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International Economic Survey

Overview

The world economy is expected to strengthen moderately in 1994 after a slower growth of only 1% to 2% a year during the past three years. With world output projected to increase by 3% in 1994, the volume of world trade is also expected to expand by almost 7%. Given that large margins of production capacity are expected to continue in many industrial countries, there appears to be little risk of a generalised pickup in inflation, notwithstanding the recent increases in commodity prices. The improvement in the global economic climate since the early part of 1994 can be attributed to the substantial improvements in economic policy and performance in a growing number of developing countries, the improvements in economic management under way in the economies in transition, the growing recognition in the industrial countries of the need to improve the labour markets and strengthen the financial position of the public sector as well as the considerable progress in price stability in many countries. The global economic outlook has also been further enhanced by the successful conclusion of the Uruguay Round (UR) of trade negotiations in December 1993 and its political acceptance by participating countries in April 1994.

Beginning the second half of 1994, recoveries were finally under way across most of continental western Europe, while the upswings in Australia, the United Kingdom (UK) and Canada have strengthened considerably. In the United States (US), expansion has been proceeding at a strong pace since the third quarter of 1993, such that by mid-1994, a high level of capacity utilisation had already been restored. Japan's prolonged stagnation has also bottomed out and there is evidence that some rebound of the economy can be expected by the end of 1994.

As in the past three years, a particularly positive aspect of the world economic situation remains the continued robust performance in the developing countries, although the strong aggregate performance masked considerable diversity. Growth in a large number of Asian economies and some Latin American developing countries is likely to remain strong throughout 1994, against a background of rising consumption and investment demand. In Central Europe and the Baltic states, the contraction in output experienced during the early years of market reform has bottomed out and economic growth has resumed in some of these countries. Although the outlook appears to be improving in some African countries as a result of stronger commodity prices and continued macroeconomic reform efforts, conditions are expected to remain difficult especially in the sub-Saharan region. In addition, Russia, the Ukraine, Belarus, and the Transcaucasian and Central Asian countries in transition remain exceptions to the generally encouraging picture in the developing countries.

World Trade

In line with the recovery in world growth, continuing internationalisation of manufacturing production as well as the impetus brought about by the successful conclusion of the Uruguay Round, world trade is expected to rebound in 1994, rising by 6.8% (1993: 3.7%). The spread of recovery to Europe and Japan, the appreciation of the yen and the deutschmark, the rise in commodity prices, stronger import demand from a number of countries in transition, the continued dynamism of the South and East Asian as well as Latin American economies, will combine to induce a large acceleration of world trade. Associated with the broadening of the recovery in the global economy, import demand will also redistribute more equally across regions.

Industrial countries' exports are projected to rise by 5.4% (1993: 1.8%), while imports are also likely to rise to 6.6% in 1994 (1993: 1.2%). Stronger activity in the US and a strengthening of recovery across the rest of the countries of the Organisation of Economic Cooperation and Development (OECD) will spur an increase in import demand. While import growth in North America, particularly in the US, is expected to slow down slightly, it will accelerate markedly in Japan. Total import volume into the US is expected to rise by more than 11.6% in 1994, only slightly less than that in 1993, at 12.6%. A number of developing countries are expected to benefit from the continuing US demand, notably South and East Asia and Latin America. Imports into Japan are also expected to grow in 1994 despite that country's nascent recovery, largely caused by the appreciation of the yen. Exports however, are projected to decline steadily from -1.1% growth in 1993 to -0.7% in 1994, despite the strong demand growth in Japan's major markets, namely the US and East Asia. Import demand from the European Union (EU) is also projected to recover in 1994 at 4% after a -5.1% decline in 1993, as the economies of the 12 member states strengthen.

Trade among the developing countries is also expected to expand strongly in 1994, supported by trade liberalisation and increased intra-regional foreign direct investment. Intra-regional trade which already accounts for 15% to 20% of trade among developing countries in East Asia and Latin America, in particular, is expected to become an important stimulus to world trade growth. In contrast to recent experience, benefits from the substantial rise in demand for developing countries' exports projected for 1994 will be more evenly spread, including countries in sub-Saharan and North Africa, Middle East and Eastern Europe. While imports and exports by developing countries as a group are likely to moderate slightly to 7% (1993: 8%) and 9% (1993:10%) respectively in 1994, imports into the fast-growing Asian developing countries, especially East Asia will remain buoyant. In Latin America, high levels of capital inflows, albeit more modest than those achieved in 1992-93, as well as continued output expansion, are expected to induce a sustainable level of imports at 7.3% in 1994 (1993:8.6%).

A significant factor in the improved outlook for several developing economies has been the improvement in commodity prices. Although

commodity prices experienced sharp price movements over 1993, by mid-1994, prices had on average risen by about one third above their very low level in the previous year. While increased demand from continental Europe and North America is an important factor in the rise of commodity prices, additional price pressure has also emanated from supply constraints. In addition, increased demand for many commodities has also been due to rising demand from the Asian economies which are relatively large users of raw materials. While the broadening of recovery among the industrial countries is expected to improve the outlook for commodities, prices remain subject to volatile fluctuations due to weather conditions and stock availability.

Capital Flows

The world-wide flows of foreign direct investment totalled US\$185 billion in 1993, up from US\$171 billion in 1992. They are, however, well below the 1990 peak of US\$232 billion. Developing countries benefitted from international bond and equity flows amounting to US\$71 billion (1992: US\$33 billion), whilst net foreign direct investment totalled US\$59.3 billion, twice the level of 1991, and up from US\$39.9 billion recorded in 1992. With over US\$20 billion in inflows, China has emerged as the largest developing-country recipient. Flows into the developed countries are estimated to increase to US\$109 billion in 1993 as growth resumed in these countries. Foreign direct investment flows into the US recovered in 1993 to reach almost US\$32 billion from US\$3.4 billion in 1992. Inflows into Western Europe remained relatively stable despite recessionary conditions, reaching US\$109 billion in 1994, as corporations adapted and restructured to take advantage of the emerging re-configuration of the Western European markets arising from the Single Market, the expected extension of the European Union (EU) to include four new members as well as freer flow of trade and investments resulting from association agreements between the EU and several Central and Eastern European states.

The surge in capital flows - foreign direct investment, short-term inflows, long-term portfolio investment and equity - in 1993 to developing countries was partly due to the successful adjustment and stabilisation efforts of a large number of developing countries, which have led to buoyant domestic markets and improvements

in production costs and productivity growth. The inflows have also been spurred by the weak activity and thereby, the demand for funds and the associated decline of interest rates in the industrial countries. In 1993, improved conditions in the world's major capital exporting countries, including the US and the attraction of gaining market entry in developing countries accounted for the upsurge in capital flows, which exceeded US\$130 billion.

However, while total capital flows to the developing countries as a group increased strongly in 1993, the majority of these flows continued to be concentrated in a relatively small number of middle-income countries in Asia and Latin America. Some low-income countries with promising growth potential and commanding large markets especially China and India, have also been very successful in attracting foreign direct investment. Between 1991 and 1993, these selected Asian and Latin American countries have been major recipients of portfolio and foreign direct investment, receiving an estimated US\$66 billion in inflows, about half of the total flow to developing countries. Intra-regional foreign direct investment, notably by residents of Hong Kong and Taiwan, has also grown significantly during the same period. Portfolio investments have been substantial as well, with inflows averaging over US\$110 billion a year and outflows averaging over US\$3 billion a year during 1991-93.

In 1993, China emerged as the largest recipient of foreign direct investment, accounting for more than 40% of the inflows to Asia. Malaysia and Singapore were also major beneficiaries of foreign direct investment, but at less than half of the level of flows to China. In the case of Malaysia, this represented a sizeable pickup in inflows, while for Singapore, it represented a relatively steady inflow. Thailand and Indonesia also saw sizeable foreign direct investment inflows in the same period.

Mexico, Argentina and Chile have benefited considerably from foreign direct investment, which has amounted to over US\$12 billion annually between 1991-93. Mexico, in particular, enjoyed a boost in foreign direct investment in 1992 at the height of the North American Free Trade Agreement (NAFTA) negotiations as investors foresaw new opportunities through the creation of a wider economic space. In Latin America, inflows in the form of private bond and equity financing have also played an important role, reflecting the changing structure of capital markets in these countries. Portfolio investment inflows in

Latin America have averaged US\$25 billion a year, partially offset by an average outflow of US\$7 billion a year in the same period.

Foreign direct investment inflows to the economies in transition in Central and Eastern Europe have also risen sharply over the period 1991-93, amounting to 10% of total foreign direct investment inflows to the developing countries. However, most African countries continue to attract very little private capital, reflecting slow growth prospects and political and economic instability. Annual flows of foreign direct investment to Africa remained unchanged in 1991-93, with almost all of these flows going to Nigeria, Tunisia and Morocco.

Several external and domestic factors accounted for the concentration of capital inflows to a selected group of countries in Asia and Latin America. The cyclical downturn in activity and the decline in interest rates in the large industrial countries during the recession of the past three years have played an important role in the recent surges in capital flows to these countries. Notwithstanding that, the recent flows also reflect a longer-term trend toward globalisation and international diversification of industrial-country investment. Another equally important factor is the financial deregulation in the industrial and developing countries, which has resulted in greater competition in financial markets and has increased international capital mobility.

While external development factors are important, domestic factors have also been decisive in attracting capital flows to countries in Asia and Latin America. These countries have made significant progress in fostering macroeconomic stability, structural reforms and outward orientation of trade policies. Financial deregulation and liberalisation of capital controls, privatisation and tax reforms have led to an improved supply condition, thereby enhancing the potential returns on long-term investments. In many cases including Argentina, Chile, Malaysia, Mexico, and the Philippines, privatisation programmes have spurred capital inflows.

Inflows to developing countries are expected to remain positive in 1994. Although the economic recovery in the developed countries currently under way will attract considerable capital flows again, substantially higher economic growth rates in the developing countries combined with higher savings in industrial countries and improved confidence

should help to sustain the supply of flows to developing countries in the aggregate. These favourable influences should more than offset the dampening effects of higher short-term interest rates, uncertainties with respect to long-term interest rates and the tendency to reduce the portfolio share of emerging markets as the industrial countries recover.

