3 International Economic Survey

Overview

The outlook for world economic growth continues to be encouraging in 1996 with output expansion estimated at 3.8% (1995: 3.4%), and further accelerating to 4.1% in 1997. Growth has become more widespread among the developing countries with strong economic activity emanating, particularly from the emerging market economies. Economies of the developing world are experiencing expansion, with Asia continuing to outpace the others, albeit at a more moderate pace than those recorded in previous years as economies continue to undertake measures to address pressures of overheating. Aggregate output is expected to stabilise across most of the economies-in-transition as private sector led growth has contributed positively to expansion of economic activity, while in a number of countries where contraction had been severe in previous years, some positive growth can be expected for the first time since the transition process began. Performance in the industrial countries have been mixed however, with the United States entering its sixth year of consecutive growth while in Japan, positive signs have emerged indicating that the economy has finally entered a phase of steady recovery. In much of Europe, prospects still remain uncertain to a significant extent as the continent grapples with structural and macroeconomic weaknesses in their economies.

World Trade

In 1996, world trade is expected to expand at a slightly slower pace of 7% (1995: 9%) after a rebound that began in 1994. This is on account of the projected moderation in major trading countries, primarily in Western Europe. Developing country imports are again expected to provide the growth in world trade, growing at about 11%, as the moderate growth in most of Europe is expected to slow down overall global import demand. World exports and imports will grow at only 6.6% or US$6,509 billion (1995: US$6,191 billion), of which exports of goods will amount to US$5,182 billion (1995: US$4,936 billion).

The deceleration in industrial country import growth will continue into 1996, with growth estimated at 5.6% (1995: 7.2%) from the peak of 9.2% in 1994. This modest import growth reflects the softening of demand from the US of about 6% compared with 8.3% in 1995, although imports by Japan will remain at a high level of about 13%, reflecting mainly reverse imports but also the lagged effects of the strong yen and the deregulation of the Japanese internal market. Continuing weakness in the **European Union (EU)** is expected to moderate imports by Germany, France and Italy.

Developing country exports will moderate in 1996 to 9.7% compared to 12.1% in 1995, while the growth of imports will decline to 10.3% (1995: 11.1%). **Asia** is expected to lead overall growth in trade among the developing countries at 11%-12%, although exports of the four Newly Industrialising Economies (NIEs) will lower to 9.7% compared to a strong expansion in 1995 of 13.8%. Import demand is also expected to slow down in the NIEs as their overall output growth moderate to a more sustainable level. **East Asia**'s overall trade pattern is gradually changing. The region has substantially increased its trade with Japan, particularly exports. Although US interest rates and exchange rates still have a major influence on East Asian interest and exchange rates, the region is becoming less vulnerable to changes in trading conditions in the US. In 1996, East

Asian imports and exports are estimated to reach a total of around US$1500 billion, compared to US$1,360 billion registered in 1995. **ASEAN**'s total trade is also expected to remain vibrant, reaching US$696.7 billion from US$616 billion in 1995 as AFTA-based trade and inter-regional trade and investment gathers momentum.

Overall Latin American imports is expected to register 10.4% while exports will slow to 7.4% in 1996. Import demand in **Africa** is projected to drop to 5.9% in 1996 (1995: 9.6%) as stabilisation measures across some 40 states reduces the propensity to import. Exports on the other hand is projected to improve to 13.4% in 1996 from 7% in 1995, on account of higher prices for commodities and growing trade and investment within and among the African states.

International Financial and Capital Markets

The performance of the **financial markets** in the industrial countries has been mixed given the divergence in economic performance among them. In most of Europe, weak growth and low inflation have encouraged monetary easing with short-term interest rates declining substantially since early 1996. In contrast, short-term rates have remained largely unchanged in the United States and Japan where growth has been stronger. In both these countries however, short-term rates could trend upwards by the end of 1996. Long-term rates on the other hand, have varied considerably with bond yields rising in Japan, Germany , the United Kingdom and Canada but declining in Italy and Spain while in the exceptional case of the US, the rise in bond yields since early 1996 has reversed close to half the declines experienced in the preceding 12 to 15 months. The fluctuations in yields can be attributed to market expectations about adjustments in monetary policy in the US and Japan and a protracted debate about a balanced budget between the Administration and the US Congress as well as continued weak fiscal positions in Germany, France and a number of important EU countries.

Foreign exchange markets in industrial countries have been generally stable for the most part in 1996. The major currencies in the Exchange Rate Mechanism (ERM) have moved closer to their actual levels in part due to improving prospects for fiscal consolidation and strong commitment of key EU member states to proceed with Monetary Union (EMU). Meanwhile, associated changes in international interest rates differentials have brought about a moderate strengthening of the US dollar against most other major currencies. In real effective terms, the dollar has risen to levels in early 1994, while the yen has declined to the levels of early 1993. The alignment of the exchange rate between the dollar, yen, deutsche mark, Swiss franc and the Italian lira has also been due to the combination of economic fundamentals in these countries' economies, interest rate differentials in favour of assets denominated in dollar as well as a decline of the Japanese yen due to the continuing reduction of its current account surplus.

In the developing countries, foreign exchange markets were generally stable during the first half of 1996 due to sustained recovery of capital flows and tightened policy measures in countries that had suffered the contagion effects of the Mexican financial crisis. However, in several Asian economies, large capital inflows have put upward pressure on their currencies. In China, the authorities have intervened to maintain broadly stable exchange rates, but in Indonesia and Korea, despite relatively stable exchange rates against the US dollar, real effective exchange rate have risen further due to the general depreciation of the yen as well as to relatively high domestic inflation. In Thailand, the baht faced intense pressure in mid-1996 following downward revisions of GDP growth and exports and an upward forecast for the balance of payments deficit. The Bank of Thailand (BOT) intervened outside the Bangkok market for the first time, selling dollars for baht in Hong Kong and Singapore in order to control the devaluation of the baht.

In recent months, net **capital flows** to developing countries gathered strength with some countries experiencing surges in capital inflows which, as earlier in the 1990s, have posed problems for macroeconomic policy. The countries affected were not only from Asia and Latin America but also, for the first time, from Central Europe. In 1996, capital flows are expected to rise to a level estimated at US$224.8 billion, almost twice the level achieved in 1995. As in previous years, there continue to be great disparities in the experiences of developing countries and transition economies regarding the availability of external financing. A minority of countries in Asia, Latin America and Eastern Europe raise significant sums in the forms of equity and direct investment, while the rest of the developing countries continue to depend more heavily on official financing. Private capital flows into Latin America in 1996 is expected to improve significantly as a result of strong adjustment measures that have renewed investor confidence. In the absence of adverse shocks, the total net inflows is envisaged to exceed US$50 billion in 1996, almost double 1995's level.

Foreign Direct Investment (FDI) is also expected to rebound in 1996 brought about by growing international competition, globalisation and advances in communications and information technology as well as the privatisation of state-owned enterprises. Global FDI which reached an estimated US$235 billion in 1995, is expected to rise to US$250 billion in 1996, as major capital exporting countries emerge from a period of weakness and as advanced developing countries become significant investors in other developing country markets. It has been estimated that developed countries received 60% of world FDI in 1995 , with the US retaining its position as the single largest recipient, while flows to Japan continue to remain small. FDI to western Europe as a whole continue to be substantial but in a number of countries such as the Netherlands and the UK, FDI recession in terms of inflows have continued.

Selected developing countries continue to attract FDI flows accounting for 35% to 40% of the world FDI inflows, estimated at US$90 billion in 1995. Given their dynamic growth performance and large and growing market which provide profitable investment opportunities in manufacturing and services, the emerging economies in Asia received the bulk of FDI flows. Total FDI inflows to Asia estimated at US$52.7 billion in 1995 is expected to increase by 15% to US$61 billion in 1996. However, within Asia, countries have had differing levels of success in attracting FDI with China and East and Southeast Asia at the forefront, accounting for almost 60% of total flows to the region. The South Asian countries by contrast are still lagging, although since 1994, India has emerged as an important FDI location. In the case of the ASEAN economies, despite increasing competition for FDI globally and regionally, the grouping is expected to remain attractive to investors as efforts are further intensified to promote intra-ASEAN and outside FDI. In 1995, Japan was the largest source of investments for ASEAN contributing US$13.5 billion followed by the US (US$9.6 billion), the UK (US$7.6 billion) and Taiwan (US$2.4 billion). With continuing liberalisation of investment regimes in individual member states and the privatisation of infrastructural projects coupled with strong promotion efforts, FDI flows into ASEAN is expected to reach US$75 billion in 1996.

Meanwhile Latin America and the Caribbean economies are also expected to experience renewed FDI interest as a result of greater regional liberalisation efforts under regional arrangements, such as the Andean Pact and Mercusor. In addition, privatisation programmes announced in several Latin American countries have been opened to foreign investment. Total FDI is estimated to reach a record US$25 billion, compared with US$17.1 billion in 1995. FDI flows will be significant in Argentina, Brazil, Chile, Colombia and Peru, with Brazil, Chile and Columbia likely to receive record volumes. Bolivia, Costa Rica and Venezuela will also show a positive trend. Mexico however, is expected to receive just US$7 billion, compared with US$11 billion in 1994.

In the **equity markets**, although prices across most emerging market countries recovered strongly in the first half of 1996, it has since been lacklustre. In Asia, with the exception of Hong Kong, the Philippines and Taiwan, monetary tightening to contain overheating pressures had limited the increase of equity price in most other countries. Notwithstanding this, however, equity investment flows in developing countries continue to remain strong as investors take into account the growth trend in the size of emerging markets, their overall liquidity levels and the increasing number of new companies being listed on the exchanges.

Economic Situation Of The Industrial Countries

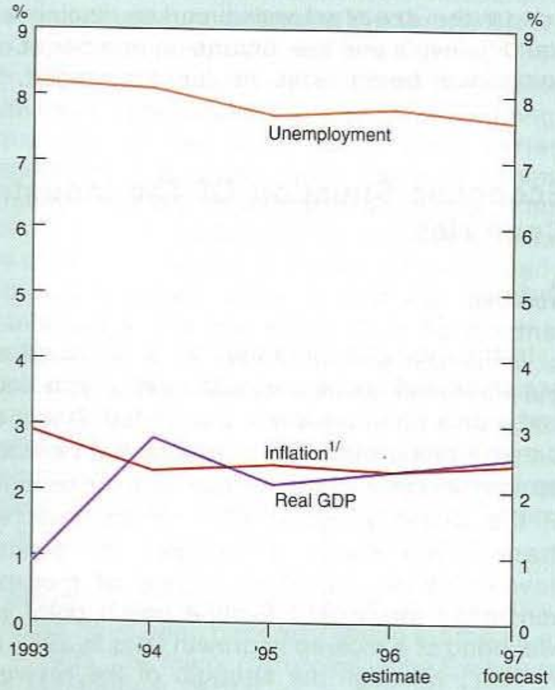
Output

In the industrial countries as a whole, growth has remained moderate, with recovery in Japan and a pick up in growth in the United States and Canada being offset by a substantial slowdown across most of Western Europe, with the exception of the United Kingdom (UK). Since mid-1996, there have been a number of positive developments, including easing of monetary conditions throughout Europe which point to a likelihood of a pick-up in growth later in 1996 and in 1997, although the strength of the revival in growth was uncertain. An encouraging aspect in almost all industrial countries continues to be their success in achieving low inflation, averaging

2.5%. In contrast, a majority of industrial countries continue to face challenges in the fiscal area and in the labour market. High unemployment rates, in particular have persisted throughout most of Western Europe.

