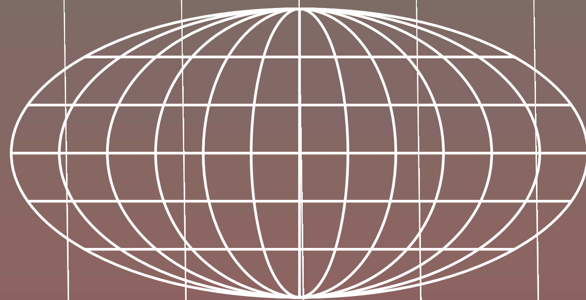
World Economic Situation and Prospects 2004



United Nations

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The following symbols and conventions have been used in the tables throughout the report

.. **Two dots** indicate that data are not available or are not separately reported.

– **A dash** indicates that the amount is nil or negligible.

- **A hyphen** indicates that the item is not applicable.

- **A minus sign** indicates deficit or decrease, except as indicated.

. **A full stop** is used to indicate decimals.

/ **A slash** between years indicates a crop year or financial year, for example, 1990/91.

- **Use of a hyphen** between years, for example, 1990-1991, signifies the full period involved, including the beginning and end years.

Reference to "dollars" ($) means United States dollars, unless otherwise stated.

Annual rates of growth or change, unless otherwise stated, refer to annual compound rates.

In most cases, the growth rate forecasts for 2004 are rounded to the nearest quarter of a percentage point.

Details and percentages in tables do not necessarily add to totals, because of rounding.

The following abbreviations have been used:

ACP African, Caribbean and Pacific (Group of) States
AGOA African Growth and Opportunity Act
AML/CFT anti-money-laundering efforts and efforts to combat financing of terrorism
ASEAN Association of Southeast Asian Nations
AU African Union
BCBS Basel Committee on Banking Supervision
BITs bilateral investment treaties
bpd barrels per day
bps basis points
BTAs bilateral trade agreements
CAC collective action clause
CACM Central American Common Market
CAP Common Agricultural Policy (EU)
CARICOM Caribbean Community
CCL Contingent Credit Line
CEE Central and Eastern Europe
CEFTA Central European Free Trade Agreement
CEMAC Communauté Economique et Monétaire de l'Afrique Centrale
CIS Commonwealth of Independent States
COMESA Common Market of Eastern and Southern Africa
CPI consumer price index
CTD Committee on Trade and Development (WTO)
DAC Development Assistance Committee (of OECD)
DTTs double taxation treaties
DWP Doha Work Programme
ECB European Central Bank
ECCAS Economic Community of Central African States
ECE Economic Commission for Europe
EMU European Monetary Union
ERM Exchange Rate Mechanism
EU European Union
FAO Food and Agriculture Organization of the United Nations
FATF Financial Action Task Force (Bretton Woods institutions)
FDI foreign direct investment
Fed United States Federal Reserve
FSF Financial Stability Forum
FTA free trade agreement
FTAA Free Trade Area of the Americas
GATT General Agreement on Tariffs and Trade
GDP gross domestic product
GI geographical indicators
GMOs genetically modified organisms
GNP gross national product
GSP Generalized System of Preferences

GSTP Global System of Trade Preferences among Developing Countries

GWP gross world product

HICP Harmonised Index of Consumer Prices

HIPC heavily indebted poor countries

ICCO International Cocoa Organization

ICT information and communication technologies

IFAC International Federation of Accountants

IMF International Monetary Fund

IMFC International Monetary and Financial Committee

LCP local currency pricing

LDCs least developed countries

LME London Market Exchange

M&As mergers and acquisitions

mbd million barrels per day

MCA Millennium Challenge Account

MDGs Millennium Development Goals

MERCOSUR Mercado Común del Sur (Southern Common Market)

NAFTA North American Free Trade Agreement

NAMA non-agricultural market access

NEPAD New Partnership for Africa's Development

NIEs newly industrialized economies

NPLs non-performing loans

NPV net present value

NYBOT New York Board of Trade

ODA official development assistance

OECD Organisation for Economic Cooperation and Development

OPEC Organization of the Petroleum Exporting Countries

pb per barrel

PPP purchasing power parity

PRGF Poverty Reduction Growth Facility (IMF)

Project LINK international econometric modelling group, coordinated jointly by the Development Policy Analysis Division of the United Nations Secretariat and the University of Toronto

PRSPs Poverty Reduction Strategy Papers

PTM pricing-to-market

ROSCs Reports on the Observance of Standards and Codes (Bretton Woods institutions)

RTAs regional trade arrangements

SADC Southern African Development Community

SARS severe acute respiratory syndrome

SDRs special drawing rights (IMF)

SDRM Sovereign Debt Restructuring Mechanism

SDT special and differential treatment

SGP Stability and Growth Pact

SRF Supplemental Reserve Facility

TDB Trade and Development Board (UNCTAD)

TIFAs Trade and Investment Framework Agreements

TNCs transnational corporations

TRIPS trade-related intellectual property rights

UEMOA Union Economique et Monétaire Ouest Afrique

UN/DESA Department of Economic and Social Affairs of the United Nations Secretariat

UNCTAD United Nations Conference on Trade and Development

VAT value added tax

WTO World Trade Organization

EXECUTIVE SUMMARY

After growth of less than 2 per cent for over two years, the world economy is gaining momentum. Following the setbacks caused by the prospects of war in Iraq and the outbreak of severe acute respiratory syndrome (SARS) early in 2003, economic growth in an increasing number of countries shifted to a measurably higher gear in the second half of the year, raising the growth of gross world product (GWP) for 2003 as a whole to 2.5 per cent. Despite some lingering uncertainties and downside risks, the economic recovery is expected to strengthen and broaden further, raising global economic growth to 3½ per cent in 2004. The growth of world trade is expected to reach 7½ per cent in 2004, up from 4.7 per cent in 2003. The improved performance and outlook does not, however, compensate for the subdued growth of the previous two years when world per capita output failed to increase.

The global economic recovery is being driven mainly by the United States, but increasing contributions from a number of other economies are becoming evident. Particularly notable is the rapidly rising weight of China in the world economy and its role in the present recovery. East Asia has maintained its strength, accompanied by a turnaround in Japan that has been stronger than anticipated. In 2003, some of the economic difficulties facing a number of Latin American countries diminished, while the short-term prospects for Africa also improved. After the setbacks associated with their transformation, the economies in transition have achieved sound growth for a number of consecutive years despite the slowdown elsewhere. In contrast, Western Europe has been a source of the weakness that began to dissipate only in late 2003.

The recovery is being accompanied and supported by a degree of improvement in international trade and finance. World trade grew by 4.75 per cent in 2003, with much of the increase attributable to import demand from developing countries, and is forecast to grow 7½ per cent in 2004. The international prices of non-fuel commodities have been rising as the demand for minerals and metals and, to a lesser extent, agricultural raw materials strengthens, but a large part of the increase is accounted for by the depreciation of the dollar. Further increases in non-fuel commodity prices are expected in 2004, but the price of oil is expected to ease.

At almost $82 billion, net private capital flows to developing countries were about 50 per cent higher in 2003 than in 2002, but mostly as a result of lower repayments and other outflows. Foreign direct investment (FDI) and official loans and grants were the only net sources of capital inflow for these countries. FDI, both globally and to developing countries, was almost unchanged from 2002, and in both cases was well below the peak it reached in 2000. Official development assistance (ODA) increased in 2002 but data are not yet available for 2003. Taking into account developing countries' accumulation of reserves and their net outflows of dividends, interest and other payments on capital, there was a net transfer of financial resources from the developing countries of almost $190 billion in 2002. This is estimated to have remained largely unchanged in 2003.

The strength of the current recovery is still heavily dependent on the policy stimuli of low interest rates and expansionary fiscal measures. While the required mix of such policies varies across countries, continued stimulus remains crucial for nurturing the recovery because autonomous effective demand remains below potential in many economies. The challenge for policymakers in the short run, particularly in the developed countries, is to strike a balance between two possible outcomes: either choking off the recovery through a premature withdrawal of stimuli or sowing the seeds of economic overheating through a precipitate tightening of policy.

An overriding weakness in the world economy is the large international imbalances, manifested in the large external deficit of the United States and a matching aggregate of surpluses in a few other economies. These global imbalances reflect not only a substantial disequilibrium in international trade and capital flows, but also

cross-country disparities in long-run growth and in economic structures. They will, therefore, not automatically be corrected by the global recovery; to the contrary, the imbalances are expected to widen further in 2004.

Alone, the ongoing realignment of exchange rates is unlikely to be either an efficient or an effective means of removing the imbalances; neither is international protectionism an appropriate response to the problem. A preferable adjustment process would be gradual and would involve policies in both surplus and deficit economies to narrow structural differentials in growth rates among major countries as well as international cooperation that would facilitate an increase in growth and income in developing countries. The goal should be to ensure that global growth is sustained and less unstable and that the benefits of growth are more equally shared among all nations and peoples. In addition to pursuing domestic policies to these ends, policy makers worldwide should expedite the reforms of the international trading and financial systems, proceeding expeditiously with the multilateral trade negotiations agreed at Doha and enhancing the capacities for crisis resolution and counter-cyclical policies at both the international and national levels.

CHAPTER I: GLOBAL OUTLOOK

IMPROVED GLOBAL ECONOMIC PROSPECTS

Overcoming the shocks

The world economy experienced two different phases in 2003: a ubiquitously fragile situation in the first half of the year and a stronger-than-expected upturn in the second half.

In the first quarter of 2003, when the world economy was overshadowed by the geopolitical uncertainties associated with the war in Iraq and by the outbreak of severe acute respiratory syndrome (SARS), analysts broadly had two competing views about the prospects for the world economy.

A pessimistic view was that the anaemic world economy was primarily a consequence of several fundamental weaknesses. These weaknesses included the large and persistent external imbalances across countries, particularly the continuously expanding current-account deficit of the United States; the severe and perennial structural problems in some countries, epitomized by the situation in Japan; the policy rigidities and constraints in a number of economies, such as in the euro area and in some Latin American countries; and the pervasive overcapacity in global manufacturing, especially in the information and communication technologies (ICT) sector. According to this view, the exogenous shocks of the possibility of war in Iraq and SARS only exacerbated these underlying global weaknesses; the world economy was therefore unlikely to achieve a meaningful recovery in 2003-2004, even if these shocks faded. Two aborted recoveries in 2001-2002 were cited as evidence for such a gloomy scenario.

In contrast, optimistic analysts argued that the weak economic situation in early 2003 had been caused predominately by exogenous factors of a temporary nature and that, if these factors dissipated, there would be a sound recovery. According to this point of view, despite the plethora of uncertainties, the conditions for a recovery had been laid and were discernible: household spending remained resilient in many economies; business investment had shown incipient signs of rebounding as corporate profits began to improve; inventories were low and needed replenishing; the protracted consolidation of earlier excess investment, and the accompanying substantial correction of equity prices, seemed to have reached a nadir; productivity gains from ICT innovations were tangible, not virtual, so that the ICT revolution would continue to improve efficiency and lift productivity for the foreseeable future; and macroeconomic policies in a large number of economies were accommodative, even though they were constrained in some other countries. Overall, optimistic forecasters expected that repressed consumer and investor confidence would recover and the world economy would revive once the shocks abated, most likely in the second half of 2003. The United Nations forecast of early 2003 shared this latter view, although a number of downside risks had also been emphasized.[1]

Developments in the world economy in the second half of 2003 seem to have largely conformed with the optimistic view: the recovery in a number of economies, particularly the United States and some countries in Asia, has been even more vibrant than most earlier optimistic forecasts.

An international business cycle, such as the current one, is not a simple alternation of decreases and increases in aggregate output and trade; it also involves changes in the structure of national economies and in the international patterns of trade, production, financing and economic growth. In a business cycle in a national economy, labour, capital and other resources are reallocated across sectors, reducing excesses, inefficiency and imbalances; for example, labour shed from some sectors in the downturn may not necessarily be rehired in the same sectors during the upturn. Across countries, international comparative advantage is similarly likely to change during the cycle, as are various international flows and balances; some countries will increase their shares in global markets while others will lose. As a result, a global business cycle can lead to faster-than-usual changes in cross-country differences.

Recovery broadening across countries

The acceleration in growth in 2003 was greater in the developed countries than in the developing countries, most of which continue to lag in the present cyclical recovery (see table I.1). Among the developed regions, growth was highest in North America, but Asia and Oceania achieved the greatest improvement because of Japan's return to positive growth. For the year as a whole, Western Europe performed less well than in 2002, but this belies the improvement as the year progressed. The Commonwealth of Independent States (CIS) rebounded solidly from its deceleration in 2002, and growth in the other groups of economies in transition also improved. Among the developing countries, there was less disparity in growth among the regions than in 2002, mainly because Latin America reversed the decline in output of the previous year. Growth in Africa and Western Asia improved but not to any significant degree, while substantially faster growth in Eastern and Southern Asia moderated but to a similarly inconsequential extent.

The *United States* remains the locomotive of growth in the *developed economies*.[2] Household spending remains strong, but growth in business spending is beginning to assume a greater role. Improving corporate profits and strengthened equity prices have laid foundations for the further growth of business investment and for an improvement in employment into 2004.

Meanwhile, the *Japanese* economy has also improved measurably, led by private sector demand, particularly business investment, and with an acceleration in exports to other Asian economies being a key factor. While household consumption remains weak, consumer confidence showed some signs of a rebound in late 2003. After a decade of stagnation, and while many challenges remain, the latest strengthening may provide an opportunity for the Japanese economy to finally move on to a path of more sustained growth.

The situation in *Western Europe* is less encouraging, although signs of recovery have emerged. The resurgence in global demand has reduced the drag of weak exports on growth, and strengthening domestic demand is expected to

Table I.1.
GROWTH OF WORLD OUTPUT AND TRADE, 1994-2004

Annual percentage change

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003[a]	2004[b]
World output[c]	3.1	2.8	3.3	3.6	2.2	3.1	3.9	1.3	1.7	2.5	3½
of which:											
Developed economies	3.0	2.4	2.8	3.1	2.5	2.9	3.4	1.0	1.2	2.0	3
North America	4.1	2.7	3.7	4.6	4.1	4.6	3.8	0.6	2.3	2.9	4
Western Europe	2.9	2.4	1.6	2.5	2.8	2.9	3.4	1.5	1.0	0.8	2
Asia and Oceania[d]	1.3	2.1	3.4	2.1	-0.6	0.4	2.7	0.6	-0.1	2.5	2½
Economies in transition	-7.2	-0.6	-0.1	2.4	-0.8	3.4	6.7	4.4	3.9	5.1	4¾
Central and Eastern Europe	4.0	5.7	4.1	3.3	2.6	1.4	3.9	2.7	2.7	3.3	4
Baltic States	-4.7	2.2	4.2	8.4	5.8	-0.2	5.5	6.7	6.2	6.4	6
Commonwealth of Independent States	-13.7	-5.1	-3.6	1.4	-4.0	5.5	9.3	5.7	4.7	6.5	5¼
Developing economies	5.6	5.0	5.7	5.4	1.6	3.5	5.8	2.1	3.2	3.8	5
Africa	2.3	3.0	5.3	3.0	3.1	3.1	3.3	3.1	2.9	3.2	4¼
Eastern and Southern Asia	8.4	8.1	7.3	6.0	0.5	6.3	7.1	3.7	5.6	5.4	6¼
Western Asia	-0.8	4.0	4.6	5.5	4.1	0.7	6.4	-1.1	2.4	2.6	4
Latin America and the Caribbean	5.3	1.4	3.7	5.2	2.0	0.4	3.9	0.4	-0.7	1.4	3½
World trade	10.5	8.6	5.5	9.2	3.3	5.2	11.5	-0.7	3.0	4.7	7½
Memorandum items:											
Least developed countries	1.3	5.2	5.5	5.9	4.9	4.9	4.9	4.6	3.9	3.8	5
World output growth with PPP-based weights[e]	3.5	3.4	3.9	4.1	2.5	3.6	4.6	2.2	2.7	3.3	4

Sources: UN/DESA.

a Partly estimated.
b Forecast, based in part on Project LINK.
c Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 1995 prices and exchange rates.
d Japan, Australia and New Zealand.
e Employing an alternative scheme for weighting national growth rates of GDP, based on purchasing power parity (PPP) conversions of national currency GDP into international dollars (for explanation, see the introduction to the statistical tables in the *World Economic and Social Survey 2003*).

provide a further stimulus in the near future. Private consumption will benefit from the appreciated euro, which will dampen inflation and boost real disposable income, and by low interest rates, which will reduce the burden of consumer debt. Investment has been a weakness, but business confidence is showing signs of recovery, with investment expected to respond accordingly. Unemployment is, however, expected to remain high, leading to caution regarding spending and to higher rates of saving. Government spending continues to have a positive impact on demand in the major countries, but this will be gradually reduced as budgetary difficulties are addressed.

Among the *economies in transition*, growth in the countries of the *CIS* has been accelerating, bolstered by higher production and exports of oil, increased domestic and foreign investment and consumption boosted by higher real wages and pension payments. The *Russian Federation* continues to be the economic engine for the region, but its growth is expected to moderate in 2004 as a result of lower prices of oil. The robust growth in the *Baltic States* is expected to be maintained although these countries' forthcoming accession to the European Union (EU) will make their prospects more dependent on the economic strength of the euro area. Growth in *Central and Eastern European* countries is expected to improve in line with the anticipated recovery in the EU, lower oil prices and EU transfers to the countries expected to join the Union in 2004.

The international economic environment for most *developing countries* improved during 2003.[3] In terms of United States dollars, the international prices of many commodities increased on average by more than 10 per cent from the previous year, partly because of the depreciation of the dollar. Capital inflows are beginning to increase for a number of developing countries, and external financing conditions for many developing countries, as well as for some economies in transition, have also been improving, as indicated by the downward trend in the differences between the yields on their sovereign bonds and those on the government bonds of major developed countries. The long-term downward trend in the real prices of most commodities and the pro-cyclical nature of international capital flows will, however, continue to challenge many developing countries over the longer term.

