveness and burden monetary policy; (2) foster the illusion that macroeconomic discipline can be relaxed, and in some cases weaken political support for reforms; and (3) undercut efforts to boost domestic saving." The advice offered by the IIF, to counter some of these risks, consists of the following measures: counter upward exchange rate pressure by reducing underlying fiscal imbalances; sustain disciplined policies and deepen structural reforms; increase transparency by releasing data on a timely basis; finally, the area that requires more urgent attention is to strengthen and deepen financial systems. The IIF concludes that the IMF and the development banks can help sustain private flows "by continuing to adapt their roles in a rapidly changing world."

### V. 3. PRIVATE CAPITAL FLOWS TO DEVELOPING COUNTRIES (WDW/19/97 2 JULY 1997)

This is the title of a book recently released by the World Bank, examining what has already become a most important issue of the present international economic agenda. The World Bank's report joins similar explorations of this issue. First, the experts of the Group of Ten (G-10) study on financial stability in emerging markets (WDW/18/97, p.28), also the recent letter issued by the Institute of International Finance (IIF) on the same topic (WDW/17/97, p.33).

Introducing the volume, the World Bank's Vice President and Chief Economist, Joseph Stiglitz says that the developing countries, ready or not, are being drawn into the process of integration of financial markets that is leading to a single global marketplace.

This "new age of globalized capital" is characterized by the following indicators. Net private capital flows, excluding Korea, recently promoted to the high-income category, reached \$240 billion in 1996. Such amounts are almost six times greater than in 1990 and four times more than the level reached at the previous peak, during the 1979-82 commercial bank lending boom.

Official flows have been left far behind, since private capital flows are now five times greater than official flows. This represents a remarkable turnaround, since at the beginning of the nineties official flows were still greater.

The relative participation of the developing countries in these flows has also increased spectacularly. The share of developing countries in foreign direct investment (FDI) flows has jumped from 15 percent in 1990 to 40 percent in 1996, and their participation in global portfolio equity flows has moved from 2 percent at the beginning of the decade to almost 30 percent.

Additionally, commercial bank lending, which amounted to two-thirds of all private flows to the developing countries at the beginning of the eighties, now represents less than one fifth of such flows.

Simultaneously, governments have become less active borrowers in world capital markets, representing now even less than one fifth of all private flows to developing countries. However, these indicators also reveal that the pace at which developing economies are integrating into the global financial market is quite uneven, because most of these economies remain excluded from such flows.

For instance a dozen countries--listed in decreasing order, China, Mexico, Brazil, Korea, Malaysia, Argentina, Thailand, Indonesia, Russia, India, Turkey and Hungary--accounted for about 80 percent of net private flows to developing countries during 1990-1995.

Even more concentrated, less than twenty developing countries accounted for almost 95 percent of such flows in the same period. Therefore, 140 countries, out of a total of 166, account for less than 5 percent of private flows to developing countries.

On the supply side there have also been profound transformations. Perhaps most remarkable has been the spectacular increase in the number of institutional investors interested in international investments.

For instance, while total assets of pension funds in the world are estimated to have increased from \$4.3 trillion to \$7 trillion, between 1989 and 1994, the share of international investments in their portfolios increased from around 7 percent to 11 percent, in the same period. These two factors, according to the World Bank, "have resulted in an increase in total international investments by pension funds from \$302 billion in 1989 to \$790 billion in 1994."

FDI has "responded most vigorously" to the circumstances that are producing these spectacular increases in international investment. A major change can be observed in the primary motives for FDI flows going to developing economies, from the interest in "resource extraction and import substitution," during the 1970s and early 1980s, to "efficiency seeking, associated with the globalization of production."

However, perhaps the "most striking" change has been the turn toward portfolio investment, from barely nil a decade ago, to almost a third of the equity capital moving across national borders worldwide going to developing countries, in the last five years.

Again, "the driving force behind portfolio flows of the 1990s has been institutional investors," with mutual funds leading the way in investing in emerging market equities. For instance, in 1986



there were 19 emerging market country funds and nine regional or global emerging market funds. By 1995, the numbers were "over 500 country funds and nearly 800 regional and global funds."

Additionally, the combined assets of all emerging market funds "increased from \$1.9 billion in 1986 to \$10.3 billion in 1989 to \$132 billion at the middle of 1996." Therefore, the exposure of U.S. open-end mutual funds in emerging markets went from "just \$1.5 billion in 1990 to \$35 billion in 1995, or 14 percent of international exposure" and 2 percent of their assets.

Pension funds have followed this trend, with the exposure of U.S. pension funds in emerging markets amounting, in 1994, to between \$50 and \$70 billion, which represented also about 2 percent of their total assets.

## VI. U.S. TRADE POLICY

### VI. 1. U.S. TRADE POLICY AGENDA FOR 1997 (WDW/9/97 19 MARCH 1997)

This year's trade policy agenda is the first presented in the second mandate of President Clinton. Therefore, it contains the main elements of what the Administration expects to accomplish in the next four years. The presentation of the agenda is required by Section 163 of the Trade Act of 1974, as amended (19 U.S.C. 2213) which mandates that "the President shall submit to the Congress during each year (but not later than March 1) a report on A) the operation of the trade agreements program . . . and B) the national trade policy agenda for the year in which the report is submitted."

Both requirements are contained in a single volume, issued on deadline by the Office of the U. S. Trade Representative (USTR), titled 1997 Trade Policy Agenda and 1996 Annual Report of the President of the United States on the Trade Agreements Program. The volume also includes, for the second consecutive year, the annual report on the functioning of the World Trade Organization (WTO), required by the Uruguay Round Agreements Act (1994 Trade Act). Finally, an annex includes a listing of trade agreements reached by the United States since 1984, "which afford increased foreign market access or reduce foreign barriers and other trade distorting policies and practices by other parties to those agreements."

Also, this is the first major statement on U.S. trade policy presented by Ambassador Charlene Barshefsky, recently confirmed as new U. S. Trade Representative. Ambassador Barshefsky's appointment is an expression of continuity, since she acted as Deputy of her predecessor, Ambassador Michael Kantor, throughout the first Clinton Administration.

The introductory overview, signed by Ambassador Barshefsky on February 28, just before her confirmation by the Senate, looks back and describes the major accomplishments of the "Clinton market-opening strategy," which covers "a wide spectrum of products and a broad geographical sweep."

This strategy envisages the combined application of "bilateral, regional, and multilateral initiatives." Its main purpose is to open new markets and make "strong gains in exports throughout Asia, Latin America, Europe, and the nations of the former Soviet Union."

Ambassador Barshefsky describes the "high points" of the Clinton Administration's record in enforcing such a strategy. 1) approval of the NAFTA and the contribution it made to pull Mexico out of "its worst financial crisis in modern history"; 2) entry into force of the Uruguay Round and the establishment of the WTO; 3) the Information Technology Agreement, to enter into force in July 1997, liberalizing trade in products where the United States enjoys competitive advantages, such as semiconductors, telecommunications equipment and computer software and hardware; 4) enforcement of the framework agreement with Japan; 5) response to the "critical diplomatic challenge" posed by China; 6) accomplishment of market opening initiatives within the Asia Pacific Economic Cooperation (APEC) process; 7) progress in preparing negotiations for achieving the Free Trade Area of the Americas (FTAA); 8) launching the initiative to build a New Transatlantic Marketplace with the

European Union (EU); 9) advances in the consideration of "new issues," such as labor rights, the environment and corruption; finally, 10) enforcement of trade laws and agreements.

The 1997 agenda promises to continue implementing trade agreements, enforcing trade laws, opening markets, creating opportunities for U.S. business, and "continuing the legacy of U.S. leadership in the global economy." Economically, "strong export growth" is necessary to sustain strong economic growth at home. Politically, trade is a "tool" to "project America's core values globally." Strategically, economic alliances are essential "to project American leadership around the world."

The instruments to accomplish these objectives are described in the following order. First, the Administration needs fast-track authority. Second, this is required to build the FTAA by 2005. Third, it is also required to continue encouraging APEC to open its markets, including through bilateral agreements with individual nations, such as Australia, New Zealand and Singapore. Fourth, to deepen the relationship with the EU, through the New Transatlantic Marketplace Initiative. Fifth, to support trade liberalization in Africa. Sixth, the inclusion of labor standards as part of the WTO and in bilateral and regional trading agreements. Sixth, to incorporate new members to the WTO. Seventh, to enforce the two recently signed agreements on information technology and basic telecommunications. Eighth, other sectoral and bilateral issues, such as trade liberalization in agriculture, specific issues with Mexico, Japan and on shipbuilding. Finally, to continue making trade and environmental policies mutually compatible.