Developments in Trade and Economic Cooperation

In April 1994, the signing of the Final Act of the Uruguay Round (UR) and the agreement to establish a World Trade Organisation (WTO) signalled a defining moment in world trade history. The Marrakesh Meeting marked an important step towards a universal trading system, expected to enhance world trade, thereby leading to new opportunities for investment and employment. The various agreements will substantially advance trade liberalisation prospects, expand and strengthen multilateral rules and disciplines governing international trade, promising further non-inflationary growth in accordance with the objective of sustainable world wide development.

As at October 1994, the ratification of the UR Agreements remains outstanding in the major countries as only 27 of the 125 GATT member countries have ratified the April accord. In the US, the ratification process appears to be progressing steadily within the Congress whilst ratification in the EU has been delayed by a debate as to whether the European Commission should submit the Agreements for the consideration of the European Parliament or whether member countries must take the final legal steps. In 50 other countries, administrative and/or constitutional processes for ratification are proceeding positively. A minimum of 75% of the participating countries of the UR must confirm acceptance of the Final Act and the WTO by end-1994 to be in time for entry into force by 1 January 1995.

Political acceptance of the Final Act and the Agreement to establish the WTO has not meant that trade disputes have been on the decline. Trade relations between Canada and the US encountered a difficult phase in early 1994 over softwood timber, grain and subsidies, whilst the US took on China over possible revocation of Most-Favoured-Nation (MFN) status. Trade acrimony between Japan and the US persisted well into 1994 over the Japanese Government's procurement policies ranging from telecommunications and medical supplies to cars, car

parts, satellites and insurance services. The talks under the US-Japan Framework for a New Economic Partnership were carefully monitored by all countries, especially with regard to qualitative and quantitative indicators to measure progress in market opening. Although the US has given assurances that achievements under the Framework would be available on a MFN basis, countries have been concerned about numerical targets, the management of markets and the threat of unilateral trade sanctions. In August 1994, the US and China signed a Framework Trade Agreement aimed at further expanding commercial ties between the two countries. In particular, the accord is expected to foster cooperation in several important sectors including chemicals, electric power, aviation, machinery and services.

In Europe, negotiations for the enlargement of the EU to include Austria, Finland, Norway and Sweden were completed. These four European Free Trade Area (EFTA) members are expected to accede in 1995 if referenda are passed in their respective countries. The EU also debated over the admission, in some form, of the east European countries. In fact, Hungary and Poland have applied for EU membership. The question of enlargement continues to beset the EU, especially over issues such as budget contribution, agricultural policies and regional funding. Meanwhile, the central and east European countries are negotiating association, partnership and cooperation agreements with the EFTA; the Visegrad countries (Hungary, Poland, the Czech Republic, and the Slovak Republic) concluded a free trade agreement among themselves, as did the Baltic states. In negotiations with Turkey on a customs union, the EU has insisted on faster progress on legislative reforms. Turkey is due to enter the customs union on 1 January 1996 which will require it to lower its trade barriers to zero, and adopt the EU's common external tariffs.

The NAFTA came into effect at the beginning of 1994 as scheduled, and already, there was interest among the parties in discussing accelerated tariff reductions. Over the next 15 years, NAFTA will remove barriers to trade and investment within North America. It also sets the stage for reforms in domestic policies to foster trade and competition within an area that will rival the EU in economic size. The three members of the NAFTA espouse support for free trade for the North and South, but there are still questions on how to proceed with NAFTA enlargement or which countries might be candidates for early accession. Chile appears to be the most likely candidate.

Post Uruguay Round: Opportunities, Challenges And Future Agenda For Developing Countries

I. Assessment of benefits and opportunities from the Uruguay Round

Overall gains

The conclusion of the Uruguay Round negotiations promises to end the use of voluntary restraint agreements, reduce agricultural subsidies and protection and clarify anti-dumping rules which have all burdened developing-country exporters. Tariffs on industrial products have been substantially reduced and eliminated in many sectors of actual or potential interests to the developing countries while GATT-type disciplines have been extended into new areas such as services, intellectual property and investments. Most of the concrete gains from the Uruguay Round will, however, only be felt in the medium- to long- term, as the market-opening reforms have gradual phase-in periods, ranging from five to ten years starting in mid-1995.

The most important outcome of the Uruguay Round agreement is, however, unquantifiable: restoring predictability and discipline to the multilateral trading system by halting the backsliding in the trading environment that had been occurring in the past several years. Failure to secure an agreement could have snowballed into serious deterioration in trade relations between countries possibly delaying recovery in the world economy.

In the long term, the world economy is expected to reap both static and dynamic gains emanating from the reforms of the Uruguay Round. It has been suggested that static gains from the market access commitments would be a 1% annual increase in world income over the next ten years, with estimates ranging from US\$214 billion to US\$224 billion per year (in 1992 dollars). Developing country share of this gain is about one-third.

More important are dynamic gains, although these are more difficult to measure. These are benefits that arise from externalities generated by increased competition, economies of scale, greater innovation, technological spillovers and the positive effect of higher productivity growth on investments and savings. Stronger trading rules and their enforcement by the World Trade Organisation (WTO) are also expected to bring stability to policies. All countries will therefore

gain from higher growth, and the largest gains for the developing countries will be among exporters of manufactures.

Gains for industrial countries

In the *industrial countries*, gains to the European Union (EU) are estimated to range from US\$61 billion to US\$98 billion, the European Free Trade Area or EFTA will gain between US\$17 billion to US\$39 billion, while Japan stands to benefit from US\$27 billion to US\$42 billion. The value of the pact to the United States (US) is expected to range from US\$28 billion to US\$67 billion.

Gains and losses for developing countries

The share of the *developing countries* as a group is estimated at US\$78 billion (in 1992 dollars). Tariff reductions and removal of non-tariff barriers will benefit the most efficient producers in the developing countries - clothing, textiles, agricultural products and processed food - at the cost of those countries relying on preference schemes or quotas for market access. Additionally, some net food-importing countries may experience losses because of higher world agricultural prices as well as the erosion of trade preferences as liberalisation sets in. Indeed, lower gains from trade growth are likely to go to commodity producers.

The *rapidly industrialising countries in East Asia* are likely to gain most from lower trade barriers on many products in the developed and developing countries alike, as these countries have a diversified product structure and large shares of trade in their economies. A number of countries in South and East Asia are also likely to benefit in the intermediate term from the gradual liberalisation of trade in textiles and clothing. In *Latin America*, efficient producers of agricultural and resource-based goods are likely to gain markets. Increased security of market access is also important for growth of exports from Eastern and Central Europe.

On the other hand, the erosion of preferences brought about by the Uruguay Round is expected to result in losses in some countries, most notably in sub-Saharan Africa and to some extent in North Africa. Transition costs faced by these countries will be unavoidable and quite high. Furthermore, reduced subsidies in agriculture will lead to higher food prices, causing a deterioration in the terms of trade of net food-importing countries in North Africa, the Middle East, Eastern Europe and Central Asia.

II. The new global environment

During the 1980s, trade relations between the developed and developing countries underwent significant changes. Firstly, trade flows between developing and developed countries shifted from raw commodities to manufactures, the latter dominated by intra-industry specialisation, economies of scale, product differentiation and a significant amount of intra-firm trade, providing further evidence of the increasing interdependent character of international trade. Second, developing countries stimulated by domestic factors and unrelenting pressure by developed countries, accepted a greater degree of openness in their trade regimes as demonstrated by the rapid integration of developing countries into the GATT system in recent years. Frequently, such liberalisation was carried out without receiving concessions from their developed-country partners (or from other developing countries for that matter). At the same time that developing countries became more committed to multilateralism, there was growing ambivalence in key developed countries regarding the principles of a rule-based system as manifested in the drift of trade policies and the gradual *de facto* abandonment of GATT-rules.

This incoherence in developed countries' policies undermined the trade liberalisation policies in developing countries making it harder for some to sustain or to achieve outward-oriented growth. Indeed, the proliferation of managed trade, regional agreements and more ingenious non-tariff restrictions or 'grey-area measures' rendered insignificant whatever tariff liberalisation that might have been achieved over the previous seven GATT rounds.

A third trend in the 1980s was the intensification of globalisation. With the rapid increase in intra-firm trade (which accounted for a third of world trade in 1992) and more complex forms of market interpenetration, developing countries, particularly the most industrially advanced among them were pressed to abandon the use of discretionary trade and industrial policy tools and to accept new rules in areas previously out of bounds to international negotiations. The multilateral disciplines emerging from the Uruguay Round will clearly reduce the scope of available policy options aimed at increasing the competitiveness of developing countries' exports or achieving other development goals.

As the world enters the final decade of the twentieth century, given the accelerated rate of growth of an increasing number of developing countries, it is expected that the markets of these

countries, especially in South and East Asia, will be growing in importance to the industrialised countries. For this reason, the demands on the former to assume greater responsibilities within the multilateral system will become more insistent. Increasing globalisation of international trade, finance and investment while having a beneficial impact on local economies of the developing countries are not an unmixed blessing as many countries found out in the 1980s. Therefore, the vigour with which developing countries can continue to pursue domestic policies in order to channel the positive impact of globalisation will be one of the most important items in future trade negotiations.

In the last decade of the 1990s, despite the conclusion of the Uruguay Round, the international trade and financial system will continue to face challenges from formal and informal plurilateral systems, including the continuing intensification of GATT/WTO-consistent trade measures and the rise of regional trading arrangements. In this context, the conclusion of the Uruguay Round is but one element required to ensure the continued growth of the world economy.

III. Challenges and issues

Global institutions

The relationship of the new WTO with the International Monetary Fund (IMF) and the World Bank remains to be defined. However, they can be expected to act in concert to ensure the effective cooperation in addressing mutual concerns regarding the interactions of trade and other economic and financial policies. It has been argued that globalisation of economic activity makes effective central coordination of policies more necessary, and, therefore the three global institutions should assume a larger role as manager of the international economic system.