Growth in *Africa* is expected to accelerate somewhat in 2004. In addition to continued progress in political and economic governance and in achieving macroeconomic stability, a number of positive factors that characterized 2003, such as increased agricultural output due to improved weather conditions, a rise in industrial and manufacturing output, higher consumer demand and increased investment, including foreign direct investment (FDI), are also expected to continue to prevail in 2004. Growth in *Latin America and the Caribbean* is expected to recover in 2004, boosted by the improvement in both external conditions and the domestic economic policy environment. Increased external demand, firmer commodity prices and more favourable external financing terms are improving the conditions for economic recovery in the region. In *East Asia,* the external sector, private consumption, public spending and business investment are all contributing to a strong recovery. In *South Asia,* the economic spillover from the war in Iraq was relatively modest, and favourable agricultural production (due to improved weather conditions), rising rural incomes, increased exports, low interest rates, growing remittances and the improved security situation will continue to support a broad-based recovery in most countries. The prospects for *Western Asia* will depend critically on developments in Iraq and on the Israeli and Palestinian conflict. Growth in the oil-exporting countries of the region is forecast to accelerate in 2004, while prospects for the oil-importing countries are mixed.

A key feature of the global recovery has been the rising economic weight of the two most populous countries, China and India, both of which have been growing at a rate of more than twice the world average. Continued strong growth in these two large low-income countries will benefit the world economy as whole, reduce global poverty and serve as an incentive for other developing countries. However, the size of these two economies means that their fast growth will have far-reaching implications for international patterns of trade, production and financing and for the global supply and demand of energy and commodities. For example, transnational corporations (TNCs) have been relocating plants from other economies to China, attracted partly by its vast domestic market and partly by its enormous supply of low-cost labour as an input for their global manufacturing operations. As a result, international competition in some manufacturing sectors has intensified profoundly. This is a positive force for global efficiency and growth in the long run, but it also creates difficulties for some other countries, including many developing countries, in the short run.

Almost two thirds of the population of the developing world lived in countries that achieved per capita output growth in 2003 of at least 3 per cent, but this group was almost entirely accounted for by countries in Eastern and Southern Asia, particularly China and India; in other developing regions, very few people lived in countries that achieved this long-term benchmark rate of growth for meaningful poverty reduction (see table I.2). There was a decrease in 2003 in the number of developing countries where per capita output fell but, because of a change in the composition of the group, the number of people living in such countries increased. Among 41 least developed countries (LDCs) for which data are available, only seven achieved a 3 per cent increase in per capita output, and

Table I.2.
FREQUENCY OF HIGH AND LOW GROWTH OF PER CAPITA OUTPUT, 2001-2003

	Number of countries monitored	Decline in GDP per capita			Growth of GDP per capita exceeding 3 per cent		
		2001	2002	2003[a]	2001	2002	2003[a]
		Number of countries					
World	145	41	37	33	46	41	45
of which:							
Developed economies	24	3	4	6	2	3	1
Economies in transition	26	1	1	0	23	21	22
Developing countries	95	37	32	27	21	17	22
of which:							
Africa	38	11	10	11	12	6	8
Eastern and Southern Asia	18	7	2	2	4	7	7
Western Asia	15	7	7	5	4	3	5
Latin America	24	12	13	9	1	1	2
Memorandum items:							
Least developed countries	41	13	14	14	12	7	7
Sub-Saharan Africa	31	10	9	11	10	6	6
	Share[b]	Percentage of world population					
Developed economies	14.9	4.8	2.4	0.6	0.2	0.3	0.2
Economies in transition	7.4	0.0	0.1	0.0	5.6	5.3	6.2
Developing countries	77.8	10.4	7.4	8.4	45.8	30.0	48.8
of which:							
Africa	12.1	2.6	2.0	3.0	3.9	1.4	2.0
Eastern and Southern Asia	53.3	1.3	0.5	0.2	40.4	25.8	43.8
Western Asia	3.8	2.4	1.3	1.2	1.2	2.3	2.4
Latin America	8.5	4.2	3.6	4.2	0.2	0.4	0.6
Memorandum items:							
Least developed countries	10.2	2.1	2.1	2.7	4.2	2.2	3.7
Sub-Saharan Africa	7.3	2.5	1.9	3.0	3.3	1.4	1.3

Source: UN/DESA, including population estimates and projections from *World Population Prospects: The 2000 Revision, Vol. I, Comprehensive Tables* and corrigendum (United Nations publication, Sales No. E.01.XIII.8 and Corr. 1).

a Partly estimated.
b Percentage of world population of 1995.

these accounted for a very small proportion of the population of this group of countries. These data reflect an extension, for another year, of the trend that suggests that Eastern and Southern Asia are likely to achieve the Millennium Declaration goal of reducing poverty by half by 2015 but other regions are unlikely to do so unless more decisive action is taken. For the first time since their transformation began, all of the economies in transition increased their per capita output in 2003, whereas there were declines in six developed market economies.

Benign inflation and lagging employment growth

Inflation has been edging up in a large number of economies in North America, Europe and Asia, primarily because of higher prices for many commodities, most notably energy and food. Nevertheless, worldwide, the long-run disinflationary trend remains.

Inflation rates in many developed economies and some Asian countries have remained around their historical lows and are, in general, within the target bands that these countries have set for themselves. At the same time, many

developing countries in Latin America and Africa, and a number of economies in transition, have further reduced their relatively high inflation rates. In some cases, part of the decline is attributable to the abatement of short-term increases in inflation that had resulted from adjustment measures. Meanwhile, for the few Asian economies that had suffered a decline in general prices, deflation has diminished, but not disappeared, in Japan and Hong Kong Special Administrative Region (SAR) of China, while the concerns about deflation in China have been replaced by worries about overheating in certain sectors.

As global demand continues to recover, there may be a cyclical acceleration in inflation in several economies, reinforced by rising commodity prices and, for countries with their exchange rate tied to the United States dollar, a continued depreciation of that currency. However, continued productivity growth, the remaining slack in global manufacturing capacity and high unemployment rates in many economies should counteract inflationary pressures.

More importantly, the worldwide long-run disinflationary trend of the past decade has been driven by a number of structural factors. In addition to the anti-inflationary policies of many central banks and improved macroeconomic management, globalization has increased international competition and curbed monopoly power, technological innovations have raised productivity growth, and economic reforms in the international trade and financial systems as well as in domestic markets have reduced rigidities and barriers. All have contributed to reducing global inflation and creating expectations of low inflation in future. As long as these factors stay in place, global inflation should remain benign.

In contrast, the unemployment situation remains difficult worldwide. Most economies have experienced an increase in unemployment or underemployment in the past few years as a result of the global slowdown and the subsequent period of low growth. An increase in employment always lags other aspects of a recovery, so that only a few economies have experienced any improvement in their labour market so far. Unemployment rates in many economies are not expected to improve meaningfully until late 2004, but growth in employment, by reinforcing demand from the household and business sectors, is necessary to solidifying the recovery.

Some analysts and policy makers have attributed unemployment in many economies to productivity growth and increased international competition, arguing that higher productivity growth, driven by ICT innovations, has made firms shed more workers in the downturn and delayed hiring in the upturn. They also argue that increased imports and international outsourcing have led to the loss of jobs in the domestic market, particularly in developed countries.

These views confuse macroeconomic with microeconomic issues and sectoral with economy-wide problems. Both productivity growth and international competition are crucial driving forces for output growth, for increasing wages and for raising income levels in the long run. In many developed economies, most of the recent rise in unemployment is cyclical and is caused mainly by a lack of aggregate demand, whereas the majority of unemployment in developing countries is structural and caused by various capacity constraints, including a shortage of both internal and external financial resources. In order to reduce their unemployment, developed countries need to ensure that the recovery is sustained and, in some cases, to address structural difficulties in their labour markets.

Developing countries need to pay more attention to their high structural unemployment and underemployment, particularly in Africa and some Latin American economies, where the rates reach 30 per cent or even higher. Inadequate employment is both a cause and a result of low growth and underdevelopment in these countries and is a root cause of their poverty, as well as a waste of a resource for the global economy as a whole. Progress in addressing this challenge could be achieved through the implementation of the panoply of actions to promote development that governments have already collectively agreed to in the global conferences of the past decade.

ADDRESSING THE GLOBAL IMBALANCES

Despite the improved global economic prospects, large imbalances remain in the world economy. The imbalances are epitomized by the United States current-account deficit of more than $500 billion in 2003, about 5 per cent of its gross domestic product (GDP). This is matched by the aggregate of the surpluses of a number of economies in Asia and Europe, such as China, Japan, Germany and Russia. The forecast indicates that the recovery in global growth will not narrow the imbalances in the near future; on the contrary, most are expected to widen further in 2004. However, they cannot be sustained indefinitely, and their eventual correction will have profound implications for the future stability, efficiency and equity of the world economy.

Reasons for the imbalances

There are wide-ranging views on the causes, effects, sustainability, adjustment and policy implications of the global imbalances. In addition to political and ideological considerations, different approaches to the analysis of the imbalances have contributed to the disagreements.

The conventional approach focuses almost exclusively on trade flows because the imbalances appear to be mainly the result of differences between the exports and imports of individual countries. According to this approach, the cross-country imbalances are temporary, caused mainly by changes in relative demand and relative prices across nations, such as terms-of-trade shocks or a temporary misalignment in exchange rates. In this case, the imbalances can be reversed through an adjustment in exchange rates.

There is no inherent connection between this approach and international protectionism, but the argument can readily be used. According to some views, for example, the large deficits of the United States are caused by foreign governments' manipulation of exchange rates, by trade barriers, by low wages in developing countries, or by developing countries' failure to adopt international labour and environment standards. Such observers argue that the imbalances have cost the United States millions of jobs and have depressed the wages of workers in the manufacturing sector in that country. They therefore call for trade protection measures and for other countries to revalue their currencies in order to correct the imbalances.

An alternative analysis of the imbalances, originating in modern international macroeconomic theory, focuses on global asset allocation.[4] The counterparts of the current-account imbalances are the corresponding changes in national holdings of international financial assets. More importantly, the current account imbalances are directly related to the saving-investment gaps and the government balances of individual countries. According to this approach, the global imbalances are the result of a worldwide asset allocation that is determined by long-run, cross-country differences in growth, rates of return on capital, saving-investment gaps and other structural factors.

An extension of this approach is that cross-country imbalances do not matter because they merely reflect the dynamic efficiency of the global mobility of capital and goods: some global savings will flow to countries that grow faster than others in order to finance both a rate of investment that is higher than the rate of domestic savings and levels of imports that are higher than exports, resulting in current-account deficits for these faster-growing countries. Ideally, such a situation would characterize developing countries; it is a reflection of the inherent asymmetry of the present international financial system that it pertains to the world's best-endowed economy.

Despite complacency in some quarters, the global imbalances are important for a number of reasons. First, contrary to some views, the global system of trade and finance is far from perfectly competitive, particularly since it includes underdeveloped markets and no market at all in many developing countries, with the result that the imbalances do not represent an efficient allocation of global capital and goods. Secondly, the global imbalances imply unequal opportunities for many developing countries. As a major issuer of international currency, the United States is in a unique position to finance its external deficit by creating debt with the rest of the world and capturing the resulting "seigniorage". Meanwhile, with one of the lowest saving rates in the world, the United States absorbs a large share of global savings, leaving many developing countries without the capital to finance their economic development, and thereby widening the income gaps between the rich and poor countries. According to this view, the large global imbalances benefit the United States at the expense of others in both the long run and the short run.

Correcting the imbalances

Historically, most current-account imbalances are reversed when they reach a certain level in relation to GDP. For many economies, as indicated in some recent cases, the reversal of a large external deficit is likely to be an abrupt process, usually involving a sudden halt in capital inflows and a severe adjustment in various sectors of the economy.[5] For an economy that occupies a key position in the world economy, such as the United States, the international repercussions of an adjustment of its imbalance would be at least as important as the impact on the domestic economy.

The current global imbalances can be broken down into a cyclical component and a perennial component. A change in the exchange rate may be appropriate to correct the cyclical component of the imbalances (see box I.1), but the adjustment of the perennial component has to be brought about primarily by a narrowing of international structural differentials. This is a longer-term process that cannot be achieved solely through a realignment of exchange rates; an attempt to do so is likely to result in extreme movements in exchange rates and correspondingly excessive adjustment costs.

Nevertheless, when confronting the need to adjust imbalances, many analysts, policy makers and financial market actors focus on the exchange rate, implying that a change in exchange rates is both necessary and sufficient to adjust the global imbalances. The depreciation of the United States dollar vis-à-vis other major currencies in 2003, the pressures on a number of developing countries to revalue their currencies and some of the rising trade tensions are all based on this belief. However, for the reasons given above, this notion is misconceived and is misleading to both foreign exchange markets and exchange-rate policy in many countries.

There is a myriad of paths for the adjustment of the global imbalances because so many variables are involved. However, a complete reversal of the present imbalances should not be a short-run objective. Accord-

Box I.1. Exchange-rate changes and trade imbalances

A change in exchange rates alters prices and relative purchasing power across countries which, together with income effects and wealth effects, is expected to lead to a switch between expenditures on foreign goods and expenditures on domestic goods: higher domestic prices for imported goods are assumed to cause people in the country with the depreciated currency to purchase more domestic goods and less foreign goods and vice versa in the country with the appreciated currency. This expenditure-switching is expected to achieve the required adjustments in the current-account balances across countries. Experience and theoretical views, however, both differ on the magnitude of the expenditure-switching effects of exchange-rate changes.[a]

As observed in practice in many cases and explained by a number of economic theories, a change in the exchange rate does not necessarily lead to an immediate change in the domestic prices of imported goods. For example, the theory of pricing-to-market (PTM) suggests that, when exporters of manufactured, particularly branded, goods are faced with an appreciation of their domestic currency, they may choose not to raise prices in terms of foreign currencies, but to reduce profit margins in order to maintain their share in foreign markets. Similarly, the theory of local currency pricing (LCP) argues that exporters not only price discriminate across markets, but also preset export prices in the buyer's currency in order to meet demand at fixed prices in local currency, at least in the short run.

Transnational corporations (TNCs) tend to locate the low value-added phases of their manufacturing in developing countries and to locate the high-value-added phases in developed countries. For this reason, the retail prices of many final consumer goods in developed countries are often several times higher than the value-added in the exporting developing country because of various mark-ups at these other stages of production and distribution. In this case, even a large revaluation of the currency of the exporting developing country would have only a marginal impact on the price of the final product.

A change in the exchange rate can, in some cases, lead to changes not only in the prices of imports but also in general prices or the rate of inflation. This is particularly true for some developing countries, especially if they use the exchange rate as the inflation anchor for monetary policy. The pass-through of exchange-rate changes to overall inflation may not necessarily be channeled only through the rising costs of imports but may also pass through the formation of inflationary expectations. Such a situation used to characterize some Latin American countries, but more recent experience suggests the role of inflationary expectations has been reduced substantially. If, however, a change in the exchange rate leads to a large and quick change in overall prices, then the change in the relative prices of imports is reduced.

Even if a change in the exchange rate leads to a change in the relative prices of imports, the response of consumers and firms in reallocating their expenditure among domestic and foreign goods still depends on the elasticity of demand. Evidence suggests that "elasticity pessimism", namely a belief that imports are not very sensitive to changes in relative prices, is valid in many cases.

A worst case scenario would be a combination of a low pass-through of a change in the exchange rate to the price of imports, a high pass-through to overall prices and a low price elasticity of demand, making the change in the exchange rate ineffective in persuading consumers and firms to switch their expenditure between foreign goods and domestic goods and thus ineffective in adjusting current-account imbalances across countries. The continued widening of the current-account deficit of the United States over the past two years, when the dollar has been depreciating, seems to validate this argument, at least in the short run. Over the longer term, the response to the change in relative prices may increase and the deficit should decline (the so-called "J-curve" effect).

The price effects of a change in exchange rates will be accompanied by income and wealth effects. In the case of developing countries, where imports and liabilities in foreign currency are large in relation to GDP, these income and wealth effects are likely to be substantial. The decline in income and wealth is often important in enhancing the substitution of domestic for foreign goods that is induced by the price effect. Overall, direct and indirect effects of the changes in wealth are likely to outweigh the substitution effects induced by the changes in prices alone.

Because many countries hold dollar-denominated assets in the private sector as well as in the form of foreign exchange reserves, a general depreciation of the dollar can reduce the wealth, and hence the expenditure, including on imports, of other countries.

a See Charles Engel, "Expenditure switching and exchange rate policy", mimeo, University of Wisconsin and NBER, June 2002, and Maurice Obstfeld "Exchange rates and adjustment: perspectives from the new open-economy macroeconomics", Monetary and Economic Studies, December 2002, pp. 23-46.

ing to some studies,[6] an adjustment process that would minimize the adverse shocks to the global economy would involve a gradual and simultaneous adjustment in both deficit and surplus countries through policies that would reduce the cross-country differences in growth rates and in saving-investment gaps. In the present case, this would require the United States to consolidate its government deficit and raise private savings, while Europe and Japan should take measures that would boost their private consumption and long-term growth. Meanwhile, countries with large and growing foreign exchange reserves should consider policies to use those financial resources more productively. Even if such measures were taken, the asymmetry of the excessive absorption of global savings by the United States and the paucity of financing for development in a large number of developing countries will likely continue for the foreseeable future as a reflection of the inadequacies of the present international financial system.

UNCERTAINTIES AND RISKS

While more analysts have revised upward their economic forecasts for 2004, there remains a debate whether the world economy can sustain a path of high growth beyond the current policy-led cyclical upturn. The forecast in this report foresees continued economic recovery in the short run, but is cautious about the strength of global growth in the medium run. Some of the forces that were responsible for global growth of 3.5 per cent or higher in the 1990s are now absent or not strong enough to produce such robust growth. For example, despite some recovery, the dynamism of trade is not broad enough, and world exports are not expected to grow at their earlier rapid pace. With the setbacks to the multilateral trade negotiations under the Doha Round and persisting trade tensions, international trade lacks any additional impetus other than the recovery in demand. Furthermore, international capital flows, another key stimulant of the 1990s, are far less buoyant. Moreover, although a recovery in the ICT sector seems to be under way, investment spending on ICT in many economies seems unlikely to reach the torrid pace of the 1990s. Finally, other developments in recent years, such as heightened geopolitical tensions, intensified international terrorism and, to some extent relatedly, rising global military spending are likely to adversely affect the potential growth of the world economy in the medium and long run.