Evidently, to carry out this ambitious agenda, it is essential that the Administration obtain fast-track authorization from the U.S. Congress. Therefore, the section on fast-track emphasizes that "to achieve these goals is, in part, dependent on whether we have trade agreement authority to use as a competitive weapon. With fast-track, a wide range of bilateral and regional initiatives become possible to pursue."

The presentation of the trade policy agenda for 1997 closes with a quotation from President Clinton's last State of the Union address: "this is about more than economics. By expanding trade, we can advance the cause of freedom and democracy around the world." in 1995.

## VI. 2. BARRIERS TO U.S. EXPORTS (WDW/12/97 14 MAY 1997)

The twelfth National Trade Estimate Report on Foreign Trade Barriers (NTE) was released, as mandated by the law, on 31 March 1997. The 1974 Trade Act, as amended by the 1984, the 1988 and the 1994 Trade Acts, require that the Office of the US Trade Representative (USTR) submit to the President, the Senate Finance Committee, and appropriate committees in the House of Representatives "an annual report on significant trade barriers."

Annual presentation of this report by the USTR has set an example, because other trading partners of the United States, such as Canada, the European Union, Japan, Latin America and the Caribbean, also release their own reports enumerating the barriers that their exports confront in the U.S. market.

The law requires that the U.S. report should contain "an inventory of the most important barriers affecting U.S. exports of goods and services, foreign direct investment by U.S. persons, and protection of intellectual property rights." However, the Report is not a merely descriptive exercise, because it is directly related to the implementation of two other U.S. trade laws. First, thirty days after the release of the NTE Report, under the "Special 301" provision "the USTR must identify those countries that deny adequate and effective protection for intellectual property rights or deny fair and equitable market access for persons that rely on intellectual property protection." Second, under the "super 301" executive order, within six months of the presentation of the NTE Report, the USTR has to review U.S. trade expansion priorities and "identify those priority foreign country practices, the elimination of which is likely to have the most significant potential to increase U.S. exports."

Trade barriers are defined broadly in the NTE Report, as "government laws, regulations, policies, or practices that either protect domestic products from foreign competition or artificially stimulate exports of particular domestic products." Additionally, barriers are classified into the following nine categories: 1) import policies; 2) standards, testing labeling and certification; 3) government procurement; 4) export subsidies; 5) lack of intellectual property protection; 6) services barriers; 7) investment barriers; 8) anticompetitive practices; and 9) barriers that encompass more than one category, such as bribery and corruption, or that affect a single sector.

This year's NTE Report includes four more countries, for a total of 46 nations, Taiwan, Hong Kong and two regional bodies, the European Union (EU) and the Gulf Cooperation Council. Among those countries recently added to the list, three are from Latin America, Ecuador, Panama and Paraguay, and one from Africa, Ethiopia.

With these additions, the number of Latin American countries that appear in the NTE REPORT has increased to seventeen, including Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Peru and Venezuela.

Measured by the length of their citations, Japan appears first, with 45 pages; followed by the European union (EU), with 25 pages, Korea is third, with 19 pages, followed closely by China, with 17 pages.

Each country or group of countries appears listed alphabetically and the enumeration of the barriers is preceded by a description of the U.S. trade deficit or surplus, the amount of U.S. imports, exports and investment, and by the rank occupied as a market for U.S. exports.

Excluding Mexico, which still ranks third, Brazil has moved from fourteenth to twelfth, as the most significant export market for the United States in Latin America. Other Latin American countries come far behind in this ranking. Venezuela ranks twenty fourth, Colombia twenty fifth, Argentina twenty sixth and Chile, which moved from twenty eighth last year to twenty seventh. Farther behind, the Dominican Republic fell from thirty second last year to thirty third this year, followed by Costa Rica that fell from fortieth last year to forty first this year. Peru comes next, falling from thirty ninth last year to forty second this year. Honduras moved from fiftieth last year to forty fifth, followed by Guatemala that fell from forty second last year to forty sixth. The newly mentioned Panama and Ecuador rank forty ninth and fifty first, respectively, while El Salvador remained fifty second, with the newly mentioned Paraguay fifty fifth and Nicaragua still in the last place despite its move from eighty first to eightieth.

Not all the citations are negative. For instance, the Brazilian government is said to have "produced significant changes in Brazil's trade regime, resulting in a more open and competitive economy.' The same is true of the government of Argentina, said to have made "significant progress in reducing traditional border measure barriers (such as tariff and import licensing) and non-border measure barriers (in areas such as investment and government procurement).

However, all the Latin American countries are cited for lack of intellectual property protection and for the erection of barriers against investment and services. For instance, also mentioned are investment incentives in the automobile sector of Brazil, lack of intellectual property protection for pharmaceuticals in Argentina, a Chilean excise tax on spirits, or television local content quotas in Colombia.

### VI. 3. NAFTA'S REPORT CARD (WDW/22/97 23 JULY 1997)

As mandated by section 512 of the North American Free Trade Agreement (NAFTA) Implementation Act, President Clinton has sent to Congress the Study on the Operation and Effect of the NAFTA. In the message of transmission to Congress, President Clinton has no doubt about the results of the evaluation, saying that it "provides solid evidence that NAFTA has already proved its worth to the United States during the three years it has been into effect."

The President places NAFTA within the wider context of the Administration's growth strategy, which "has produced the strongest U.S. economy in a generation," characterized by "strong investment, low unemployment, healthy job creation, and subdued inflation."

This strategy consists of the following three elements: first, deficit reduction; second, investing in people, through education and training; and third, opening markets, "to allow America to compete in the global economy."

The impact of the NAFTA is evaluated by means of the following indicators: 1) trade in North America; 2) trade barriers; 3) the U.S. economy; 4) the Mexican economy; 5) key sectors; and 6) labor and environmental protection.

For the United States, trade with its NAFTA partners, amounting to \$426 billion in 1996, represents one third of its total two-way trade. The rate of growth of U.S. trade within the NAFTA, at 44 percent in 1996, exceeded by far the 33 percent growth with the rest of the world.

Canada remains the largest trading partner of the United States, amounting in 1996 to \$290 billion in two-way trade. However, while U.S. exports to Canada, between 1993 and 1996, increased by 33.6 percent, U.S. exports to Mexico grew by 36.5 percent, in the same period. Therefore, U.S. exports reached a record high increase in 1996, despite the profound recession experienced by the Mexican economy, equivalent to a contraction of 3.3 percent in domestic demand.

In the first four months of 1997, U.S. exports to Mexico were similar to those going to Japan, the second largest trading partner of the United States, "even though Mexico's economy is one

twelfth the size of Japan's."

NAFTA's impact may be better appreciated by looking at trade relations within the Western Hemisphere, not mentioned in the report. For instance, in 1996 for the first time, Mexico's two-way trade with the United States, at \$131 billion, surpassed by a wide margin Latin American and Caribbean total trade with the United States, at \$102 billion. Moreover, in 1996, U.S. exports to Mexico, at \$56.8 billion, were almost the same as those going to the rest of Latin America and the Caribbean, at \$52.5 billion. However, the most spectacular difference was in U.S. imports from Mexico, which in 1996 reached \$74.3 billion. By contrast, U.S. imports from the rest of Latin America and the Caribbean remained far behind at \$49.5 billion.

Under NAFTA, Mexico has reduced its average import tariffs, which were at 10 percent in 1993, by 7.1 percent, while U.S. tariffs, at an average of 2.07 percent, have been reduced by 1.4 percent. Therefore, U.S. relative participation in total Mexican imports increased from 69.3, when NAFTA went into effect, to 75.5 percent in 1996. This reflects, according to the study, a 10 percent average tariff advantage over other suppliers.

The report cites other studies that have attempted to isolate the effects of the NAFTA on the U.S. economy, from the severe recession and devaluation in Mexico and the tariff reductions from the Uruguay Round. The conclusion is that NAFTA had "a modest positive effect" on the U.S. economy. For instance, a study by DRI estimated that NAFTA increased real exports to Mexico by \$12 billion in 1996 and imports from Mexico by \$5 billion. Another study by the Federal Reserve Bank of Dallas concluded that U.S. exports to Mexico increased \$7 billion, while imports from Mexico increased only \$4 billion.