In recent months, it has become increasingly clear that there is a debate between the development needs of developing countries and the trends towards convergence of policies implicit in the cooperative framework being established in the global institutions. Developing countries are concerned that in the search for a wider mandate for the WTO, IMF and the World Bank, there will be increasing tendencies to exercise more comprehensive surveillance where every policy and domestic institution would be subject to scrutiny as to its possible effect on trade, finance and investment.

The possibilities for achieving greater coherence in global economic policy-making could, in effect, extend the ability of the three institutions to exercise cross-conditionality. Developing countries have long expressed concern that Bretton Woods surveillance over industrialised countries is weak. The concern of developing countries is that these global institutions should remain a synonym for economic growth for the entire membership. As a start, there should be more participatory decision-making with developing countries assuming a role commensurate with their economic importance. In carrying out its mandate, the WTO, IMF and the World Bank should concentrate on the basic distinction between reviews designed to ensure observance of multilaterally agreed rules and those intended to facilitate the achievement of objectives propounded by particular groupings or countries. Therefore, the structure and areas of competence of the Bretton Woods institutions merit fresh adaptation at the same time that the WTO is being established to come into effect in 1995.

Regionalism

While the Uruguay Round negotiations were under way, major regional trade agreements were being negotiated in Europe and in North America. The mutual trade among the partners to these agreements was already extremely important in both absolute and relative terms, and their desire to enter into more extensive and intensive contractual arrangements was largely prompted by the perception that the GATT had become an enfeebled system not adequate to govern trade relations between countries which had already reached a high level of economic integration. While regional arrangements are not limited to industrial countries, an aspect of regionalism in those countries of concern to developing countries is selective access to markets. Even post-Uruguay Round, in certain sectors, relatively high tariff walls to imports from developing countries will be maintained by some of these regional groupings. Combined with stringent rules of origin, diversion of trade in goods and services and investments flows may ensue, which are issues of continuing importance to developing countries.

In the GATT context, the process of regional economic integration is the promotion and creation of opportunities in trade and investments. This would finally support the multilateral process. In the new global context, however, hedging strategies become increasingly attractive and it was evidently

clear in the recent experience that such arrangements were being promoted as a leverage for other negotiations, including the Uruguay Round negotiations.

With small markets, an expected high rate of export growth and demand for investments, the developing countries' need for access to the global market place will grow. One of the factors motivating smaller countries to pursue regional approaches is that such agreements provide greater security of market access than the GATT. But developing countries have not abandoned multilateralism, as the adoption of export-oriented development strategies would require a vigorous international trading system. Developing countries consensus seems to be building towards 'open regionalism' as a forum for expanded and constructive engagement in the next round of global talks.

Competition

Prior to, and during the Uruguay Round negotiations, trade and trade-related measures, such as subsidies, voluntary export restraints, marketing arrangements and laws governing competition and the ways in which they were enforced were subject to intensive negotiations. At the conclusion of the talks, the rules on most of these have been significantly improved, but the permissible role of subsidies in some areas, including services and high technology, has been expanded.

This has important implications for governments, as in recent years, the direction of trade policy in many countries has shifted to new sectors - high technology is one - where the pattern of trade is still being determined. Many governments conduct industrial policies to lend direction and support to firms in order to improve their international competitiveness as competitiveness arises not only from attributes which are inherent to the firms or to particular locations.

Policies of 'industrial targeting' applied in various forms are potential areas in future trade negotiations. As firms in developing countries improve their supply capacities, disputes over the legitimacy of any kind of government support which have an impact on competitiveness, including production, investments, and research and development subsidies will be subject to scrutiny.

There is merit in creating better mechanisms for addressing measures affecting competition as restrictive business practices in the form of export cartels and market exclusions can erode the benefits of trade liberalisation achieved through the Uruguay Round. The concern of developing countries is that the convergence of trade and competition policies should be addressed through consensus building, not merely, negotiations involving their legitimate autonomy over the identification, creation and acquisition of potential comparative advantage for their firms.

Standardisation and harmonisation

The GATT, as it has existed up to the Uruguay Round, was built on the proposition that differences between countries are so many that criteria for harmonisation can never be universally agreed upon. With globalisation and more complex forms of economic interpenetration of markets, however, problems associated with different regulations and practices that affect the business environment for firms would increasingly become a source of friction between trading nations.

The response from developed countries has been to negotiate for 'deeper' integration. The experience of the Uruguay Round has demonstrated that the trade door will be used to go to the heart of a range of laws, institutions and other governmental practices sometimes labelled as 'structural impediments to market access' or 'distortions to trade'. At the regional and multilateral level, pressures to accept new rules aimed at harmonising different regulations, standards and practices have been increasingly evident.

The pursuit of structural economic harmonisation in areas such as workers' rights, environmental policies, the incidence of savings rate, land costs, even shopping habits, is essentially positing that *everything* has a trade effect and therefore must be the subject of international scrutiny. This trend poses risks not only to the multilateral system but to developing countries in particular.

Developing countries will face demands to accept rules that would align their policies, standards and institutional practices to those of their trading partners. This would imply the reduction of national autonomy in a diverse number of areas as developing countries have already observed in the negotiations to set up the North American Free Trade Area (NAFTA) and the European Economic, Monetary and Political Union.

Environment

In principle, an open international trading system need not be in conflict with the sustainable use of resources or other environmental objectives. It is also generally true that internationally traded goods and services often do not fully reflect the environmental costs of their production, consumption, or disposal. To developing countries, however, trade measures are not the best instruments to achieve environmental goals as the response of trade policy can lead to global controls.

Developing countries are further concerned that differences in priorities as regards environmental quality among varying societies may not be adequately recognised, that cost considerations influence such priorities and that trade measures may be misused to enforce individual countries' preferences. The concern is that environmental protection requirements could in reality be excuses for protectionist intervention in trade.

The challenge for all countries is to develop policies that, based on free trade, maximise environmentally sustainable growth. Developing countries have agreed to address this inter-relationship in the WTO. A consultative approach between the North and South that facilitates both effective environmental protection and allows trade to promote growth and employment should appropriately be premised on initiatives already under way in the United Nations Conference on Environment and Development (UNCED).

Social policies

In recent years, the links between trade policy and labour and social standards are also being debated, gaining special prominence following the side agreement to the NAFTA and the attempt to include a social clause in the final settlements to the Uruguay Round agreement. One aspect of the debate relates to the appropriateness of trade policy instruments as a means to bring about improvements in labour and social standards. Another aspect relates to the implications of varying labour standards on international competitiveness. Some feel that labour and trade issues should be addressed more directly in fora such as the GATT and the WTO, whereas others fear that such an approach may be misused to increase trade barriers or to avoid structural adjustments in the countries concerned.

Developing countries were concerned that expressions of concerns regarding violations of social objectives were really aimed at erecting import barriers on products of importance to them. The observance of human rights and minimum social standards is interpreted differently in different political and social systems. A linkage between social policies and trade would not be in the best interest of a free trade system, as restrictions based on misguided approaches may instead counteract the integration of developing countries into the multilateral trading system.

New trade negotiations

In the past three years, in an environment of sluggish economic activity, discussions over trade and industrial policies have gained centre stage. The centre of the debate is whether sustained outward-oriented approach is best achieved through trade liberalisation and incentive neutrality or whether it requires selective trade policies and active pro-industrialisation government stances, the right to which is under increasing challenge in international negotiations. It has been observed that the agenda of international and also regional negotiations have shifted from the treatment of goods to the treatment of policies.

This trend is reflected in the use that developed countries are making of trade negotiations which are increasingly becoming a vehicle used by the most powerful trading countries to dictate the terms of a single world-wide model of economic policy-making. To developing countries, future trade negotiations may go into the areas of setting limits on policy autonomy, on top of preconditions or reciprocity for maintaining or seeking improvements to market access, or if they wish to retain some flexibility or exceptions from global rules.

IV. Policy options

It now seems essential that new initiatives be taken to deal with the trade issues of the 1990s. Developing countries have generally demonstrated excellent cooperative efforts during the seven and a half years of the Uruguay Round process. During the process, experience and considerable expertise have been developed among and within groups of developing countries on many trade-related issues. One way of nurturing a greater

appreciation of the issues in future negotiations is to foster regular and systematic dialogue between developing country institutions, such as the United Nations Conference on Trade and Development (UNCTAD), Group of 77 and the Group of 15.

Individual developing countries are unlikely to have much bargaining strength collectively, however, they may be able to extract meaningful concessions as a *quid pro quo* for past and prospective liberalisations. Flexible coalitions of developing countries around specific interest may prove an avenue worth exploring. Creating and enhancing links among the various groupings in developing countries could be a desirable way in managing the new issues in trade negotiations.

Formal and informal processes would be helpful to define the posture with respect to the post-Uruguay Round agenda in order to avoid past situations where the concerns of the developing countries were not taken into account in the final result because of protracted debate among them. It has been suggested that the East Asian economies are well placed to assume the initiative in the relevant international and regional fora. Already increasing trade and investment among these countries have provided the necessary incentives to facilitate greater access to each other's market. By continuing to support a multilateral system that had been so crucial to their success, the East Asian economies can play a leadership role in shaping the next agenda for international negotiations.

V. Conclusion

It has been observed over the 1980-1990 period, that the pursuit of national development policies need not be at complete variance with the overall liberalising trend and the pressures towards increasing convergence within the multilateral framework. Economic and trade policy decisions taken either by developed or developing countries are becoming, with the increase of interdependence, more interconnected than ever and therein lies the scope for increased frictions. However, cooperation, consensus-building and consultations between developed and developing countries are essential in future trade negotiations not only to ensure adherence to the improved international environment engendered by the Uruguay Round, but also to sustain and build on its achievements.

Third countries are concerned with NAFTA's domestic content regulation which could prevent member countries from relying on some low-cost (non-NAFTA) sources of production inputs - a factor that would restrict the ability of members to use their NAFTA tariff and non-tariff preferences. Additionally, studies on the trade effects of NAFTA show that while Mexico's and Canada's exports to the US are estimated to rise by 11% and by 9%, respectively, third countries' exports to the US are expected to fall by 3%.