Even in the short run, the world economy is still subject to a number of downside risks: international trade imbalances continue to widen and exchange-rate adjustments among major currencies are accompanied by considerable volatility, complicating domestic economic policy in many countries. The widespread worsening fiscal deficits also create risks of instability, as do the high levels of household debt and the possibility of a "bubble" in real estate prices in a number of countries. These vulnerabilities will become more acute when interest rates increase, as is forecast to be the trend in 2004. On the geopolitical front, some tensions have been reduced, but far from eliminated, while others remain.

A particularly adverse possibility would be a rapid depreciation of the United States dollar and an abrupt reversal of its trade deficit. If the consequent adjustment mainly involved a substantial cut in consumption, investment and import demand in the United States, the global economic recovery would probably be aborted, reverting to another slowdown.

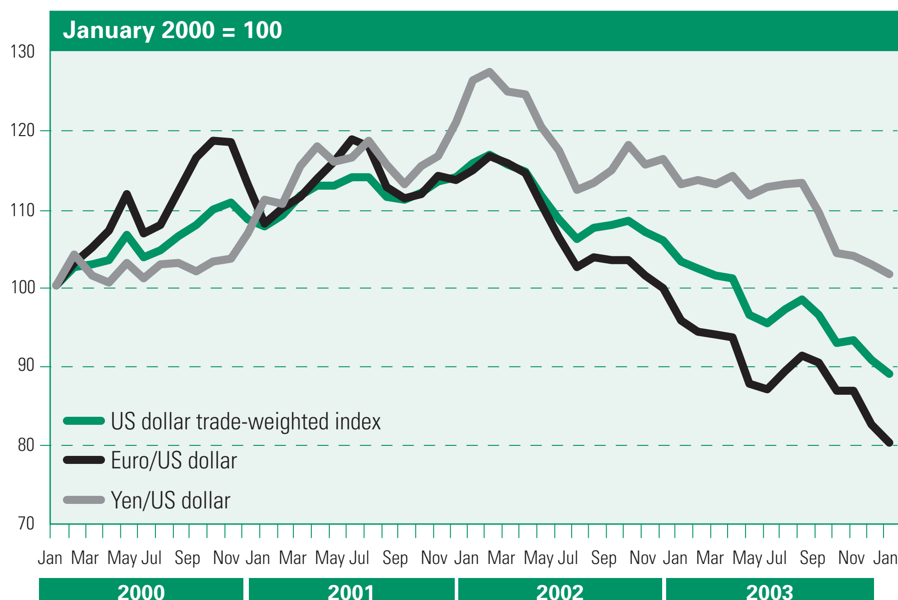
This possibility has existed for some time,[7] but changes in the factors behind the external deficit of the United States have heightened the risk. Three years ago, the United States current-account deficit reflected mainly the gap between investment and savings in the private sector, but now the main element is the government budget deficit. From the perspective of net foreign holdings of United States assets, three years ago foreign investors were mainly financing the high growth of business investment in the United States through FDI and equity flows; now capital inflows are largely taking the form of increased holdings of United States government bonds, as reflected in the increase in the foreign exchange reserves of many developing countries, a large proportion of which is in the form of United States Treasury bonds.

The emergence of the twin deficits has weakened market confidence in the United States dollar, triggering its depreciation (see figure I.1). As bond yields are low by historical standards and would be expected to rise along with the economic recovery, foreign bond-holders become more vulnerable to two possible risks—a drop in United States bond prices in terms of dollars and a decline in the value of the dollar itself. This presents the risk of a vicious circle in the form of a chain reaction of foreigners selling United States assets and a rapidly depreciating dollar, forcing an abrupt adjustment in the external deficit of the United States.

CURRENT POLICY CHALLENGES

In many economies, economic policies have been critical in stimulating the global recovery, but in a number of other economies the capacity for such policy measures has been weak, or heavily constrained, and has failed to reduce the cyclical shocks and to sustain economic growth. As the recovery continues, economic policies worldwide face new challenges. Meanwhile, to galvanize and guide an appropriate adjustment of the global imbal-

Figure I.1.
UNITED STATES DOLLAR EXCHANGE RATES
JANUARY 2000-JANUARY 2004



Source: Federal Reserve Board, European Central Bank.

ances, both domestic economic policies and global economic cooperation should play important roles.

Managing the shift in macroeconomic policies

Macroeconomic policy in many economies, particularly the largest, has been accommodative or stimulatory, but the forecast expects that policy in many of these economies will shift to neutral. The challenge for policy makers is to manage this shift in ways that will neither choke off the economic recovery nor sow the seeds of economic overheating by allowing the present countercyclical policy to metamorphose into a pro-cyclical one. In line with the benign inflation outlook, policy makers should be patient in tightening monetary policy in order to allow the recovery in growth and employment to solidify.

A three-year phase of global monetary easing is about to end, to be replaced by a phase of tightening. Since late 2000, the central banks in a majority of economies have been reducing interest rates in order to alleviate the adverse effects of the cyclical downturn, to stabilize financial markets amidst plummeting equity markets and exogenous shocks and to stimulate demand. Interest rates in many economies were further reduced during 2003, particularly during the period of heightened uncertainties associated with the possibility of war in Iraq and the outbreak of SARS. As a result, interest rates in many economies reached historical lows. The central banks in a few developed economies have already started tightening monetary policy and, as the recovery strengthens further, central banks in other major developed countries are expected to raise interest rates, probably in the second half of 2004. Central banks in a large number of developing countries and economies in transition are expected to follow suit. An exception will be the few developing countries that still have high interest rates and may continue to ease when they have increased policy flexibility.

Fiscal policy actions have been much less homogenous across countries. Some economies, such as the United States and a number of Asian countries, have adopted sizeable stimuli, but the policy stance in many other economies has been only modestly stimulatory or neutral, while a third group of economies has had to adhere to restrictive fiscal policies. Nevertheless, a common global trend is the deterioration in government budget balances compared with the positions prior to the downturn of 2000. Consolidation will be the fiscal objective of many, but not necessarily all, governments in 2004.

More important than finesse in timing policy changes would be an enhancement of policy capacity so that macroeconomic policies could be more effective in promoting stable, sustained and robust growth. The experience of the latest business cycle has once again shown that varying policy capacity across countries in response to cyclical shocks can make a significant difference in countries' economic performance. Moreover, it is more opportune to implement policy reforms when the economy is on the upturn than when it is on the downturn, and so the debate on these policy issues should continue. Policy makers may wish to consider whether rule-based policies, such as the inflation-targeting mechanism adopt-

ed by a growing number of economies in recent years, are too rigid to respond effectively to shocks, particularly in an economic downturn. Among the developing countries, there are questions of whether the conditionalities associated with the programmes of the international financial institutions are pro-cyclical and lead to unnecessary losses in output and employment, particularly in a crisis, or near-crisis, situation. Finally, there is the question of how macroeconomic management in developing countries facing increasing global economic integration can be enhanced.

Deciding exchange-rate policy in developing countries

Particularly in the light of the large realignments in the exchange rates among the major currencies, exchange rate and other macroeconomic policies in many developing countries are facing new challenges. There has been mounting pressure for revaluation on China and a few other Asian economies whose currencies are pegged, *de jure* or *de facto*, to the United States dollar and who have been experiencing a rapid increase in their large foreign reserves. Developing countries that have floating exchange rates, such as those that were forced to abandon their fixed exchange-rate regimes in the past few years because of financial crises, seem likely to fare well as the depreciation of the United States dollar gives them more flexibility to implement monetary easing to stimulate economic recovery. However, even for these economies, continued real appreciation is likely to become a concern at some point.

These challenges for exchange-rate policy in many developing countries are a direct result of the inconsistency between the use of a few major national currencies —the dollar, euro and yen—as world money and increasing global economic integration, particularly the rapid growth of trade and capital flows. Monetary policy and exchange-rate policy in these currency-issuing countries focuses primarily on their domestic needs, rather than on the needs of the rest of the world. The system therefore fails to fulfill the function of stabilizing international trade and capital flows and promoting global growth. As a result, it remains the responsibility of individual countries to maintain an appropriate exchange-rate policy. However, it has become increasingly costly and difficult for many developing countries to do so, partly because of increased global capital mobility.

The competing demands for flexibility and stability are at the center of the quandary for many developing countries in choosing and maintaining an appropriate exchange-rate policy and regime.[8] The role of the exchange rate in determining relative purchasing power and relative prices across countries and in acting as a buffer to absorb and dampen international shocks calls for flexibility. Over time, as international differentials in growth, productivity, income, resources endowment, technology and other economic structural aspects change, the parities among currencies should also change to ensure an efficient allocation of resources across nations. Meanwhile, when an economy faces an external shock, such as a drop in import demand, a flexible exchange rate could dampen the adverse effects on output and employment. However, as so often observed in reality, the fluctuations in exchange rates under a floating exchange-rate regime are often too volatile to be explained by changes in economic fundamentals.

In contrast with this need for flexibility, the interconnection between the exchange rate and domestic monetary policy and the use of the exchange rate as a key variable in decision-making by firms engaged in international trade and by global investors makes stability in the exchange rate desirable. In a number of developing countries, particularly those having a history of hyperinflation or lacking credibility and capacity in controlling inflation, the exchange rate has been used as the anchor to stabilize the value of the local currency and thus to stabilize the economy. At the same time, firms and individuals engaged in international trade and investment usually prefer a stable exchange rate because of the costs they may incur if there are large changes in the exchange rate.

To maintain a stable, or fixed, exchange rate can, however, be costly for many developing countries. In the first instance, holding large amounts of foreign reserves involves opportunity costs because the rate of return on such reserves is much lower than the rate of interest that these countries pay on their foreign debts. There are also the potentially large financial losses in the value of foreign reserves due to realignments in the exchange rates of major currencies—the recent depreciation of the United States dollar, for example will have led to significant losses for those developing countries with a large portion of their reserves denominated in dollars. Finally, there are the losses in reserves incurred during currency crises or speculative attacks. Moreover, a stable peg to one major currency can mean an unstable exchange rate vis-à-vis other major currencies because of the volatility among major currencies. Overall, there is the question of whether these risks associated with a fixed exchange rate regime should be solely borne by the government or be shared by businesses and international investors.

The panoply of exchange-rate regimes that has evolved in the past few decades reflects the efforts of many economies to make an appropriate trade-off between flexibility and stability. After the international financial crises of the 1990s, however, the trade-off seems to have become even harder to resolve. Some countries have maintained, or adopted, a fixed exchange rate but a larger number of economies have moved to a

floating exchange-rate regime. In practice, however, few currencies float completely freely; in most cases, governments intervene on occasion, leading to a "dirty float" which endeavours to capture the benefits of both regimes while reducing their respective costs.

It is difficult to define an optimal exchange-rate regime and even more so to determine an optimal exchange-rate level. The key is the consistency between exchange-rate policy and other economic policies and between the exchange-rate regime and other aspects of the institutional framework. The countries that are currently under pressure to revalue should consider their exchange-rate policy in the broader context of overall economic management and reform, including macroeconomic management, current-account and capital account regulations and reform of the financial system.

Improving global development prospects

As elaborated above, the global imbalances are not only a problem in themselves, presenting risks to the world economy in the short term, but are also a manifestation of longer-term structural problems that require correspondingly longer-term solutions. Part of the longer-term solution lies in accelerating growth in the parts of the world where it is currently lagging, including both developed and developing countries.

Among the slow-growing developing countries, which includes most of those in Africa, Latin America and Western Asia, improved economic performance will require sustainable macroeconomic frameworks, productive development strategies aimed at guaranteeing international competition and improved governance. It is essential that developing countries and economies in transition make every effort to mobilize additional resources for development purposes and to ensure that all domestic and international resources for this purpose are used effectively.

Equally, however, restoring economic growth in these countries requires, first and foremost, a prompt, solid and supportive recovery in the developed economies. Achieving the internationally-agreed development goals, including the Millennium Development Goals, requires progress to be sustained over the longer term. This, in turn, will require prompt and complete delivery on the international commitments to development that have already been made, most notably in the Millennium Declaration, at the Fourth Ministerial Meeting of the World Trade Organization (WTO), the Monterrey Consensus adopted by the International Conference on Financing for Development and the Plan of Implementation of the Johannesburg World Summit on Sustainable Development.

Progress to date in the implementation of the international commitments made at Doha, Monterrey and Johannesburg has been mixed. Although data for 2003 are not available, an early outcome was a turnaround in 2002 in the previous downward trend in flows of official development assistance (ODA). It is increasingly recognized that ODA can be very effective in accelerating development if conditions in both the recipient country and the international economy are supportive.[9] This not only testifies to the need for both sound domestic policies and a conducive international development environment but also underscores the need for previous commitments of further increases in ODA to be realized.

In contrast, total private capital flows to developing countries, including FDI, have declined each year since 2000, belying the high hopes that were ascribed to the future role of international private sector entities in development. While some increase in private sector flows is likely to form part of the global economic recovery, a substantial increase, particularly in comparison with the needs of developing countries, seems unlikely. Moreover, experience suggests that such flows tend to be concentrated in a relatively small number of countries and these are not necessarily the poorest countries or those where the needs are greatest. Nor do such flows normally address needs in such areas as education and health. Particular attention should therefore be given to identifying ways and means of increasing official non-concessional flows to developing countries, particularly for infrastructure and similar investments that might serve as catalysts for private sector financing.

Despite progress over the years, external debt continues to constrain development in many countries and to present new challenges to the international community. Progress in implementing the enhanced Heavily Indebted Poor Countries (HIPC) initiative has proven to be slow, and even those countries that have completed the process have not necessarily received sufficient relief to fully remove the obstacle that external debt presents for their development. Further efforts need to be made to ensure that this initiative achieves its intended result of ensuring that the external debt burden of each of the poorest countries is made sustainable as soon as possible. This requires providing further support to ensure that countries are able to fulfill the procedural requirements; further consideration of the amount of relief required to ensure that the process results in each country's achieving a sustainable external debt position; the full and prompt provision of the necessary financial resources by developed countries and international institutions; and, last but not least, ensuring that new financial flows to these countries are provided on a grant basis so that they do not face new external debt problems in future.

The continued periodic eruption of financial crises also testifies to the continuing lack of adequate arrangements for dealing with the external debt problems of non-HIPC countries. Incremental progress continues to be

made, most recently with the more widespread use of collective action clauses (CACs) in bond issuances by developing countries and the refinement of arrangements for the rescheduling of official bilateral debt by the Paris Club. Nevertheless, further work is required to ensure that resources are available to respond to prospective financial crises where appropriate,

The very limited progress in the global trade negotiations at the Fifth Ministerial Conference of the World Trade Organization in Cancún in September 2003 was a setback, tempered only by the apparently universal recognition that reviving the negotiations is indispensable. Given the slow and discouraging start, the successful completion of the Doha programme will require a high degree of political determination on the part of all countries to deliver on the commitment to make these negotiations a "development round". From a shorter-term perspective, they should also be seen in the context of the current need to provide a boost to confidence that will sustain the present global economic recovery.

Independently of the adjustments that are required or will occur in response to the global imbalances, the world economy is in a process of rapid change, driven by the new political economy that has evolved over the past decade or so, new technologies and the emergence of new actors. Such change will bring benefits to the world at large over the longer term, but it is also likely to create a succession of short-term economic difficulties for different parties. Because of the intensified interdependence that now characterizes the world economy, international cooperation, most particularly in the areas of international trade and finance, will continue to be central to ensuring that the inevitable short-term difficulties of adjustment and change do not derail longer-term progress.

Notes

1 See *World Economic and Social Survey 2003* (United Nations publication, Sales No. E.03.II.C.1).

2 See Chapter III for a more detailed economic analysis of each of the main country groupings.

3 See Chapter II for a review of developments in international trade and finance.

4 For the development of this approach, see Maurice Obstfeld and Kenneth Rogoff, *Foundations of International Macroeconomics* (MIT Press, Cambridge, Massachusetts, and London, England, 1996).

5 For a historical review and analysis of current-account adjustment in many countries, see Sebastian Edwards, "Current Account Imbalances: History, Trends, and Adjustment Mechanisms", Fourth Annual IMF Research Conference, November 6-7 2003 (www.imf.org/external/pubs/ft/staffp/2003/00-00/arc.htm).

6 See, for example, IMF, *World Economic Outlook, May 2000*, pp. 40-42, and Pingfan Hong, "Global implications of the United States trade deficit adjustment", *DESA Discussion Paper No. 17*, United Nations, 2001.

7 See, for example, *World Economic and Social Survey 2001* (United Nations publication, Sales No.E.01.II.C.1), pp. 23-24.

8 See José Antonio Ocampo, "Developing countries' anti-cyclical policy in a globalized world" in Amitava Dutt and Jaime Ros (eds.), *Development Economics and Structuralist Macroeconomics: Essays in honour of Lance Taylor* (Edward Elgar, Aldershot, U.K., 2003).

9 See, for example, World Bank, "Supporting Sound Policies with Adequate and Appropriate Financing", Development Committee document DC2002-0016 (http://siteresources.worldbank.org/DEVCOMMINT/Documentation/20127712/DC2003-0016(E)-Financing.pdf).