In the **United States (US)**, the economy is considered to be operating at almost full potential. Economic activity picked up again since early 1996, responding to monetary easing that began in mid-1995, encouraging strong growth in private fixed investment, especially in technology enhancing equipment as well as home sales. Output growth is however expected to slow to a more sustainable pace in the second half of 1996, as consumption of durables are reduced as short-term rates and debt servicing gradually rise. Business fixed investment and residential investment could also moderate as the effects of long-term rates are being felt. For the whole of 1996, real GDP is projected to be 2.4% with an unemployment rate of 5.6% and inflation at about the 2.8% level. Given that the US economy is on the verge of very high resource utilisation and low unemployment, a rekindling of price pressures

Chart 3.1
Industrial Countries -
Major Economic Indicators



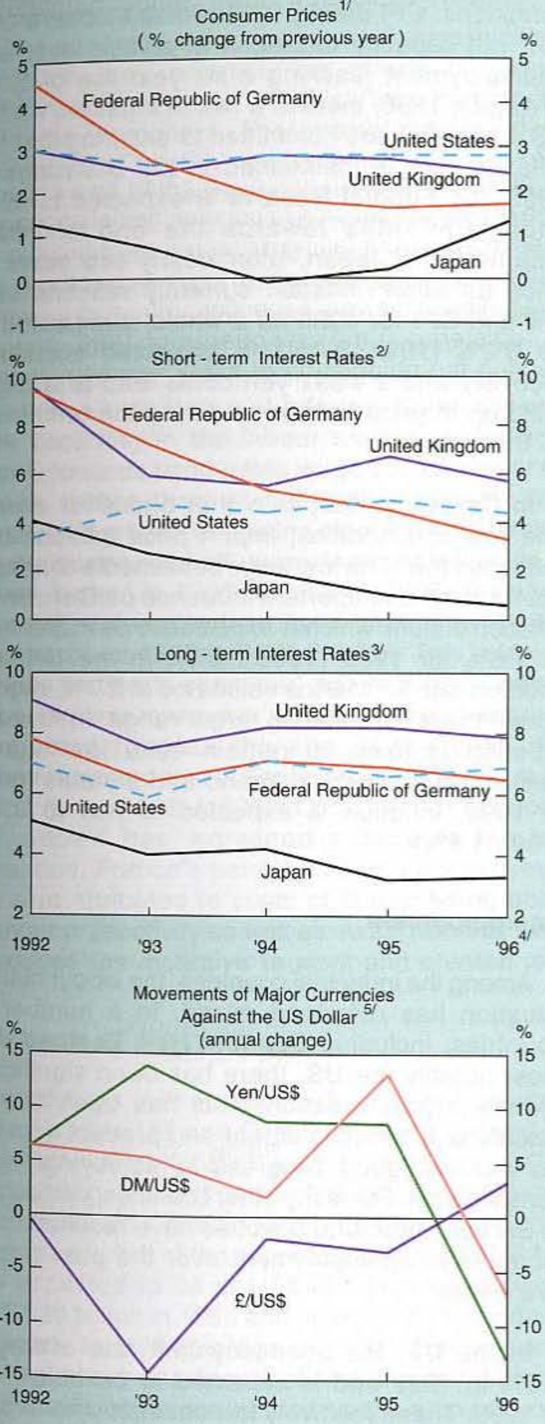
1/ Consumer prices
Sources :IMF World Economic Outlook , September 1996 and national sources

remains a major area of concern for the Federal Reserve. However, consumer price inflation has been subdued for the most part of 1996 and thus the economy could slow down without monetary tightening.

In **Japan,** the recovery appeared to be proceeding and growth is expected to accelerate to 3.5% in 1996 compared with 0.9% in 1995. The pick up in growth has been aided by a broad range of policy measures to counter the deflationary forces arising from falling asset prices, difficulties in the banking sector and the excessive appreciation of the yen. Exceptionally strong growth was registered in the first quarter of 1996, partly reflecting the completion of many reconstruction projects after the 1995 Kobe earthquake and a revival in business investments on account of easier monetary conditions that have prevailed since late 1991. Growth surged to almost 13% of the annualised rate in the first quarter. Although the acceleration in GDP growth overstated the underlying strength of activity, it signalled that the economic stagnation of the past four years has finally reached a transitional phase towards recovery. Growth will be spurred by private demand and consumption as public investment is expected to decelerate. A modest public spending package of about Y3,000 billion (US$27.2 billion) approved in September will facilitate the transition from fiscal expansion to contraction.

In continental Europe, there have been encouraging signs of a pick-up in activity, notably in Germany, although more broadly based revival of growth in the region is still not apparent. The ongoing fiscal consolidation efforts in most European countries to satisfy the Maastricht criteria by 1997, has partly caused the drag on economic activity. The absence of a significant recovery in economic activity might renew concerns about the ability of EU countries to fulfill the Maastricht's single currency requirement regarding the level of budget deficit, inflation and government debt. Such concerns could result in a re-emergence of interest rates rise in some countries thereby affecting confidence and dampening demand. In **Germany**, output indications in the second quarter suggests that growth prospects are brighter. The indicators showed a revival in construction, a moderate increase in industrial output and a positive export performance. With the rebound in the second quarter and a sustained growth path expected for the second half of 1996, the economy in 1996 will register a slightly slower GDP growth of 1.3% compared with 1.9% in 1995.

Chart 3.2
Current Trends in Key Economic Determinants in Industrial Countries



1/ 1996 figures are estimates.
2/ Averages of interest rates weighted by the average US dollar value.
3/ Average yield on Government bonds.
4/ Until June 1996
5/ End of period except for 1996, up to mid-September.

Sources : IMF World Economic Outlook, September 1996.

In the **United Kingdom (UK),** while real GDP growth is expected to decline slightly to 2.2% in 1996 (1995: 2.5%), the rate of expansion is relatively stronger compared with the average in the rest of the **EU** projected at 1.6%. Continued slack in UK's economy, particularly in the manufacturing sector, has partly been due to subdued demand in the UK's major European trading partners and this has helped keep down inflationary pressures. Growth in 1996 will be led by robust consumer spending and the services sector, especially tourism. In **France,** the economy appears to be almost at a standstill for the most part of 1996. GDP growth is expected to decline to 1.3% (1995: 2.2%), as a result of weak private consumption, uncertainty in the employment market, rising inflation and slower growth in household disposable income. The lagged spillover effects of the German recovery will only positively impact on French exports in 1997. However, towards the end of 1996, exports could increase as the economies in the EU area strengthen and the greater exchange rate stability will provide French exporters with some advantage to regain their market shares.

In the smaller European economies, Ireland and Norway are projected to continue their strong growth. In **Ireland**, buoyant exports and consumer spending are expected to continue to grow at a robust pace. Combined with financial discipline, outward looking policies and considerable FDI, Ireland's GDP growth is projected to remain strong at 7.0% in 1996 (1995:10.3%). Economic activity in **Norway** has also remained buoyant against a background of strong consumption and large external surplus. GDP growth in 1996 is projected at 4.5% (1995:3.3%).

Australia and **New Zealand** are also projected to continue with their strong growth performances of recent years, despite tighter monetary policies to rein in price pressures. Growth in New Zealand is expected to remain at a steady 2.3% in 1996 (1995:2.2%), while Australia will grow at 3.8% in 1996 (1995:3.2%).

Inflation

Across the industrial world, inflation has been subdued in recent years as monetary authorities in the industrial countries have been sensitive to price pressures as growth continues or strengthens. Overall, consumer price inflation is expected to be in the region of 2%-2.5% in 1996 (1995:2.4%).

Table 3.1

Selected Industrial Countries Major Economic Indicators

	Industrial Countries	*United States*	*Japan*	*Germany*	*United Kingdom*
Growth of Real GDP (%)					
Year					
1993	0.9	2.2	0.1	−1.2	2.3
1994	2.8	3.5	0.5	2.9	3.9
1995	2.1	2.0	0.9	1.9	2.5
1996[e]	2.3	2.4	3.5	1.3	2.2
1997[f]	2.5	2.3	2.7	2.4	3.0
Inflation[1] (%)					
Year					
1993	2.9	3.0	1.3	4.5	3.0
1994	2.3	2.6	0.7	2.7	2.4
1995	2.4	2.8	−0.1	1.8	2.8
1996[e]	2.3	2.8	0.2	1.6	2.7
1997[f]	2.4	2.8	1.3	1.7	2.4
Unemployment (%)					
Year					
1993	8.2	6.9	2.5	8.9	10.3
1994	8.1	6.1	2.9	9.6	9.3
1995	7.7	5.6	3.1	9.4	8.2
1996[e]	7.8	5.6	3.5	10.3	7.7
1997[f]	7.6	5.6	3.4	10.0	7.3
Current Account Balance (US$ billion)					
Year					
1993	−30.0	−99.9	132.2	−16.3	−16.6
1994	−7.4	−148.4	130.6	−21.4	−2.9
1995	15.8	148.2	111.4	−17.4	−12.0
1996[e]	−2.5	150.9	70.7	−10.7	−7.2
1997[f]	−1.0	154.8	77.1	−7.3	−8.0

[1] Consumer prices
[e] estimates
[f] forecast

Sources: IMF World Economic Outlook, September 1996 OECD Economic Outlook June 1996 and other sources.

In the **US,** consumer prices increased by 4% during the first half of 1996, partly due to increases in food and energy prices. Wage prices have also picked up given the relatively tight labour market conditions. CPI during 1995 remained below 3%, but with capacity utilisation at a high level and unemployment reaching a six year low of 5.1% in August 1996, there is a risk of inflation. As the US authorities are committed to ensuring that the inflation rate is maintained in the 3% range in 1996, the Federal Reserve is expected to raise short-term rates towards the end of 1996. Meanwhile in **Japan**, after nearly two years of price deflation, inflation currently remains very low and CPI for 1996 as a whole is expected to be 0.2% (1995:-0.1%). A projected sustained recovery and a weak yen could lead to a slight build up in price pressures during the remainder of the year.

In **Germany,** despite higher prices for energy and raw commodities, import price inflation has remained low. The low wage settlements of around 2% has had an important influence on Germany's inflation outlook which is expected to be maintained at 1.6% for 1996 (1995:1.8%). In the **UK**, the inflation rate for 1996 is estimated at 2.7%, slightly above the 2.5% inflation target range. In **France,** inflation is likely to remain quite low due to depressed domestic demand and a stable franc. In 1996, inflation is expected to rise to 2.1% (1995:1.8%).

Unemployment

Among the industrial countries, the labour market situation has remained mixed. In a number of countries, including **Canada, New Zealand** and most notably the **US**, there has been significant growth in jobs creation. This has been due to flexible and dynamic labour and product markets as well as, good progress in achieving fiscal consolidation. For many other countries, particularly in Europe, structural rigidities have resulted in an increase in unemployment over the past twenty five years.

In the **US**, the unemployment rate averaged 5.6% in 1995 and is expected to be below 6% in 1996. These relatively low unemployment rates have the potential to exert some pressure on prices, as corporate profits provide scope for further wage increases. The US has been particularly successful in recent years in achieving a high level of employment and maintaining growth close to its potential rate with low inflation. These achievements are due to dynamic and flexible labour market that has accommodated a growing labour force and facilitated macroeconomic management. In **Japan,** there will be no rapid improvement in the coming months of 1996, even as the economy picks up because companies will maintain their restructuring efforts to reduce corporate fixed costs, of which labour costs are a major component. The unemployment rate is expected to slightly increase to 3.5% in 1996 (1995:3.1%). In **Germany,** unemployment currently stands at 8.7% in the western states and 15.7% in the eastern states. With such persistent high unemployment rates in recent years, there is a growing understanding among government, labour and business leaders that reducing unemployment will require not only faster economic growth but extensive labour market reforms. Some changes are occurring in the labour market, including a move towards conducting wage bargaining at the plant, rather than at the industry level. With economic growth remaining sluggish and industry restructuring, overall unemployment will edge up even further in 1996 to 10.3% (1995: 9.4%). In the **UK,** unemployment is expected to decline from 8.2% in 1995 to 7.7% in 1996. This is largely due to moderate economic growth in the economy and the improvement in major export markets projected towards the end of the year. The unemployment rate in **France** is expected to reach 12.4 % for 1996 (1995:11.6%), as an economic slowdown has worsened prospects for jobs creation. France's persistent high unemployment is also attributed to costs of labour being above labour productivity as well as social benefits which reduced the incentive to work and created jobs.

Balance of Payments

Although in the major industrialised countries such as the US and Germany, the growth of the current account deficit as a percentage of GNP is slowing, international imbalances are expected to continue to remain large. In 1996, the current account deficit of the major industrialised countries is expected to be at US$46 billion compared to US$29 billion in 1995 and is expected to moderate slightly to US$45 billion in 1997. The tightening of monetary and fiscal policies in many industrial countries have contributed to the slower growth of the deficit.