Meanwhile, in **Latin America**, the trend towards regional arrangements also accelerated. The Southern Cone Common Market (MERCOSUR) comprising Brazil, Argentina, Paraguay and Uruguay is fast moving into a customs union, expected to come into force in 1995, although problems relating to a substantial number of items eligible for the common external tariff (CET) remain outstanding among the members. Another grouping that has achieved considerable progress towards adoption of a CET is the Andean Pact comprising Bolivia, Colombia, Ecuador, Peru and Venezuela. Implementation is expected in early 1995. The Central American Common Market (CACM) comprising Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua have also agreed on a common external tariff. Other groups, such as the Caribbean Common Market (CARICOM) also became more active, forming new bilateral arrangements, frequently taking the form of free trade agreements (FTAs) with countries which are already members of other groupings. Some examples include the negotiations of three FTAs: Colombia, Mexico, and Venezuela; CARICOM-Colombia FTA; and a CARICOM-Venezuela FTA.

In **East Asia**, developments include the consideration of an enlargement of the Association of South East Asian Nations (ASEAN) grouping to include Vietnam and Cambodia. There was increased activity within the Asia-Pacific Economic Cooperation (APEC) forum despite reservations expressed by some members that the loose, consultative nature of the forum was becoming increasingly institutionalised. The ASEAN proposal for an East Asia Economic Caucus, or EAEC, held an officials-level meeting in July with China, Korea and Japan, the latter three countries considered prospective members of the Caucus. In August, China expressed willingness to work with ASEAN towards allaying the concerns of other countries in the Asia-Pacific, notably the

US, with regard to the formation of the EAEC, its main objective being the promotion of free trade through open regionalism. Elsewhere in **Asia**, a decision reached in 1992 to develop a preferential trading arrangement for the South Asia Association for Regional Cooperation (SAARC) comprising India, Bangladesh and Sri Lanka, is progressing on track including the finalisation of schedules of concessions. The SAARC-CEPT is expected to be completed before 1995.

Economic Situation of Industrial Countries

Output

In most of the industrial countries, economic growth is steadily gaining momentum. Recovery is firmly established in the US, the UK, Australia and Canada. In these countries, output is expected to continue to grow resulting in improvements in the unemployment outlook. Output for the industrial countries as a whole is likely to increase by 2.6% in 1994 compared with 1.2% achieved in 1993. In Japan, the recovery of the economy is contingent on the strength of domestic demand supported by additional fiscal stimulus and continued low interest rates. Although recent indicators have been encouraging, output growth in Japan is nevertheless expected to remain weak because of a continued decline in net exports due to the appreciation of the yen. In continental Europe, signs of a recovery are imminent with a modest pick up in domestic demand. However, output growth is projected to strengthen steadily during the course of 1994 and 1995 as households reduce their savings rate and business investment rises.

The **US** economy has been expanding since the second quarter of 1991, and by the middle of 1994, the economy approached full capacity. Growth in the Gross Domestic Product (GDP) is expected to reach 3.7% in 1994 compared with a growth of 3.1% in 1993. The current strength of the economy is mainly being driven by non-residential fixed investment which is expected to continue to lead demand growth. Growth has been particularly robust in the interest-sensitive components of demand, notably consumption of durables, housing and business equipment investments, offsetting cutbacks in defence expenditure. The prevailing short-term low interest rates have helped contribute to improved business conditions and disposable household incomes while debt-service charges and mortgage refinancing

were reduced. In an effort to prevent an overheating of the economy and suppress upward pressure on inflation rates, the Federal Reserve Board has raised interest rates five times throughout 1994. The levels of interest rates in August at 4.75% are at their highest in 2 1/2 years.

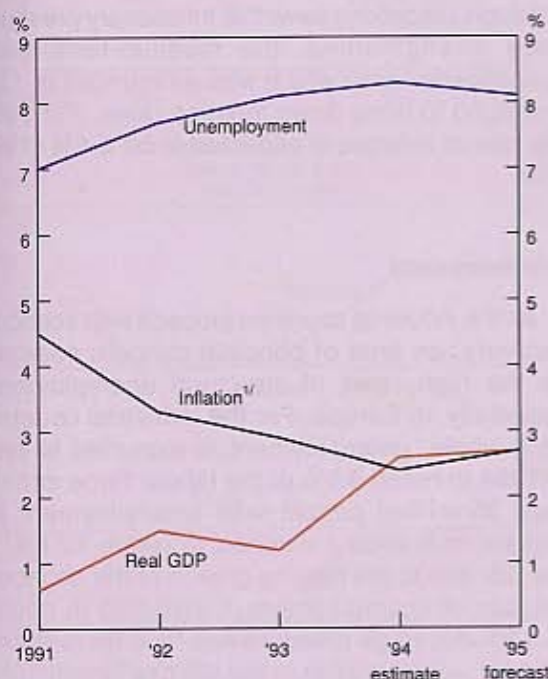
The economy of **Japan** seems finally to have emerged from the recession and indications are that a recovery is firmly in place. However, the appreciation of the yen in recent months, the continued weakness in business investment and the remaining problems in the banking sector continue to be a drag on stronger economic recovery. For 1994, GDP is projected to grow at 0.9%, an improvement when compared to the 0.1% growth in 1993. Early 1994 saw an increase in activity as industrial production picked up and export volumes surged while the Government's earlier fiscal pump-priming packages appeared to steer the economy out of the recession. Elements of the expansionary package, amounting to 3.2% of GDP included several measures to increase public investment spending and reduce income

taxes. Monetary policy has also been aligned to aid the recovery and interest rates were progressively lowered from 4.5% in September 1991 to 1.75% in August 1994. The Japanese authorities have also introduced several measures to liberalise the economy to support domestic consumption, including personal income tax cuts. These measures were also in response to US pressure to deregulate the Japanese economy so as to improve the trade imbalance. However, the trade friction between Japan and the US has since intensified, bringing about considerable fluctuations in the exchange rate markets. The persistent appreciation of the yen against the US dollar since late 1993 continues to affect the profit of export enterprises, further dampening business confidence. Despite these mixed signals however, the improvement in the Japanese economy appears more broadly based in comparison with the recovery in 1993. There have been further stock and inventory adjustment and industries have generally made progress in adapting to the higher yen.

In **Germany**, indications are that a gradual recovery is under way led primarily by a surge in exports and an improvement in the current account balance. Real GDP is expected to reach 1.7% in 1994. In east Germany, where growth has been robust, output is projected to expand by 6% while in west Germany where recovery is slow and unemployment continues to increase, output is projected to be 2%. As most countries in Europe emerge from the recession, external demand is expected to further spur Germany's economic recovery. The growth in merchandise exports has led the recovery whilst that of private consumption showed signs of a recovery. This, however, is expected to improve towards the end of 1994. Business investment which suffered due to the recession has picked up, in tandem with the economic recovery. A further lowering of leading interest rates by the Bundesbank would give a boost to domestic investment. The privatisation of Deutsche Telekom and a reduction of corporate tax are expected to improve business conditions and encourage inflows of long-term capital.

Economic recovery in the **UK** has continued to strengthen and GDP is expected to reach 3.1% in 1994 (1993:2%) as private consumption led by consumer durables continues to remain buoyant. Consumer borrowing is also expected to increase due to significant reductions in interest rates which have been on a downward trend since late 1990. Business investment has begun to show signs of an upturn as capacity utilisation continues to

Chart 3.1
Industrial Countries -
Major Economic Indicators



1/ Consumer prices
Sources: IMF World Economic Outlook, September 1994
and national sources

increase. The sterling's large nominal depreciation has improved the competitiveness of Britain's exports which remains the main engine behind the economic recovery.

Table 3.1

**Selected Industrial Countries—
Major Economic Indicators
(1991-1995)**

	<i>Industrial Countries</i>	<i>United States</i>	<i>Japan</i>	<i>Federal Republic of Germany</i>	<i>United Kingdom</i>
Growth of Real GDP (%)					
<i>Year</i>					
1991	0.6	-0.6	4.3	1.5	-2.2
1992	1.5	2.3	1.1	2.1	-0.5
1993	1.2	3.1	0.1	-1.2	2.0
1994 ^e	2.6	3.7	0.9	1.7	3.1
1995 ^f	2.7	2.5	2.5	2.6	3.0
Inflation¹ (%)					
<i>Year</i>					
1991	4.5	4.2	3.3	4.6	6.8
1992	3.3	3.0	1.7	4.9	4.7
1993	2.9	3.0	1.3	4.7	3.0
1994 ^e	2.4	2.7	0.7	3.1	2.6
1995 ^f	2.7	3.4	0.8	2.2	3.1
Unemployment (%)					
<i>Year</i>					
1991	7.0	6.7	2.1	6.7	8.1
1992	7.7	7.4	2.2	7.7	9.8
1993	8.1	6.8	2.5	8.9	10.3
1994 ^e	8.3	6.3	3.0	9.9	9.5
1995 ^f	8.1	6.3	3.1	9.9	9.1
Current Account Balance (US\$ billion)					
<i>Year</i>					
1991	-30.5	-6.9	72.9	-19.4	-13.5
1992	-41.2	-67.9	117.6	-22.0	-18.6
1993	17.2	-103.9	131.4	-21.3	-16.3
1994 ^e	14.6	-149.6	130.3	-11.6	-15.3
1995 ^f	1.0	-171.3	121.6	-6.7	-19.4

¹ Consumer prices.

^e estimates

^f forecasts

Sources: IMF World Economic Outlook, September 1994 and national sources.