CHAPTER II: INTERNATIONAL TRADE AND FINANCE

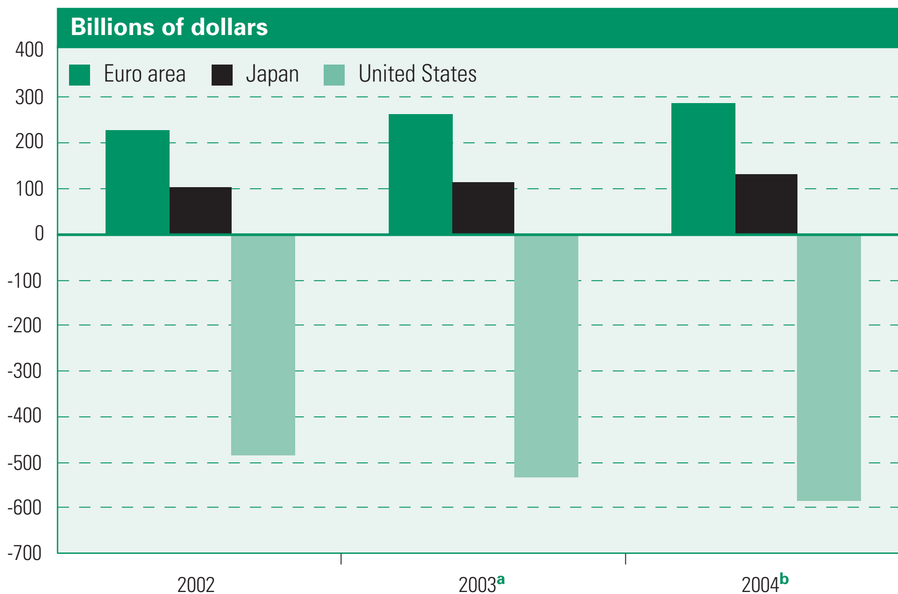
INTERNATIONAL TRADE RECOVERS

Growth in the volume of merchandise trade accelerated from 3.0 per cent in 2002 to an estimated 4.7 per cent in 2003. Much of this improved performance was attributable to increased import demand in developing countries, particularly in Asia, and, to a lesser extent, in the transition economies (see table A.7). Additionally, most of the growth occurred in the second half of the year. In dollar terms, world trade grew by almost 13 per cent, reflecting not only the increased volume but also the continuing depreciation of the United States dollar during the year. In 2004, growth in the volume of world trade is forecast to reach 7½ per cent.

Although the acceleration of international trade in 2004 is anticipated to be more geographically even, trade imbalances are expected to deteriorate further (see figure II.1). Moreover, shifts among the exchange rates of major currencies, as well as the greater participation of low-cost producers, have increased competitive pressures in international markets. Both factors increase the risk of protectionist measures; adoption of such measures (as occurred in 2003) would disrupt and compromise the expansion of world trade.

Because world merchandise trade is dominated by manufactures and, because of the integration and restructuring of production processes across countries, the growth of world trade has been correlated with the growth of manufacturing output. Since 2000, global manufacturing activity has been affected by excess capacity, particularly in the information and communication technologies (ICT) sector, weak business confidence and increased uncertainty caused by non-economic shocks. These factors have had divergent regional consequences, with manufacturing in the major developed economies taking longer to recover than elsewhere (see figure II.2) and the trade of those countries being similarly slow to revive. Since October 2003, however, the recovery of manufacturing activity has spread as inventories are replenished and remaining excess capacities are worked

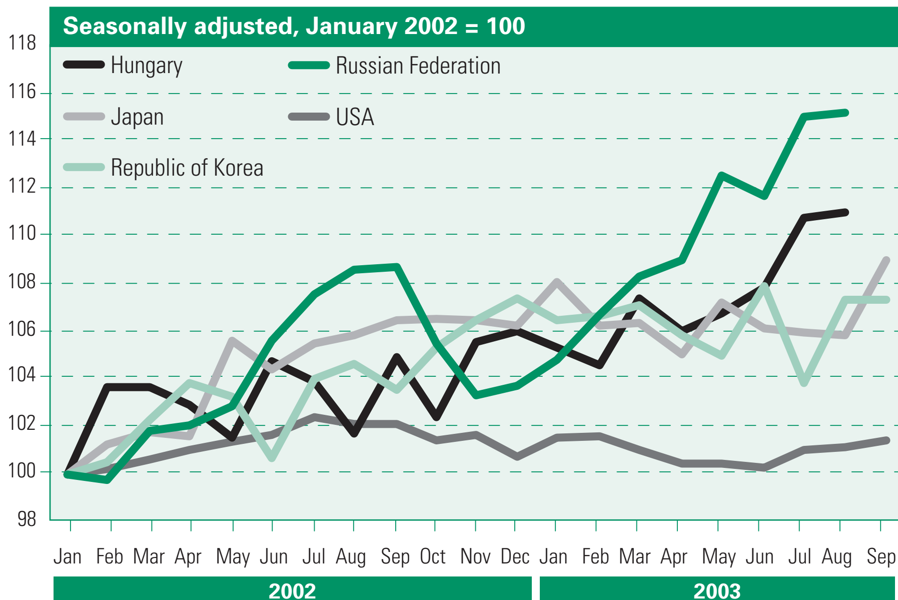
Figure II.1.
EURO AREA, JAPAN AND USA: MERCHANDISE TRADE BALANCE, 2002-2004



Source: Project LINK.

a Estimated.
b Projected/forecast.

Figure II.2.
SELECTED ECONOMIES: INDICES OF INDUSTRIAL PRODUCTION, JANUARY 2002-SEPTEMBER 2003



Source: OECD, *Main Economic Indicators.*

off, making prospects for 2004 more favourable.

Among the developed economies, the merchandise exports of the United States rebounded in the third quarter of 2003, after having declined for more than two years. Exports of capital goods led the recovery. United States real imports, which had recovered in 2002, were erratic during 2003, but grew by almost 4 per cent. Historical evidence indicates that imports of capital goods grow twice as fast as equipment spending, so that stronger import demand is expected in the coming quarters as the basis of the recovery shifts from household spending to business spending (see chapter 3).

The impact of the dollar depreciation on both United States exports and imports has been limited so far due to the low price elasticities of demand.[1] With the dollar depreciation forecast to continue, it will gradually stimulate United States exports while curbing imports. United States exports and imports are both expected to increase by 7-8 per cent in 2004. However, since imports are greater than exports, the trade deficit will continue to grow in the near term (see figure II.1).

Japanese exports recovered during the second half of 2003, when there was an acceleration in exports of capital goods and ICT products to East Asia. This offset the decline in exports to the United States, particularly in the automobile sector and in consumer goods. Real exports are estimated to have grown by 6 per cent in 2003 and will continue to grow in 2004 (see table A.7). The appreciation of the yen will moderate this growth, but demand from other Asian economies is expected to be sustained. Meanwhile, the volume of Japanese imports from the rest of Asia has been growing steadily, while imports from the United States and Europe have remained weak. Total imports are expected to continue their growth of around 5 per cent, along with the gradual rise in domestic production and investment.

After low growth in 2003, export and import volumes in Western Europe are forecast to grow by about 6 per cent in 2004, despite the expected continuation in the appreciation of the euro. Partially because of this appreciation, the competitive pressure on many European Union (EU) exporters has increased. Improved cost performance has allowed exporters to absorb some of the effects of the appreciation and some "pricing-to-market" (PTM) has taken place (see box I.1), so that exports priced in United States dollars have not fully reflected the degree of appreciation. In addition, growth in world demand has partially offset the negative impact of the stronger euro on exports. Germany, for instance, has seen rapid acceleration in the growth of its exports, due to Asian demand for machine tools and the continued strength of markets in Central and Eastern Europe. Imports by Western Europe are expected to pick up with the strengthening of domestic demand, supported by the effects of appreciation on the domestic prices of imports. This pass-through has been limited so far, suggesting that more stimulus to demand from these price effects may be in the pipeline.

Both Australia and New Zealand have experienced weak exports and strong imports, due to their robust domestic demand and the appreciation of their currencies (see chapter III). Exports are expected to recover in 2004, owing to stronger demand from the rest of the world.

Meanwhile, increased international competition, trade disputes and the appreciation of its currency have been reducing Canada's share in the United States market, particularly in motor vehicles and parts, pulp and paper products, information technology equipment, wood products,[2] chemicals and fertilizers, and machinery.

The economies in transition have had a solid trade performance in recent years (see table A.7). The rapid growth of the trade of the Commonwealth of Independent States (CIS) region is being driven by strong regional economic growth and higher oil prices. In 2003, robust import demand by the Russian Federation boosted exports by neighbouring states, and hydrocarbon investments in the Caspian Sea region contributed to increased demand for imports of capital goods from these countries. Despite the anticipated weakening of oil prices in 2004, the growth of these countries' trade is forecast to remain robust, although diversification of the Russian economy away from the energy sector may reduce its growth and therefore its demand for imports from the region. On the other hand, the creation of a single economic space, as envisaged by the summit of the Presidents of the CIS in Yalta in September 2003, will further foster trade and foreign direct investment (FDI).

The export performance of Central and Eastern Europe in 2003 was mixed. Exports stalled in some cases because of earlier currency appreciation, whereas in other cases they increased as competitiveness improved. Exports are expected to remain strong in 2004, in line with the recovery in the EU and the removal of the last trade barriers following the entry of five Central European countries into the EU in May 2004.[3] At the same time, stronger border controls with eastern neighbours may adversely affect informal trade. The opening of most of the Central European Free Trade Agreement (CEFTA) markets to the EU, following the enlargement, poses another risk to intraregional trade. The region's imports remained strong in 2003 due to higher disposable income in most countries and strong investment in some. Imports will remain firm in 2004, as the implementation of public infrastructure projects and a recovery of investment in general will lead to increased imports of capital goods.

At 9 per cent, developing countries' external trade grew well above the world average in 2003. Imports grew more slowly than exports as several economies experienced external financial constraints as well as weak domestic conditions that curbed import demand. In 2004, the constraints are expected to ease and relative growth rates to reverse, with exports forecast to increase by about 9¾ per cent and imports by some 11 per cent in real terms.

Africa recorded a modest growth of trade in 2003. Export growth is forecast to reach 4½ per cent in 2004 as global economic recovery stimulates increased demand for African products. Export revenues will increase, but at a marginally lower rate than in 2003 due to the expected decline in the price of oil, a major export for the region as a whole. On the other hand, the prices of minerals and metals are expected to strengthen further which, together with increases in export volumes, including manufactures under the United States African Growth and Opportunity Act (AGOA), will raise export revenue in many sub-Saharan countries.

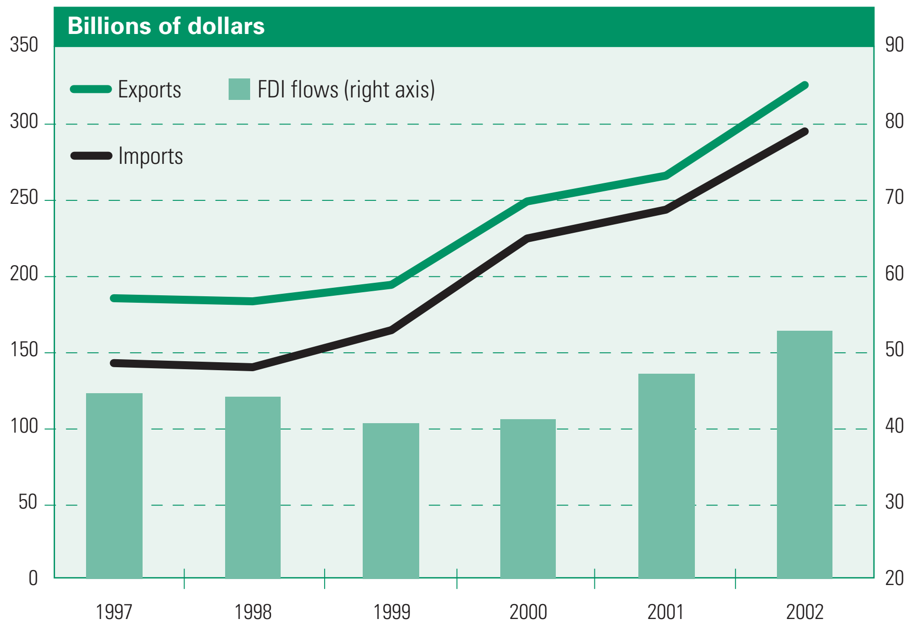
In 2003, imports of food commodities, particularly in Southern Africa, declined due to the return of normal weather conditions. High oil-import bills also impacted negatively on the volume of imports of many countries. In several countries, notably South Africa, currency depreciation also constrained import demand. Growth in African imports in 2004 is expected to accelerate in keeping with overall gross domestic product (GDP) growth.

East Asia's recent trade performance has been remarkable, with China playing a dominant role. China's exports and imports grew by around 30 per cent in nominal terms in 2003 (see table A.7), mainly due to post-World Trade Organization (WTO) accession momentum, a continued increase in FDI flows (see below), further relocation of manufacturing to China by transnational corporations (TNCs), a strong domestic economy and the recovery in world economic growth. The growth of China's exports has been well balanced across all major markets, although exports to the EU have grown faster than to other major economies, partially due to the change in the exchange rate resulting from the devaluation of the dollar. Non-state firms account for more than two thirds of exports by value, with foreign-owned enterprises accounting for more than 50 per cent of the total, highlighting the impetus to China's exports provided by FDI (see figure II.3). Driven by domestic demand, as well as by exports (about 50 per cent of exports are categorized as "processed" imports of intermediate goods), imports grew more strongly than exports in 2003. Among imports, ICT products, steel and auto parts grew the fastest, in response to the surge in domestic consumption and the high growth in infrastructure investment. In 2004, growth of both exports and imports is expected to decelerate to around 15 per cent.

Elsewhere in East Asia, export growth picked up towards the end of 2003 and is forecast to remain vigorous in 2004 in line with strengthening global demand and an upturn in a wider spectrum of ICT exports. Imports by China are an increasingly important component of total exports from many countries in the region (see table II.1). Imports by other East Asian economies also rebounded in the second half of 2003 and are expected to accelerate in line with stronger domestic demand.

Export growth was robust in South Asia in 2003, partially because Pakistan's preferential textile export quotas

Figure II.3.
CHINA: FOREIGN DIRECT INVESTMENT INFLOWS, EXPORTS AND IMPORTS, 1990-2002



Sources: IMF, *International Financial Statistics,* and UNCTAD, FDI database.

Table II.1.
EXPORTS TO CHINA BY SELECTED ASIAN COUNTRIES, 1998-SECOND QUARTER 2003

Percentage of total merchandise exports

	Average 1998-2000	2001	2002	First quarter 2003	Second quarter 2003
India	1.6	3.5	4.2	4.9	4.2
Indonesia	4.1	3.9	5.1	5.9	4.9
Japan	5.7	7.7	9.6	11.2	11.0
Korea, Republic of	9.8	12.1	14.7	17.7	14.7
Philippines	1.5	2.5	3.9	4.2	3.6
Singapore	3.7	4.4	5.5	6.1	6.7
Thailand	3.5	4.4	5.2	7.0	6.8
Memorandum item:					
World	5.6	6.5	7.3	6.7	7.3

Source: IMF, *Direction of Trade Statistics.*

to the EU and the United States were expanded. They are unlikely to increase further and, more generally, competition from low-cost producers, inadequate infrastructure and other structural weaknesses will continue to weigh on the region's export growth. The region's imports also grew strongly in 2003 in line with rising domestic demand and increasing demand for inputs to export industries. Import growth is likely to strengthen in 2004 and lead to worsening trade balances in most countries. However, the effect of this deterioration on the current-account balance will be mitigated by lower prices for oil imports and higher prices for exports of non-oil commodities.

Western Asia's trade performance is closely tied to developments in the world oil market and political stability in the region. The rise in oil prices boosted the region's export revenues by about 12 per cent in 2003. In volume terms, however, the region's oil-importing countries performed better than the oil-exporting countries as Israeli exports recovered and Turkey sustained strong export performance. Meanwhile, the region's import growth slowed to 3.5 per cent in real terms in 2003 from

about 7 per cent in 2002 due to weak domestic demand. Exports are forecast to decline in 2004 due to the lower quotas for Organization of the Petroleum Exporting Countries (OPEC) (see below), although exports of oil-importing countries will continue to benefit from the global recovery. Import growth is forecast to accelerate in 2004 (see table A.7), due in part to the reconstruction of Iraq and in part to downstream projects to be implemented elsewhere in the region.

Latin American and the Caribbean achieved a more balanced trade performance in 2003. Imports grew modestly in value terms but continued to contract, albeit at a decelerating rate, in real terms. Imports are expected to increase substantially with the further recovery of the region in 2004. As a result, the region's trade surplus is expected to decline.

Latin America's volume of exports grew by only 1.4 per cent in 2003, largely reflecting Mexico's poor performance, lower oil exports by Venezuela and weak exports from Argentina. Mexico suffered from the weakness of manufacturing activity in the United States, increased competition from China in specific sectors of its in-bond manufacturing, particularly the low-skilled industries, and a relatively strong currency. Central American and Caribbean exports did not fare much better, although exports from some special zones continued to increase. Exports from Brazil benefited from both higher prices and greater external demand as a result of the diversification of its trading partners, notably China. Regional exports are forecast to grow by 7½ per cent in 2004. Apart from the more favourable international environment, internal conditions will continue to support an increase in exports as exchange rates stabilize and a number of countries prepare to negotiate and/or sign free trade agreements (FTAs).