Estimates of job creation associated to U.S. exports to Mexico are between 90,000 and 160,000. These should be contrasted with the petitions for assistance filed under the NAFTA Transitional Adjustment Program (TAA), at the U.S. Labor Department. Until December 1996, NAFTA-TAA related petitions covered approximately 99,497 workers whose jobs had been affected by imports from Canada and Mexico.

As it could be anticipated, NAFTA's effects on the Mexican economy are more important. By contrast with the crisis of 1982, when Mexico increased tariffs by 100 percent and U.S. exports fell by half and took seven years to recover, under the NAFTA tariff reductions continued in Mexico and U.S. exports recovered in 18 months.

The study also analyzes NAFTA's impact on several sectors of the U.S. economy, such as textiles, automobiles and electronic appliances. For instance, in the apparel industry, U.S. imports from Mexico increased from 4.4 percent in 1993 to 9.6 percent in 1996. Meanwhile, the share of U.S. apparel imports from China, Hong Kong, Taiwan and Korea fell from 39 percent in 1993 to 30 percent in 1996.

Therefore, the report card presented by the Administration on NAFTA is positive, but its effects on the U.S. economy are modest. NAFTA's impact on U.S. trade relations is significant, particularly within the Western Hemisphere.

VI. 4. THE WITHDRAWAL OF THE REQUEST FOR 'FAST TRACK'  
(WDW/34/97 19 NOVEMBER 1997)

After a long and protracted battle for what some called "the soul" of the Democratic Party, President Clinton decided to withdraw the request for authorization to negotiate trade agreements on 'fast track.' The President thus decided to retreat, instead of experiencing a defeat inflicted by some leaders of his own party. Additionally, in a puzzling political paradox, the leadership of the Republican Party could not come up with five votes, estimated necessary to approve the measure, in the late hours of a long weekend of congressional hyperactivity.

Such are the ways of Washington, where "all politics is local." In the south grounds of the White House, President Clinton conceded defeat. He asked, "was there some politics in it? Of course, there is. But there is politics in every tough vote that has been held in the Congress and in any legislative body in my lifetime."

The President explained quite candidly what happened. First, he said, for several years there has been a "big debate" within the Democratic Party "on the question of trade and its role in our economic future."

Second, the President had the support of most Democratic mayors and governors and a majority in the Senate. But he did not have a majority in the House of Representatives, where the Democratic leadership was openly against the President's position.

Third, since he could not come up with enough Democrats in support of his position, "a bigger share of the Republican vote" was necessary. However, this ignited a "controversy over international family planning," which could not be solved. Therefore, the President said, "had we been able to resolve that, I think we could have gotten enough votes on the Republican side, to go with the Democrats' votes we had, to pass the bill. Clearly, I think we could have. But we were not able to do that."

The President concluded optimistically saying: "I expect that we will successfully press forward with this issue in this Congress, and at the appropriate time. So I'm, I'm not particularly concerned about the long run. I think we'll be able to prevail."

Be it as it may, the aftermath has consisted of assessing the consequences of this setback for the bipartisan, centrist coalition that approved the North American Free Trade Agreement (NAFTA) and the Uruguay Round.

There is almost unanimous agreement that President Clinton has been weakened by the resistance that emerged within his own party. For instance, the Wall Street Journal estimated that, for the President, "the defeat could hasten his descent into lame duck status." As an indicator, the Journal said that the President was unable to obtain the support of 80 percent of the House Democrats. The JOURNAL also quoted George Stephanopoulos, a close presidential advisor in the first Clinton Administration, who said that, legislatively, "the last three years will be largely a rhetorical presidency."

Internationally, this will be reflected in the next summit of the Asia Pacific Economic Cooperation (APEC) forum, as in the next summit of the Americas, to be held next April in Santiago,

Chile, where it is expected that negotiations will be launched for the Free Trade Area of the Americas (FTAA).

On this last possibility, administration sources are quick to remind that the Uruguay Round negotiations were launched when President Reagan did not have fast track authorization. The same sources also recall that last month, in Brasilia, Presidents Cardoso and Clinton agreed that negotiations for the FTAA were to start at the Santiago summit.

The main casualties of the defeat were Chile and the countries of Caribbean and Central America that participate in the Caribbean Basin Economic Recovery Act (CBERA), better known as CBI.

Without fast track authorization, Chile remains standing at the door of the NAFTA, where it has been since the last Miami summit. Chilean Minister of Foreign Affairs Jose Miguel Insulza was also quoted, in the Wall Street Journal, saying that even the Santiago summit was at risk. The participants in the Santiago summit, "won't move much of anything if the U.S. does not have this authority."

The CBI countries were also hurt, because they had previously been defeated in the U.S. Congress in their attempt to obtain parity with the treatment granted in the NAFTA for the products excluded from the CBI. These governments argue that, with the approval of the NAFTA, intense trade and investment diversion is taking place from their countries, because investors prefer to settle in Mexico due to the access it enjoys in the U.S. market.

Given these consequences, optimists, like President Clinton, said "this bill is not dead . . . we will bring it back up at the appropriate time and when we think we can pass it."

Pessimists, like Senate Majority Leader Trent Lott, said "maybe it will come back to life next year, but I would expect it would be even more difficult" to pass.

Finally, some skeptical observers are hoping that the withdrawal of the request for fast track does not signal a sustained turn toward protectionism in the United States.



## VII. TRADE LIBERALIZATION IN THE WESTERN HEMISPHERE

### VII. 1. THE RECIFE TRADE VICEMINISTERIAL (WDW/7/97 5 MARCH 1997)

The second viceministerial on Hemispheric trade, in preparation of next May's ministerial meeting, was held in Recife, Brazil, from February 25 to 27.

The mandate for the viceministerial is part of the ongoing implementation of the decisions adopted, in December 1994 in Miami, by thirty four heads of state and government of the Americas. The purpose of these meetings is to prepare the ground for the creation, starting in 2005, of the Free Trade Area of the Americas (FTAA).

In their last meeting, held in Cartagena, Colombia, the trade ministers decided it was time to respond to the basic questions raised by how and when to start the negotiations.

After Recife, four proposals have been presented to respond to these basic questions. Two proposals circulated before the Recife meeting. One month before, a Canadian proposal was presented, while the proposal from the United States was circulated two weeks before.

Additionally, on the first day of the viceministerial meeting, the Brazilian delegation circulated the proposal supported by MERCOSUR, describing in detail the position sketched during the previous viceministerial of negotiating in three stages. Finally, the Jamaican delegation, on behalf of CARICOM, presented a formal proposal at the end of the first day of meetings.

Gone is the skepticism about the participants' commitment. Although the proposals reveal differences and coincidences about how to carry out these complex negotiations, the Recife meeting's highlight was that the proposals contain more coincidences than differences.

The details contained in each proposal were not even discussed, it was enough just to place them side by side, in a matrix, to discover the agreements and disagreements. Therefore, the decision was that each participant would examine the matrix leaving the discussion of the differences for the next viceministerial, to be held in Rio de Janeiro by mid-April. Furthermore, the Brazilian delegation, was asked to begin drafting the project of declaration that will be the main outcome of the next ministerial meeting of Belo Horizonte.

The matrix comparing the proposals has five components: 1) level of obligations; 2) focus/phases/calendar; 3) format of the negotiations; 4) business facilitation and immediate action; and 5) smaller economies.

The main difference revealed by the matrix has to do with the sequencing of the negotiations and what to do first. The MERCOSUR proposal contains a detailed sequence, whereby the negotiations would take place in three stages, beginning with the easiest and concluding by focusing on the toughest.

In the first phase of the MERCOSUR proposal the negotiations would be focused on business facilitation and they would last until 1999. The second phase would focus on standards and disciplines and it would last until 2002 and the final phase would conclude on 2005 and focus on other disciplines and market access.

By contrast, the US proposal contains two phases. The first one is similar to the second phase of the MERCOSUR proposal and would start immediately and last until 2000, while the second phase is similar to the third of the MERCOSUR proposal.

The Canadian and CARICOM proposals do not contain phases and all four agree that the kickoff for the negotiations should be the next Summit of the Americas, to be held in Santiago, Chile in March 1998.