Inflation

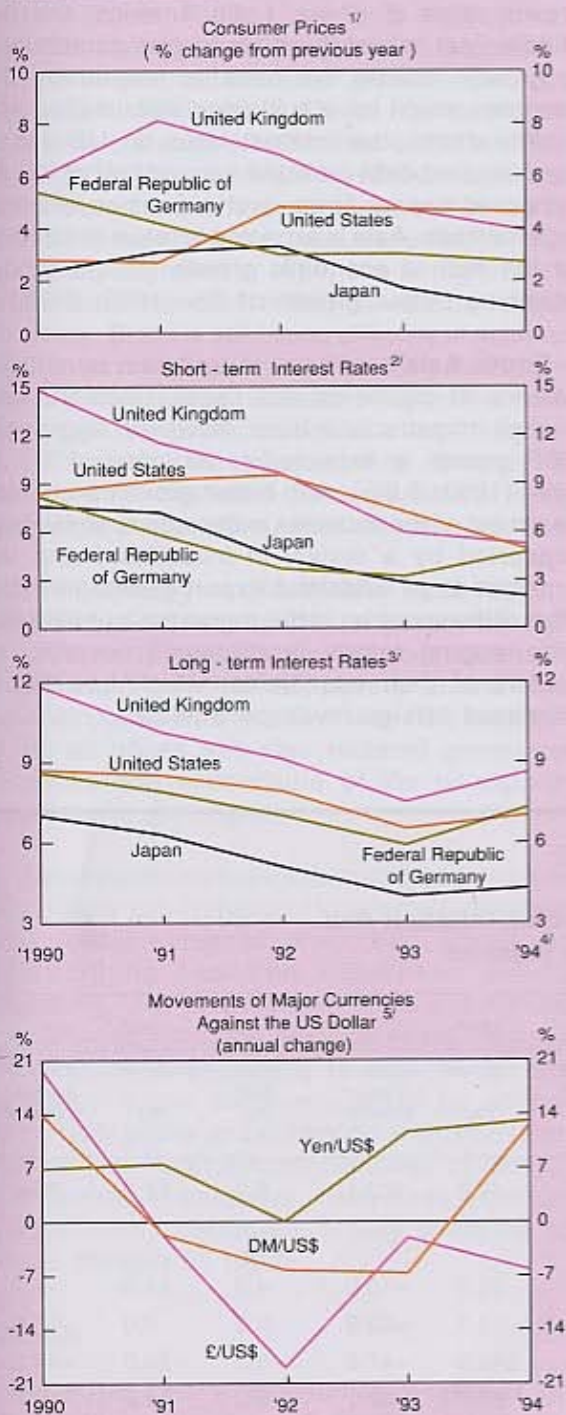
The **industrial countries** are expected to experience a stable rate of inflation in tandem with the gradual economic recovery. Against a background of investment-led growth and rapidly disappearing excess capacity, inflation is expected to be around 2.4% in 1994 (1993:2.9%). In the **US**, the decline in oil prices in 1993 has contributed to a decline in prices generally. However, as it approaches full capacity, inflation could pose a problem if output growth exceeds potential growth. The tightening of monetary conditions through increased discount and federal fund rates by the US Federal Reserve Board is expected to restrain the pace of activity and contain a sustained, non-inflationary growth. Further increases in official interest rates are expected to reduce the overheating of the economy. Thus, the rate of inflation is expected to be around 2.7%.

Japan is expected to experience weak inflationary pressures (1994:0.7%) due to the strength of the yen coupled with lower oil prices and weak domestic demand. In **Germany**, the Bundesbank continues to be successful in curbing inflation with monetary tightening. Inflation rates have declined down from nearly 5% in 1993 and is expected to abate to 3.1% in 1994. In the **UK**, although indications were that inflationary pressures were strengthening, the medium-term fiscal consolidation plan which was announced in 1993 managed to bring down inflation rates. For 1994, the rate of inflation is expected to be 2.6% (1993: 3%).

Unemployment

As the industrial countries proceed with economic recovery, an area of principal concern seems to be the high rates of structural unemployment, especially, in Europe. For the industrial countries as a whole, unemployment is expected to peak in 1994 to reach 8.3% of the labour force or more than 35 million people with unemployment the highest in France estimated to reach 12.6%. In the **US**, due to the healthy growth of the economy, the rate of unemployment is expected to decline to 6.3% but wage pressure has thus far remained modest. Jobs creation in the US has largely taken place in the private sector where investment has increased to cater to prospective demand growth. **Japan** is able to maintain a generally low level

Chart 3.2
Current Trends in Key Economic Determinants in
Industrial Countries



1/ 1993 figures are estimates.

2/ Averages of interest rates weighted by the average US dollar value.

3/ Average yield on Government bonds.

4/ Until July 1994.

5/ End of period except for 1994, up to mid-September.

Sources: IMF World Economic Outlook, September 1994,
and other reports.

of unemployment compared to other industrial countries due to a well-developed internal labour market which is able to adjust to structural changes. However, the prevailing weak demand conditions are expected to increase rates of underemployment as labour hoarding and withdrawal of women from the labour force occur. Unemployment is thus expected to reach 3%.

In west Germany, the rate of unemployment has continued to increase unabated as domestic demand continued to remain relatively weak while in east Germany, as economic activity has picked up, the labour market has begun to stabilise and unemployment has levelled off. For 1994, the pan-German unemployment rate is expected to be 9.9%. The UK employment rate has begun to pick up moderately largely due to a growth in part-time employment. However, the full-time employment rate has hardly changed, reflecting continuing down-sizing and cost-cutting in manufacturing and construction. Its unemployment rate is expected to be 9.5% in 1994.

Trade and Balance of Payments

The US trade balance is expected to move further into deficit to US\$149.6 billion from US\$103.9 billion in 1993 due to the further strengthening of domestic demand as well as the weakening of the dollar against the yen and deutschemark. The strength of investment and consumption within the US is expected to buoy imports while export growth is expected to strengthen in the light of the strengthening of the economies of some of the US's major trading partners.

Japan is expected to register an increasing surplus in its current account balance despite a fall in export volumes due to the appreciation of the yen and depressed private investment. US-dollar denominated export volumes grew faster than imports, although "reverse imports" (imports of finished manufactures assembled in Japanese-owned plants overseas) registered strong growth. The trade surplus is expected to reach US\$130.3 billion (1993: US\$131.4 billion) due to the appreciation of the yen. In the short-term, this could further aggravate US-Japan bilateral trade relations.

German exports for 1994 are expected to grow by 1.4% against a background of an improved world economy, stronger export demand within Europe particularly for capital goods, as well as

sustained demand from Asia for German exports. This is evident from the increase in merchandise exports in the first half of 1994. The current account deficit is, thus, expected to improve to US\$11.6 billion. In the **UK**, the balance of payments deficit is expected to narrow to US\$15.3 billion (1993: US\$16.3 billion) as recoveries in continental Europe are expected to spur external demand, providing further stimulus to economic growth.

The growth of US and European exports in 1994 is expected to be particularly strong to countries outside of Europe, especially to the non-OECD regions, as reflected in the current account deficits in Asia and Latin America projected for 1994. The latter's deficit is expected to widen from US\$9 billion in 1990 to an estimated US\$75 billion in 1994, with Europe, in particular the key beneficiary.

Economic Situation of Developing Countries

Output

The **developing countries** as a group are expected to continue charting a respectable rate of economic growth in 1994, albeit a lower rate

compared with that of 1993, with GDP growth estimated at 5.7% (1993: 6.1%). The moderation in 1994 is due to the expected slowdown in the growth rates of China, Latin America and the Middle East, whilst the main factors contributing to growth include the benefits reaped by the countries which have sustained stabilisation and reform efforts, low interest rates on US dollar-denominated debt (until the second half of 1994), increased capital flows, and expansion of intra-regional trade. **Asia** is expected to retain its position as the hub of economic growth for the group, achieving output growth of 8% (1993: 8.5%).

South Asia continues to be beset by difficult balance of payments and fiscal conditions and a weak infrastructure base. However, aggregate GDP growth is expected to increase at 5% in 1994 (1993: 3.8%), with better growth prospects for almost all the countries in the region, particularly supported by a revival in investment and the expectation of sustained export growth in India. Most of the countries in this region have undertaken wide-ranging reform programmes covering all sectors of their economies, which has led to increased foreign investment inflows.

Table 3.2
Developing Countries: Output, Inflation And
Current Account Balance

	1993			1994 ^a			1995 ^f		
	Real GDP (%)	Inflation ¹ (%)	Current Account Balance ²	Real GDP (%)	Inflation ¹ (%)	Current Account Balance ²	Real GDP (%)	Inflation ¹ (%)	Current Account Balance ²
Developing countries	6.1	46.1	-105.7	5.7	47.3	-102.1	5.7	12.8	-94.4
By region:									
Africa	1.0	32.5	-7.4	3.3	39.3	-10.0	4.5	14.0	-7.7
Asia	8.5	9.7	-24.6	8.0	10.3	-22.9	7.3	7.0	-17.6
Latin America	3.3	235.8	-45.8	2.8	243.9	-47.0	3.2	28.0	-49.2
Middle East	4.8	24.7	-28.0	2.0	26.7	-22.1	3.2	14.6	-19.9

¹ Consumer prices - weighted averages.

² US\$ billion.

^a Estimates.

^f Forecasts.

Source: IMF World Economic Outlook, September 1994.

The economic performance in **Latin America** continues to be varied, with aggregate growth projected to be slower in 1994, at 2.8%, compared with 3.3% in 1993. Chile and Mexico have significantly improved in terms of progress in structural reforms, with GDP growth expected to be 4.5% for Chile and 2.5% for Mexico in 1994. In addition, Mexico's ratification of the NAFTA is expected to attract private investment as a result of increased economic confidence in that country. Argentina is another success, expected to record a 6% output growth in 1994, due to higher levels of domestic demand, mainly private investment. However, Brazil is still facing difficulty in achieving macroeconomic stability and is anticipated to grow at 2.8% after having recorded 5% growth in 1993. Venezuela is expected to register a negative growth of 3.7% due to the collapse of its currency, the bolivar, which has led to the suspension of foreign exchange transactions, thus affecting its trade.

The economy of the **Middle East** region is expected to expand by 2% compared with 4.8% in 1993, as growth has slowed down due to the dissipation of the temporary boost from reconstruction after the Gulf war. The decline in world oil prices has also reduced government revenues and expenditure of the oil-exporting countries in the region.