COMMODITY PRICE RECOVERY LED BY RAW MATERIALS

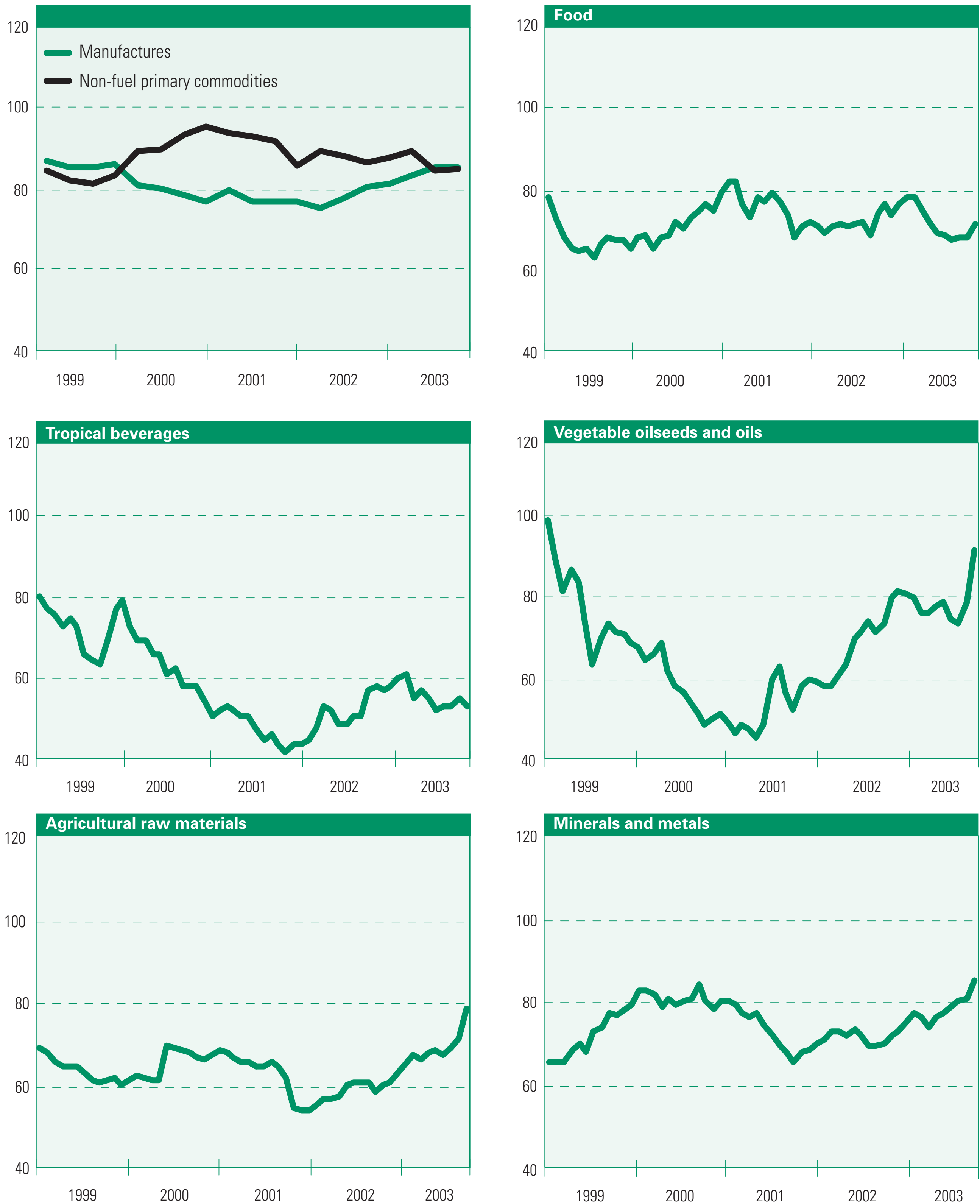
Commodity prices improved slightly in 2003. According to the United Nations Conference on Trade and Development (UNCTAD) combined index, non-fuel commodity prices increased by 5.8 per cent in nominal dollar terms over the first ten months of the year (see figure II.4). This recovery, however, largely reflected the weakening of the dollar. When measured on the basis of special drawing rights (SDRs), average commodity prices fell by 1 per cent over the same period. As usual, price trends diverged across the different groups of commodities. Over the first three quarters of the year, the combined index for minerals and metals prices rose by 7.4 per cent in current dollar terms and the index for agricultural raw materials by 11.4 per cent. In contrast, the food index fell by 10 per cent.

The economic upturn in major developed economies in the second half of the year exerted an influence on raw materials prices, although the continued high growth of Chinese demand was probably a more important factor behind the price increase. While a large portion of Chinese demand derives from the rapid growth in its exports, domestic demand for both consumer goods and for investment in infrastructure is playing an increasingly important role. China is a major importer of cotton, iron ore, nickel, copper and alumina, with developing countries supplying a major part of such imports.[4] Concerns about the possible risks of dependence on China as a major customer have lessened as growth in China has been supported by stronger domestic demand and seems likely to be sustained in the longer run, albeit at lower rates. China is also an important exporter of several raw materials. These include products where the rapid growth in domestic demand has facilitated investment in capacity and opened the possibility to export (for example, tin and zinc) and processed products partly based on imports (such as aluminium).

Weaker demand and declining prices for food products were partly a consequence of the unevenness of the world economic recovery and partly the result of continued supply overhangs. Although prices of most food products increased from very low levels in the latter half of 2002, demand in the first half of 2003 was not sufficient to eliminate excess production capacity and stocks.

The strengthening of commodity prices in 2003 raised the question of whether the price rise for some commodities was about to become a general phenomenon. In considering this question, it is important to distinguish the factors that determine variations in prices for food products from those affecting industrial raw materials. Usually, the demand for food does not vary much over the business cycle, but depends more on long-term income growth, particularly in developing countries, with the distribution of demand among food products changing over time. Accordingly, short-term price variations for food products are determined largely by weather conditions and other supply-side factors, as demand is relatively stable. For industrial raw materials, in contrast, the business cycle is of paramount importance. In the case of metals, demand for capital goods is a major factor. The business cycle affects the demand for consumer goods and hence the demand for agricultural raw materials, although less than the demand for metals. Investment often increases early in the business cycle and stimulates demand for metals, followed by a rise in demand for consumer goods that increases demand for agricultural raw materials. At this point, the business cycle may also increase the demand for certain food products. In addition, a general surge in demand for industrial raw materials may influence prices of food products indirectly, as a result of

Figure II.4.
PRICES OF PRIMARY COMMODITIES AND MANUFACTURES, 1999-2003
(Indices of prices in United States dollars, 1995 = 100)



Sources: UN/DESA and UNCTAD, *Monthly Commodity Price Bulletin.*

speculation or general market sentiment, particularly if inflation is expected to accelerate.

As noted in chapter I, the global economic upturn was delayed by a number of factors including excess capacity—and hence weak investment—in several sectors in the developed economies. Meanwhile, investment in Asia, particularly China, was growing rapidly. The resulting Asian demand for investment goods led to reductions in metal stocks, and this coincided with the external upturn in the major industrial economies. At this point, around October 2003, prices of almost all metals started rising rapidly. In view of the low stock levels for most metals and the expectation that industrial production will increase further in 2004, the price boom for these commodities seems likely to continue. For agricultural commodities, the situation is less clear: although the economic upturn is likely to have a positive influence on the prices of these products, the extent of this influence will depend mainly on supply-side factors, including the weather, as well as on stock levels, which vary from one product to another.

Finally, some of the factors underlying the rise in prices were not directly related to market fundamentals. For instance, alternative investment funds, including hedge funds, as well as private equity and property funds, were active in several commodity sectors, temporarily switching from traditional assets, such as shares and bonds, to positions in such commodities as coffee or cocoa[5]. With the economic recovery in the United States and, to a lesser extent, in Japan and Europe, the importance of this phenomenon may decline as stock markets become more attractive to investors.

Agricultural commodities

The trend of falling **coffee** prices was reversed in 2002, but prices have not yet recovered from the fall of the previous five years. According to UNCTAD estimates, if the prices of coffee had remained at their 1998 levels between 1999 and 2002, coffee-producing countries would have earned US$19 billion more than they did. The drop in income led some producers to temporarily withdraw from the market. Between the crop years 2001-2002 and 2002-2003, Central American production decreased on average by 9.1 per cent. Similarly, there were large cutbacks in such other countries as Cameroon, Kenya and Uganda. Since coffee production in these countries mainly takes place on small farms, the fall in production and prices has had severe impacts on rural income levels. The decline in supply from these countries might partly explain the modest strengthening of prices in 2003. However, excess supply still weighs on the market due to production increases in Brazil. In all, world coffee production increased by 8.2 per cent and world stocks by 4.9 per cent, while consumption grew by only 2.3 per cent during the crop season of 2002-2003 so that significant price increases should not be expected.

The price of **tea** rose by 7 per cent over the first three quarters of 2003, mainly driven by increasing imports by the EU and CIS. However, rising Indian production, combined with sluggish imports from Western Asia, might have a dampening effect on the market in 2004.

Cocoa prices experienced a short-lived peak at the end of 2002 and the beginning of 2003 (see table A.8) as a result of concern about political developments in Côte d'Ivoire, demonstrating the importance of supply-side factors. However, since then, cocoa prices have fallen steadily because of the rise of 8.4 per cent in world cocoa production in 2002-2003. The surge in supply was driven mainly by increasing production in Western Africa, since the world's third largest producer, Indonesia, was affected by drought in 2003.

Cereal prices increased in the second half of 2003 because of reduced production in the northern hemisphere summer, due to adverse weather conditions in major producer countries. It is estimated that global wheat production in 2003 was around 2 per cent less than in the previous year. EU wheat production, for instance, is estimated to have decreased by 11 per cent. To counteract this, the EU reduced the set-aside rate[6] by 10 per cent to boost production in 2004. The fall in production may have adverse consequences on net food-importing developing countries in the short term.

The price of **rice** rose slightly in 2003. Although favourable weather conditions and an expansion of planted areas contributed to an increase in rice production, especially in India, world production is forecast to be insufficient to match demand. In addition, Chinese production is expected to fall due to a reduction in planted areas. World stocks are anticipated to decrease further in 2003-2004 to reach their lowest level since 1987.

The price of **sugar** continued to fall in 2003, and market fundamentals, particularly booming Brazilian production, cast a gloom on the near future. Despite the negative impact of poor climatic conditions in China and the EU, different sources, including the International Sugar Organization, anticipate that world sugar stocks will reach 70 million tons by the end of 2004, equivalent to six months of consumption, and will maintain the downward pressure on prices.

Banana prices fell by 44 per cent during the first three quarters of 2003. The re-emergence of such producers as Brazil and China, combined with competition from low-cost producers such as the Philippines, contributed to an increase in supply. Since the price elasticity of demand for bananas is low, the lower price did not lead to any significant increase in demand.

The prices of **vegetable oilseeds and oils** continued to recover in 2003 (see figure II.4). The prices of some products, including soybean oil and groundnut oil, increased due to growing demand, including massive imports of soybean oil by such countries as China. Over the past fifteen years, the growth of Chinese demand has turned the country from a net exporter into a net importer of oilseeds and oil meals, as well as of vegetable oils. For soybeans, while output in Argentina and Brazil rose, production in the United States declined for a second consecutive year. World production of soybeans is expected to grow by 2 per cent in the 2003-2004 crop year.

Among agricultural raw materials, **cotton** prices rose significantly in 2003, particularly for coarser varieties, mainly due to a fall in Chinese production, which led to an increase in imports. Adverse weather conditions in China were the foremost factor in the fall in production, leading to an increase in the Chinese import quota from 856,250 tonnes in 2002 to 1.36 million tonnes in 2003.[7] The surge in price was intensified by the influence of hedge funds and speculators that were reported to hold close to half the open positions on the New York Board of Trade (NYBOT) at the beginning of October 2003. Supply and demand conditions, including no expected changes in subsidy policies or in the competitive position of cotton vis-à-vis synthetic fibres, suggest that prices will remain largely unchanged until the beginning of 2004.

Meanwhile, **rubber** prices increased, primarily due to coordinated supply management by Indonesia, Malaysia and Thailand. These three countries account for roughly 80 per cent of world production and their joint launch of the newly-created International Rubber Company Limited, designed to influence rubber price movements, appears to have had a positive impact on prices.

Minerals, ores and metals

Excess capacity continues to be a problem for some metals, while shortfalls developed for others during 2003. As a result, prices recovered on average for this group of commodities (see figure II.4). A return to higher economic growth could lead to the emergence of additional shortfalls over the next few years. China's demand for minerals and metals continues to grow and has become the most dynamic element of otherwise relatively calm markets. Developments regarding China are now given considerable weight by market observers and exercise a strong influence on prices. Nonetheless, China's share of global consumption of some metals is still relatively small.

Iron ore production increased in all major producing countries, supported by strong demand from the steel industry in almost all countries. Chinese demand, in particular, was a major factor: iron ore imports in the first half of the year increased by 30 per cent. Steel demand is forecast to increase by almost 6 per cent in 2004, which implies continued high growth rates in iron ore demand. Concerns have been raised about the ability of iron ore mining companies to respond to the rapid growth in demand. Most of the additional ore supply in 2003 came from existing mines now operating at full capacity, with port and shipping facilities being expanded and stocks being drawn down. More projects therefore need to come on-stream to meet the expected rise in iron ore demand in 2004. However, large capacity expansions cannot be expected before 2005. Additionally, a shortage of shipping capacity appeared in 2003. Ocean freight rates for iron ore skyrocketed and became more expensive than the ore itself. In view of the depreciation of the United States dollar and the increasingly tight supply situation, further price increases in 2004 appear likely and will, together with higher freight rates, raise the costs of steel producers.

The rise in **nickel** prices continued in 2003, fuelled by robust demand growth and limited additions to supply, resulting in a growing gap between supply and demand. Growth of Chinese demand continues to account for a major portion of the global growth in demand. Supply disruptions in Canada supported higher prices, which were particularly significant towards the end of the year. The market is expected to face significant shortfalls at least in 2004 and 2005. Expected additions to capacity in Canada and Indonesia, for instance, will increase supply by 2006/2007, but other sources of capacity expansion in the short term are limited. Additionally, small additions to capacity elsewhere will be offset by expected reductions due to the depletion of reserves.

Primary **aluminium** production increased by more than 3 per cent during the first three quarters of 2003. As consumption kept pace and stocks remained stable (although still at historically high levels), prices increased. On the other hand, the balance between supply and demand is considerably tighter in the case of **alumina**, the raw material for aluminium. The re-emergence of Chinese aluminium production, and resulting growth in alumina imports, has led to a deficit of alumina and rising prices worldwide. Previously closed alumina refineries restarted production in 2003 and new projects are being speeded up. The evolving deficit is likely to affect prices in medium-term contracts. Alumina prices are usually set as a percentage of the London Market Exchange (LME) quotation for aluminium. Prices have traditionally been 12-13 per cent of the aluminium price, but may now move to 15-16 per cent or even higher. Since the lead time for additions to capacity to enter into production is around three to four years—depending on whether it is an extension to existing capacity or a new refinery—and there are few new projects underway, the deficit is likely to persist for the next few years. Meanwhile, demand for aluminium is likely to rise faster in 2004, leading to further tightness of the alumina market as well as to rising aluminium prices.

The price of **copper** increased rapidly towards the end

of 2003. During the first part of the year, prices held up, due mainly to production cutbacks, including temporary mine closures, and a build-up of stocks by one of the leading producers. Later, the fall in stocks held in LME warehouses (by almost half since the beginning of the year), together with improved general economic prospects, pushed prices up. A situation analogous to that in aluminium markets developed, with the supply-demand balance for copper concentrates being tighter than that for metal. In addition to mine closures, rapidly increasing metal production in India and China contributed to market tightness. Moreover, a scrap shortage developed during the course of the year, mainly due to increasing demand from China. With demand showing signs of growth, the increase in prices is likely to persist in 2004.

Both production and consumption of **lead** have been relatively stagnant over the past several years. Due to the increasing use of secondary lead, coming mainly from used batteries, primary producers have been squeezed and there have been closures of both mines and smelters. The closures have, however, not been large enough to prevent a fall in treatment charges. At the same time, a shift in both mine and smelter production has taken place, with China emerging as a major producer. A turning point was reached in September 2003, when prices rose due to several announcements of closures of both primary and secondary plants. The rise continued late in the year when a fall in LME stocks was a contributing factor. Since further stock decreases are probable, the rise in prices is likely to continue.

Tin prices began to recover in the second half of 2002, when stocks at the LME started to fall as a result of reductions in Chinese production and an export ban by Indonesia. The downward trend in stocks persisted in 2003. As a result, prices continued to increase (see table A.8). Strong demand growth and falling production in most parts of the world indicate a continuation of the rising price trend in 2004.

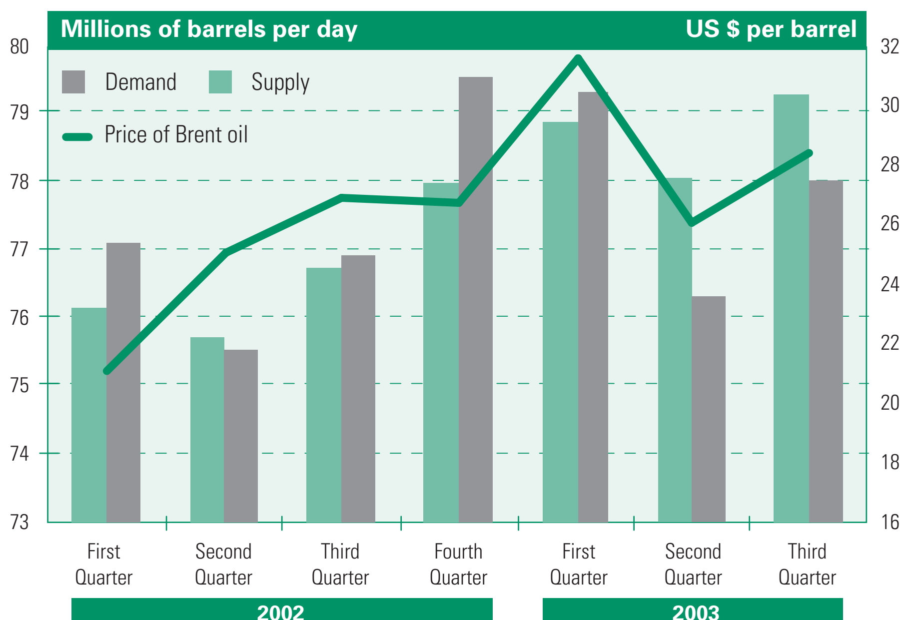
Mine production of **zinc** is estimated to have increased in 2003, but smelter closures in Western Europe led to a loss of between 420,000 and 460,000 tones of smelting capacity. An additional factor in 2003 was the reduction in refined zinc exports from China. As a result, the price of zinc recovered during the year. Continued world economic recovery in 2004 is likely to lead to some strengthening of demand and to higher prices.

World oil market: increased volatility and uncertainty

Global oil inventories remained low throughout 2003, making prices more sensitive to market developments. Responding to geopolitical uncertainties, notably developments in Iraq, as well as market fundamentals, oil prices were particularly volatile during the year. Overall, the price of Brent oil averaged around $29 per barrel (pb) for the year as a whole.

Oil prices rose in late 2002 and early 2003 (see figure II.5) as uncertainties related to the situation in Iraq increased and inventories in the major industrialized economies declined. During the second quarter of 2003,

Figure II.5.
WORLD OIL SUPPLY AND DEMAND AND OIL PRICES, FIRST QUARTER 2002-THIRD QUARTER 2003



Sources: International Energy Agency, *Monthly Oil Market Report*, and U.S. Department of Energy/Energy Information Administration, *Selected Crude Oil Spot Prices*.

however, world oil demand weakened, global oil inventories increased and oil prices dropped, though remaining within the OPEC target band of $22-$28 pb. By the beginning of May, oil prices had reached their lowest level for the year, as major military hostilities ceased in Iraq. Despite the drastic drop in Iraqi oil production, there was excess oil supply during the second quarter of 2003, as OPEC and non-OPEC countries increased output to compensate for Iraq's shortfall and calm the markets. After the seasonal weakness in the second quarter of 2003, global oil demand strengthened, supported by economic growth in China and the United States and the economic recovery in Japan. The situation in Iraq is also contributing to increased world oil demand, mainly owing to rising demand from military operations and diesel generators.