The **US** current account deficit is expected to remain in the region of US$150 billion in 1996 (1995: US$148.2 billion) or 2% of GNP. Interest receipts from abroad are growing significantly slower than interest payments paid abroad which mainly explains the widening of the current account deficit. In **Japan,** the correction of the yen/$ rate in the past 12 months, is likely to lead to further narrowing of the current account surplus. It is expected that the current account surplus will decline by 26% (1996: US$70.7 billion) as import growth continue to increase by double digit, reflecting a shift in import penetration overseas. The impact of this shift to overseas production was to reduce the trade surplus in July 1996 by 27.3% (June: 25.5%).

In **Germany,** with domestic demand growth remaining depressed but export growth sustained, the current account deficit in 1996 is expected to remain at its 1995 level of US$17.4 billion or 0.9% of GNP. **France's** external position remain strong with current account surplus in 1996 expected to rise again in due to the strength of exports of capital goods. Overall, the current account surplus should still remain above 1% of GNP (1995: US$18.2 billion or 1.5% of GNP). In **UK**, the current account is expected to register a surplus in 1996, the biggest in nine years. The surplus will emanate from a strong showing in the services account, as tourism and investment income register strong growth. There is however, a slight worsening in the merchandise account to US$19.4 billion in 1996 (1995: US$18 billion).

Economic Situation Of Developing Countries

Developing countries are expected to register a strong economic expansion of 6% in 1996 (1995: 5.8%) due to recoveries that have begun in Mexico and Argentina, stronger stabilisation and reform efforts in many countries, particularly in Africa and continued expansion, albeit at a more moderate pace in a number of Asian emerging market countries. In the emerging market countries, activity is expected to remain buoyant in 1996 given strong domestic fundamentals and continued large capital inflows, especially of FDI. With a projected high growth rate, many emerging market countries continue to face the risk of overheating, which can lead to unsustainable macroeconomic balances, inflationary pressures, and strains in their financial markets. As in previous years, the emerging market countries continue to be dynamic markets for exports from developed countries as well as for each other.

The ASEAN Economies

In 1996, GDP growth in the ASEAN region is expected to remain strong at 7.0% (1995: 7.4%). Strong investment and domestic demand continue to drive growth in Malaysia, Thailand, Indonesia and Singapore. ASEAN inflation is expected to ease to 4.8% (1995: 5.4%) attributable largely to tighter monetary and fiscal policies.

Output

Brunei's economy is expected to grow at a higher rate of 3% in 1996 (1995: 2%) boosted by higher oil prices and robust growth in the non-oil sector. The services and construction sectors are also expected to contribute to overall economic performance as a result of new programmes implemented under the Seventh Five-Year National Development Plan, beginning in 1996. **Indonesia's** growth is expected to remain quite strong bolstered by increasing investment, further diversification of the industrial base and rising consumer purchasing power. In 1996, output is projected at 7.6% (1995: 8.1%). Public investment will also increase to meet the country's extensive infrastructural development needs. Meanwhile, rising labour costs following a decade of substantial economic progress and the emergence of new players in Asia, particularly in the textile and garments sector have somewhat eroded Indonesia's competitiveness. Consumption will increase with further gains in disposable incomes. The **Malaysian** economy is expected to grow at a more sustainable pace of growth of 8.2% in 1996 (1995: 9.5%), with the rates of growth in all sectors expected to moderate. The growth continues to be driven by an expected double-digit growth in manufacturing sector as well as strong expansion in the services and construction sectors. In the **Philippines,** the economy continued to sustain the strong growth momentum which began in 1992 and is expected to grow by 5.9% in 1996 (1995: 4.8%) led by investments and exports. The strong growth is due to the successful implementation of reform measures beginning in 1995, including full liberalisation of current account transactions, tax reform, deregulation of the energy sector, and the adoption of a uniform tariff system. This will be the highest rate of growth for the Philippines' economy in this decade, reflecting greater political stability and strong commitment to strong macroeconomic policies. On the demand side, strong growth in private consumption, rapid expansion of foreign and domestic investment, as well as strong export performance are major contributors to the economy's performance in 1996. The pick-up in the Philippines' growth performance in 1996 will also improve the labour market situation, with unemployment expected to drop to around 8.5% of the labour force from almost 10% in 1995.

Singapore's economy is expected to slow down further to 7%-8% in 1996 (1995: 8.9%) due largely to slower growth in manufacturing arising from weaker world demand for electronics, as well as reduced competitiveness of their manufactured products resulting from continued appreciation of the Singapore dollar. Despite the slowdown in the manufacturing sector, growth in the services sectors including financial, business, telecommunication, tourism and related manufacturing-servicing activities continued to be sustained. After a strong GDP expansion of 8.7% in 1995, a surplus fiscal position, tight monetary policy and a softer external demand for Thai exports are expected to help moderate **Thailand's** economic growth in 1996 to a rate slightly below 7%. The sharp slowing of exports during the first half of 1996 is expected to tail off, recovering in the second half of 1996 although the country's slight erosion in competitiveness will continue to drag a better outturn for export industries. Growth will emanate from domestic demand, especially in the construction and manufacturing sector, as well as in the tourism sector. Thailand's growing openness of the capital account have resulted in large and volatile capital inflows in 1996. The Thai authorities have responded through a mix of monetary and fiscal policies aimed at curbing excessive spending. The Government has instituted measures to promote domestic savings, controlled credit more tightly, imposed stricter guidelines on finance companies and commercial banks. In **Vietnam**, economic growth is expected to remain at the 1995 level of 9.5%, owing to continued increases in investment and a booming construction sector.

Inflation

Inflation will continue to be low for several ASEAN countries. The inflation rate in **Brunei** is projected to ease to 3.4% in 1996 (1995: 6%) as the impact of the higher import duties on motor vehicles imposed in the early 1995 is absorbed. In **Indonesia**, inflation is envisaged to decrease marginally to 9.1% in 1996 (1995: 9.4%) as the authorities continued to rein in inflation by holding down administered prices, which represent about a quarter of the CPI basket. With a consumption boom and strong growth in all demand aggregates, inflationary pressures continue to persist. The inflation rate in **Malaysia** is expected to remain low at 3.6% in 1996 (1995: 3.4%) resulting from continued tightened monetary policies and prudent fiscal policies, as well as, effective administrative and enforcement measures. In 1996, inflation in the **Philippines** is likely be around 8.5% (1995: 8.1%) largely on account of wage increases and a one-time expected cost-push resulting from the introduction of the VAT. **Singapore** is expected to contain inflation at the 1995 level of 1.7% in line with a moderation in growth. The inflation rate in **Thailand** is expected to decelerate to 4.2% in 1996 (1995: 5.8%) as food prices have returned to more reasonable levels coupled with policy measures to moderate domestic demand. Pressure on prices has shown clear signs of easing since the second quarter of 1996. The inflation rate in **Vietnam** is expected to decelerate to 9% in 1996 (1995: 12.8%), resulting from stringent financial and monetary measures such as selling bonds to promote savings, strictly controlling compulsory reserves of commercial banks and stabilising the exchange rate.

Trade and Balance of Payments

Overall export growth in the ASEAN region is expected to decelerate slightly in 1996 brought about by a moderation in the US economy, modest outlook for Europe, global overcapacity for semiconductors and a slight loss of competitiveness due to appreciating currencies. Total ASEAN trade in 1996 is expected to amount to US$696.7 billion compared to US$616 billion in 1995. The current account for the ASEAN region as a group is also expected to show an overall improvement with the Philippines expected to experience a narrower current account deficit in 1996, while Brunei Darussalam and Singapore are expected to increase their surpluses. In spite of fluctuations in the price of oil, with the increasing contribution from the non-oil sector, **Brunei's** exports are expected to increase by 8.6% in 1996, higher than that of imports at 7.4%. **Indonesia's** exports for 1996 is forecast to increase by almost 12%. Imports of capital goods are expected to still remain high at 13.6% as many industries are at the consolidation or expansion stage and given that the construction sector continues to experience strong growth. Even so, the deficit in the current account in 1996 is forecast to decline from US$8.7 billion in 1995 to US$7.3 billion or 1.5% of GNP. This forecast however, is made on the assumption that non-oil exports growth will be more stable between 16% to 18% annually and no major change is expected in the exchange rate. For 1996, **Malaysia's** current account is expected to improve

Table 3.2

ASEAN: Gross Domestic Product, Inflation and Current Account Balance

	1995	*1996[e]*	*1997[f]*
Gross Domestic Product Growth (%)			
ASEAN	7.4	7.0	7.2
Brunei	2.0	3.0	3.0
Indonesia	8.1	7.6	7.9
Malaysia	9.5	8.2	8.0
Philippines	4.8	5.9	6.2
Singapore	8.9	7.7	7.5
Thailand	8.7	7.0	8.0
Vietnam	9.5	9.5	10.0
Inflation Rate (%)			
ASEAN[1]	5.4	4.8	4.6
Brunei	6.0	3.4	3.0
Indonesia	9.4	9.1	7.0
Malaysia	3.4	3.6	3.5
Philippines	8.1	8.5	6.2
Singapore	1.7	1.7	2.5
Thailand	5.8	4.2	4.5
Vietnam	12.8	9.0	12.0
Current Account Balance (US$b)			
ASEAN	−22.2	−20.0	−16.1
Brunei	0.6	0.7	0.6
Indonesia	−8.7	−7.3	−7.0
Malaysia	−7.5	−5.9	−4.6
Philippines	−3.5	−2.7	−2.4
Singapore	10.2	10.8	12.0
Thailand	−11.5	−12.4	−11.5
Vietnam	−2.3	−3.2	−3.2

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

[e] Estimates

[f] Forecast

Sources: World Economic Outlook, September 1996, APEC Economies: Recent Development and Outlook, October 1996 with the deficit envisaged to narrow from 9% of GNP in 1995 to 6.3% of GNP in 1996. This is largely on account of a larger surplus in the merchandise account which is envisaged to increase from US$0.1 billion in 1995 to US$1.8 billion in 1996. A slightly wider trade and current account deficit is expected to accompany the economic expansion in the **Philippines**. The trade balance is projected to record a larger deficit of US$9.2 billion in 1996 (1995: US$8.7 billion). However, surpluses in trade in invisibles and transfer payments are envisaged to partially compensate the larger trade deficit, resulting in the current account to decline to US$2.7 billion in 1996 or 3% of GNP(1995: US$3.5 billion). **Thailand's** exports are still expected to grow at a moderate pace to US$65.6 billion in 1996 (1995: US$56.2 billion) as it recovers from an initial slowdown in the first half. Imports are expected to increase to US$79.8 billion in 1996 due to higher demand for imported capital and intermediate goods. While the build-up in short-term external liabilities has opened Thailand's economy to the risk of capital flight, a large scale outflow is highly unlikely as Thailand's long-term economic prospects remain favourable and macroeconomic policies are sound. In 1996, the current account deficit is expected to widen slightly to US$12.4 billion in 1996 (1995:–US$11.5 billion). As a share of GNP, the deficit will remain steady at about 8.1%. In 1996, **Vietnam** is expected to experience increases in exports by 35.9% as exports of crude oil, rice, coffee and garment products rises in the face of good international market prices. Imports are expected to grow by 31.7% in 1996, although the import growth of consumer goods will be kept below 20%. Overall, the current account deficit is expected to be approximately 8.9% of GNP in 1996 (1995: 10.2% of GNP).

Economic Cooperation

Following the Fifth Leaders Summit in December 1995, ASEAN has focussed its work on deepening and widening economic cooperation among its Member States. Key to the renewed efforts in enhancing such cooperation in recent months has been the acceleration towards establishing the ASEAN Free Trade Area (AFTA) from 15 to 10 years. The implementation of the Common Effective Preferential Tariff (CEPT) has made great strides including increased product coverage, thereby signalling that AFTA itself is well on the way to realisation by the year 2003. Various trade facilitation measures have been implemented to support the AFTA-CEPT process including, among others, harmonisation of tariff nomenclature, customs valuation and procedures, and elimination of non-trade barriers (NTBs) for manufactured and agricultural products. To ensure the smooth and barrier-free flow of goods across borders in the ASEAN region, a green lane system to expedite customs clearance of CEPT products is now in operation in all member states. It has been shown that processing time has been reduced by 40% to 60% at these green lane check points. Another significant achievement in supporting the AFTA process is the CEPT Rules of Origin for Textiles and Textile Products which was approved by the AEM at their 28th Meeting in September 1996. The CEPT Rules of Origin for Textiles and Textile products allow the use of substantial transformation criterion as an alternative to the existing percentage criterion. This new ruling will help to increase intra-ASEAN trade in textiles and textile products as well as make ASEAN textile products more competitive in the global market.