Africa continues to experience serious problems, particularly sub-Saharan Africa where population growth still outpaces production growth and deteriorating economic conditions are still prevailing. GNP is estimated to expand between only 2% and 3% in the next few years. However, the outlook is beginning to improve in other countries in the continent, aided by stronger commodity prices and enhanced economic reform efforts. The North African countries of Morocco and Tunisia in particular, have seen significant improvement in economic activity since the end of the drought of 1993.

Inflation

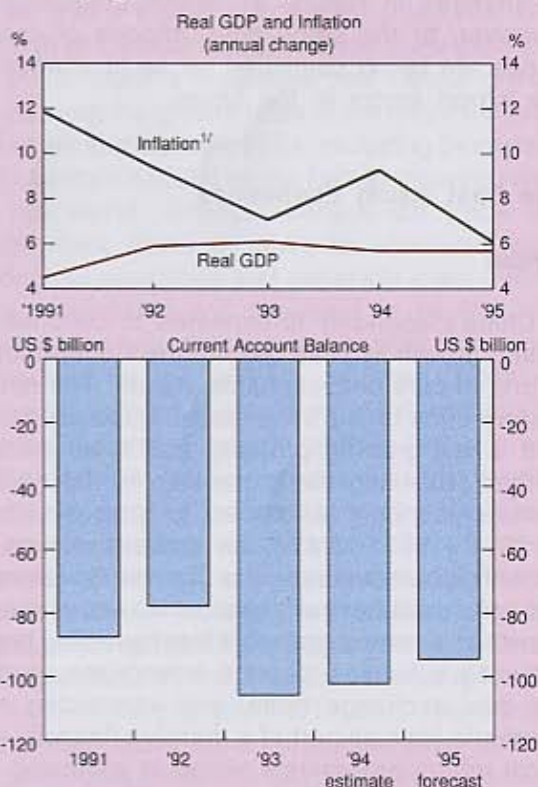
Inflation in the developing countries has generally improved, but median inflation is estimated to rise slightly to 9.3% in 1994 from 7.1% in 1993. In Asia, inflation should rise about 10.3% if China successfully implements stabilisation policies aimed at keeping inflation down. To a lesser extent than China, the dynamic Asian economies also need to rein in inflation. Other

Asian countries where inflation is anticipated to pose difficulties include Iran where currency depreciation has led to price adjustments and inflation. The *Communaute Financiere Africaine* (CFA) countries in Africa are also facing problems with inflation. In Latin America, Brazil in particular has suffered hyper-inflation and inflation will continue to stay at high levels until stabilisation efforts take hold. Venezuela is another country where a loosening of financial policies has resulted in inflated domestic prices. However, Argentina has achieved remarkable success at overcoming hyperinflation. From 3,000% hyperinflation in 1989, it is expected to be reduced to 2.7% in 1994 due to the deregulation of the economy and the opening up of the market as part of the economic reforms introduced.

Trade and Balance of Payments

The aggregate **current account deficit** of the developing countries is expected to decline slightly from US\$105.7 billion in 1993 to US\$102.1 billion in 1994. In Asia, the large deficits in recent years

Chart 3.3
Developing Countries - Major Economic Indicators



have been due to increases in imports as a result of investment and capital inflows. Latin America, too, has attracted significant foreign investment which has increased the ability to import although this has also led to a widening of current account deficits. In Africa, where many countries still have commodity-based economies, the recent increases in commodity prices are likely to contribute towards higher export earnings.

The growth in the developing countries' trade is expected to be more buoyant in 1994, with rates of growth of exports and imports of 9% to 10%, remaining much above the world average of 6% to 7%. Trade of the East Asian economies is also expected to achieve faster rates of growth than those of other developing countries on account of the improved outturn in the industrial countries and a sustained expansion in the region. China's export performance is not expected to match its outstanding performance in the 1991-1993 period when it averaged 18%-20%. In fact, China expects to incur a trade deficit of US\$9.7 billion in 1994.

Meanwhile, the Latin American countries as a whole are likely to import at lower volumes in 1994 compared with the 1991-1992 period, due to attempts to reduce excessive consumption. However, at the same time, imports of capital goods are being continued so as to strengthen the export sector in the future.

The East Asian Economies

Output

China's economy is expected to continue its strong growth in 1994 despite the Government's efforts to curb unsustainable growth. The strong performance is led by a robust industrial sector and a fast-growing property and retail market, further propelling the expansion in the region. China's economy is forecast to grow by 10.5% in 1994 (1993: 13.4%), an impressive rate by current global standards. The Chinese Government has introduced several measures to keep economic growth at a more sustainable rate by raising taxes, reducing subsidies to state enterprises, ending the dual exchange rates, and introducing new corporate laws as part of a massive financial and fiscal reform programme aimed at improving the financial system, reducing regional inequities and increasing revenue.

In 1993, Hong Kong, Singapore, South Korea and Taiwan or the Newly Industrialising Economies (NIEs) started to reverse the trend of slower growth which they had undergone since 1987. This was on account of strong demand growth, including from China; positive signs of recovery in the major industrial countries which are their major trading partners; and significant competitive advantage resulting from the appreciation of the yen, especially for South Korea and Taiwan. This acceleration is expected to improve in the light of improvements in the global economy. NIE exports should perform well on the assumption of favourable exchange rates.

Taiwan's GDP is forecast to grow at 5.9% in 1994 (1993: 6.1%), led by exports, private consumption and private investment. Private sector investment is projected to grow at 14%-15%, due to the upturn in the world economy, depreciation of the New Taiwan dollar and the Government's expansionary fiscal policies. In South Korea, exports and fixed investment are expected to spearhead growth of 7.2% estimated in 1994 (1993: 5.5%). A steep rise in investment spending is attributed to higher profits, increasing capacity utilisation and an encouraging budget. Hong Kong's economic growth in 1994 is expected to slow down slightly to 5% as China's projected slowdown from its 1993 performance will have a direct impact on the island's economy. China accounted for 35% of Hong Kong's external trade in 1993.

Inflation

Inflation is the main downside risk in the economic outlook of the East Asian economies. In China, the authorities recently made attempts to control non-infrastructure investment which may help rein back inflationary pressures emanating from the demand side. China, however, faces a tough time in the coming months over efforts to rein in inflation which is expected to hover around 18%-19%, well above the Government's target of 10%. In South Korea, the prospect of growth accelerating to almost its potential rate combined with a generally high degree of capacity utilisation and a shortage of agricultural produce may result in the inflation rate rising to 6.3% in 1994 (1993: 4.8%). A steep rise in rents and wages in Hong Kong is likely to result in inflation accelerating at the rate of 9.5% in 1994, compared with 8.5% in 1993. Another factor pushing up prices in Hong Kong is imported inflation from China. Taiwan is

also likely to experience a higher inflation rate of 3.8% (1993: 2.9%), partly due to the rise in unit labour costs in an economy experiencing full employment.

Trade and Balance of Payments

China's exports picked up in the first quarter of 1994, but this is not expected to be sustained for the rest of the year because competitiveness will be eroded by high inflation and continued development in the country is likely to divert the attention of manufacturers from the export market. Meanwhile, imports are expected to remain robust due to the relatively strong investment boom. China's current account deficit is estimated to decline to US\$3.8 billion in 1994 (1993: -US\$11.9

billion), aided by the strong growth of merchandise exports. South Korea is expected to record a current account deficit of US\$1.9 billion in 1994 due to imports, particularly of capital goods, exceeding exports. On the other hand, Hong Kong is expected to record a smaller visible trade deficit of US\$2.2 billion in 1994 (1993: -US\$3.4 billion), due to better terms of trade for the island. In the case of Taiwan, its trade surplus continued to shrink in the first half of 1994. Exports and imports are expected to pick up in the second half of the year due to the expansion of private investment, the pickup in imports being due to expected tariff reductions as a result of bilateral and multilateral negotiations with GATT members. Hence, for the whole of 1994, Taiwan's current account is expected to shrink slightly but still remain a surplus of US\$4.2 billion, compared with a surplus of US\$5.8 billion in 1993.

Table 3.3

East Asia*: Gross Domestic Product, Inflation and Current Account Balance

	1993	1994 ^a	1995 ^f
Gross Domestic Product Growth (%)			
China ¹	13.4	10.5	8.0
Hong Kong	5.5	5.0	4.0
South Korea	5.5	7.2	6.9
Taiwan	6.1	5.9	6.4
Inflation Rate (%)			
China ²	19.6	25.0	15.0
Hong Kong	8.5	9.5	8.0
South Korea	4.8	6.3	5.3
Taiwan	2.9	3.8	4.1
Current Account Balance (US\$b)			
China	-11.9	-3.8	-4.6
Hong Kong ³	-3.4	-2.2	2.6
South Korea	0.4	-1.9	0.1
Taiwan	5.8	4.2	5.4

* Comprises the Newly Industrialising Economies excluding Singapore, and People's Republic of China (China).

¹ GNP.

² Urban.

³ Visible trade balance (US\$billion).

^a Estimates.

^f Forecasts.

Sources: Economist Intelligence Unit Country Reports and national sources.

The ASEAN Economies

Output

In 1994, the ASEAN economies are expected to achieve a higher average weighted **real GDP growth** of 7.4% compared with the 6.9% expansion in 1993. Such a creditable real output growth, surpassing the growth rates of the major industrial countries and the three NIEs (excluding Singapore), will maintain ASEAN as the fastest growing region in the world. Greater intra-Asian trade and investment flows as well as improved world economic conditions and generally lower interest rates worldwide are expected to be the main contributing factors to the significantly high growth estimated for the ASEAN countries. Additional impetus to growth is also being provided by strong domestic demand emanating from higher private consumption and increased infrastructure expenditure. The acceleration of intra-ASEAN economic cooperation, in particular the efforts towards realising the goals of the ASEAN Free Trade Area (AFTA) and the promotion of growth areas, such as the Singapore-Johore-Riau Growth Triangle (SIJORI), the Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT) and the Brunei-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA), are also expected to help maintain the high growth rates achieved in 1993.