If the drafting of the matrix did not generate major discussion, the other issue that dominated most of the Recife meeting required more time and detailed discussion. It had to do with the instructions to the eleven working groups that have been gathering information on different negotiating topics.

There was agreement that the eleven working groups that exist do not represent the number of negotiating groups that will be required and that a smaller number of them will be established for the negotiations. Still, as mandated by the Cartagena ministerial, terms of reference were submitted for the creation of a twelfth working group on dispute settlement procedures.

Indicating a high degree of sensitivity, the most debated instructions to a specific working group were those for the one that has functioned on the small economies. After lengthy discussions, the attempt by some delegations to introduce language that could anticipate a negotiating outcome on this issue led only to reiterate the terms of reference already approved in the Cartagena Ministerial.

It was also evident that there still remain differences among the small economies about how to deal with this issue. The delegations from the CARICOM and the Dominican Republic were more emphatic in their demand for specific language about negotiating outcomes. The Central American delegations, short of two participants because of the absence of Nicaragua and Guatemala, were less cohesive. Honduras appeared closer to the CARICOM position, while El Salvador and Costa Rica appeared less inclined at this point to insist on specific language.

Finally, there was agreement that the next viceministerial in Rio de Janeiro will have to last more, from April 15 to 18, since the purpose is to start drafting the project of declaration that the trade ministers will issue at the end of their meeting in Recife, scheduled for mid May.

## VII. 2. THE RIO DE JANEIRO TRADE VICEMINISTERIAL (WDW/11/97 7 May 1997)

The third viceministerial on Hemispheric trade, in preparation of next May's ministerial meeting of Belo Horizonte, was held in Rio de Janeiro, Brazil, from April 13 to 17, 1997.

As it is known, the mandate for the viceministerial emanates from the Miami Summit of the Americas, of December 1994, under which thirty-four heads of state decided the creation of a Free Trade Area of the Americas (FTAA), by 2005.

This third, but not last, viceministerial held in Brazil became more focused on the preparation of the statement that will be issued by the Ministers of Trade, when they meet for their third annual meeting, in Belo Horizonte, Brazil, in mid-May.

Other items on the agenda were the reception of reports from some working groups, left pending from the previous viceministerial; terms of reference for the launching, at the next ministerial, of a new working group on dispute settlement procedures; and terms of reference for a feasibility study on the creation of a secretariat for the negotiations, to be requested from the Tripartite Committee OAS/IDB/ECLAC.

Final reports from the working groups on small economies, investment and sanitary and phytosanitary measures were presented at the beginning of the meeting. Additionally, the viceministers authorized the release of documents prepared by the working groups on standards and technical barriers; on subsidies, antidumping and countervailing duties; and on government procurement.

Based on the discussion of a first draft, the viceministers agreed that the final version of the terms of reference and the chair for the new group on dispute settlement will be approved by the Ministers in Belo Horizonte. Uruguay and Venezuela have presented themselves as candidates to coordinate this last working group.

Also discussed by the Viceministers were the terms of reference for the feasibility study required to create a secretariat for the negotiations, which will be requested from the Tripartite Committee OAS/IDB/ECLAC.

The viceministers decided that those governments interested in serving as hosts of the negotiations should submit their proposals to the Brazilian chair, in order for those sites to be considered as alternatives in the feasibility study. Informal manifestations of interest in serving as sites for the negotiations were expressed by Colombia, Jamaica, Mexico and Panama.

Most of the meeting was dedicated to drafting the declaration that will be approved by the Ministers in Belo Horizonte. The discussions were based on two projects submitted by the Brazilian chair and by the delegation of the United State and it took place in two stages. First, the outline of the declaration was agreed and second, the viceministers attempted to find consensus on the specific language of the declaration, based on a common proposal submitted by the chair.

Basic consensus emerged that the Belo Horizonte declaration will instruct the viceministers to identify the elements that will be included in the declaration that the heads of state will issue to launch the negotiations, at the next Santiago Summit of the Americas, in March 1998.

For this purpose, the viceministers will meet three times, under the new Costa Rican chair that starts functioning after Belo Horizonte. The purpose of the next three viceministerials is to prepare the fourth ministerial meeting of San José, Costa Rica, in February 1998, which will draft the text that will be proposed to the heads of state before the Santiago summit.

Therefore, the attempt at drafting the Belo Horizonte declaration consisted in finding points on which there was consensus, leaving "in brackets" those issues on which there was no agreement.

These "brackets" are the items that will be discussed by the fourth viceministerial, to be held in Belo Horizonte, two days before the ministers meet. Although many differences remain about the content of the Belo Horizonte declaration, most of them are not substantive, they concern mainly the specific language to be used in the declaration.

However, some substantive differences persist. For instance, the MERCOSUL delegation holds that the negotiations should take place in three different stages. By contrast, the United States informed that they would not insist in their original proposal of holding the negotiations in two stages.

Finally, there is also disagreement about how to incorporate into the ministerial meeting the results of a labor forum that will be held for the first time in Belo Horizonte, similar to the business forums that until now have preceded other ministerial meetings. Only the delegations of MERCOSUL and of the United States agree that the conclusions of the labor forum should be presented to the Ministers.

Consequently, after the Rio meeting, there is consensus that formal negotiations for the FTAA will be launched at the Santiago Summit. Meanwhile, as agreed in the Cartagena ministerial, the Costa Rican government will host the next ministerial, which will take place before the Santiago Summit. In these terms, the new host consulted tentative dates for holding the next three viceministerial meetings and the ministerial.

Until then, forthcoming activities will be centered on identifying and agreeing on the elements of the portentous declaration of the 34 heads of state launching the negotiations to negotiate the terms of the Free Trade Area of the Americas.

### VII. 3. THIRD TRADE MINISTERIAL IN BELO HORIZONTE (WDW/14/97 28 MAY 1887)

The third ministerial on Hemispheric trade liberalization took place in Belo Horizonte, Brazil, on 15 and 16 May 1997. The mandate for the meeting emanates from the Miami Summit, of December 1994, when thirty four heads of state decided the creation of a Free Trade Area of the Americas, by 2005.

In preparation of the Belo Horizonte ministerial, the trade vice-ministers held four meetings, chaired by the host government, to draft the project of declaration that was approved by the ministers. Therefore, the agenda of the meeting was centered around the approval of the points left pending by the last viceministerial, held also in Belo Horizonte only two days before the inauguration of the ministerial.

Viewed from the vantage point of the way they were covered in the media, particularly in the Brazilian media, the meetings were portrayed, in the terms of Argentina's Minister of Foreign Affairs Guido Di Tella, as "a David vs. Goliath confrontation." However, Minister Di Tella concluded that

without this perspective, the press would be without news and then the big news would come out that there was agreement. This characterization of the Belo Horizonte Ministerial perhaps is closest to what happened during the three days of intense consultations, at both viceministerial and ministerial levels.

To be sure, as soon as there was agreement that the negotiations will be launched at the Santiago Summit, in March 1998, the Belo Horizonte ministerial was devoid of a sense of urgency. This allowed leaving for the next meetings, to be chaired and held in Costa Rica, the most difficult and controverted issues.

Even so, there were disagreements that held back issuing the final communiqué until the very last minute. Among these, as revealed by points 14 and 4 of the final declaration, language was found to include labor participation and the coexistence of the Free Trade Area of the Americas (FTAA) with bilateral and subregional agreements.

The reception by the Ministers of the conclusions of a labor forum became the most contentious issue of the meeting. These were contained in a Declaration of the Workers of America, where several participating governments were accused of being anti-democratic, because of their opposition to receiving the conclusions. In the end, the Brazilian chair circulated the declaration among the participants, which led to its rejection, particularly but not only, by those governments that were mentioned.

Still, other controversial issues were addressed generically, in a way that left them pending for the forthcoming meetings. As with the issue of negotiating in stages, proposed by MERCOSUL, point 4 declares that the next San Jose ministerial "will formulate how the negotiations will proceed, including such features as their objectives, approaches, structure and venue."

At the end of the day, the outcome of Belo Horizonte reveals that consensus already exists on some major points. These are contained in a section of the declaration that describes "areas of commonality."