ASEAN economic cooperation has also been expanded into other areas including services, intellectual property and the development of an ASEAN Investment Area (AIA). In order to maintain ASEAN's industrial competitive edge and to ensure that the grouping remains attractive as an investment region for global production, an ASEAN Industrial Cooperation Scheme (AICO) Agreement was agreed to by Economic Ministers in September 1996. AICO which will be operationalised by 1 November 1996 is expected to encourage investment in technology-based industries and value-added activities. A Plan of Action on Cooperation and Promotion of Foreign Direct Investment and Intra-ASEAN Investment has also been endorsed. It is being implemented through the Work Programme for 1996-1998 comprising 32 projects. The 28th AEM also agreed to a proposal by the Heads of Investment Agencies (AHIA) to realise an ASEAN Investment Area (AIA) by 2003. The main objectives of the AIA are to increase ASEAN's share of FDI flows into Asia and to increase investment in the region from ASEAN and non-ASEAN sources by enhancing ASEAN's attractiveness and competitiveness through progressively reducing or eliminating impediments to investments. In the area of services, Member States have begun market access negotiations in financial services, telecommunication services, tourism services, air transport services, maritime transport services, construction and business services. Negotiations on tourism and telecommunication sectors have been scheduled to conclude by 30 June 1997, while the other five sectors will conclude by 31 December 1998. Meanwhile, cooperation in the intellectual property area has been directed to conduct regular consultations so as to monitor regional and international developments with a view to seek common positions on matters of concern. A Program of Action has also been formulated for the 1996-1998 period, which will be implemented on a gradual basis.

In recognition of the increasing complexity of ASEAN economic arrangements, the need for greater transparency and to ensure that commitments are implemented in a non-discriminatory manner, there was agreement among Member States that a mechanism providing for the settlement of trade disputes was needed. In that regard, the 28th. AEM approved a Dispute Settlement Mechanism (DSM) Agreement covering all economic agreements. The agreement which will be officially signed in November 1996 at the First Informal Summit of ASEAN Leaders was modelled on the WTO Agreement relating to settlement of disputes. However, in the ASEAN context, the process of consultation in the DSM has been given added emphasis in line with the grouping's philosophy of settling problems in an atmosphere of cordiality and concord.

The need to intensify trade and investment relations with ASEAN's immediate neighbours in order to harness the political and economic potential of an enlarged grouping has preoccupied policy-makers in the region in recent months. An important step towards realising the goal of an ASEAN Ten was the ASEAN-Mekong Basin Development Cooperation initiative adopted on 17 June 1996 by the seven ASEAN Member States and the four Mekong riparian states. This initiative which is intended for mutual benefit to all Southeast Asian countries will now see ASEAN and the CLM countries (Cambodia-Laos-Myanmar) and China too, as the core group. Cooperation in various sectors have been prioritised based on proposals from the riparian states with the development of infrastructure, particularly in the areas of transport, communications, irrigation and energy designated as top priority. A Malaysian proposal to link Kunming in China to Singapore via high-speed electric rail links, gas pipelines linking ASEAN with the CLM states and a common time zone in ASEAN after the CLM countries join ASEAN are all being considered. By September 1996, two Working Groups set up to study the financial implications of the Mekong initiative and the rail link proposal have submitted their initial reports.

ASEAN Sub-Regional Arrangements

Two of the sub-regional groupings within ASEAN are witnessing an expansion path bringing in more areas under the coverage of the respective growth centres with the objective of spreading further the benefits of economic cooperation and development. Malaysia extended the coverage of the **Indonesia-Malaysia-Singapore-Growth Triangle (IMS-GT)** to include the States of Melaka, Negeri Sembilan and Pahang, while Indonesia incorporated West Sumatra, which is a natural economic hinterland for the Riau provinces. Under the **Brunei-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA),** seven additional provinces in Indonesia, namely Central Kalimantan, South Kalimantan, Central Sulawesi, South Sulawesi and Southeast Sulawesi, Maluku and Irian Jaya were included. With these expansions, the growth areas offer more options for investors and enhance further private sector collaboration.

The first **IMS-GT** Ministerial and Senior Officials Meetings were held in March 1996. It was decided that two Working Groups be established to cater for cooperation initiatives in the services and tourism sectors, in addition to the four Working Groups originally set up to look into investment and development potentials in the infrastructural, agricultural, industrial sectors as well as in human resources development. Since the formalisation of the trilateral cooperation in December 1994 joint-investment activities between Johor and West Sumatra have accelerated. The Malaysian private sector has entered into several joint-venture projects which include the development of 11,000 hectares and 3,000 hectares of palm oil plantations in West Sumatra, the construction of a Cement Plant and Terminal in Padang, the development of 350ha. Dumai Industrial Park, Pipe Fabrication and Pipeline construction in Duri, Riau and ferry services in IMS-GT area. The estimated costs of these investments alone amount to RM1,083.6 million. Other projects being initiated include cooperation in human resource development, namely the recruitment and training of skilled and semi-skilled workers, post-graduate training programmes in the various engineering disciplines and pre-employment training; water treatment as well as tourism-related projects. An IMS-GT

Business Council has also been established to facilitate intra-regional interaction and networking among the businessmen.

In **BIMP-EAGA**, the thirteen Working Groups established have within a span of two years, identified and implemented several cooperative initiatives. These include expanded air, sea and telecommunication facilities, measures to facilitate movement of people and resources within EAGA and sustainable management of natural resources. In terms of air services, there are currently 13 air service points within the sub-region compared to 5 before the formation of BIMP-EAGA. The Working Group on Air Linkages is targeting to increase it to 21 air service points over the next three years. Shipping routes have been established linking Mindanao to Sabah, as well as other major ports along the coasts of Borneo, Bitung, General Santos and Davao. Telecommunication tariffs have also been reduced by as much as 40% for overseas calls within EAGA. Policy reforms instituted to facilitate border crossings include the exemption from payment of exit travel taxes for EAGA bound overseas workers by the Philippines, adoption of a Full Disclosure Policy and a Standard Contract of Employment to be implemented on a bilateral basis as well as granting of Fifth Freedom Traffic Rights for the priority points and designated BIMP-EAGA airlines by Brunei and Indonesia. A BIMP-EAGA Growth Fund with an initial capitalisation of US$300 million is expected to be launched soon to finance viable infrastructure and commercial projects in the region. In terms of sustainable management of natural resources, a significant achievement was the proclamation of the Turtle Island Heritage Protected Area as a sanctuary and breeding ground for marine sea turtles by Malaysia and the Philippines.

The establishment of a permanent Secretariat of the East ASEAN Business Council in Brunei Darussalam in early 1996, ensures that the private sector would continue to play a central role in BIMP-EAGA activities. Active participation of the private sector is reflected in the number of MOUs signed since 1994 and the formation of BIMP-EAGA sectoral councils and associations. Based on the MOUs signed, estimated investments to be generated total RM1.08 billion and cover mainly the plantation, forestry, fisheries, telecommunications and utilities sectors. To promote cooperation and strengthen linkages in the shipping sector, a Regional Ship Operators' Association has been established. An East ASEAN Tourism Council has also been set up to undertake among others joint promotional activities. To form strategic alliances between groups involved in the construction sector, an Association of Contractors and Consultants has been established. An ADB sponsored BIMP-EAGA Investigative Study was carried out from May 1995 and completed in April 1996. The study identified some 150 policy, program and project initiatives to be implemented at both public and private sector level, covering all the major sectors.

The **Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT)** has progressed in many areas since its formation in 1993, with more projects identified for cooperation and joint ventures. In terms of facilitation, substantial progress were made in expediting the process of obtaining approvals and implementing projects, promoting exchange of information, as well as adjusting and streamlining policies, rules and procedures for the creation of a more conducive investment climate. Based on the MOU's signed, total investment involving Malaysian companies is estimated at RM10.7 billion and cover a wide range of economic activities, trading, energy, telecommunications, tourism, construction, shipping services and air and sea links. Among the major joint-venture projects being undertaken include a three-star hotel in Medan, development of telecommunications infrastructure in Medan and Acheh, a 190 km toll road connecting Medan and Binjai, 400 hectares of industrial estate in Medan, and a housing project in Medan. To facilitate further cross-border activities, the Government of Thailand and Malaysia have agreed to have a single border inspection policy. This will involve a single check point, a single declaration form, computerisation of customs procedures and usage of bilingual documents in order to expedite immigration clearance. The Malaysian government has also extended the hours for the clearance of ferry services plying Penang, Lumut and Belawan. Ferry Services can now operate between 6.00 am to 8.00 pm Malaysian time. Facilities for the exchange of labour market information and a register on training institutions within the region have also been developed. Efforts are being made to create an identity for the IMT-GT region in order to attract investors from outside. To assist in the further development of IMT-GT, the ADB, which had conducted a Development Study for the region in 1994, has offered to provide technical assistance, project financing as well as implementation assistance.

FEATURE ARTICLE 1

Financial Resource Mobilisation in the ASEAN Sub-Regional Growth Areas

I. Introduction

1. Economic cooperation at the ASEAN sub-regional level accelerated with the formation of the Indonesia-Malaysia-Singapore Growth Triangle (IMS-GT), the Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT) and the Brunei-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA). Joint trade and investment activities in these areas have steadily gained momentum. However, a faster rate of development of these sub-regions, especially IMT-GT and BIMP-EAGA, to fully realise their economic potentials will require substantial financial resources outlay. This article examines the identified financing needs of the sub-regional growth areas, the alternative financing sources that could be explored and the initiatives presently taken by the participating regions to mobilise the required financial resources.

2. The lack of a well-spread financial infrastructure base in IMT-GT and more particularly in BIMP-EAGA has been regarded as a major constraint in the development of these two sub-regions compared to IMS-GT which has access to the advanced capital market facilities in Singapore. Entrepreneurs and investors more often than not encounter difficulties in getting the necessary financial support due to the reluctance of most banks to extend loans for cross-border investments, high cost of credit especially in certain parts of the sub-region and the generally poor access to financial services. Relatively more pronounced are the problems encountered in the BIMP-EAGA region which lags behind in economic development. Being relatively unexplored, the sub-region has not been able to attract sufficient enterprise and capital. High bank charges, delays caused in cross-border transactions and unwillingness of financial institutions to finance the operations of small-scale enterprises are among the factors affecting trade and investment in BIMP-EAGA. In general, the financial markets of the sub-regions of IMT-GT and BIMP-EAGA are not developed beyond the limit of their major urban centres.

II. Identified Financing Needs

(a) Development Requirements

3. The Asian Development Bank (ADB) undertook Development and Investigative Studies for the IMT-GT and BIMP-EAGA subregions. A multifaceted set of policy, program and project initiatives was proposed by the ADB for the development of **IMT-GT**. The policy initiatives include removal of constraining policies, the modification and simplification of existing policies and the coordination and harmonization of policies among the IMT-GT countries to facilitate and attract investments. The programs identified to enhance cooperation cover human resource development, information dissemination, natural resource management, technology development, common industry quality standards and transportation safety standards. The projects proposed are for the development of physical infrastructure and facilities and these include upgrading industrial and trade infrastructure, developing facilities for agribusiness activities and upgrading the transportation infrastructure to support trade, investment and tourism activities. The full implementation of the development proposals was estimated to costs **US$$15-20 billion** over a **ten-year** period. The private sector was envisaged to be the major source of project funding.