Malaysia, Singapore and Thailand are expected to sustain **GDP growth** of between 8% to 10% while Brunei Darussalam (Brunei) is projected to improve, with an expected real output decline of 2% (1993: -4.1%). GDP growth in the Philippines is expected to pick up to 4.2% from 1.7% in 1993, as an improvement in power supplies has resulted in an increase in industrial production, boosting growth in exports, consumer spending and fixed investment. A value-added tax on goods and services has put the Philippine Government's medium-term economic policy back on track and gained IMF approval for a three-year credit worth US\$634 million. This in turn will boost investor's confidence in the economy. Indonesia is expected to maintain a real output growth of 6.5% in 1994, on account of a sustainable export growth in an improving global economy as well as high public expenditure to alleviate its infrastructure constraints.

Real GDP growth in Thailand is estimated at 8.1% in 1994 compared with a 7.7% expansion in 1993. Domestically, increased investment in both construction and real estate, strengthened by strong purchasing power in the private sector, will be the main factor spearheading Thailand's GDP growth. On the external front, higher levels of manufactured exports and capital inflows from abroad will contribute to the rapid growth. The outlook for Singapore in 1994 is bright with GDP growth likely to be between 9% and 10%, the highest growth rate in the ASEAN region. Singapore's key export markets are expected to sustain their growth performance or recover from their economic downturn, while economies in the region are booming. Coupled with the strong performance in exports of manufactured goods, particularly electronic components and computer equipment, growth will also emanate from expansion in investment, and robust growth in private consumption. Malaysia is expected to maintain strong output growth of 8.5% in 1994, but infrastructure bottlenecks and renewed inflationary pressures will have to be dealt with for sustained growth in the medium-term.

Inflation

ASEAN member countries have been fairly successful in using both fiscal and monetary policies to curb **inflation**. In 1994 the rate of inflation in the ASEAN economies is expected to increase slightly with average weighted inflation rate at 6.2% compared with 6.1% in 1993. Indonesia

and the Philippines, however, are estimated to experience inflation rates higher than the ASEAN average. Indonesia's still high inflation rate at 8%, may necessitate a partial reversal in the relaxation of its monetary policy. In the improving Philippine economy, a hike in fuel prices and electricity rates as well as stronger demand are expected to push up the inflation rate to 10% and well above the government's forecast of 8.9%, compared with the 7.6% rate in 1993. In Malaysia,

Table 3.4

ASEAN: Gross Domestic Product, Inflation And Current Account Balance

	1993	1994 ^e	1995 ^f
Gross Domestic Product Growth (%)			
ASEAN	6.9	7.4	7.0
Brunei	-4.1	-2.0	-0.5
Indonesia	6.5	6.5	6.4
Malaysia	8.3	8.5	8.5
Philippines	1.7	4.2	5.4
Singapore	9.9	10.0	6.8
Thailand	7.7	8.1	8.2
Inflation Rate (%)			
ASEAN ¹	6.1	6.2	6.0
Brunei	4.3	4.5	5.0
Indonesia	9.7	8.0	7.1
Malaysia	3.6	3.8	—
Philippines	7.6	10.0	10.0
Singapore	2.4	4.7	3.5
Thailand	3.3	4.1	3.8
Current Account Balance (US\$b)			
ASEAN	-11.2	-16.0	-16.6
Brunei	1.4	—	—
Indonesia	-3.4	-3.7	-3.6
Malaysia	-2.4	-4.5	-4.8
Philippines	-3.3	-2.0	-2.5
Singapore	3.3	2.5	3.0
Thailand	-6.8	-8.3	-8.7

¹ Estimates, weighted by relative shares of GNP average for 1988-1990.

^e Estimates.

^f Forecasts.

* Targeted to be below that of 1994.

Sources: ASEAN Macroeconomic Outlook 1994, IMF International Financial Statistics and ADB Asian Development Outlook 1994.

monetary and fiscal restraints are expected to continue dampening consumer demand pressures despite an estimated pickup in domestic and aggregate consumption in 1994. The inflation rate in Malaysia is expected to increase slightly to 3.8% in 1994 compared with 3.6% in 1993. Inflation in Singapore is estimated to increase from 2.4% in 1993 to 4.7% in 1994, due mainly to higher food prices and increased costs of housing, transport and communications with the implementation of the 3% goods and services tax (GST) starting April 1994. In Thailand, inflation is estimated to rise by 4.1% in 1994 compared with the 3.3% inflation rate in 1993. This is despite the Government's efforts to restrain increases in wages and the appreciation of the baht.

Trade and Balance of Payments

The ASEAN economies are expected to continue recording **current account** deficits, with the total deficit expected to remain around US\$16 billion in 1994 (1993: -US\$11.2 billion). Although export performance remains encouraging, the increasing level of merchandise imports comprising mainly intermediate and capital goods for the manufacturing sector in Thailand, the Philippines and Indonesia is expected to exacerbate the total current account deficit in the future. Indonesia's foreign debt which now stands at US\$89 billion is also exerting pressures on its balance of payments. For Malaysia, its current account is projected to register a deficit due to the continued large outflows of investment income, freight and insurance payments. Singapore is expected to continue registering a current account surplus, of US\$2.5 billion in 1994.

Foreign Direct Investment

The increase in the overall foreign direct investment into the ASEAN economies is expected to accelerate by 11% (1993: 3.1%), even after taking into account the global shortage of capital and competition from new lower-cost producing countries, such as China and Vietnam. Foreign investment approvals in Malaysia surged by 148% in the first half of 1994, while Thailand registered a continued inflow of foreign direct investment with growth of 50% in the number of proposed investment projects during the same period of 1994. Foreign investment commitments in the manufacturing sector in Singapore increased by

16% to US\$1.3 billion in the first half of 1994, while approved foreign investment in Indonesia increased by 9.4% to US\$5.3 billion during the same period of 1994 after the introduction of two deregulation packages in June and October 1993 aimed at checking the decline in new foreign investment approvals. Improvement in dealing with the problem of power shortages is likely to help the Philippines attract higher levels of foreign direct investment in 1994. Brunei is embarking on more serious efforts at attracting foreign direct investment by reviewing investment incentives as well as creating a more conducive climate for industries.

At the same time, several ASEAN countries, notably Malaysia, Indonesia and Singapore, have continued to embark on a 'reverse investment' policy, particularly in the emerging markets and the new attractive low-cost production bases of China and Vietnam. Singapore, in line with its policies to transform the city state into a hi-tech centre has turned venture capitalist by providing funds for firms specialising in telecommunications and computer technology in the Silicon Valley of the US.

Economic Cooperation

The creation of growth triangles has provided additional impetus for increasing intra-ASEAN trade in the medium-term. Over the longer term, the AFTA should contribute to greater complementarity among the economies of the ASEAN member countries. At the 26th ASEAN Economic Ministers' Meeting held in Chiangmai, Thailand on 22 and 23 September 1994, the Ministers agreed to the inclusion of agriculture into AFTA, as well as intellectual property rights and services into the sphere of economic cooperation in the non-goods sector. Ministers also agreed that the implementation of AFTA could be accelerated to take effect five years earlier, by 1 January 2003. In the wake of improvement in the traditional markets of the US, Japan and the EU, and the conclusion of the Uruguay Round in April 1994, ASEAN is expected to benefit from greater world trade growth. The dismantling of trade barriers should lead to a more efficient allocation of resources in the region which, in turn, will make ASEAN more productive and competitive in the global market, and thus making the region more attractive to foreign investors.

Prospects for 1995

Industrial Countries

Recovery in the **industrial countries** will be more broad based but modest. Output growth for the industrial countries as a group is expected to be 2.7% in 1995. In the US, recovery is expected to be firmly established while in Japan, although the economy has moved into the path of recovery, the biggest downside risk seems to be the appreciating yen. In Europe, where recovery is expected to be driven by net exports, domestic demand is expected to continue at a modest pace, considered insufficient to reduce the rates of unemployment until well into 1995. However, consumption may be boosted slightly as households are expected to reduce their savings rate. At the same time, business investments are expected to rise not only in Europe, but also in the US and Japan. Inflation is not expected to be a real threat as long-term interest rates are expected to increase further.

With a tighter monetary policy to rein in a rapid expansion, GDP growth in the **US** is expected to decelerate to 2.5%. Inflation will continue to be a concern as the economy gains momentum and as commodity prices recover. With further reductions in unemployment leading to an increase in demand, upward pressures on price levels can be expected. Investment climate and consumption demand are expected to slow down concurrent with the increase in long-term interest rates. The current account deficit is expected to widen further to US\$171.3 billion if real exchange rates and the fiscal deficit remain at the 1994 levels.

In **Japan**, despite mixed policy signals from the government and a strong yen, the economic recovery taking place in the second half of 1994 is expected to continue and strengthen in 1995. Pent-up demand following the two years of recession aided by an increase in disposable incomes following a tax cut, are expected to boost consumption which will remain the main engine for growth. Public investment is also expected to help lead the economy towards a more stable recovery during 1995. However, should the yen continue to maintain its upward trend, the fragile economic recovery experienced in 1994 may be adversely affected. GDP growth for 1995 is expected to improve to 2.5%, a higher growth when compared with 1994. The unemployment rate is not expected to change significantly and

will continue to hover at 3%. The large output gap in the economy is expected to keep inflation at 0.8% while the current account surplus is expected to fall to US\$121.6 billion. The growing stock of direct manufacturing investment in other Asian countries will help to reduce the current account surplus through reverse imports. On the other hand, exchange rate factors and an expanding Japanese economy are expected to encourage car and electronic industries to locate a higher percentage of production overseas.

For 1995, the economic turnaround for **Germany**, which began in the second half of 1994 is forecast to gain momentum and reach 2.6% due mainly to a recovery in domestic demand and a booming export market. Capacity utilisation is expected to increase and consequently, an increase in fixed investment will follow. With an accumulated spare capacity, unemployment may continue but conditions are expected to improve towards mid-1995. Even so, registered unemployment is expected to hover at 9.9%. With the slack in the labour market and wage growth remaining at modest levels, the inflation outlook is expected to improve in 1995(2.2%).