For instance, first, decision making will be by consensus of the 34 participating governments. Second, the outcome of the negotiations will be a "comprehensive single undertaking," that will be consistent with the WTO. Third, governments can participate in the negotiations individually or in sub-regional groups and "special attention should be given to the interests of the small economies." Fourth, it will be necessary to set up "a temporary administrative Secretariat to support the negotiations." Fifth, 2005 is "the date for concluding negotiations, at the latest." Henceforward, the Viceministers are instructed to function as a "Preparatory Committee" to deal with the "remaining issues" and to oversee the functioning of the working groups that have been created.

With the addition in Belo Horizonte of a working group on dispute settlement procedures, the twelve working groups are now instructed to identify "negotiating alternatives in their respective disciplines." When the negotiations start, these working groups will be "reconfigured as negotiating groups."

Another agreement was to request from the Tripartite Committee OAS/IDB/ECLAC to carry out a "feasibility study on alternatives for establishing a temporary administrative secretariat." For such a purpose, specific terms of reference for the study were also approved.

According to the approved terms of reference, the secretariat will be temporary and it is expected to perform the following tasks: 1) support for the negotiating groups; 2) translation of documents and interpretation of deliberations; 3) maintain, publish and distribute official documents.

Moreover, the terms of reference specify that "support to the negotiating groups is separate from any provision of technical advice to FTAA participants." Therefore, in tune with recent subregional institutional developments in the Hemisphere, the temporary secretariat will only perform administrative tasks, it will be devoid of initiative and will not grant technical assistance to the participating governments.

Nine cities in the Hemisphere submitted their candidacy to become sites of the negotiations and secretariat--Buenos Aires, Kingston, Lima, Mexico City, Miami, Panama City, Rio de Janeiro, Bogota and Washington.

#### VII. 4. TRADE REPRESSION IN THE WESTERN HEMISPHERE (WDW/23/97 30 JULY 1997)

Enough evidence is available to demonstrate that trade relations in the Western Hemisphere are below potential.

A quick look at the latest figures reveals that the most intense trading relationship among any pair of countries in the world exists in the Western Hemisphere. Two-way trade between Canada and the United States in 1996 was close to \$300 billion and this represents almost half of all trade within the Western Hemisphere.

Moreover, at the ongoing rate of growth, Mexico in 1997 may become the United States second most important trading partner, surpassing Japan. In 1996, two-way trade between the United States and Mexico amounted to \$131.1 billion. Thus, Mexico alone, as a consequence of the North American Free Trade Agreement (NAFTA), traded significantly more with the United States than the rest of Latin America and the Caribbean together. Two-way trade between Latin America and the Caribbean, excluding Mexico, with the United States amounted in 1996 to \$102.0 billion.

Such intense trading relationships are influenced decisively by shared land borders and geographical proximity. However, trade figures between the United States and the rest of Latin America and the Caribbean reveal, contrastingly, that it remains far behind the levels already attained by Canada and Mexico.

For instance, two-way trade between Brazil, the largest Latin American economy, and the United States amounted in 1996 only to a bit more than \$20 billion. Also, in 1996, two-way trade between the United States and MERCOSUR, which includes Brazil, Argentina, Paraguay and Uruguay, barely reached \$30 billion.

By contrast with the trade figures for the two neighboring economies of the United States, the figures for Brazil and MERCOSUR constitute solid evidence that trade relations between the United States and the rest of the Hemisphere are below potential.

It is unfortunate that the notion of "trade repression" does not exist, as does the equivalent term "financial repression." However, both convey the existence of circumstances, either deliberate measures or structural factors, which obstruct and distort trade or finance relations.

As in financial repression, equivalents of negative interest rates, subsidies and direct controls can be found in trade relations, in the form of tariff and non-tariff barriers, direct subsidies and even licensing and direct controls.

However, in the developing economies of the Western Hemisphere, basically as a consequence of the unilateral liberalization of the eighties enforced as a sequel to the debt crisis, most of the traditional obstacles to trade have been gradually dismantled.

True, there remains a hard core of obstacles to be removed, but these are of a kind that is more difficult to remove unilaterally. These remaining obstacles are more amenable to reduction by means of detailed negotiations, particularly among significant trading partners, which exhibit higher levels of interdependence.

Therefore, the contemporary trend in the Western Hemisphere, for the removal of remaining obstacles to trade, has been dominated by regionalism among neighboring trading partners.

This trend complements the movement towards global liberalization within the framework of the General Agreement on Tariffs and Trade (GATT), now the World Trade Organization (WTO).

Both trends towards trade liberalization, the regional and the global, can be fully compatible. Additionally, there is almost widespread consensus, except among a small hard core of global liberalizers, that regional trade liberalization can be a stepping stone, or a building block, for the construction of a more open world trading system.

In this context should be placed the project, endorsed by thirty-four heads of state and government of the Hemisphere in Miami in December 1994, of building a free trade area in the Americas by 2005, encompassing from Alaska to Patagonia.

For this reason, the most recent attempts at regional integration undertaken in the Western Hemisphere, in the nineties, have attracted a lot of attention. Three of these recent attempts can be considered the most significant, enumerated chronologically, the Common Market of the South (MERCOSUR), the North American Free Trade Agreement (NAFTA), and the still to be negotiated Free Trade Area of the Americas (FTAA).

This does not mean that previous attempts at regional integration in the Western Hemisphere have lost relevance. However, previous subregional integration schemes in the Hemisphere are now struggling to adapt themselves to a new reality. This new reality includes two subregional newcomers, that count among their participants the most significant economies of the Hemisphere, and the future all inclusive Free Trade Area of the Americas (FTAA).

Such adaptation is required from the oldest subregional process, the Central American Common Market (CACM), the most ambitious, the Andean Pact known today as the Andean Community, and the most pragmatic, the Caribbean Community (CARICOM).

## VII. 5. THE POTENTIAL OF A MERCOSUR-NAFTA NEGOTIATION (WDW/24/97 10 SEPTEMBER 1997)

Consider the significance of bringing together MERCOSUR and NAFTA, the two subregional processes of integration to which belong Brazil and the United States. Both account for 85 percent of intra-hemispheric trade and both represent more than 95 percent of the Hemisphere's Gross Domestic Product (GDP).

Moreover, consider the enormous potential that would be unleashed by freeing the trading relations between these two integration processes. This can be better appreciated by focusing on the fact that Brazil's two-way trade with the United States in 1996 amounted to only \$20 billion, while two-way trade between the United States and MERCOSUR amounted to almost \$30 billion.

These figures are certainly not commensurate to the size of these economies, which illustrates the point made in a previous DISPATCH that trade relations within the Hemisphere remain below potential (WDW/23/97, p.49).

In addition, there is also evidence that while U.S. exports to Brazil have been growing at an average rate of about ten percent, Brazilian exports to the United States have stagnated at around \$8.7 billion since 1994.

It is true that such stagnation reflects the structural adjustment experienced by the Brazilian economy under what is known as President Cardoso's Real Plan. However, it also emphasizes the need for engaging in deliberate measures to overcome the obstacles that are hindering the development of trade relations among these two giant economies.

As indicated by the figures revealing the stagnation of Brazilian exports to the United States, Brazil cannot afford, for too long, to lose market share in the United States. The reason is that for Brazil, besides MERCOSUR, the United States remains the most important market for its non-traditional exports and its most sophisticated manufactures. Therefore, circumstances are compelling the governments of both Brazil and the United States to negotiate and adopt jointly more deliberate ways of dismantling existing trade barriers.

For the United States, interest in the negotiations is based also on a compelling need to preserve market share in a region that is becoming the fastest growing market for U.S. exports, but in which U.S. products are subject to increased competition from rival advanced economies.

By the force of numbers, therefore, Brazil and the United States must improve their bilateral relations to the point that both envisage the same outcome in the forthcoming hemispheric trade negotiations, which include the members of MERCOSUR and NAFTA. If the two giant economies of the Hemisphere are looking in the same direction, there will be grounds to anticipate a positive outcome for the negotiations.

For this purpose, the United States will have to exercise active leadership. It has been recently confirmed, again, that the only way the United States can exercise effective international leadership is if it is based on a solid bipartisan consensus.



Recent events have demonstrated that neither the Administration, nor the Congress can do it alone in international affairs. Their active collaboration is more than ever essential for the accomplishment of a proactive international agenda.

Therefore, it is encouraging that, by the end of this month, the President will seek fast track authorization to negotiate trade agreements.