4. For the **BIMP-EAGA**, the Investigative Study carried out by ADB proposed some 150 policy and program interventions for the implementation of the EAGA Development Strategy. The Development Strategy is to increase cross-border trade and investment through enabling and facilitating regionalisation and specialisation of production in the region. These interventions address key constraints related to commercial and physical infrastructure and human resource of the sub-region, identify investment opportunities in the productive sectors for private sector participation and focus on the development of non-resource based and high value-added processing industries for the local and export markets. Unlike in the Development Study for IMT-GT, the ADB did not estimate the magnitude of the financial resources required to fully implement the Development Strategy. However, the study made preliminary cost estimates for the Early Action Plan which consists of policy and project interventions to be implemented within a **two-year** period which amount to **US$16 million**. In contrast to the IMT-GT, the BIMP-EAGA

participating countries were required to fund the bulk (81%) of the estimated cost while the balance is to be contributed by the private sector and the multilateral financial institutions. It is expected, however, that the share of private sector finance will increase substantially once infrastructure project implementation is undertaken.

(b) Potential Joint-Venture Investments involving Malaysian firms

5. The number of known investment projects coming on stream in these growth centres also adds to the overall financing needs. Based on the Memorandum of Understandings (MOUs) signed by the Malaysian firms during the period 1994-1996 with their joint-venture partners in the respective participating countries, the potential investments in the various sectors are estimated to total nearly **RM11.8 billion**. The table below presents a sectoral breakdown of the envisaged investments:

Table 1

Estimated Investments based on MOUs signed with Malaysian firms in the ASEAN Sub-Regional Growth Centres 1994-1996

(RM million)

Sectors	*IMT-GT*	*BIMP-EAGA*
Plantation	—	750.0
Industry/manufacturing	50	2.6
Tourism	222.5	—
Forestry	—	22.0
Fisheries	202.0	51.0
Utilities	3,100.0	250.0
Trading	43.0	1.16
Telecommunications	61.3	4.0
Agriculture	—	49.86
Infrastructure	6,810	—
Construction	210	—
Total	10,698.8	1,130.6

6. In the IMT-GT, investments in infrastructure and utility projects require substantial financing amounting to nearly RM10 billion. The proposed projects include the construction of a teleport in Langkawi, a land bridge between Songkla and Penang, development of Independent Power Plants on a build-own-operate basis and highway construction between Medan and Binjai in Indonesia. In BIMP-EAGA, the concentration is in the plantation and utility sectors. Major projects include the development of 7 oil palm plantations in Kalimantan, Indonesia involving a total of at least 154,000 hectares; water supply project in General Santos, Philippines; and the construction of low-cost housing in Palawan, Philippines. The agriculture, fisheries and trading activities in BIMP-EAGA are undertaken on a much smaller scale.

III. Alternative Financing Sources

7. As noted, the financing needs are large. The bulk of the funding requirements is envisaged to be mobilised from the private sector which is expected to propel the economic development of the sub-regional growth areas. The resources of the multilateral financial institutions such as the Asian Development Bank could be sourced to finance, especially the transnational projects, which need to be jointly developed between two or more of the participating countries. Government funding may be essential for many aspects of policy modification and program development. However, it must be acknowledged that traditional financing sources are limited. As such, alternative financing sources i.e. private financing, external financing including foreign direct investment, equity portfolio investment and private non guaranteed debt will have to be successfully and innovatively mobilised.

8. The potential financial modalities that could be further explored include the following:

- (I) domestic and international capital markets;
- (ii) contracting out or privatization schemes;
- (iii) venture capital;
- (iv) Islamic financing facilities;
- (v) offshore financing schemes;

(I) Capital markets

Financing infrastructure-related investment is likely to require more extensive use of the domestic and international capital markets. Debt financing, either through revenue bonds or corporate bonds and other capital market instruments, would mobilise savings to support infrastructure development in the region. The pension funds and life insurance companies seeking long-term, stable returns could be seen as major investors in these bonds. Both Malaysia and Thailand are encouraging domestic placements by setting up securities rating agencies and relaxing laws allowing domestic pension and insurance funds to invest in capital projects.

(ii) **Privatization Schemes**

Private sector involvement in infrastructure development could also be enhanced through various contracting out or privatization schemes. These include the build-operate-transfer (BOT) schemes and its many variants. These approaches enable infrastructure projects to be undertaken more quickly. What is of importance is to put in place an investment environment that promotes such investment schemes.

(iii) **Venture capital**

Venture capital facilities to promote new cross-border investments would assist especially the small and medium scale enterprises (SME) to undertake financially viable projects in the sub-regions. The venture capital facility, whereby participants would realise equity participation, should preferably be a private sector initiative. Funding sources could be multilateral development agencies, private sector funds from within the region and foreign investor groups. Malaysia and Indonesia encourage the formation of venture capital companies and there are nearly 20 and 70 such companies in the two countries, respectively which could be mobilised to undertake cross-border investments.

(iv) **Islamic Financial Facilities**

Another potential source of financing would be through the provision of Islamic financial facilities which would effectively mobilise the uninvested funds of the largely Muslim population in the sub-regions such as in Southern Thailand, Mindanao and in Indonesia. Malaysia has forged ahead with establishing interest-free banking facilities and is currently also promoting Labuan IOFC as an Islamic financial centre. Vast amounts of foreign funds, especially from the Middle-East economies, could also be captured through the Islamic financial mechanisms. Financial instruments such as Islamic trusts and Islamic funds would become available in Labuan.

(v) **Offshore Financing Schemes**

The offshore banks in Labuan IOFC offer several types of financing facilities. The non-ringgit credit facilities include short and medium term advances, project finance, trade finance, standby letter of credit, bank guarantees and performance bonds, loan syndications, and financial advisory services. These credit facilities are competitively priced because Labuan has low corporate tax (3% or RM20,000), foreign currency borrowings from offshore banks are not subject to witholding tax and documentations are exempted from stamp duty. Hence, the cost of borrowing is lower. Other than the conventional financial products, Labuan offshore banks are also involved in the issuance of Private Debt Securities. With the wide range of facilities available in the Labuan IOFC, Labuan is in a position to provide the financing needs and requirements for not only the BIMP-EAGA region but for the other sub-regional growth areas as well.

IV. Financing Initiatives Undertaken

9. The specific Finance Working Groups established in the sub-regional growth centres have been tasked to explore ways of mobilising resources in these regions. Several initiatives have been taken, especially by the private sector, to make available the funds required. In **IMT-GT, an Over The Counter Market (OTC)** has been proposed to be established by the private sector. Eligible companies in the region would have their shares traded along the lines of the London Stock Exchange Automated Quotations (SEAQ) or Singapore Club International. The shares would be traded, cleared and settled electronically and brokerage firms from the three countries will be appointed on the basis of a minimum paid-up capital or shareholders funds. The centre of operations is proposed to be in Penang. The project would in fact create a regional investment fund to facilitate funding for development projects in IMT-GT.

10. Efforts are also being made to establish **Interest-free banking services** in Acheh, Medan and Padang in Indonesia and in Southern Thailand. Malaysia, having established Islamic banking facilities, has taken the lead through Bank Islam (M) Bhd. to provide these facilities in joint venture with their counterparts in Indonesia. It is expected that the first Islamic Bank will be operational in Medan, Indonesia by early 1997. Initiatives are also underway to set up such facilities in Southern Thailand.

11. In **BIMP-EAGA**, under the initiative of the Working Group on Capital Formation and Financial Services, a **BIMP-EAGA Growth Fund** is expected to be launched this year. The Fund is a direct investment fund with a US$300 million financing facility and dedicated to participate in the equity of private infrastructure and commercial enterprises in BIMP-EAGA. It is expected that at least one-Core- Investor to the Fund would come from each of the participating countries. The principal objective of the Fund is to act as a catalyst to fast-track the growth of BIMP-EAGA. The Fund aims to have a balanced investment portfolio in the four participating countries by imposing country limits on investments. Apart from statutory bodies or government financial institutions, investors to the Fund may be financial, commercial or strategic institutional investors from the region and the rest of the world.

12. The **Labuan Offshore Financial Centre** is also being promoted as a potential focal source for financial services in BIMP-EAGA and become a financial hub for the region. Labuan is currently the host to among the top 100 banks in the world. As an offshore centre, Labuan banks enjoy certain priviledges which domestic financial institutions do not have, such as low tax, minimum supervision, free from statutory reserve requirement, absence of exchange control regulations and strict secrecy provision. EAGA participating countries could look to Labuan as one of the alternatives for sourcing of funds. Efforts are being made for the proposed EAGA Growth Fund to be incorporated in Labuan.

V. Conclusion

13. Access to adequate capital is a key requirement for the success of the ASEAN sub-regional economic cooperation. Every effort must be made therefore, to ensure that the investment climate in the region is favourable. This requires putting in place basic infrastructure and financial framework to enhance the potentials of the sub-regions and attract intra-ASEAN as well as foreign investments.

The North East Asian Economies

Growth in North East Asia comprising China, South Korea, Hong Kong and Taiwan, is expected to moderate in 1996, with most economies experiencing some slowing down relative to 1995. Overall GDP is expected to register 6.5% (1995: 7.5%) with inflation contained at a lower rate of 6.2% (1995: 8.5%).

Output

In 1996, economic expansion in **China** is expected to slow down to a more sustainable pace, with real GDP growth expected to be between 8% and 9% (1995: 10.2%). Demand has slowed because of rising inventories, poor budgetary outcomes of state sector and weak performance of the agriculture sector. Economic activity has primarily emanated from foreign investment spending. The major drag on the economy include the debt-burdened state sector, tight credit policies and an overvalued exchange rate which had stifled export growth. In **South Korea,** growth is expected to slow to 7.3% in 1996 (1995: 9%), owing to a weakening of exports and a winding down of the investment boom. Although growth of investment in plant and equipment will slow from the rapid rates of the past two years, expenditures will remain relatively strong as companies continue the process of shifting away from labour-intensive to capital-intensive industries. Consumption expenditures will also remain strong in 1996 because of strong wage increase. **Taiwan's** growth moderated to 5.7% during the first half of 1996 as destructive typhoons and tensions in the Taiwan Straits slowed activity in the exports sector. Economic activity is expected to expand during the second half of 1996 however, as private consumption increases, exports recover and the government's pro-growth economic programmes generate stronger activity. For the whole of 1996, Taiwan's economic growth is expected to be 6.0%, almost the same as in 1995 (1995: 6.1%). In **Hong Kong,** overall real GDP growth for the whole of 1996 is forecast to be 5% (1995: 4.6%) mainly driven by the investment in infrastructure facilities, improved property market conditions and sustained growth in trade-related services and tourism. With a few months left to the official hand over to China, confidence about Hong Kong's future remains strong among both foreign investors and the local business community.

Inflation

Inflation in the North East Asian region as a whole is expected to moderate to 6.2% in 1996 (1995: 8%), owing to monetary tightening in many countries and steady import prices. Inflation in **China** is expected to be contained at 9% in 1996 (1995: 14.8%) as a result of tightened fiscal and monetary policies to restrain price increases. Despite engineering a successful soft landing in early 1996, policy makers continue to face potentially strong growth of demand aggregates, especially given the mid-year selective monetary easing to state enterprises. In **Hong Kong**, inflation is forecast to be lower at 7.5% in 1996 (1995: 9%) as the rate of increase in imported prices has been moderating. A slowing down of the rate of increase and cost of residential accommodation is also helping to rein in price pressures. The inflation rate in **Taiwan** is expected to be 3.6% in 1996 (1995: 3.7%) reflecting the Government's monetary stance and steady import prices. Stronger consumption expected in the latter half of 1996 and higher utility prices are expected to push prices in **South Korea** despite steadier import prices in recent months. For the whole of 1996, inflation is forecast at 4.7% in 1996 (1995: 4.5%).