In the **UK**, growth is projected to be around 3% as employment continues to increase and consumer confidence strengthens. Private investment bolstered by domestic demand is expected to contribute to the UK's growth. Price pressures are expected to reemerge in the face of the recovery gathering pace. However, to rein in the rates of inflation, the UK government is expected to push up interest rates by at least, 1%. The rate of inflation is expected to be 3.1% in 1995. Underlying labour market conditions are firming slowly and supply side reforms adopted by the UK Government over the past 15 years have made the labour market more flexible and responsive, thus helping to reduce unemployment rates.

Developing Countries

The **developing countries** as a whole, are expected to maintain their current growth momentum to achieve overall output of 5.7% in 1995, although disparities between and among regions are expected to persist. Growth will emanate from exports, since access to most western markets continues to increase. The

international environment is also likely to be more favourable for South and Central American countries. This is largely on account of better commodity prices, especially for coffee and copper, buoyant export markets as well as efforts made in the last few years to restructure and improve supply-side conditions which could prove increasingly beneficial to the export sectors.

Growth rates in the East Asian economies could rise further to nearly 8%. Growth in export markets, public and private sector investment, increased foreign direct investment and intra-regional trade will be the main forces driving growth in 1995. China's output growth is expected to continue to slow in 1995 to about 8% as Government efforts to reduce the inflation rate take effect. The inflation rate may decline to 15%. The economies of the NIEs are expected to stabilise in 1995. Hong Kong's GDP growth is forecast to be 4% in 1995 as private consumption stabilises, and the impact of China's economic slowdown takes further effect. Inflation should also ease to 8%. Taiwan's economy is forecast to expand by 6.4% due to faster world trade growth, and inflation is expected to rise at a higher rate of 4.1% as consumers' expenditure increase in tandem with their rapidly rising incomes. South Korea's economic growth is likely to slow down slightly to 6.9%, as a result of faster import growth compared with the growth in capital investment and exports. The rate of inflation is envisaged to slow down to 5.3%, aided by a tight monetary policy and the appreciation of the won.

The six-member ASEAN is projected to grow at an estimated 7% in 1995, as recoveries in the region's major trading partners become more firmly established, as well as further improvement in intra-regional trade and investment. Brunei's economy is envisaged to contract by 0.5% assuming that world oil prices do not improve and despite government and private sector efforts to diversify the economy as Brunei sees the need to find other sources of revenue in the face of declining revenue from oil to finance its increasing expenditure. The rate of inflation is estimated at 5%. Indonesia's growing interdependence on global economic conditions will increasingly determine its economic situation. With the world economy expected to perform better in 1995, exports are expected to be the major source of growth. As macroeconomic stabilisation efforts take hold, inflation is expected to fall to 7%.

On the basis of improvements in political stability, macroeconomic indicators and power availability, the Philippine economy should grow by an estimated 5.4% in 1995, led by higher investment. Stronger demand will likely keep inflation to about 10%. Singapore expects a slowdown in 1995, and estimates growth for the Republic to be slightly down to 6.8%, as it is unlikely that current export levels can be sustained. Inflation is expected to be well under control at 3.5%. Thailand's economic expansion in 1995 will continue to be led by investment in construction and real estate. Labour constraints will continue posing a challenge to faster growth. The lower rate of inflation of 3.8% is not expected to pose a great problem for Thailand in 1995.

The ASEAN economies are also expected to renew their efforts to expand their economic cooperation through sub-regional integration schemes or 'growth triangles'. The earliest of the growth triangles, the Singapore-Johor-Riau Growth Triangle (SIJORI) has garnered strong support, particularly from Singapore's private sector, where entrepreneurs are ready to 'regionalise' their activities.

The Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT) is expected to accelerate synergistic economic growth in ASEAN. The Asian Development Bank (ADB) has identified projects for greater cooperation within the growth triangle which comprises the four northern states of Peninsular Malaysia, five provinces in Southern Thailand and two provinces in Northern Sumatra. Besides the possibility of relocation of labour-intensive industries within this sub-regional grouping, this growth triangle will also seek collaboration in the areas of physical infrastructure and telecommunication development as well as joint development and sharing of water resources. The triangle has vast untapped resources and economic possibilities, and a proper and systematic management of the synergy will ensure the full realisation of its potential as another engine of growth in ASEAN, and an effective instrument of AFTA intra-regional cooperation which can help in the redistribution of income in the regions.

Another growth area which is being developed is the Brunei-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA) which

encompasses parts of the four countries mentioned. At the first Ministerial Meeting held at Davao City, Mindanao in 1993, ten sectors were identified for cooperation amongst the areas included in the growth area. Each country was chosen as the 'lead agency' for two to three sectors, and would be responsible for identifying projects for cooperation with the other countries or areas involved.

World Trade

With GDP in the industrial countries and some fast growing developing countries rising, **world trade** is expected to grow in volume at a robust 5.9% in the 1994-95 period. Developing countries' exports are forecast to rise about 0.5 percentage points above the global average. The pace of world trade may well exceed 6% after 1995 as activities in Japan and Europe recover more strongly, and as new plurilateral agreements and the Uruguay Round Agreement begin to be implemented.

Capital Flows

The expansion in capital flows to developing countries in the past three years and the ability of a majority of these countries to rebound from a moderate correction in 1992 provides optimism about the sustainability of these flows. Despite an outflow of portfolio capital from emerging markets triggered by increases in US interest rates, the emergence of a recovery in May and June in the Latin American and Asian bond markets reinforces the optimism.

However, rising interest rates, reflecting recovering investment demand in the industrial countries, will tend to slow the large increases in private capital flows to developing countries. Capital flows in 1994-96 are expected to grow at 8% to 10% per year, instead of the 50% average growth seen in the 1991-93 period. In 1994-95, foreign direct investment to developing countries is expected to moderate to about US\$45 billion to US\$50 billion, as total outflows from industrial to developing countries decline somewhat with the projected strengthening of economic conditions in Europe and Japan.

Issues In The Global Economy

Although the near-term growth prospects for the industrial countries as a group has improved, the projected resumption of stronger growth forecast to average 2.7% in the next few years is low in comparison to past trends. Notwithstanding this, there are a number of mitigating factors to justify greater optimism for the years ahead, and developing countries can look forward to a marked improvement in the international economic environment. Export markets are expected to recover with stable and relatively low inflation in the industrial countries, which in turn, should allow world interest rates to remain moderate, while private capital flows are expected to continue albeit at a less spectacular pace than in the 1991-93 period. Growth in world trade is also projected to increase with the coming into force of the UR agreements and commodity prices are projected to stabilise after more than a decade of decline.

Many developing countries have, by and large, succeeded in sustaining their high rates of economic and trade growth in the first three years of the 1990s, despite the recession and slow output expansion in the major industrial countries. This has given rise to suggestions that the economic growth in the industrial countries is no longer the driving force in the growth performance of the developing economies. Undoubtedly, many developing countries have acquired strength and a capacity for resilience largely the result of better domestic policies.

In the current situation, the risks of a less favourable international economic environment continue to stem from the possibility that supply side reforms may falter in the industrial countries in trade, fiscal and labour market policies. Therefore, strong commitment by industrial countries to ensure conditions for a durable expansion through macroeconomic policies such as fiscal consolidation, deficit reduction programmes, labour market and other structural reforms, are important factors underpinning growth in the near to medium term. In the rapidly industrialising developing countries, steadfast implementation of stabilisation policies and structural reforms would reinforce their present success, while in the low and medium income countries as well as the economies in transition, implementation of appropriate policies would reverse the recent patterns of declining living standard.

Despite the projected improvement in world growth and trade, and taking into account their resilience to demand and interest rate cycles in recent years, developing countries continue to be concerned with their trade prospects. Improving market access conditions in the developed countries, including for agriculture and commodities, would therefore constitute additional important factors in the outlook of developing countries. With the planned enlargement of the EU and the NAFTA, and the possibility of a growing internalisation of trade and investment within those areas, there is now an added element of uncertainty to the outlook for developing countries, as the EU and North American markets still absorb between one-third to one-half of many developing countries' exports.

The lingering recession and the high unemployment situation in the industrial countries over the past three years have resulted in the intensification of protectionist pressures in developed countries against imports from developing countries. As has been clearly observed, while the UR negotiations dragged on for seven years, trade relations between several important trading nations came to be managed under bilateral deals. GATT rules were being circumvented by 'grey area measures' resulting in export losses to the developing countries. Additionally, the actual or potential use of unilateral measures by leading trading nations have kept the highly trade-oriented developing countries, including those in the East Asian region, in a state of uncertainty for a number of years.

Trade related policies are crucial for a revival of world growth as a setback in the global outlook could stem from continuing trade friction, especially among the leading trading nations. The ratification of the Final Act of the UR without delay, and consequently the resolution of bilateral trade

disputes through the WTO process would foster a more predictable and transparent global trading environment, enhancing efficiency and helping keep inflationary forces at bay.

Strong policies in many developing countries have created good investment opportunities, bringing about a substantial rise in private capital inflows. Long-term flows will continue to be an important source to finance private and public investment needs, but such flows are subject to fluctuations, oftentimes challenging the management of fiscal and monetary policies. Notwithstanding a sharp correction in early 1994, there are grounds for optimism about the sustainability of these inflows. Given that growth trends will continue - with underlying growth of about 2.5% to 2.7% in the industrial countries and of 5% to 6% in the developing countries - the share of foreign direct investment inflows to the developing countries will be favourable. In addition, adequate policy responses in recipient developing countries would also provide sufficient incentives to investors in industrial countries to diversify their investment portfolios.

The maintenance of a conducive investment climate by developing countries will also be influenced by increased competition for global capital and the sensitivity of such flows to international interest rates. Aside from adaptation of macroeconomic and structural policies to minimise the effects of fluctuations, recipient developing countries would be faced with demands to liberalise investment rules, including providing non-discriminatory treatment of foreign investors, adopt competition policies, even harmonise investment rules so as to promote foreign direct investment inflows. These demands are part of a process, already started in some regional arrangements, to extend the competence of the WTO to deliberate issues relating to competition.