The timing is right, since the thirty-four Ministers of Trade of the Hemisphere have recommended launching negotiations to create a Free Trade Area in the Americas (FTAA) at the next Summit of the Americas, in Santiago, Chile, in April 1998.

However, it is not essential for launching the negotiations that President Clinton travels to Santiago, next April, endowed with fast track authorization. Experienced observers recall that the Uruguay Round was launched, in 1986, before the President of the United States obtained fast track authorization. But there is also consensus that the approval of fast track would represent a very encouraging signal.

Additionally, as clarified in the Economic Report of the President, practicing the principle of nondiscrimination, as the cornerstone of the present international trading system, makes of trade liberalization a public good. Consequently, since the results of negotiations benefit everybody, it is essential that the United States also practice "with ingenuity . . . the artful use of the fear of exclusion," to persuade "free-riders" against sitting back, while others liberalize.

Also, the United States, as the leading economy in the present international system, must make sure that practicing regionalism is compatible with global trade liberalization. This means that the process of negotiation cannot involve exclusively "principal suppliers," or major trading partners. It has to include the smaller economies of the Hemisphere and those that are relatively less developed.

Only in this inclusive manner can the process prove it is open and accessible to at least those governments who originally participated in the Miami Summit. This means that the principle of open regionalism must be observed by all the participants.

Finally, the private sectors from all the participating countries, understood in the widest sense, must also be incorporated into the negotiations for the FTAA.

#### VII. 6. SAN JOSE TRADE VICEMINISTERIAL (WDW/25/97 17 SEPTEMBER 1997)

The first viceministerial on Hemispheric trade, in preparation of next year's ministerial, was held in San Jose, Costa Rica, from July 28 to 31, 1997. The mandate for the meeting emanated from the Belo Horizonte Ministerial, which instructed the Viceministers of Trade, from the 34 governments that participated in the Miami Summit of 1994, to function as Preparatory Committee (Prepcom) to launch the Free Trade Area of the Americas (FTAA) negotiations.

There was some expectation about the meeting, because it was the first of the recently created

Prepcom and the first of three viceministerials that the Government of Costa Rica will chair as new host, until the next Ministerial to be held in San Jose, on 19-20 March 1998.

Three topics dominated the discussions in San Jose. First, the functioning of the twelve working groups that have been carrying out the groundwork for the negotiations; second, how to deal with the small economies; and third, the outline of the San Jose Declaration, that the Ministers of Trade will issue in March 1998.

The Prepcom drafted a list of instructions basically aimed at completing the tasks that have been requested from the working groups. There is consensus that, at some point, the existing working groups will become negotiating groups, consequently, those groups that have been operating will have to cease functions.

The instructions are contained in a general guide reproduced as Annex 3 of the meeting's minutes. The priority for all the working groups, except for the one on dispute settlement, is to present alternatives to the next Prepcom meeting on technical issues and negotiating approaches.

Specifically, the working groups also were instructed to consider explicitly the relevance of their conclusions for the smaller economies and to present their conclusions to the next Prepcom meeting in October. If there is no consensus within a Working Group on certain issues, the different alternatives discussed will have to be elevated also for the consideration of the next Prepcom meeting.

Finally, the working groups are instructed to consider the recommendations of the Business Forum, especially those made on business facilitation measures. For this purpose, each working group was instructed to organize joint seminars and conferences with the private sector.

How to deal with the small economies came to the forefront, again with full force, as the Viceministers were drafting the instructions to the working groups. Despite the functioning of a specific working group, dedicated to this topic, there seems to be no consensus yet on how to deal with the participation of the small economies.

The delegations from these economies are divided on how to approach the issue. One group holds that it is necessary to discuss the topic in all the working groups, to identify specific measures aimed at assuring the full participation of the small economies in the negotiating process. Another group holds that this is not necessary, because the specific recommendations that will emanate from the working group on small economies will be enough to deal with the issue.

Behind this divergence among the representatives of the small economies, which cuts across some existing subregional integration processes, lies a different perception of the treatment that will be granted to these economies. Obtaining non-reciprocal, preferential treatment still exercises a powerful attraction among some governments. Others believe, by contrast, that circumstances have moved this possibility beyond such unilateral measures and that, today, there is no substitute for reciprocal concessions granted through negotiations.

This divergence remains as one of the most difficult to have appeared during this preparatory stage. Meanwhile, the working groups were instructed to make specific recommendations to the next Prepcom meeting.

Also discussed by the Viceministers was an annotated outline of the San Jose Declaration, which will have to be approved by the ministerial of March 1998. The outline was based on the Declaration of Punta del Este of 1986, which launched the Uruguay Round negotiations, containing the following items: objectives; general principles; issues for negotiation; participation; management, organization and site. The delegates commented on the outline and requested from the chair the preparation of a draft, including their comments, for consideration of the next viceministerial.

Another point discussed during the meeting were measures for business facilitation. The next business forum was asked to include such measures in the agenda of the next meeting, to be held in San Jose from 16 to 18 March 1998. The outcome was that the chair was asked to prepare a document, to serve as basis for the discussions that will take place on business facilitation during the next viceministerial.

The chair also proposed new dates for the next meetings as follows: second viceministerial, 28-30 October; third viceministerial, 10-12 February; business forum, 16-18 March; and fourth ministerial 19-20 March.

To conclude, by contrast with the previous meetings, chaired by bigger economies, this time the new chair made a difference. Except for the always-thorny treatment of the small economies, there were no major controversies and most of the issues were discussed in a cordial atmosphere. It was evident that the chair by a smaller economy appears as having less of an agenda of its own, which makes less controversial the presentation of initiatives and suggestions.

VII. 7. FEINBERG ON SUMMITRY  
(WDW/26/97 24 SEPTEMBER 1997)

Before departing to a prestigious academic job in the West Coast, Richard Feinberg, the most senior "Latin Americanist" of the first Clinton Administration, has written a description of the Miami Summit. The book's title is Summitry in the Americas: A Progress Report (Washington: Institute for International Economics, 1997).

Feinberg considers his participation in these events the most valuable contribution he made during his tenure as Special Assistant to the President and Senior Director for Inter-American Affairs, at the National Security Council (NSC). What this lengthy title means is that Feinberg, for almost four years, was President Clinton's closest advisor on Latin America.

His credentials for that position were impeccable and his appointment raised high expectations among the small but outspoken Washington network of Latin Americanists. It is fair to say that he lived to that promise, particularly because of his role, described in the book jacket, as "an architect of the Summit of the Americas."

Given his decisive contribution to the Summit, Feinberg promises a book of historical interpretation, policy analysis and prescriptive advice, but that is also a personal memoir.

There is always a risk that "instant" memoirs avoid controversy and end up being either boring descriptions of rituals and formalities, or self promotion exercises. Feinberg recognizes these inherent risks of being a "participant-observer" and avoids both pitfalls with dexterity.

For instance, he never uses the first person singular and gives more credit to others than to himself. Additionally, when he cannot avoid talking about himself, he uses the more modest third person, identifying himself as "the author."

The other pitfall is more difficult to overcome, because the book deliberately refrains from revealing secrets, since it is based on "cleared" documents and interviews with participants, most of which remain unidentified. Still, Feinberg offers a good description of the preparatory events that led to the Summit and he is right, given the history of U.S.-Latin American relations, just the fact that the Summit took place is already an accomplishment.

Feinberg attempts to enliven the description of Summit preparations identifying several villains and heroes. Perhaps the main villain is the bureaucracy. He has a Kissingerian perception of the National Security Council's role, as the purveyor of substance to bureaucratic rituals more concerned with procedure.

Among the delegations, the Brazilians from Itamaraty, the Ministry of Foreign Affairs, are singled out as constant spoilers. This triggered a response, from the Brazilian Ambassador to the United States, saying that Feinberg is still too paternalistic and that he is obviously not used to negotiating with partners that have a mind of their own.

Finally, the idea of "hemispherism," understood as closer political and economic ties among the nations of the Hemisphere, has also many enemies in both the United States and in Latin America and the Caribbean. These are identified as isolationism, nationalism, Bolivarianism, Yankeeophobia,

imperialism, protectionism, and so forth.

Among the heroes of the narrative, within the U.S. government and perhaps with an eye on 2000, Vice President Al Gore is singled out. By contrast, President Clinton comes out not as deeply engaged. Perhaps the unsung heroes are the profound changes in Latin America and the Caribbean that have led to the emergence of democracies and open economies.