Trade and Balance of Payments

China's exports growth in 1996 is expected to slow from the previous year's growth because of the loss of external competitiveness and the reduction in value-added-tax (VAT) rebates to exporters, coupled with moderating growth in the United States and slower expansion in Europe, as these markets account for almost 40% of China's total exports. Import growth is expected to slow in 1996. Overall, China will incur a large trade surplus in 1996 of nearly US$25 billion. The current account will remain in surplus of around US$30 billion in 1996. Due to a stronger world outlook, **South Korea's** exports is expected to grow steadily, though at a slower rate compared with 1995. The trade and current accounts are expected to be reduced in 1996 even with slowing export growth because imports of intermediate and capital goods will also be reduced as investment slows and the slower export growth reduces the demand for

Table 3.3

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

	1995	*1996[e]*	*1997[f]*
Gross Domestic Product Growth (%)			
China[1]	10.2	7.5	9.0
Hong Kong	4.6	5.0	5.0
South Korea	9.0	7.3	7.0
Taiwan	6.1	6.0	5.9
Inflation Rate (%)			
China[2]	14.8	9.0	8.5
Hong Kong	9.0	7.5	7.2
South Korea	4.5	4.7	4.8
Taiwan	3.7	3.6	3.7
Current Account Balance (US$b)			
China	17.2	30.0	11.7
Hong Kong[3]	–3.3	9.1	–10.0
South Korea	–8.6	–4.1	–2.4
Taiwan	5.0	6.2	7.9

[1] GNP
[2] Urban
[3] Visible trade balance (US $billion)
[e] Estimate
[f] Forecast

Sources: Economist Intelligence Unit Country Reports and National sources, OECD Economic Outlook June 1996, IMF World Economic Outlook September 1996.

imported components. South Korea's trade deficit is projected at US$2 billion in 1996, (1995: -US$4.7 billion) while the current account deficit will decline to US$4.1 billion (1995: -US$8.6 billion) or 1.3% of GNP. **Taiwan's** overall exports outlook is softer in 1996 reflecting a slowing down of growth in the US as well as in Europe, a weak in demand for computers and the increased competitiveness of Japanese exports as a result of the weaker yen. Given Taiwan's large dependance on imported materials and components used in exports, import growth will also slow down in 1996. However, the current account surplus is still expected to widen to US$6.2 billion (1995: US$5 billion), reflecting higher income from the larger holdings of foreign financial assets by Taiwanese investors offshore. For 1996, rapid growth in the tourism sector, offshore trading activities and an improvement in the terms of trade is expected to provide **Hong Kong** with a current account surplus of US$9.1 billion, in contrast with a deficit of US$3.3 billion in 1995.

Other Developing Countries

Output

Economic growth in other developing countries comprising South Asia, Latin America, Africa and the Middle East, is expected to be slightly better in 1996 as some countries in Latin America have begun to recover and stronger stabilisation efforts in Africa have brought about positive growth after several years of poor performance. In the **South Asian** region, the overall outlook remains rather volatile as countries adopted tighter monetary policy to reduce overheating as well as to tackle the recent problem of deterioration in the current account and loss of external competitiveness. **India** is expected to achieve a moderate growth of 5.9% in 1996 (1995: 6.2%) although infrastructural bottlenecks and high interest rates will continue to restrain domestic demand. However, continued structural reforms after the elections, have boosted investor confidence and FDI is gradually picking up. In **Pakistan**, real GDP is expected to grow at 6% in 1996 (1995: 4.5%) with improved performance expected in the agricultural, mining and construction sectors. **Bangladesh** is also expected to register a slightly higher growth of 4.8% in 1996 (1995: 4.5%) led by a strong export sector and a more stable political situation, which will encourage stronger FDI inflows.

Latin America's rebound from the Mexico-induced gloom of 1995 has been rapid. Growth in 1996 for the region is likely to reach 3% after a meagre 0.3% growth in 1995. The stronger growth envisaged will emanate from higher exports despite weak prices for some products, recovery in foreign capital flows and successful adjustment efforts. External factors have also contributed to Latin America's growth. As the region's economies remain tied to the US interest-rate cycle and given that US growth is slightly above trend, export growth has been strong. Expected growth will not be enough to reduce unemployment however, which rose to its highest level in a decade in 1995. And since the region still remains too dependent on conditions of the world's capital market, especially those in the US, Latin America's economic outlook for 1996 as a whole would be to a large extent influenced by the outlook on US rates before end of the year. In **Mexico**, tight fiscal and monetary policies brought about a major adjustment of the economy in 1995, promoted the recovery of investor and consumer confidence, and helped to stabilise the financial market. Economic activity is expected to recover in 1996 and real GDP is forecast to record a growth of 3.6% (1995:-6.9%). In **Argentina**, the economy turned around in the second quarter of 1996 and is envisaged to record a GDP growth of 2.5% (1995:-4.4%). Activity was initially led by exports and investment but beginning the latter half of 1996, a revival in domestic demand is expected as consumer confidence rally. Full recovery however, will be slow given the Government's firm commitment to the Convertibility Plan (in which the Argentinean peso is pegged to the US dollar) and uncertain export markets in the US and Brazil. In **Chile,** prudent market-oriented policies continue to promote sustained growth, albeit at a more moderate pace in 1996 to 7.5% in 1996 (1995: 8.5%). Strong domestic investment encouraged by an easier monetary stance in combination with an optimistic outlook for manufactured and commodity exports and a recovery in capital inflows are expected to sustain Chile's growth.

The **Middle East** region is expected to witness a recovery in its economic growth due to expansion in economic activity in several countries. However, large government deficits and fluctuating oil prices seem could cloud the outlook for several oil producing countries. Output in this region as a whole is expected to increase slightly to 3.3% in 1996 (1995: 2.7%). **Turkey** continues to implement tight fiscal policies expected to restrain growth to 4.8% in 1996 (1995: 7.5%). In the **Islamic Republic of Iran** and **Saudi Arabia,** economic growth is expected to record 4.2% and 0.7%, respectively (1995: 3% and -0.8%, respectively) owing to still tight fiscal policies, import controls and a slow down in non-oil exports.

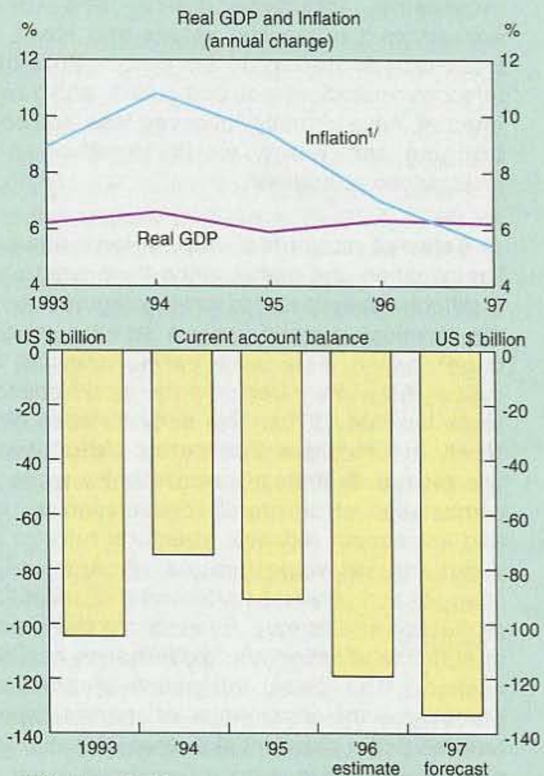
In **Africa** there is now greater optimism that economic growth would strengthen more significantly in 1996. Real GDP growth for the continent as a whole is expected to improve to 5.4% in 1996 (1995: 3.0%), positive outcomes of commitment to structural reforms and stabilisation programmes, reduced inflation rate, greater private sector participation in the economy, liberalisation of trade and exchange system, and a more realistic exchange rate. In **South Africa,** economic activity is expected to expand further in 1996, driven by strong exports and private investment. Real GDP is forecast to grow by 4% in 1996 (1995: 3.5%). In **Kenya,** with the implementation of prudent policies and the deepening of structural reforms, economic growth is projected to remain at the same pace as in 1995, at 5% while in **Algeria**, economic growth is maintained at 4.2% in 1996 (1995: 4.3%).

Inflation

The rate of inflation in developing countries of South Asia, Latin America, Africa and the Middle East as a group is expected to improve at a rate of 13.5% in 1996 (1995:20.3%). In South Asia, a lower rate of inflation is expected at around 8% in 1996 (1995:9%). The inflation outlook is also expected to reduce in Latin America as tighter monetary and fiscal policies are implemented in most countries. The inflation rate in Latin America as a group is forecast at around 20.4% in 1996 (1995: 37.9%) with Mexico (34.1%), Argentina (0.6%), Brazil (12.3%) and Chile (7.6%). On the other hand, Venezuela continues to experience high rates of inflation expected to reach 94.4% in 1996 (1995: 60%).

Inflation in **Africa** is expected to further decline for the third consecutive year to a rate of 21.7% in 1996 (1995: 32.1%). This remarkable improvement has been due to tighter monetary conditions and a strong recovery in the prices of commodity exports, especially coffee. Inflation in Algeria is expected to rein in at 16.9% in 1996 (1995: 29.8%) due to tight demand management and strong wage restraint. Although, the rand has weakened and the fiscal deficit has declined, inflationary pressures remain a major concern in South Africa. A tight monetary stance could still contain inflation, projected at 7.5% for 1996 (1995: 8.7%). Reflecting prudent monetary policies and continued economic reforms, inflation in most of the **Middle East** countries are expected to be lower. However, inflation in this group of developing countries continues to be higher than other regions with expected rates of 26.2% in 1996 (1995:32.6%).

Chart 3.3
Developing Countries - Major Economic Indicators



1/ Median estimate
Source : IMF World Economic Outlook, September 1996

FEATURE ARTICLE 2

Globalisation and the Developing Countries

Introduction

Over the last two decades a sea-change has taken place in the pattern of production, pace of diffusion of knowledge and information and in the convergence of factor markets all of which have reshaped the world economy. These changes, broadly described as the twin processes of **liberalisation** and **globalisation** have separately and simultaneously impacted relationships between nation-states and societies. The final outcome of these processes remains unclear, but both would have important implications for governments, businesses and society. The process of globalisation can be characterised by the rapid growth of international trade and capital flows, the increasing importance of services in trade, the global integration of production processes, and greater willingness to cooperate among countries within the context of multilateral and regional institutions. A common assumption is that globalisation has only an economic dimension, but globalisation is in fact also the process of increasing interdependence and global enmeshment of people, values and ideas that criss-cross national borders. Satellites, telecommunications and computers, and now the Internet, have virtually collapsed time and space bringing the entire world together in an instantaneous manner.

Between countries and regions however, liberalisation and globalisation have progressed at different speeds and to varying degrees. Across the developing world, only a small number of countries in Asia and Latin America had successfully integrated into the world economy since the late 1970s. The early success of the Newly Industrialised Economies' (NIEs) export-oriented growth strategy is evident of the successful combination of unilateral liberalisation of trade and investment regimes, structural reforms and wider market opportunities engendered by liberalisation of world trade and globalisation of production and finance. Even so, the track record of both liberalisation and globalisation has been uneven. The global integration of production processes, the dominance of market-oriented policies and a substantial degree of institutional cooperation between countries have given rise to interdependence among national economies which in several aspects have had positive influences on national economies. Such consequences would however, have to be weighed against the progressively reduced ability of policy makers to pursue national goals by promoting or using the various policy instruments at their disposal, given that developments that occur outside a country's borders have come to have a considerable influence on a country's economy and society. In the foreseeable future, as more developing economies become increasingly drawn into the globalising world, governments could be expected to monitor the effects and impact of the globalisation phenomenon particularly as it affects issues of sustainable development, prosperity and the distribution of benefits. This is especially important given that some aspects of liberalisation and globalisation have been shown to have had negative consequences on national economies and societies.

Opportunities in a Globalising World

A globalising world economy can bring about valuable opportunities thus adding new momentum to the development process. In the area of trade for instance, growth in international trade is expected to be robust over the next decade as the conclusion of the Uruguay Round (UR) opens up new trading opportunities. A strengthened rule-based multilateral system now embodied in the World Trade Organisation (WTO) has the potential to further expand the scope of world markets. Trading opportunities will also stem from the inclusion of "new" areas such as textiles, clothing, services and agriculture. It has been theorised that the internationalisation of services combined with the liberalisation of trade in services would improve the ability of developing countries to develop efficient producer services which can then be exploited in niche markets. In the case of a selected minority of developing countries, the globalisation of finance and the consequent dramatic increase in capital flows, especially since 1992, has enlarged the pool of financial resources available to their firms. A component of these flows, foreign direct investment (FDI) has been and, will continue to remain in the foreseeable future an important component of long-term net resource flows for the industrial development of developing countries. Directly related to FDI is the development effect brought about by the globalisation of production. Since the 1970s, developing countries have promoted the participation of transnational corporations (TNCs) in the industrialisation of their economies. TNCs in turn, have promoted their involvement as providing these economies with the means to strengthen their technological capacity and human resource capabilities, both requirements considered as key determinants of economic progress. Many developing countries have successfully combined the assets of the TNCs, including their R & D, with that of their own - location, labour, natural resources, leading to jobs creation and new markets thereby spurring economic growth.