For 2003 as whole, world oil supply rose by 3 per cent to 78.7 million barrels per day (mbd). Oil demand increased by 1.7 per cent to 78.6 mbd and is expected to reach 79.6 mbd in 2004. The anticipated increase in supply by non-OPEC countries in 2004 will be sufficient to match this increase in demand, while cuts in OPEC output, if fully implemented, should accommodate growing Iraqi production. Oil prices are forecast to average $25 pb in 2004, as petroleum stocks in industrialized countries gradually return to more normal levels and uncertainties regarding Iraqi output diminish.

The resumption of oil production in Iraq has been slower than anticipated. In the third quarter of 2003, oil production in Iraq averaged 1.1 mbd, significantly lower than the pre-war level of about 2.6 mbd. In addition to other difficulties, limited storage capacity and the inability of Iraq to use its oil transportation facilities due to security problems have forced the country to re-inject a part of its oil production after removing natural gas for domestic use. Iraqi exports have not recovered as expected either. The country's main pipeline to the Turkish port of Ceyhan was shut down due to sabotage, and the pipeline to the Gulf is not fully operational because of repeated power outages. Oil production in the northern part of the country has continued to be constrained by the lack of export outlets due to pipeline bottlenecks. Reduced crude oil production has negatively affected the country's oil refining capacity. As a result, Iraq has been importing refined products.

Among other OPEC countries, Venezuela had not restored production to its pre-strike level by the end of 2003, producing 2.6 mbd compared to its quota ceiling of around 2.9 mbd. Meanwhile, civil strife and political disturbances reduced oil production in Nigeria during the second and third quarters of 2003.

In September 2003, OPEC countries agreed to cut oil production by 900,000 barrels per day (bpd) to 24.5 mbd, starting on 1 November 2003. The cut was aimed at preventing a possible oil glut and a slide in prices; prices remained firm for the remainder of 2003. OPEC countries met again on 4 December 2003, concerned about possible lower prices in the second quarter of 2004—usually the weakest period of the year for global oil demand. They noted that the strength of the oil price was clouded by the weakness of the dollar (in which oil is priced), which has been eroding oil's purchasing power. Nonetheless, quotas remained unchanged at about 24.5 mbd for the group as a whole, excluding Iraq.

KEY TRADE POLICY DEVELOPMENTS

Slow progress in World Trade Organization (WTO) negotiations

Multilateral trade negotiations failed to advance in 2003. The Doha Work Programme (DWP), launched at the Fourth Ministerial Conference of the World Trade Organization in Doha, Qatar, in 2001, provided for a mid-term review of progress in the negotiations at the Fifth Ministerial Conference of the World Trade Organization, in Cancún, Mexico, in September 2003. The Cancún meeting was also meant to be an occasion for political guidance and decisions in a number of areas. However, the meeting was largely unsuccessful in moving the DWP programme ahead.

Process-related issues

The seeds of the Cancún setback were sown by general problems of missing deadlines that had been set at Doha, inadequate treatment of development issues and unfinished business and imbalances from the Uruguay Round. On particular areas of negotiation, the key problems were the slow pace of agricultural reform in developed countries and inadequate progress on core market access and development issues.

Leading up to and at Cancún, procedural difficulties were among the impediments to progress. In addition to the process overload, particularly for developing countries, these difficulties included the timing of issues and their maturity for resolution; procedures relating to record-keeping and dissemination and to the preparation and transmission of texts; when and how to reflect alternative views of WTO Members; how to select officers; and how to ensure the inclusiveness of the process at all times. There were also expectations in some quarters that the Cancún meeting would result in a positive-sum agreement on all accounts for all WTO Members, but the linkages, balances, sequencing and perceived costs and benefits were too complex to achieve such an outcome.

The decision-making processes in the WTO have also become more complex and difficult, partially because of the larger membership (now 148) and the broadened agenda, but also because most participating countries are democracies. The prominence of civil society and private sector organizations, as well as the increasingly important role of

Parliamentarians, should be seen in this context. The result is that WTO negotiating dynamics have changed, with the Governments of both developed and developing countries having to consider political, social and economic interests and other considerations involving their people and constituencies. The negotiations have to take into account the interests and concerns of all participants, regardless of their level of development, size or share of world trade. In particular, the developing countries are demanding that their core market access and development concerns be addressed and that they have a real say in decisions that affect their economies and peoples.

A number of issue-based alliances have evolved among groups of developing countries, for example the Group of twenty-plus, focusing particularly on agriculture but also on non-agricultural market access (NAMA), the grouping of African, Caribbean and Pacific Group of States/ African Union/least developed countries (ACP/AU/ LDCs) on so-called Singapore issues and the coalition of Benin, Burkina Faso, Chad and Mali regarding cotton. These alliances point to a greater assertiveness of developing countries within the WTO and have thereby strengthened the WTO by the redressing the imbalances in countries' negotiating leverage.

Divergent views emerged on the decision-making process. Some contended that there was an imbalance between a consensus-based decision-making process, which was inefficient in reaching agreements quickly, on the one hand, and an effective and time-bound enforcement and dispute settlement system, on the other. Others encouraged further democratization of the decision-making process of the WTO. Yet others cautioned that an examination of reforms in the WTO ran the risk of diverting attention from the main issues facing the multilateral trading system, particularly market access and development issues.

Substantive issues

In part because of the procedural reasons outlined above, but also because of substantive differences, progress following the launching of the negotiations was slow, with most intermediate deadlines being missed. Nevertheless, results were achieved in some areas. Agreement was reached on overall guidelines on accession for least developed countries (LDCs) and on the special treatment to be accorded to LDCs in negotiations on services. At the end of August 2003, after a number of missed deadlines, a decision was adopted on trade-related intellectual property rights (TRIPS) and public health, aimed at ensuring that countries with insufficient or no pharmaceutical manufacturing capacity have access to medicines at affordable prices or low cost. Finally, a number of new members joined the WTO, including China. The membership of Cambodia and Nepal, the first LDCs to join the WTO since its creation, was agreed during the Cancún Meeting after long prior negotiations that resulted in these two countries assuming a higher overall level of obligations than the original LDC members.

At the Cancún meeting, the key difficulties were in the areas of agriculture, cotton, NAMA and the four Singapore issues (the relationship between trade and investment, trade and competition policy, government procurement and trade facilitation). In addition, there were a number of development issues emphasized by developing countries, including special and differential treatment (SDT) and implementation issues, on which commercially meaningful agreement could not be reached.[8]

In regard to agriculture, effective realization of the Doha provision of substantial improvements in market access, reductions of, with a view to phasing out, all forms of export subsidies, and substantial reductions in trade-distorting domestic support, is pivotal to ensuring that the DWP is successful in achieving its purpose as a "development round". While some concessions were proposed, developed countries have resisted undertaking the comprehensive removal of subsidies and other domestic support measures that distort global agricultural trade, to the detriment of most developing countries. Agriculture has long been excluded from global trade negotiations, and the lack of progress in this area must therefore be viewed as one of the major failures of the Cancún Conference.

A particular flashpoint within the negotiations related to cotton, in particular the subsidies provided to cotton farmers in the United States. A number of African cotton-producing countries called for a phasing-out of these subsidies, arguing that their cotton farmers were being threatened by the resulting depressed world cotton prices. For its part, the United States argued that cotton should be part of the overall negotiations on agriculture.

On NAMA, the revised draft Cuncún Ministerial text proposed a non-linear formula requiring countries, among other things, to make greater reductions in tariffs above their average rates and smaller reductions in tariffs below their average rates. Developing countries argued that, besides the complexity of this approach, it would result in their making the largest cuts (since they have the highest tariffs) which, in their view, was inconsistent with the principle of less than full reciprocity contained in the Doha Declaration, while entailing substantial adjustments in their nascent industrial sectors.

Another area of contention was the so-called Singapore issues. The Doha Declaration provided that negotiation on these issues would take place on the basis of a decision to be taken by explicit consensus at the Fifth Ministerial Conference of the WTO on modalities of negotiations, but developing countries have resisted such a broadening of

the multilateral trade agenda in areas that they view to be within the realm of domestic policy. Also to a certain degree, the attitude of developing countries to the Singapore issues has been conditioned by the lack of progress on implementation-related issues, SDT and agriculture. In addition, in the light of the difficulties they are already having in implementing commitments from previous rounds of trade negotiations, they anticipate that such agreements will be burdensome for them. In the negotiations, the Chair proposed a differentiated approach, with negotiations to commence on transparency in government procurement and trade facilitation. However, the meeting was aborted before any agreement could be finalized.

With a view to breaking the impasse that had evolved, the Cancún Conference instructed the WTO General Council to convene "no later than 15 December 2003 to take the action necessary … to move towards a successful and timely conclusion of the negotiations."[9] The meeting of the WTO General Council on 15 December 2003 focused on agriculture, NAMA, cotton and Singapore issues, but agreements proved elusive and there was no concrete outcome. The Chairman said, in his closing remarks, that he did not see "the closing of the gap between expressions of flexibility, commitment and engagement and a translation of these into new negotiating positions that would allow us to look for common ground or to accommodate the position of others… we have to narrow the gap between expressions of goodwill, commitment and their translation into negotiating positions." There was, however, a reconfirmation of a sense of engagement and a commitment to the DWP, to the multilateral trading system and to finishing the round on time. There was a willingness to restart the work of all the negotiating groups and other bodies, including the Trade Negotiations Committee, which have to deal with the Doha agenda, in early 2004, on the understanding that restarting this work does not in any way mean losing an overview of the process or a sense of the horizontal integration of issues. There were informal discussions regarding extending the current deadline of January 2005 for concluding the DWP negotiations.

The way forward

As emphasized by the Trade and Development Board (TDB) of UNCTAD following the Cancún meeting, there is a need for urgent and purposeful work on the key outstanding issues in order to put the DWP back on track. Efforts should concentrate on the Doha mandate and on core issues: a balanced outcome both within and across the spectrum of negotiating areas; full realization and importance of the development agenda; complete inclusiveness, transparency and democracy in the negotiating processes, procedures and decision-making; concentration on trade liberalization and border measures; completion of the unfinished business of the previous rounds, especially in agriculture, textiles and Mode 4 in services; implementation issues; SDT; and enhanced technical assistance and capacity building to meet the needs of developing countries. More generally, there is also a need to ensure coherence and consistency between trade, financial, monetary and technological policies in support of development and to take into account the implications for the multiple issues that operate in the interface of trade, development and globalization.

The negotiations need to recognize, take into account and provide for *ab initio* the adjustment and social costs that their implementation will involve, particularly for developing countries. In addition to support in participating in the negotiations, developing countries require additional financial and technical resources and capacity and institution-building to prepare for the implementation of the outcomes of trade negotiations. Targeted and comprehensive technical assistance is already an element of the DWP and, in addition to ongoing programmes, the International Monetary Fund (IMF) and World Bank have launched an initiative to support adjustment by developing countries to address the impact of multilateral trade liberalization. A commitment of further support of this nature, including by bilateral donors as part of their pledges to increase official development assistance (ODA), should pay a "double dividend" by providing developing countries with greater flexibility in the negotiations and thereby giving a boost to the negotiations themselves.

The DWP was launched as a "development round" of trade negotiations. Progress should therefore be monitored against a set of benchmarks relating to development objectives. The TDB of UNCTAD, and subsequently the General Assembly at its fifty-eighth session,[10] took note of a series of possible development benchmarks (see box II.1). Such benchmarks are a useful way of systematically assessing progress in assuring development gains from the international trading system in general and from trade negotiations.

Regional and bilateral trade agreements

At present, some 215 regional trade agreements (RTAs) and bilateral trade agreements (BTAs) are operational. By 2007, some 300 such agreements are expected to be in force. Some 40 per cent of global trade is currently conducted within existing or emerging RTAs and BTAs, and it is estimated that more than a half will be covered by RTAs by 2005. These agreements, which developed parallel to the evolution of the MTS, have become a permanent feature of international trading. As in the run-up to the completion of the Uruguay Round, the current impasse in multilateral trade negotiations may give

Box II.1: Development benchmarks[a]

The following development benchmarks have been identified by UNCTAD for assessing progress in mainstreaming development in trade negotiations.

Openness and Liberalization. An important development benchmark is how open, liberal and fair the premium markets are to which developing countries export their agricultural and manufactured goods and services. In this regard, barriers to market entry (in the form of discretionary standards, technical and environment requirements and rules of origin) are as crucial as formal market access conditions. In addition, the pace and sequencing of trade liberalization and the relative ability of countries to absorb the costs and dislocation involved have to be taken into account in determining the development gains. Particularly for developing countries to capture the benefits of liberalization, mechanisms to increase supply capacity and to cope with adjustment difficulties and costs (such as social safety nets, adjustment support, infrastructure investment, institution-building etc.) need to be in place. These may require external support beyond the traditional technical cooperation directed at implementing WTO Agreements.

Equal opportunity for unequal partners. Equitable rules and their fair application are the ultimate protection of weaker trading nations. From this standpoint, the principle of special and differential treatment (SDT) is meant to take into account structural and emerging asymmetries between the developed and developing countries, including those relating to per capita income; supply capacities; size, market power and scope of their industries and enterprises; capital and technological advantages; ability to subsidize agriculture, industry, services and research and development (R&D); and availability and costs of economic, trade-related and financial infrastructures. These asymmetries need to be addressed in all existing agreements while any new agreements need to be such that the rules fully accommodate the "developmental, financial and trade needs" of developing countries, and provide them sufficient policy space.

Striving for a better balance. The present multilateral trade negotiations are also about the balance between the legacy of rights and obligations and costs and benefits from previous rounds and those from this round; balance of loss and gain within each area and in overall terms; balance in the processes, selection of issues, sequencing and timelines and the levels of ambition and of outcome. Rebalancing would involve dealing purposefully with implementation issues. Care also needs to be taken not to give rise to new imbalances even as the previous ones are remedied. Balance requires that trade-offs lead to positive sum outcomes for all parties, particularly for developing countries. Transparency and the increased participation of developing countries in the decision-making processes is another imperative. Accession of developing countries to the WTO on terms commensurate with their level of development continues to be a key priority.

Serving public interest. The Millennium Declaration commits the international community to making the right to development a reality for everyone and resolves to create an environment at national and global levels conducive to development and to the elimination of poverty. The common good, public interest and ways to help the poor should be the guiding light of a development-oriented multilateral trading system. Efforts must be made to ensure that the trading system is responsive to the key development issues, including the eradication of poverty, fighting infectious diseases and epidemics and ensuring provision of basic social services to the poor and the underprivileged. The TRIPS and Public Health Declaration at Doha and the recently adopted decision was a breakthrough in that it recognized that trade is not value neutral and that public interest must be a priority.

Revitalizing the commodities sector. Raising the profile of commodities in the multilateral and wider international trade and development cooperation agenda whilst evolving a supportive international environment for commodity-dependent developing countries is long overdue. Some fifty developing countries depend on just two or three commodity exports and thirty-nine of them on exports of single commodities. In order to reach the millennium development goals on poverty reduction, these countries need to achieve a strong revival of their commodity sectors and higher value realization from their exports.

Coherence. Key to the development orientation of the multilateral trading system is the degree of coherence that can be brought to bear among the different areas of negotiations and disciplines, between the different multilateral institutions and policies and between these and regional and national processes and strategies. Three aspects of coherence need to be monitored: (i) synergy and proper sequencing between the capacities of the developing countries, their level of obligations, the cost of implementation and the adequacy of financial and technical resources made available to them; (ii) positive linkages between the trade, financial, monetary and technology policies of developed countries and the ability of developing countries' trade liberalization and their reaping of development gains; and (iii) implications of the multilateral trade negotiations and the multilateral trading system for such key development issues as poverty elimination, employment, food security and rural development, environment, health, culture, gender, migration, competition, technology and enterprise development.

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[a] For an elaboration, see UNCTAD document TD/B/50/8.

added impetus to the formation and deepening of RTAs and BTAs.

A major aspect of in the evolution of the RTAs and BTAs has been the development of agreements involving both developed and developing countries. An early example was the North American Free Trade Agreement (NAFTA) among Canada, Mexico and the United States, which celebrated its tenth anniversary of going into effect at the beginning of 2004. More recent examples include the Euro-Med Association Agreements concluded between EU and Mediterranean Basin countries (Morocco, Tunisia, Egypt, Jordan, Israel); EU-Chile; EU-Mexico; EU-South Africa; EU-Jordan; United States-Israel; United States-Singapore; Canada-Chile; and Canada-Costa Rica. Under the Cotonou Partnership Agreement, ACP and EU are negotiating economic partnership agreements based on reciprocal opening of markets, the second phase of which, dealing mainly with the liberalization of market access, was launched in September 2003.

In November 2003, Western Hemisphere trade ministers adopted a compromise declaration on the way forward for the Free Trade Area of the Americas (FTAA). Ministers reaffirmed their commitment to " the successful conclusion of the FTAA negotiations by January 2005, with the ultimate goal of achieving an area of free trade and regional integration" and agreed that the negotiators should aim "at a balanced agreement that addresses the issue of differences in the levels of development and size of economies of the hemisphere." The declaration recognized that countries might assume different levels of commitments by selecting the obligations they will assume, instead of committing to a 'single-undertaking' arrangement. The implications of this, especially for smaller partners, remain to be seen. It was also agreed that the negotiations on market access must lead to conclusion by 30 September 2004.

Bilateral and regional FTAs have become an important element in United States trade policy. In addition to concluding the FTAs with Canada and Mexico, as well with Jordan and Singapore, referred to above, during 2003, in December 2003 it concluded a collective agreement with El Salvador, Guatemala, Honduras, and Nicaragua.[11] The United States is currently negotiating FTAs with Australia and Thailand and has also proposed FTAs with, among others, sub-Saharan African countries (under its African Growth and Opportunities Act (AGOA)) and the Arab States.