But the book is not only an attempt to describe what happened, it also draws a balance between strengths and weaknesses of what resulted from the Summit. The accomplishments were the emergence of a new agenda, which overcame the North-South divide in the Hemisphere and that expanded the scope of collective action. The weaknesses were that the agenda, with its 23 initiatives and more than 150 actions, was too broad and ambitious. Additionally, there was no commitment to dedicate fresh financial resources to accomplish the goals, which revealed in effect that, with a few exceptions, the diplomats managed to avoid committing their governments to binding obligations, backed by credible enforcement mechanisms.

That represents an honest evaluation of the outcome, although Feinberg tries to show, using a Spanish saying, that the governments have moved from "dichos" to "hechos," (from words to deeds). However, he must have forgotten that in Spanish the saying has a pun, "del dicho al hecho, hay mucho trecho" (from word to deed, there is a long stretch).

Therefore, the author accomplishes three of the four objectives he promises to deliver in the book's introduction. The description of the origins and the policy processes that led to the Miami Summit, the evaluation of its accomplishments and shortcomings are among the strengths of the book.

Unfortunately, as a "personal memoir," the book remains far from the goal. Particularly because of the absence of an explanation for the still incomprehensible fact that the author immediately after the Summit quietly left the Administration, despite his convictions about the accomplishments and promises of summitry in the Hemisphere.

This enigma remains unanswered and demands explanation. Perhaps Feinberg will do that, hopefully when distance and time allow it, in his next book.

#### VII. 8. GUANACASTE TRADE VICEMINISTERIAL (WDW/33/97 12 November 1997)

The second viceministerial on Hemispheric trade liberalization, in preparation of next year's San Jose ministerial, was held in Playa Conchal, Guanacaste, Costa Rica, from 28 to 30 October 1997.

The mandate for the viceministerial emanates from the Belo Horizonte Ministerial, which instructed the viceministers of trade, from the 34 governments that participated in the Miami Summit of 1994, to function as Preparatory Committee (Prepcom) to launch the negotiations for the Free Trade Area of the Americas (FTAA).

The meeting's agenda contained the following topics: 1) report by the Chair on the IV Ministerial and IV Business Forum of the Americas; 2) revision of the reports submitted by the working groups; 3) structure of the negotiation; 4) feasibility study on an administrative secretariat; 5) technical note on business facilitation; 6) outline of the Declaration of San Jose.

Three topics dominated the discussions in Guanacaste. First, the principles and objectives of the negotiations; second, the structure of the negotiations; and third, the creation of an administrative secretariat.

The discussion about the principles and objectives of the negotiations took place as part of the analysis done by the PREPCOM of the different proposals presented by the working groups, summarized by the chair in a matrix, according to the instructions each group received from the first PREPCOM.

The discussions of these principles and objectives were the lengthiest, because the delegates were drafting the text of what will later become the draft of the Declaration of San Jose, which will be elevated to the Ministers.

As a result of the discussions, several points of consensus have emerged from the proposals presented by the working groups. However, it was left to the discretion of the working groups to hold additional meetings, with the exception of the group on sanitary and phytosanitary regulations, which was instructed specifically to meet again, to attempt achieving consensus among still divergent proposals.

Perhaps the issue that will require more debate is a proposal presented by the delegation of MERCOSUR, which continues participating in the debates with impressive discipline through a single spokesperson.

The Viceminister of Foreign Affairs of Uruguay, on behalf of the four member countries of MERCOSUR, proposed that the negotiations be subject to the following three principles: balance, gradualism, and simultaneity.

The MERCOSUR delegation understands these principles in the following manner: 1) Balance means that the process and the results will "contemplate the objectives and interests of all the parties." 2) Gradualism refers to the evolution of the negotiations, which should take place in accordance with the sequence demanded by each thematic area." 3) Simultaneity consists of the requirement that partial understandings be part of a general agreement, in accordance with the commitment that the result of the negotiations will be a "single undertaking."

The MERCOSUR delegation indicated that these principles, presented for the first time, replaced the position previously held that the negotiations should take place by stages. Several delegations requested clarifications about these principles proposed by MERCOSUR, while the debate about them was left for the next meeting.

There was also agreement that the Chair should gather all the points of consensus and incorporate them in the project of declaration, which will be also discussed in the next meeting.

The discussion on the structure of the negotiations was based on two separate written

proposals, presented by the Canadian and the U.S. delegations, and other verbal proposals presented by several delegations.

The main difference between the Canadian and the U.S. proposals lies in the number of working groups proposed. The Canadian proposal suggests the creation of three main negotiating groups, on goods, on services and on rules, and a consultative group on smaller economies and another group on dispute settlement and institutional issues.

The U.S. proposal enumerates the following nine negotiating groups: market access, investment, services, government procurement, subsidies, competition policy, intellectual property, antidumping and countervailing duties, and dispute settlement. Additionally, the U.S. proposal includes the creation of two "study groups," on labor and environmental issues.

The MERCOSUR delegation, in a verbal presentation proposed the creation of a negotiating group dedicated to agriculture. While there was also opposition to placing the group on small economies at a consultative level.

The preliminary discussion revealed consensus on the role of the Ministers of Trade, as the supreme decision making body of the negotiations. There was also agreement that the Viceministers will conduct the negotiations, through their participation in a "negotiation committee." Other issues were discussed, such as the number of negotiating groups and subgroups and how to deal with the small economies and with dispute settlement procedures, but they were left for the next meeting.

On behalf of the Tripartite Committee (OAS-IDB-ECLAC), the representative from ECLAC summarized the contents of the previously circulated study. The Prepcom received the study and asked the chair to initiate consultations with the purpose of building consensus on this issue.

Several delegations confirmed the candidacy of different cities as siege for the Secretariat. The candidates are: Bogota, Buenos Aires, Kingston, Lima, Mexico, Miami, Panama, Rio de Janeiro, and Washington. The Brazilian delegation presented a detailed proposal, including costs, of locating the Secretariat in Rio de Janeiro.

Finally, the delegations were asked to present, by November 17, comments and observations on the document presented by the chair on business facilitation, to be discussed in the next meeting, which will take place in San Jose, Costa Rica, on 10-13 February 1998.

## VIII. MULTILATERAL FINANCIAL INSTITUTIONS

### VIII.1. THE RESILIENCE OF SOME INTERNATIONAL ORGANIZATIONS (WDW/27/97 1 OCTOBER 1997)

Funding international organizations has become entangled with the reduction of domestic fiscal deficits. In the most advanced economies, the reduced margin that exists to balance domestic budgets comes from the difficulties of cutting those expenditures that finance so-called "entitlements."

This rigidity emanating from expenditures in entitlements has led to concentrating the search for balanced budgets on so-called "discretionary" spending, among which figure most prominently the contributions to international organizations.

In these conditions, expenditures earmarked for certain specific activities, which may be eliminated without major consequences, have become easy victims of domestic bickering about balanced budgets.

Attempts to overcome these funding controversies, through negotiations, have only led to stiffening the conditions for disbursements to meeting certain targets. This has led to some instances of outright micro-management by the contributing governments.

However, there are exceptions to this trend toward austerity and "cherry-picking," which prevails among governments concerning the functioning of international organizations. It has remained almost unnoticed that there is a group of international organizations that have escaped some of the budgetary restrictions and the nasty debates which prevail today.

This group is composed by some international organizations whose operational budgets are not financed by outlays that are subject to a yearly authorization by the parliaments of the member countries. Such is the case of international financial institutions (IFIs), as the International Monetary Fund (IMF) and the World Bank, as well as of the regional and subregional development banks.

Notice that the contributions to the capital of these institutions have not escaped the controversy. Only the IFI's operational budgets have not been subject to the scrutiny and approval of the national parliaments of the member governments. The main reason is that these operational budgets are not financed with voluntary contributions from the member governments. This is not the case, for instance, of the most vulnerable peace-keeping operations of the United Nations.

The budgets of the IFIs are financed from the mandatory commissions collected for executing the loans that these institutions grant to their member governments and, to a lesser degree, to the private sectors of the member countries.

As integral parts of the loans granted, the commissions are paid by the debtors. Therefore, they enjoy the same sovereign guarantees that protect all the loans granted by these multilateral institutions.