Challenges to Development

Notwithstanding these benefits, increased globalisation of production and finances have posed difficult challenges and given rise to a number of negative consequences for developing countries. In so far as the UR is concerned, many developing countries continue to face problems of converting the market access commitments made by developed countries into commercial trading opportunities. An added complication is that some of the agreements are so vague as to their interpretation that they hold open the possibility for abuse, including providing creative ways to reintroduce protectionist barriers. Since the coming into force of the WTO in early 1995, there have been several backsliding of commitments by major trading countries and attempts to link trade to non-trade issues, as a means of discouraging developing country exports.

For many developing countries, liberalisation of FDI regimes had also proven to be a double-edge sword. The adverse effects of the globalisation of production can be easily observed in the behaviour of TNCs. To the TNCs, specific advantages countries might have as destinations for FDI have become less important given that the production process is sub-divided across many different countries. Thus, investment projects targeted purely for the domestic market are not so attractive anymore. In producing for the global marketplace, FDI decisions will be made based on "traditional" factors such as labour and raw materials. Investments such as these have therefore, tended to be footloose as competition will naturally emanate from ever more lower-cost locations elsewhere. In an environment of global production, investment decisions are made based on the relative costs for each stage of the production process and since factories can be easily moved across borders or rapidly built at another location, the role for the host country or participation of local firms would be very minimal. Without direct intervention or conscious efforts at upgrading skills, improving infrastructure support and fine-tuning of incentive packages and, without strong linkages with domestic suppliers, host countries will find it difficult to raise the value-added content of their exports in industries dominated by foreign firms.

On another level, as developed country firms realise that transnational production is necessary to maintain competitiveness and profitability, pressures have mounted on governments to provide conditions that will allow them to operate worldwide. This involves not only further liberalisation of international trade but also freedom of entry, right of establishment and national treatment as well as freedom for international financial transactions, deregulation and privatisation. This mainly explains calls in recent months by developed countries to introduce multilateral rules in the WTO for the protection of investment. Another important negative consequence of the globalisation process for development has been the loss of policy autonomy in some areas at the national level, resulting in the scope of development being altered or even restricted. Again the example of the East Asian economies can be used. The economic liberalisation strategy implemented in these countries in the 1970s-1990s has had extensive participation of the state which had provided a necessary compliment to, and sometimes corrective influence on the market, particularly by promoting a rapid pace of capital accumulation and technological progress that was linked to exports. However with more stringent multilateral disciplines after the UR, policy choices that were at one time available to the East Asian developing countries may not be available to the newly emerging developing countries and the countries in transition that want to catch up. This is because industrial policies such as export subsidies, investment performance requirements and compulsory licensing, that were successfully used by the East Asian economies to increase the competitiveness of their industry and exports have been required to be phased-out.

An independent monetary policy has also been made difficult with the globalisation of financial markets due to openness and the dismantling of barriers to capital flows. The high mobility of capital as demonstrated by recent episodes of surges of short-term capital flows have greatly reduced the ability of national authorities to use macro-economic policy instruments to influence objectives such as the volume of output, the level of employment and the rate of inflation. As has been established across several developing country economies in recent years, it is no longer possible to de-link national interest rates from those abroad without suffering large amounts of capital flows and sharp swings in the external value of the currency. In recent years, policy makers across Asia and Latin America have not only had to deal with sharp increases in short term capital inflows but also occurrences of volatility, owing to abrupt shifts in the sentiments of external investors.

The Special Case of the Least Developing Countries

Some developing countries, especially the least developed countries (LDCs) and other structurally weaker economies such as those in Africa, have been at the periphery of global processes, unable to benefit from, and meaningfully participate in, the globalisation process. This phenomenon of marginalisation is the consequence of the combination of developments in the global economy that have not been favourable to the LDCs, or their internal political and economic problems. These two sets of factors have interacted to reinforce the LDCs marginalisation.

As a group, the LDCs have not fared well in terms of economic development. Over the last two decades, although individual countries have made some significant progress, economic progress has been slow for the majority of LDCs, and whatever growth achieved has failed to keep pace with the rapid rise in population size, as a result of which per capita income and living standards have declined and poverty intensified. The marginalisation of a large number of the LDCs from the mainstream of the world economy is reflected in a number of important economic and social indicators. Since the 1970s, not only have LDC growth rates lagged behind those of other developing countries but they have attracted a negligible share of global flows of FDI, and consequently, their investment rates as a percentage of GDP have been lower than of the average for developing countries. LDCs have achieved very little structural reforms and remain heavily dependent upon primary commodities for exports' earnings and on Official Development Aid (ODA) to finance their investment.

The recent trends of liberalisation and globalisation could however, assist the integration of the LDCs into the world economy. A major effort is required by LDCs themselves. Some LDCs have made a start in implementing reforms in their economies, but a great deal more is required. The nature and quality of domestic policies will be crucial in determining whether LDCs can adjust to the changing demands of the global economy. It is possible that as wages rise in the NIEs, labour-intensive manufacturing industries may relocate to LDCs to take advantage of lower labour costs. This in turn could provide the stimulus for export diversification in the LDCs. In their adjustment efforts, the LDCs require the support of the international community, including support for concessional financing to finance the infrastructural and social development investment needed, as well as the balance of payments and budgetary support to facilitate economic reform programmes. Technical assistance to enhance capacities for policy formulation and implementation in LDCs is also needed. Stronger support from the international community for the recent debt initiative by the IMF and the World Bank is a crucial step towards assisting low-income countries exit their debt trap. Equally important is to ensure that market access to LDCs' exports are not undermined by protectionism. In particular, the growth of regional trading arrangements covering industrial countries should not reduce the trading interest of the LDCs.

Conclusion

The processes of liberalisation and globalisation offer developing countries important opportunities to ensure sustainable growth driven by investment flows and an expanding world market. For the LDCs, these twin processes can provide the very same opportunities, thereby holding out the possibility of reversing the economic decline experienced over the last two decades. At the same time, these processes also raise serious concerns about the potential disruptive effects due to the enhanced interlinkages of trade, finance and investment. A large number of developing countries that have become integrated into the global economy have experienced some of these difficulties and recognised that agility is required in policy making so as to avoid the negative consequences. Cooperation among the global community should be further enhanced as part of the international strategy for promoting sustainable development, including promoting the integration of the LDCs into the world economy so that they too could have an equal share of the benefits of globalisation.

Table 3.4

Developing Countries: Output, Inflation and Current Account Balance

	1995			1996[e]			1997[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	5.8	20.3	-91.0	6.0	13.5	-119.1	6.2	11.1	-133.2
By region									
Africa	3.5	32.1	-15.9	5.4	21.7	-16.4	5.0	9.3	-16.1
Asia	8.4	10.9	-29.3	7.7	8.1	-51.2	7.6	7.9	-58.0
Latin America	0.3	37.9	-33.4	3.0	20.4	-38.8	4.0	12.9	-43.3
Middle East	2.7	32.6	-12.4	3.3	26.2	-12.7	3.3	27.4	-15.8

[1] Consumer prices-weighted average
[2] US$ billion
[e] Estimate
[f] Forecast

Sources: IMF World Economic Outlook, September 1996.

Trade and Balance Of Payments

Trade performance of this group of developing countries as a whole is expected to weaken given the economic slow down of the major trading partners. However, capital flows to these countries are expected to be large even though there are signs of overheating and worsening in the external account, reflecting excess demand pressures. In 1996, exports by South Asia, Latin America, Africa and the Middle East as a group is expected to decline to 7.6 % (1995: 14.6%) . Their imports are also expected to experience slower growth but slightly higher relative to exports. Import growth as a whole is expected to register 8.1% in 1996 (1995: 14.2%) with Latin America expected to maintain the 1995 level of growth at 9.7%, South Asia (8.1%), Africa (7.5%) and the Middle East (7%). The current account deficit of this region is expected to widen in 1996, reflecting the growth of domestic demand and continuing large capital inflows. In Latin America, the current account balance is expected to widen but only marginally to 1.7% of GDP in 1996 (1995: 1.6% of GDP). In Chile, the deficit is projected to deteriorate to close to 3.8% of GDP in 1996 from a small surplus of 0.2% of GDP in 1995, while in Argentina, the current account deficit is expected to remain between 1.5%-2% of GDP. Africa and the Middle East are expected to experience a slight increase in their current account deficits at US$16.4 billion and US$12.7 billion in 1996 or at 13.5% and 5.2% of GNP respectively (1995: -US$15.9 billion and -US$12.4 billion).

Prospects for 1997

A strong expansion for the global economy is expected for 1997 at 4.1% up from 3.8% in 1996, with growth either strengthening or maintained in almost all regions of the world. With world trade and investments projected to continue with its present steady rate of growth and with inflation contained at modest rates, the world economic outlook is both optimistic and sustainable, enhancing the potential for both developed and developing countries to benefit from opportunities from deepening globalisation and liberalisation.

Growth in the **industrial countries** as a whole is expected to improve, with output reaching about 2.5%, even as growth in the US moderates to a more even pace. This is because Japan's economic recovery will be on a steadier path while growth in western Europe is projected to gather strength to 2.5%, as monetary easing in 1995-96 finally work its way through the economy. In the **US,** output is expected to moderate to 2.3%, following the rise in long-term interest rates as well as a probable increase in short-term rates beginning the end of 1996 or early 1997. Inflation is expected to remain below 3% against a background of moderate wage increases and continuing productivity gains. In **Japan,** the expansion which began in 1996 will continue into 1997 as effects of monetary easing becomes more widely spread across all sectors of the economy. However, consumer spending could be dampened by a removal of deductions in personal income taxes and a rise in the consumption tax. GDP is estimated to grow at 2.7% in 1997.

Domestic demand in **Germany** is expected to recover strongly in 1997, allowing growth to accelerate to 2.4%. Unemployment is expected to decline though it will not be below 10% as structural rigidities in the labour market still remain. In the **UK**, the growth in private consumption will continue given a combination of low interest rates and tax cuts. An improvement in the international economic condition is expected to provide an impetus to the UK's exports sector. GDP will rise slightly above potential to 3% in 1997. Unemployment is expected to decline further to 7.7%. Inflation, meanwhile is forecast to dip below the 2.5% target range, although a tight labour market could pose some upside risks. In **France**, improved prospects in Germany and easier monetary conditions since mid-1996 will influence a pick-up in economic activity and GDP growth for 1997 will likely rise to 2.4%.

The economic growth in the **ASEAN** countries as a group is projected to remain at the 1996 pace as member countries continue with tight monetary conditions to rein in price pressures. Growth will emanate from improved exports, high rates of investment and domestic demand. The inflation prospect is also optimistic, projected to lower to 4.6%. Real GDP growth in **Brunei** is projected to remain at the 1996 level of 3%, as public investment and private consumption continue to drive demand. Inflation will be contained at below 3%. **Indonesia** 's economy is projected to continue with its 1996 growth path of around 7.9%, stimulated by high rates of exports growth, strong rates of private consumption and continued high levels of investment. Inflation is projected to be modestly restrained to around 8% by tighter monetary policies adopted by Bank Indonesia. The balance of payments' current account deficit is projected to narrow to US$7 billion in 1997 as a result of the imposition of import controls such as reviewing tax structure governing the import of luxury goods, as well as, effort aimed at promoting the competitiveness of non-oil exports. In **Malaysia**, the economic expansion is projected at a sustainable pace of 8%. The current account position of the balance of payments is expected to improve further with a small deficit. **Philippines** is expected to sustain its fiscal stabilisation and economic liberalisation packages which will be reflected in GDP growth of 6.2% with inflation contained at 6.2%. The higher growth will mainly be on account of strong exports as well as rapid expansion of investment. Agricultural production also expected to recover. **Singapore** is projected to experience a more sustainable growth of 7.5% in 1997. Aside from a recovery in exports, investments will remain at the high levels of 1996 while the financial and business services sector will show robust performance. Singapore's inflation is projected at 2.5% in 1997 on the assumption that the Singapore dollar will continue to appreciate against other ASEAN currencies. Economic growth in **Thailand** is projected to remain at around the Five Year Master Plan target of 8%, resulting from a recovery in exports, strong foreign investment and still buoyant construction sector benefiting from rebuilding work forced by the floods. The current account is projected to slightly widen to around 7%-8% of GDP. In **Vietnam**, economic growth is projected to continue at a high rate of more than 10% in 1997, as exports are expected to perform strongly, while capital investment accelerates the construction sector.