A recent feature of RTAs has been the widening coverage of the agreements beyond trade in goods to include trade in services and other trade-related policy areas, such as intellectual property rights, investment, competition policy and government procurement. In addition, physical integration through joint infrastructure development, social and cultural cooperation, political and security cooperation, and other sectors of cooperation have been pursued to enhance regional economic linkages, stability and solidarity.

A continued concern regarding RTAs and BTAs is their compatibility with the relevant WTO rules and disciplines, including General Agreement on Tariffs and Trade (GATT) Article XXIV, which concerns primarily RTAs among developed countries and between developed and developing countries. For the latter, there are important development implications arising mainly from the issues of reciprocity and SDT. Little progress has been made under the DWP in clarifying and improving the disciplines and procedures under the WTO provisions applying to RTAs in order to take into account developmental aspects of these agreements.

A key challenge for RTAs among developing countries has been the effective implementation of their liberalization programmes. Experience shows that the degree of implementation of such RTAs has been greater for traditional and less sophisticated agreements focusing on trade in goods than for agreements that seek "deeper" integration and cover such issues as investment, competition policy and government procurement. The latter type of agreements tend to lag behind the planned time frame. The South Summit, held in Marrakech in December 2003, dealt with some of these and other issues of economic and trade cooperation among developing countries.

The widening, deepening and consolidation of regional integration among developing countries has had differing impacts on intra-group trade. Between 1990 and 2001, the share of such trade within the Southern Common Market (MERCOSUR) rose from 8.9 per cent to 21.8 per cent. During the same period, the intra-trade of Association of Southeast Asian Nations (ASEAN) countries was consistently between 20 and 25 per cent, except during the Asian financial crisis. ASEAN countries (22.4 per cent in 2001) and MERCOSUR have attained a relatively high-level of intra-regional trade, but the ratio is less in the Central American Common Market (CACM) (15.0 per cent), the Union Economique et Monétaire Ouest Africaine (UEMOA) (13.5 per cent), the Caribbean Community (CARICOM) (13.4 per cent) and the Southern African Development Community (SADC) (10.9 per cent). Among African groupings, the shares of intraregional trade of the Common Market of Eastern and Southern Africa (COMESA), the Communauté Economique et Monétaire de l'Afrique Centrale (CEMAC) and the Economic Community of Central African States (ECCAS) were only 5.2 per cent, 1.3 per cent and 1.1 per cent, respectively, in 2001. In all cases, these shares remain low compared to some RTAs among developed countries, with intra-group exports accounting for 61 per cent of EU exports and 55 per cent of NAFTA exports.

The overall increase in trade under RTAs among developing countries is consistent with the burgeoning trade among these countries in general. Compared to 27 per cent in 1980, about 40 per cent of developing countries' merchandise exports are now to other developing countries, reflecting their growth of inter- as well as intraregional trade. For example, between 1999 and 2002, trade between India and Brazil increased fivefold, from an initial level of $200 million. The Global System of Trade Preferences among Developing Countries (GSTP) is an important instrument for developing countries to further promote trade among themselves. At a meeting of the G-20 developing countries in Brazil in December 2003, Brazilian President, Lula da Silva, proposed that members of the Group should implement free trade amongst themselves and that this initiative should be taken up at the eleventh session of UNCTAD in June 2004.

Trade disputes

In 2001, the United States imposed new duties on steel imports, prompting the EU and other trade partners to threaten retaliatory action against United States exports.[12] In November 2003, WTO ruled that the United States duties were in violation of WTO rules and, in December 2003, the United States announced that it would lift the duties.

This development notwithstanding, a number of other issues continue to affect United States-EU trade relations, particularly an ongoing dispute over United States tax concessions for its companies that export under the Foreign Sales Corporation law and the continued EU *de facto* moratorium on the approval of genetically modified organisms (GMOs).

Among other WTO cases, India has disputed the right of the EU to grant special tariff benefits under its Generalized System of Preferences (GSP) scheme to Pakistan's textiles and clothing exports as part of the EU "drug incentive" programme. This arrangement provides additional preferences to Pakistan (but not to India) and to Andean countries (but not to Paraguay). India argued that the EU "drug incentive" violates GATT Article I and that the EU should demonstrate that it has met the condition provided under the Enabling Clause, which requires any preferences to be generalized and non-discriminatory. India claimed that, since the EU scheme could not be seen as a measure designed or necessary to protect human life and health, the effect was to shift the burden of providing resources for countries fighting drug production and trafficking to countries that had not caused such problems. A WTO panel subsequently found the EU preferential 'Drug Arrangements' scheme to be GATT-illegal.

A first implication of this finding is that, as informally evident prior to the case, non-generalized unilateral preferences, such as the United States AGOA or the EU Cotonou Agreement (although granted a waiver), are most likely not justifiable under the Enabling Clause. Secondly, non-trade conditionality, such as the EU positive incentive scheme on the basis of labour or environmental criteria, is also not justifiable.[13]

Security-related measures affecting trade

A number of initiatives and measures have been taken, mostly by certain developed countries, regarding the security of exports. These measures may have implications for developing countries, including the possibility of increased transactions' time and costs; the additional cost of adjustment to and compliance with each new procedure and regulation; the uncertainty regarding the successful completion of formalities and the consequent risk of export loss; the possibility of discriminatory treatment; and the likelihood that these regulations might act as barriers to trade. The programme of Transport Security Action agreed by the Group of 8 (G8) at its summit in Canada in 2002, the United States security legislation and the work within the International Maritime Organization and the EU demonstrate the importance of maritime and container security issues and their implications for international trade. It is essential that a coordinated global approach be adopted to avoid the negative consequences of a proliferation of diverse unilateral and regional standards and approaches.

FINANCIAL FLOWS TO DEVELOPING AND TRANSITION ECONOMIES

Developing countries received an estimated $95 billion in net capital flows in 2003, a modest increase from 2002 and only slightly more than one half of the average annual amount in the mid-1990s (see table II.2). FDI and official loans and grants were the only net sources of capital inflow. While FDI was still the most resilient capital flow, it was unchanged from the relatively low level of 2002 (see following section). For the transition economies, FDI and commercial bank lending were the main sources of net capital inflow in 2003.

Private financial flows

Foreign investor sentiment towards emerging markets improved as 2003 progressed, bolstered by improvement in the domestic situation of a number of countries, including Brazil, Turkey and Uruguay. This was reflected both in new flows to selected emerging economies and in the reduction of the spread between the yield on emerging market bonds and that of the risk-free benchmark United States Treasury bonds during the year (see figure II.6). The decline in the yield spread was particularly sharp on bonds of a number of Latin American

Table II.2.
NET FINANCIAL FLOWS TO DEVELOPING ECONOMIES AND ECONOMIES IN TRANSITION, 1992-2003

Billions of dollars

	Average 1992-1996	1997	1998	1999	2000	2001	2002	2003[a]
Developing economies								
Net private capital flows	161.1	106.5	49.9	68.9	38.1	26.6	54.7	81.9
Net direct investment	70.0	129.0	134.8	151.6	142.3	155.0	114.9	118.1
Net portfolio investment[b]	69.1	42.6	-1.1	20.4	-0.4	-45.5	-46.2	-18.7
Other net investment[c]	21.9	-65.2	-83.7	-103.1	-103.9	-82.9	-14.1	-17.6
Net official flows	15.2	36.4	45.9	7.9	-9.0	26.8	8.9	12.8
Total net flows	176.3	142.9	95.9	76.9	29.1	53.4	63.6	94.6
Economies in transition								
Net private capital flows	10.1	26.1	27.8	17.7	8.9	16.0	25.6	31.2
Net direct investment	8.1	14.9	21.2	23.8	23.4	25.9	27.9	25.8
Net portfolio investment[b]	-1.2	20.7	12.1	-0.9	-3.4	-5.7	-6.7	-4.2
Other net investment[c]	3.2	-9.4	-5.5	-5.2	-10.9	-4.1	4.4	9.6
Net official flows	6.0	6.2	11.7	-0.4	-3.8	-5.6	-1.9	-2.7
Total net flows	16.1	32.3	39.5	17.3	5.2	10.4	23.7	28.6

Source: International Monetary Fund, *World Economic Outlook Database, September 2003.*

a Preliminary.
b Including portfolio debt and equity investment.
c Including short- and long-term bank lending, it may include some official flows owing to data limitations.

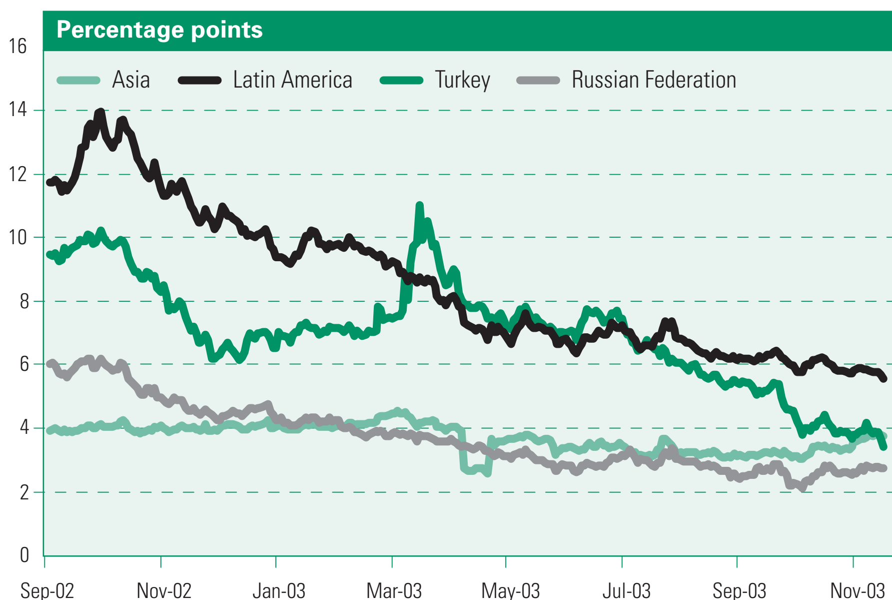
countries and Turkey, which had earlier been pushed to very high levels by financial crises and political concerns. Yield spreads on Russian bonds reached a historically low level towards the end of the year. In addition, the sovereign credit ratings of a number of developing and transition economies were upgraded, including raising Russian sovereign debt to investment grade. Positive investor sentiment was also supported by the improving international economic environment, low interest rates and the strengthening global economic recovery.

Reflecting improved investor sentiment, there was a reversal of net portfolio debt outflows from Latin America and strong net inflows to the transition economies, particularly to Hungary and the Russian Federation. These developments reflected not only the renewed investor interest in emerging market bonds but also the efforts of emerging economies to take advantage of low interest rates. Access to financing for governments with lower credit ratings improved, and large corporations also took advantage of favourable interest rates. Most issues were denominated in international currencies, but the high-yielding local currency bonds of a number of emerging economies (including Argentina, Brazil, Hungary, South Africa and Turkey) also attracted increased foreign funds because of prospects that local interest rates would fall and exchange rates would appreciate.

Foreign investor interest in the equity shares of emerging market companies also increased in 2003. There was a rally in stock prices in these markets, especially in the second half of the year, including large price increases in a number of Latin American countries, such as Argentina, Brazil and Colombia. Nevertheless, the net outflow of equity investment from Latin America continued in 2003 but was less than in 2002. The largest net inflow of equity investment was in Asia. Equity issuance was weak in the first part of the year but increased subsequently, with most of the activity being in Asia.

Commercial bank lending to developing and transition economies increased modestly in the first half of 2003 and then strengthened later in the year. Most of the increase was to Asian countries. There were substantial

Figure II.6.
YIELD SPREADS ON EMERGING MARKET BONDS,
1 SEPTEMBER 2002-1 DECEMBER 2003



Source: J.P. Morgan Chase Co., New York.

loan commitments to Chile and Mexico, but there was little lending to Argentina or Brazil. Net outflows to foreign commercial banks were mostly from Latin America but, with the resumption of interbank lending and trade financing by foreign banks in Brazil, they were lower than in 2002.

FDI in developing countries in 2003 did not rebound from the decline of the previous year, as the adverse effects of slow global economic growth, uncertain economic prospects in some developing countries and a slow-down in privatizations persisted (see below). FDI flows to Latin America continued to decrease in 2003, but those to Africa rose. A small increase in FDI in Eastern and Southern Asia was largely attributable to record flows to China. FDI in transition economies remained strong in 2003.

Official flows

Official financial flows to developing countries in 2003 reflected a mix of reduced anti-crisis multilateral lending, especially by the IMF, and increased aid flows. Net IMF flows are beginning to decline as crisis concerns in developing countries begin to recede. In addition, it will be important to ensure that the recent increase in aid does not falter.

The IMF was a net provider of $11.2 billion to the developing countries in the first nine months of 2003, compared to $13 billion during the same period in 2002. Major disbursements during 2003 included $17.5 billion to Brazil, part of the $31.4 billion Stand-By facility approved in September 2002 in support of the country's economic and financial recovery programme. Argentina received about $5.5 billion from the IMF in several disbursements aimed to restore sustained growth, reduce poverty and improve equity. Other countries receiving sizeable disbursements from the Fund in 2003 were Indonesia ($1.4 billion) and Turkey ($1.2 billion). Partly offsetting these disbursements were repayments of IMF facilities approved in previous years by Brazil, Indonesia, Pakistan, the Philippines and Turkey, among other countries. The net flow of IMF resources in 2003 reflected, to a degree, commitments in 2002, and flows in 2004 will similarly reflect the fall in commitments in 2003. Total approved IMF commitments to the developing countries for the first nine months of the year reached $17.2 billion, compared to $50.8 billion for the whole of 2002.

Fund commitments to the economies in transition totalled $0.2 billion in 2003, compared to $1.4 billion in 2002. In 2003, the Russian Federation, which made large drawings from the Fund in past years, did not borrow from the IMF, but continued to repay past loans.

While the sense of economic crisis has eased in many countries in 2003, the pace of recovery has been disappointing, leading certain countries under IMF programmes and financial packages to request one-year extensions on repayment of their loans.[14] In this regard, Brazil's agreement with the IMF in November 2003 involved not only an additional $6 billion facility, but also a one-year extension of payments totalling $8 billion. Furthermore, Brazil has requested that repayments of $5.5 billion falling due in 2005 and 2006 be delayed by one year.

Another instance is Argentina, which has been struggling under the weight of heavy debt-servicing obligations, including large private international credits that are in default. In addition to being granted permission to delay for one year payment to the IMF of $3.8 billion that fell due in August 2003, Argentina was granted waivers for non-observance of certain performance criteria and applicability of fiscal targets for end-May and end-June 2003. Argentina requested the IMF not to consider its inability to adhere to previously-agreed economic and fiscal targets as prejudicial to the approval and release of IMF loans. A new set of targets was agreed in September 2003.

Net transfer of resources

Normally, for countries at early and middle stages of development, there should be a net inward transfer of financial resources[15] that supplements gross domestic saving to help finance investment. A net outward transfer of resources may be expected in individual years, for example, in a boom year for commodity exports, or when a country enters a balance-of-payments crisis and must suddenly curtail its imports. However, over the medium term, there should be net financial transfers to developing and transition economies, raising levels of investment above what can be financed from domestic saving and permitting more imports than exports of goods and services. However, in every year since 1997, the developing countries as a whole have made, rather than received, net financial transfers. Preliminary and incomplete information suggests that the total net financial transfer in 2003 was of similar magnitude to that in 2002, when it reached a peak level of about $192 billion.[16] There was also a net outward financial transfer from economies in transition in 2003.

Among the financial components of the net transfer, there was an increase in capital flows to some countries and an increase in foreign exchange reserves by some, particularly those countries with large trade surpluses but also by some countries receiving increased capital inflows. The accumulation of reserves is held mainly in low-risk, and thus low-yield, investments in developed countries and helps to finance, in particular, the external current-account and fiscal deficits of the United States. The high levels of reserves now held by some Asian developing countries have raised questions about the need for any further accumulation of reserves by these countries, given the opportunity cost in terms of foregone imports and overall expenditure and the low utility of additional reserves in further reducing countries' vulnerability to financial crises.[17]

At the regional level, there were large net outward transfers of financial resources from Latin America in 2002 as countries in financial crisis compressed consumption and investment in response to the withdrawal of capital flows by international investors and the region's trade balance went into surplus. In 2003, there was an increase in exports and a deceleration in the decline in imports, but not enough to reverse the outward net transfer. The large net outward transfers of resources from East Asia as a result of its strong export growth in recent years continued in 2003. While this supported strong economic growth and high rates of domestic saving and investment, concerns have been raised that these economies should seek more balance in growth between tradable and non-tradable sectors, including physical and human infrastructure development. Financial resource outflows were used for net repayment of debt and purchase of foreign assets, a large part of which was in the form of official reserve accumulation.

FOREIGN DIRECT INVESTMENT: GLOBAL FLOWS BOTTOM OUT

In 2003, global FDI flows were about $650 billion, similar to 2002, suggesting a bottoming-out after the downturn from the peak of $1.4 trillion in 2000. The main factors behind this downturn in FDI were slow global economic growth, including the delayed recovery in the major developed economies, lower corporate profitability, falling stock market valuations and the decline in privatization in some countries. The continuing low number and value of cross-border mergers and acquisitions (M&As)[18]—the key driving force behind global FDI flows since the late 1980s—contributed heavily to the stagnation in FDI.

FDI flows are expected to rebound in 2004. The strengthening global economy, improved corporate profitability, a recovery in M&A transactions and growing investor confidence will all provide a stimulus for FDI flows.[19] Flows to individual countries, regions and sectors will depend on economic growth, corporate profitability and corporate strategies, the scope for, and speed of, privatization and security and safety considerations.

Inflows by region

Global FDI inflows declined by one fifth in 2002, compared with 2001, but the downturn bottomed out in 2003 at $653 billion—about the same level as in 2002 (see table II.3). FDI inflows declined in 108 out of 195 economies in 2002. The regional unevenness of flows in 2002 continued into 2003.