It is not that these operational budgets are unaccountable. To be sure, the annual meetings of the Boards of Governors and the meetings of the Executive Directors, as representative organs of the member governments and as the supreme level of decision making of the IFIs, approve every year their operational budgets. However, the sources of funding such budgets are not subject to the discretion of the parliament of each member government.

Therefore, a paradox of plenty has emerged in these times of parsimony and austerity in the functioning of some international organizations. On one side, those institutions that depend for their funding from the yearly budgetary outlays of its members receive increasingly less, amidst acrimonious debates about allegedly unaccounted bureaucratic waste. On the other, the multilateral financial institutions increase their operational budgets without much controversy.

Moreover, even the contributions to the capitalization of the multilateral financial institutions are relatively less controversial.

For one thing, these contributions may not lead to actual disbursements. As in the case of the multilateral development banks, government commitments to their capital serve only as guarantees for raising the resources through the emission of highly graded paper in international capital markets.

The same can be said of the IMF, which according to its Managing Director Michel Camdessus functions as "a financial cooperative." Each member of the Fund contributes a "quota" in foreign exchange and national currency, which does not increase outlays because it is the equivalent of a deposit in a bank. For instance, the United States considers its quota subscription as "an exchange of assets with the IMF, not as a budgetary outlay."

Additionally, donors and recipients are aware of the concrete benefits that emanate from the salvage operations and the development projects executed with the funding from these multilateral financial institutions.

Finally, circumstances are making funding these institutions even less controversial, as the flows of resources coming out of the IFIs constitute an increasingly less significant proportion of the total flows of capital in the world. For instance, in 1996, funds from the multilateral financial institutions represented only 15 percent of all the flows of resources going to the developing economies. Private, not official, capital flows constitute today the most important source of funding for the developing economies (WDW/10/97 p.32).

## VIII.2. THE WORLD BANK ANNUAL REPORT (WDW/29/97 15 OCTOBER 1997)

President J. Wolfensohn, in the introduction of this year's annual report, says that the past fiscal year, from 1 July 1996 to 30 June 1997, has been characterized by "renewal" at the World Bank. The Report's overview, perhaps with some hyperbole, refers to "an escalation of the process of renewal" at the Bank.

The specific objective of all the changes that are taking place at the Bank, according to

approved by the Inter-American Development Bank (IDB) in the same fiscal year. Therefore, the World Bank no longer holds the first place as provider of official development finance to Latin America and the Caribbean. The IDB has taken that leading position.

The three largest borrowers from the Bank in FY 97 were China (\$2.5 billion), Russia (\$1.7 billion) and Argentina (\$1.4 billion). The three largest borrowers from IDA in FY 97 were India (\$903 million); Vietnam (\$349.2 million); and China (\$325 million). Overall, in FY 97, Argentina, Brazil, Mexico and Peru appear among the top ten borrowers from the Bank and IDA together.

In the section dedicated to Latin America and the Caribbean, the Report identifies the main development challenges that exist in the region, as "serious poverty, inequality and unemployment." Additionally, the average rate of growth of 3 to 4 percent a year for most of the countries in the present decade is characterized as "insufficient to permit sustained progress on poverty reduction."

To carry out these operations for FY 98, the executive directors approved a total administrative budget of \$1,423.9 million and a net administrative budget \$1,212 million. This represents an increase of almost \$50 million from FY 96, after decreasing during the previous three consecutive years. The increase is due to the execution of the "Strategic Compact" of reforms.

Finally, at the end of FY 97, regular and fixed term staff numbered 5,443, down from 5,681, as of 30 June 1996. Also, in FY 97 207 new staff members were hired, of which 30 percent were from developing countries and 40 percent were women. The expectation is that during FY 98 recruitment of new staff will remain at a higher level, due to the requirements of the "Strategic Compact" of reforms.

### VIII.3. THE IMF ANNUAL REPORT (WDW/30/97 22 OCTOBER 1997)

This year's annual report of the International Monetary Fund (IMF), for the fiscal year ending 30 April 1997, marks the inauguration, on 1 January 1997, of the third mandate for its Managing Director Michel Camdessus.

Against the background of a world in economic recovery, the Report describes IMF operations in the following fields. First, surveillance of members' performance, including new topics, such as banking soundness, data dissemination, and good governance. Second, existing financial instruments were adapted, with the continuation of the Enhanced Structural Adjustment Facility (ESAF) and the initiative, with the World Bank, to help heavily indebted poor countries (HIPC's). Finally, the adequacy of quota resources and increasing capacity to borrow were also under consideration, as in the case of the eleventh quota increase and the creation of the New Arrangements to Borrow (NAB) (WDW/5/97, p.2).

Another significant development in FY 96/97 was the endorsement by the Interim Committee of the IMF's Board of Governors, in April 1997, of the need to amend the Articles of Agreement to make capital account liberalization a Fund's task. The amendment will give the Fund appropriate jurisdiction to oversee the orderly liberalization of capital movements, which are of decisive importance for the stability of today's international monetary system.

Additionally, the Executive Board recognized "the vital importance of good governance for economic efficiency and growth." Among other factors, emphasis was placed on efficient use of public resources, the creation of an environment conducive to private sector activity, and public support for economic reforms.

Total new commitments, during fiscal year 96/97, in 28 new stand-by, extended and ESAF arrangements, reached SDR 5.3 billion (more than \$7.1 billion). This represents "a moderation in the demand for IMF resources," compared with the commitments for 95/96 of SDR 19.7 billion (almost \$27 billion) and SDR 16.6 billion (about 23 billion) in 94/95.

The decrease in new commitments is explained by the fact that in 95/96 there were several large operations. One for SDR 6.9 billion (about \$10 billion) for Russia, the largest extended arrangement in IMF's history. Also, Mexico was closely behind with SDR 6.8 billion, under a stand-by arrangement amounting to SDR 12.1 billion.

By contrast, this year's drawings were more moderate, reaching SDR 5.6 billion, including SDR 2.1 billion by Russia, SDR 512 million by Algeria; SDR 321 million by Argentina; SDR 598 million by Ukraine; and SDR 350 million by Venezuela.

Repayments exceeded drawings, amounting to SDR 7.2 billion, including voluntary advance repayments by Mexico for SDR 2.6 billion and SDR 140 million by Hungary.

Consequently, the IMF's liquidity ratio, the relation between uncommitted usable resources and liquid liabilities, rose to 121 percent, at the end of April 1997, compared with a level of 90 percent a year earlier.

Providing technical assistance and training to the member governments were also among the main activities, amounting to 14 percent of the Fund's total administrative expenditures, during FY 96/97. To carry out these technical cooperation activities, the Fund also increasingly uses external sources.

Total person-years of technical assistance granted by the Fund, in FY 96/97, amounted to 172.7, down from 220.0 in 94/95 and 211.4 in 95/96. Out of these total, 104.2 person-years came from external sources, such as the Japanese government with 67.3 person-years, and the United Nations Development Program (UNDP) with 21.5 person-years.

To carry out its work program, the Fund in FY 96/97 hired 2,903 staff years from 121 countries, compared to 2,927 staff years the previous year. By nationality, almost 26 percent of IMF staff was from the United States, 33.2 percent from Europe, 14.8 percent from Asia, and 11.8 percent from the developing countries of the Western Hemisphere.

Recruitment of new staff amounted to 133 staff members in calendar year 1996, out of which 67 were economists, 24 were other professionals and 42 were support staff. By gender, in calendar year 1996, women amounted to 46.3 percent of total staff and 27.7 percent of combined professional and managerial staff. Among economists, the largest group of professionals in the Fund, the share of women was 18.6 percent in 1996. Among managerial staff, only 9 percent were women, by contrast with 85 percent of support staff who are women.

The Fund's administrative budget for FY 96/97 amounted to \$490.5 million, with actual administrative expenditures during the year amounting to 471.6 million and capital project disbursements amounting to \$151.5 million, including \$137.8 million for major building projects. For FY 97/98 the administrative budget will increase to \$503.6 million and the capital budget to \$42.6 million.

Surveillance with 27.8 percent and use of Fund resources with 25.7 percent, both, were the activities that required more than one half of the Fund's administrative budget during FY 96/97. Finally, membership in the Fund remained constant at 181 countries, with the Republic of Palau applying for membership in December 1996.