The **North East Asian economies** as a group is projected to continue to experience high growth of 7.1% in 1997. Most of the countries are expected to continue with tight monetary and fiscal policies aimed at reducing demand pressures. The average inflation rate in this region is projected to be contained at 5.9% in 1997. China's "soft landing" continues into 1997 with a projected growth of 9% as government continues with efforts to achieve more sustainable growth and reduce inflation rate to single-digit on account of strong construction activity and higher investment in the non-state industrial sectors. Taiwan's economy is projected to slow down to around 5.5%-6%, as business and consumer confidence lowers during the run-up to and immediately after the handover of Hong Kong to China. As a result , private consumption growth is forecast to grow at a lower rate recorded in 1995. Growth in fixed capital formation will sustain the higher public spending in infrastructure projects. Inflation is projected to remain low at 3.7% in 1997 as the Taiwan dollar gradually strengthens, which will help to contain imported inflation as well as a weaker yen. South Korea's economic expansion is projected to achieve a "soft landing" in 1997 as investment recovers slowly and private consumption growth stabilises at around 7%. With still tight fiscal and monetary policies, inflation is expected to be contained around 4.8%, slightly lower than the 1996 level. Although there are uncertainties related to the 1997 transfer of sovereignty, the sentiment of business sectors in Hong Kong as 1997 approaches remains one of cautious optimism. Economic activity in Hong Kong is expected to stabilise at 5%, with inflation estimated to be marginally higher at 7.2%.

Other **developing economies** comprising South Asian, African, Latin American and the Middle East countries as a group is projected to grow at 4.5% with continuing capital inflows, especially to African and Latin American countries. Economic growth in Africa is forecast to grow by 5% with a steep decline in inflation to 9.3% as most of the African countries continue to address policy challenges brought about by the large inflows including tightened monetary policies beside the structural reforms and stabilisation programmes. In Latin America, under the continued appropriate fiscal and monetary adjustment, recoveries are seen to be on the way especially in Mexico and Argentina. Real GDP is projected to grow at 4% in 1997 lead by Argentina with 5.8%, Brazil (4.5%), and Mexico (3.5%). The Middle East countries as a group is projected to maintain the current growth of 3.3% in 1997 with inflation brought down to 27.4%. However, the economic growth of oil exporting countries in the Middle East continue to be dependent on oil market developments. If prices of oil continue to fall in 1996, the terms of trade of fuel exporting countries will be worsened. In South Asia, India is projected to register higher growth in 1997 at a rate of 6.2%, while inflation contained at 10%. A slightly higher growth is mainly driven by strong private consumption resulting from greater access to consumer credit and improved employment opportunities.

Issues In The Global Economy

The complementarities of macroeconomic and structural policies and the need for structural reforms to be implemented more boldly are important in countries' efforts to remove distortions and ensure full utilisation and efficient allocation of resources, with the view to ensuring more dynamic and resilient economies. The Mexican financial crisis in late 1994 has brought to the forefront the realisation that the world economy is undergoing fundamental shifts and that adjustment and structural changes are required in all economies - whether industrial, developing or transitional.

Among the **industrial countries**, labour market reform, privatisation, and reductions in subsidies will remain important in Europe, while Japan needs to further liberalise and deregulate its domestic economy. Virtually all industrial countries need to reform their health care and public pension systems to ensure their long-term viability. These deep seated structural problems and macroeconomic weaknesses have prevented several industrial countries from sharing fully in the current global expansion. Such a situation merely serves to emphasise the need for adjustment and structural change if countries are to keep pace with rapid changes occurring in the world economy.

In the aftermath of the Mexican financial crisis, it has been speculated that any difficulty facing the world economy will probably come from European problems in meeting EMU criteria. Most EU members, including core countries, suffer large **fiscal imbalances**, and many among these in recent years also face very high rates of unemployment and extremely weak growth. These core countries have been committed to keeping fiscal deficits within the Maastricht Treaty reference value of 3% of GDP by 1997, which is the test year for deciding which member countries meet the criteria for participation in the third and final stage of EMU which will begin in 1999. But while economic conditions in Germany, the UK and in the smaller European economies look increasingly optimistic thus precluding an easier stance on fiscal and monetary policies, other member states face policy dilemmas as growth has remained sluggish. Tighter budgetary policies therefore, appear in direct contradiction with the current weakness of activity. At the same time, backsliding from consolidation efforts under EMU would have severe implications for interest rates and financial market confidence.

The need for increased efforts to strengthen fiscal discipline, especially among the rich industrialised countries is critical as the financing gap of the Group of Seven countries - the US, Japan, Germany, Italy, the UK, Canada and France - was a burden for the world's capital markets. By drawing constantly on the rest of the world for more capital, the G7 countries, excluding Japan, would appear to be reversing its role of supplying less prosperous, but faster growing countries with capital to help economic progress. Fiscal rectitude is even more important given the globalisation of financial markets. In recent times it has been observed that long-standing fiscal imbalances of a group of rich industrial countries have contributed to high world interest rates and exchange market turbulence.

In many industrial countries, but especially those in Europe, large fiscal imbalances are linked to rigidities in the functioning of labour markets, which have resulted in a sharp rise in mass **structural unemployment**. As much as 8 to 9 percentage points out of EU's current unemployment rate of 11% for example, is considered to be structural. While a number of important industrial countries have introduced some reforms aimed at reducing overly generous levels of unemployment compensation, tightening eligibility criteria, reducing taxes on labour and restraining increases in minimum wages, reforms have been mostly piecemeal and in some cases, the benefits derived from progress in labour markets have been negated by new distortions in other sectors. Indeed, in Europe, there might even be a risk that, in the absence of more comprehensive labour market reforms, structural unemployment rates and the associated fiscal and social costs could increase even further.

A serious outcome of the unemployment problem besetting many industrial countries, is the pressure directed on their governments by vested quarters to seek protection from foreign imports. The growth of international trade and investment, especially manufactured imports from developing countries has been blamed for the high unemployment. These quarters typically proposed solutions ranging from imposing higher labour standards in the developing world to other barriers to imports such as environmental laws and human rights. Such an approach to international trade runs counter to the spirit of the Uruguay Round and would prevent globalisation and liberalisation from yielding their benefits. This is because, while all countries would be affected by such an approach, the danger to developing countries and countries in transition would be particularly serious, since their outward-oriented development strategies will only succeed if markets in developed countries are sufficiently open to accommodate increasing exports.

While the expansion of trade and investment in recent years have provided opportunities for a majority of **developing countries**, many others continue to struggle with macroeconomic imbalances and structural barriers. Developing countries that have implemented bold reform have been rewarded by rapid economic growth with improved inflation and generally well contained fiscal imbalances. Across many developing countries progress continue to be made to reduce the role of the state in those areas where the private sector is likely to be more efficient. The role of the public sector has been mainly geared toward promoting private sector development and public finances have been devoted to enhancing the share for basic education, health care and improving poverty alleviation programmes at the same time, broadening tax revenue bases and improving tax administration. Gradually too, developing countries are reforming and strengthening their financial systems while exposing their economies to the benefits of international competition. But stronger and sustained efforts are still required, especially to build the institutions of a market economy.

The success of these developing countries holds important lessons for those countries where progress has been more limited and which continue to fall behind in relative income positions. The poor developing countries have been unable to adapt quickly and effectively enough to the rapid shifts in the global economy brought on by the twin forces of globalization and liberalisation. While it is accepted that developing countries that were facing relatively high external **debt** burden need to forge ahead with good macroeconomic policies, it is also recognised that some indebted poor countries could not plausibly be expected to meet their large debt-service obligations. To avoid marginalisation of the debt-burdened low income nations, stronger affirmation from the international community is needed to seek an end to these countries' unsustainable debt problems. In this regard, the agreement of the Interim Committee of the IMF and the Development Committee of the World Bank in October 1996 to a debt-relief plan, will go some ways towards mapping a route for these countries to exit the debt cycle. The agreement of the Paris Club to debt forgiveness of up to 80% on a case-by-case basis can also be regarded as an important contributory effort to the debt strategy .Other multilateral financial institutions and bilateral donors will need to come on board so that the solution to the debt issue will be a bold and comprehensive one.

In many emerging market economies, sustained increase in **capital flows** had renewed concerns about the risk of overheating and a widening of current account deficits. Furthermore, increasing globalization of capital markets meant that capital flows were more sensitive to a country's economy policies and prospects. The speed with which the Mexican financial crisis and its rapid spillover effects brought home to governments and the international financial community, how much financial crises have been transformed by the dramatic changes in the volume and speed of international capital flows. Quite apart from the fact that the international community should have at its disposal adequate resources readily available to deal with an international financial emergency, many governments have recognised the importance of macroeconomic and financial stability as well as the key role of economic and financial information in ensuring an early recognition of, and response to, policy changes and in avoiding sudden shocks to, and disproportionate responses by the international capital market.

Closely related to the issue of capital flows is the importance of **banking and financial soundness.** Weaknesses in the financial sector in several cases had been exposed by volatile capital flows, and this had oftentimes limited the ability of governments to pursue policies to safeguard macroeconomic stability. Given that banking systems are important to the health of economies, a number of banking problems have emerged in several countries, requiring careful monitoring to ensure that risks of widespread distress in the financial sector were minimised. To reduce such risks and minimise current and future costs, there is a need for diligent prudential regulation and supervision, better assessment of credit risk, more stringent capital requirements and timely disclosure of bank's financial condition.

In recent years both developed and developing countries have benefited from the rapid growth in **international trade**. The conclusion of the UR two years ago has brought about static and dynamic gains to most regions in the global economy. By resisting protectionist pressures and maintaining open markets, all trading partners can benefit from global economic integration of trade, finance and production. In this connection, the proclivity of leading trading countries to abuse WTO provisions relating to anti-dumping and countervailing duties, renegade on commitments for access to certain product markets as well as, backslide on interpretation of GATT rules of origin signals a serious undermining of multilateral trading principles. Unilateral actions to compel foreign companies and persons to observe aspects of US embargoes against Cuba, Iraq, Libya and Iran is a serious case in point.

For these very reasons the WTO first ministerial meeting in Singapore (SMC) in December 1996 should concentrate on ensuring that the UR world trade agreement is fully implemented and that all members are living up to their commitments. In particular, the SMC should address the significant transitional costs on poor developing countries brought about by the erosion of trade preferences and higher import bills for food and other essentials. The SMC should not launch any sweeping new initiatives, but should be confined to stock taking and to the work program already built-in when the UR was concluded. A shopping list comprising the so-called "new issues" such as competition policy, investment, stricter rules on regional trade blocs and on environment and trade and, more controversially, labour standards and corruption, could only lead to a showdown at the SMC. The WTO should stick with core trade issues and leave other issues to the competence of organisations such as the International Labour Organisation (ILO), the Bretton Woods Institutions or the United Nations (UN) and its agencies such as the UN Conference on Trade and Development (UNCTAD). As the deliberations of UNCTAD IX in Mitrand, South Africa held in April 1996 clearly showed, while trade liberalisation and globalisation of finance and production have benefited many countries, many others are left to face its adverse effects: poverty, unemployment, job insecurity, social inequalities and ecological degradation. For welfare gains to spread to many more countries, the international community needs to redirect its efforts to tackle the core issues covered in the UN Agenda For Development.