Flows to *developed countries* increased from $460 billion in 2002 to $467 billion in 2003—about 40 per cent of their peak level of $1.1 trillion in 2000. Five countries (in particular the United States, Ireland and Norway) received significantly increased inflows but most other countries

Table II.3.
INFLOWS OF FOREIGN DIRECT INVESTMENT, BY COUNTRY, 2001-2003

Billions of dollars

Host region/economy	2001	2002	2003[a]
World	823.8	651.2	659.6
Developed countries	589.4	460.3	473.5
European Union	389.4	374.4	341.8
France	55.2	51.5	36.4
Germany	33.9	38.0	36.3
Ireland	15.7	19.0	41.7
Luxembourg	..	125.7	103.9
Netherlands	51.2	29.2	30.5
United Kingdom	62.0	24.9	23.9
Australia	4.0	14.0	10.0
Canada	28.8	20.6	11.1
Japan	6.2	9.3	7.5
Norway	2.1	0.9	3.1
Switzerland	8.9	9.3	0.4
United States	144.0	30.0	93.0
Economies in transition	25.0	28.7	30.3
Czech Republic	5.6	9.3	5.6
Poland	5.7	4.1	4.1
Russian Federation	2.5	2.4	5.2
Developing countries	209.4	162.1	155.7
Africa	18.8	11.0	14.4
Ghana	0.1	0.1	0.9
Morocco	2.8	0.4	1.2
Mozambique	0.3	0.4	1.0
South Africa	6.8	0.8	0.2
Latin America and the Caribbean	83.7	56.0	42.3
Argentina	3.2	1.0	-0.3
Brazil	22.5	16.6	9.1
Chile	4.5	1.6	3.1
Mexico	25.3	13.6	10.4
Venezuela	3.4	1.3	3.3
Asia and the Pacific	106.9	95.1	99.0
China	46.8	52.7	57.0
Hong Kong SAR[b]	23.8	13.7	14.3
India	3.4	3.4	3.4
Thailand	3.8	1.1	1.6
Viet Nam	1.3	1.2	1.3

Source: UNCTAD, FDI/TNC database.

Note: Inflows are estimated on the basis of 109 economies for which data are available for part of 2003. Data for 2003 for most economies are estimated by annualizing either quarterly or monthly data. The proportion of inflows to these economies in total inflows to their respective region or sub region in 2002 are used to extrapolate the 2003 data for each region or sub region.

a UNCTAD estimates.

b Special Administrative Region of China.

experienced decreases. Weak economic conditions contributed to the decline, together with a continuing slowdown in overall corporate investment. Declining stock prices and the slowdown in the consolidation of corporate activities in some industries also continued to affect FDI flows to developed countries. Cross-border M&A activity remained weak, with only a few large deals.

Nearly all subregions of the developed countries experienced a decline in FDI inflows in 2003, although flows to the United States increased almost threefold, as the economic recovery accelerated and market conditions improved. The largest decline occurred in the EU. France and Germany were particularly affected, due partly to weak economic conditions and partly to uncertainty surrounding their economic reforms. Among other Western European countries, Iceland and Switzerland received much less FDI than in 2002. Inflows to Canada fell by almost half, and flows to Japan also declined, despite efforts by the Government to attract more FDI. Flows to Australia were less than in 2002.

With the global economic recovery gaining strength, the outlook for FDI flows to developed countries in 2004 is promising. With all subregions expected to see stronger economic growth, corporate investment is expected to be positively affected. Strategic repositioning by several TNCs may also result in industry consolidation and increasing M&As. The appreciation of the euro might favour further investment in the United States by EU companies.

After a record level of slightly below $29 billion in 2002, FDI flows to the *economies in transition* increased to over $30 billion in 2003. FDI in Central and Eastern Europe increased in 2003 for the third consecutive year. Inflows to the eight Central and Eastern European countries joining the EU in 2004 declined, but they were more than offset by increases in other countries.

FDI receipts of the forthcoming new members of the EU declined from $22 billion in 2002 to $15 billion in 2003, and their share of total inflows into Central and Eastern Europe also declined. This may confirm expectations concerning a post-EU-enlargement shift in the regional pattern of FDI inflows from relatively more advanced countries towards less developed ones. In the former group, the fall in FDI inflows was particularly pronounced in such countries as the Czech Republic, Slovakia and Slovenia, which had completed major privatization programmes involving foreign capital in 2002. With no new large privatizations in sight, inflows into these three countries declined from $15 billion in 2002 to $8 billion in 2003, despite the strong performance of greenfield projects. FDI inflows to Hungary also declined to their lowest level since 1991, mainly due to negative intra-company loans. However, other accession countries fared better: inflows to Poland remained unchanged at $4 billion in 2003, while flows to Estonia and Lithuania increased significantly. The longer-term outlook for these countries is more promising because of the incentive provided by EU membership.

In contrast to the EU accession group, FDI flows to South-eastern Europe (including Bulgaria and Romania, which are expected to join the EU in 2007) and to the CIS increased in 2003. In South-eastern Europe, Croatia and Serbia and Montenegro experienced the largest increases; in the CIS, Ukraine and, especially, the Russian Federation experienced major gains.

FDI flows to the CIS continued to surge in 2003, driven by oil investment, especially in Azerbaijan, and large flows into the Russian Federation. FDI in the Russian Federation jumped from $3 billion in 2002 to $5 billion in 2003, despite the potential negative impact of the legal problems that Yukos, a major Russian oil firm, experienced in the second half of the year. The Yukos case is not likely to deter FDI inflows in either natural resources or other activities, partially because Yukos has almost no foreign shareholders. In addition, foreign investors, especially in the oil and gas industry, interpreted the legal difficulties of Yukos as an isolated and purely domestic case, not applicable to other companies and especially not to foreign firms. Nevertheless, it may raise the cost of efforts to attract new large projects to the country in the medium and long terms.[20] Investors may require wide-ranging and stronger guarantees, access to international arbitration and incentives as means to reduce the increased risks that they may perceive in the aftermath of the Yukos case.

FDI outflows from the economies in transition increased from $4 billion in 2002 to $5 billion in 2003. With an outflow of $3 billion in both 2002 and 2003, the Russian Federation maintained its dominant position as an outward investor. Outflows from Hungary, traditionally the second largest source of FDI in the Central Eastern European region, increased, from around $300 million in 2002 to $700 million in 2003, making the country a net exporter of FDI for the first time.

Among *developing countries,* Africa registered a 30 per cent increase in FDI inflows in 2003. FDI flows to Asia and the Pacific increased only marginally, but the long-term prospects for flows to that region are promising. Flows to Latin America and the Caribbean continued to decline in 2003, but they are likely to rise in 2004.

Africa's inflows of FDI increased to $14 billion in 2003 from $11 billion in 2002. This rebound was due to a number of large investment projects in natural resources (particularly in the oil sector) as well as to the improved policy environment, including the implementation of such multinational initiatives as the New Partnership for Africa's Development (NEPAD) which served as catalysts in this respect, particularly in small economies. The oil sector accounted for the bulk of the increase in FDI flows to African countries with oil reserves (for example, Algeria, Angola, Chad and Nigeria). There were also increases in flows to the mining sector, notably in Ghana (the $1.4 billion acquisition of Ashanti gold fields by Anglogold of South Africa) and in Mozambique (the $1 billion expansion of the aluminium plant of BHP Billiton). The increase in FDI flows to Morocco was mainly accounted for by the purchase of Regie des Tabacs Marocains for 1.3 billion euros by Altadis, the Franco-Spanish tobacco group. Africa's prospects for FDI inflows in 2004 are promising, taking into account the anticipated investment in the oil sector. Privatization inflows are expected to continue to be weak, with the probable exception of some large sales, particularly in the electricity and telecommunications industries, which will stimulate increased FDI inflows to some individual countries. African TNCs, notably those in South Africa, are expected to continue their expansion worldwide. SABMiller, the South African brewing company, is

expected to become the second largest brewery in the world as a result of its investments in the Italian and Chinese markets in 2003.

FDI inflows to the Asia and Pacific region rose from $95 billion in 2002 to $99 billion in 2003, with increases in more countries than in 2002. The major recipients included China, the Republic of Korea and the more vibrant economies (for example, Thailand and Viet Nam). Strong domestic growth, the relocation of efficiency-seeking FDI to competitive locations in the region, improvements in global corporate spending and increasing oil investment were the key factors contributing to the growth of inflows. In addition, the region proved to be resilient to the predicted negative impact of severe acute respiratory syndrome (SARS) on FDI inflows.

China again received record FDI inflows (an estimated $57 billion), accounting for most of the increase in inflows to the region. FDI flows to the members of ASEAN were unchanged. The improved economic situation and the integration process in ASEAN countries averted a further decline in FDI in 2003 and should help the subregion attract higher flows in 2004. FDI flows to Southern Asia were unchanged in 2003, with most going to India. Flows to the Pacific Islands remained modest, mainly because of their small size and remoteness, while flows to Western Asia declined again due to the war in Iraq and the increasing attention of TNCs in the oil sector to investment opportunities in Africa and Central Asia.

The prospects for FDI inflows to Asia and the Pacific in 2004 are promising, with recovering global growth, sustained regional economic growth and an improvement in investor confidence and corporate profitability likely to trigger a resumption of cross-border M&As. The privatization of State assets in such countries as Indonesia will help raise FDI. Flows into the automotive, electronics and services industries are likely to benefit from the economic upswing while some Asian countries will continue to receive FDI in corporate services and back-office operations because of their comparative advantage as low-cost locations. The surge in the number of concluded regional and bilateral agreements and free trade pacts, which typically include investment issues, will further strengthen FDI flows to and within the region. The concern with terrorism remains in some countries, but its impact on FDI flows is difficult to assess, as the assessment of security risks by TNCs varies from company to company.

In 2003, Latin America and the Caribbean was again the most negatively affected developing region in terms of FDI: flows to the region fell from $56 billion in 2002 to $42 billion in 2003, a fourth consecutive year of decline. The primary reason was a further decrease in flows to the largest economies. Many smaller countries also received less FDI, but exceptions included Chile, Ecuador and Venezuela. Concern over the economic situation in some Latin American countries, their uncertain prospects, a slowdown in privatizations in the region and the weak global economy, including lower total FDI, were the key reasons for the decline in flows to the region. The relocation of efficiency-seeking FDI to lower-cost countries, such as China, contributed to reducing flows to some Latin American countries (for example, Mexico) in some industries (for example, automobiles and textiles). The consolidation and downsizing of TNCs in some countries aggravated the situation.

With the improving regional and global economic situation, the outlook for FDI flows to the region in 2004 is more promising, although much depends on the policy discipline and reforms undertaken by countries in the region (for example, Argentina and Brazil). Success in these areas should increase investor confidence and thereby lead to higher FDI inflows in the future.

Long-term sectoral changes in foreign direct investment[21]

FDI in services has increased over time in all countries and the sector now accounts for about 60 per cent of the global stock of FDI, compared to less than 50 per cent a decade ago (see table II.3). The share of manufacturing in FDI stock declined from more than 40 per cent in 1990 to 35 per cent today, and that of the primary sector from 10 per cent to 6 per cent.

The growth of FDI in services reflects the rise of the services economy in developed countries (with the services sector now accounting for two thirds of the GDP of these countries) and the opening-up to FDI in services in all groups of economies. As many services are neither tradable at arm’s length over distance nor storable, but must be produced where and when they are consumed, FDI is a key channel for supplying services to foreign markets. Moreover, host-country regulations often require local establishment for the delivery of services. In addition, manufacturing TNCs have frequently established service affiliates abroad, in particular in trading and financial services, in support of their trade and other foreign operations.[22] The expansion of FDI in services is also fuelled by ICT, which makes services, especially information-intensive ones, more tradable across borders and allows the emergence of international production networks in services. Although trading and financial services still dominate FDI in the sector as a whole, a new pattern is emerging because of increasing FDI in more dynamic sectors, including, in particular, utilities (electricity, gas and water), telecommunications and business services (for example, real estate, machinery and equipment rental, computer-related activities, research and development and advertising).

Developed countries are the dominant source of the

stock of outward FDI in all industries (see table A.9), with developing countries and the economies in transition accounting for less than 10 per cent of the total. Outward FDI is dominated by the services sector, in particular trade-supporting and "niche" FDI, such as trading and finance affiliates and business activities that support international trade and serve emigrants from the home countries.

The stock of FDI has grown in all sectors and almost all industries. Even in agriculture, hunting, forestry and fishing, traditionally not an important sector for FDI, the inward stock more than doubled between 1990 and 2001 (see table A.10). The inward stock in services, however, quintupled.

In the primary sector, FDI is determined mainly by resource endowments, not by the industrial characteristics of countries that affect FDI in manufacturing and services. In resource-intensive activities, FDI is concentrated in countries that have high-quality, low-cost resources in abundance. While developing countries are rich in natural resources and attract considerable FDI in these areas, few internationally-competitive firms in this sector originate from within these countries.

Chemicals and electronics accounted for one third of the stock of inward manufacturing FDI in 1990 and 30 per cent in 2001. As manufacturing is a mature FDI sector, none of its individual industries is as dynamic as many service industries, with the result that the shares of most manufacturing industries in total FDI stock have fallen over the years in both developed and developing countries.

FDI in the services sector was traditionally concentrated in financial and trading services. This dominance reflected an early international expansion of trading companies (for example, Japanese *sogo shoshas*[23] and West European traders) and transnational banks following their customers abroad. Although these trends continue, these industries are not as dynamic as such other services industries as power generation and distribution (a 13-fold increase in inward FDI stock between 1990 and 2001), telecommunications (including storage and transport—nearly a 15-fold increase), and business activities[24] (nine-fold). Other dynamic service subsectors include health services (including social services) and education; although the stocks of FDI in these activities are still small, they have increased twelvefold and fivefold respectively during this period. As a result, the share of the two traditionally dominant sectors in the world's stock of inward services FDI decreased from 65 per cent in 1990 to 45 per cent in 2001, while that of the new services sub-sectors rose from 17 per cent to 44 per cent.

FDI in most industries not only originates in developed countries but also takes place primarily in those countries, principally because that is where the markets are. Some notable exceptions include construction, where FDI stock in developing countries exceeds that in developed countries. In electricity, gas and water, the stock in the two country groups is not very different. In most manufacturing industries, the stock in developed countries is still several times larger than in developing countries, but the gap is shrinking: in 1990, the manufacturing stock in developing countries was one fifth of that in developed countries, but in 2001 it was half. Industries in which the gap was reduced considerably during this period include food, beverages and tobacco, wood, machinery and equipment, and especially coke and petroleum products.

Policy responses

In response to the decline in FDI inflows and with a view to improving their countries' long-term attractiveness for FDI, governments have continued to introduce unilateral measures and to conclude bilateral and regional agreements—which cover investment—in recent years. Many governments accelerated the liberalization of their FDI regimes in 2002, with 236 out of 248 regulatory changes made by 70 countries aimed at facilitating FDI (see table II.4). Asia is one of the most rapidly liberalizing host regions. An increasing number of developing countries, including those in Latin America and the Caribbean, are moving beyond opening to foreign investment to adopting more focused and selective targeting and promotion strategies. As part of a longer-

Table II.4.
CHANGES IN NATIONAL REGULATIONS RELATING TO FOREIGN DIRECT INVESTMENT, 2000-2002

Item	2000	2001	2002
Number of countries that introduced changes in their investment regimes	69	71	70
Number of regulatory changes	150	208	248
of which:			
More favourable to FDI[a]	147	194	235
Less favourable to FDI[b]	3	14	12

Source: UNCTAD, *World Investment Report 2003: FDI Policies for Development: National and International Perspectives* (United Nations publication, Sales No. E.03.II.D.8), table I.8, p. 21.

a Including liberalizing changes or changes aimed at strengthening market functioning, as well as increased incentives.

b Including changes aimed at increasing control, as well as reducing incentives.

term trend, and not solely in response to the downturn in FDI, more countries are concluding bilateral investment treaties (BITs) and double taxation treaties (DTTs). In 2002, 82 BITs were concluded by 76 countries and 68 DTTs by 64 countries. Many countries are concluding BITs with countries in their own region to promote intra regional FDI.

The number of bilateral and regional trade and investment agreements has also increased. In contrast with earlier such agreements, it has become standard for trade agreements to address investment issues, directly or indirectly. Such agreements are being concluded in all regions, with ASEAN countries taking the lead in Asia and the Pacific and NAFTA and the ongoing negotiations on the FTAA being prime examples in the Americas.

INTERNATIONAL FINANCIAL COOPERATION

At the International Conference on Financing for Development, held in Monterrey, Mexico, in March 2002, the international community committed itself to enhancing international financial cooperation as part of a comprehensive set of domestic and international policy measures. In 2003, there were noteworthy developments in several areas of international financial cooperation that pertain to commitments made in Monterrey.

Official development assistance

Data on total ODA for 2003 are not yet available but pledges made by a number of donors in the context of the International Conference on Financing for Development imply a sustained increase at least until 2006. Total pledges, if realized, will lead to an increase of about 31 per cent, or about $16 billion in annual ODA by 2006, bringing it to about 0.26 per cent of the gross national income of the member countries of the Development Assistance Committee (DAC) of the Organisation for Economic Cooperation and Development (OECD).

The pledges made at Monterrey provided an impetus to ODA in 2002, when it increased to $57 billion from $52.3 billion in 2001, or by 5 per cent in real terms. The rise in ODA included increases by Canada, the EU, Norway, Switzerland and the United States. In the case of the United States, the commitment to raise its annual core development assistance by $5 billion by 2006 (an increase of about 50 per cent) entails creating a new Millennium Challenge Account (MCA) for use by developing countries showing strong commitment towards good governance, health and education, as well as sound economic policies to promote enterprise development and entrepreneurship. During 2003, the United States Congress took steps towards authorizing an independent MCA and appropriating funds for it in fiscal year 2004 (beginning 1 October 2003).

Official development cooperation

Despite the projected increase in ODA in the near term, many governments have stressed, most recently in October during the High-level Dialogue on Financing for Development held at the fifty-eight session of the General Assembly, that a large gap remains between ODA flows and the estimated $100 billion a year needed to achieve the Millennium Development Goals (MDGs).[25] One of the steps identified by the development community to narrow the difference between current ODA flows and the amount needed is to reduce the administrative component of ODA disbursements through better harmonized aid procedures and improved donor coordination. The Rome Declaration on Harmonization, adopted in February 2003, involved a pledge to this effect.[26]

Recipient and donor countries have noted, however, that progress has been slow in improving the effectiveness of aid delivery and coordination. In addition, the limited absorptive capacity of some developing countries is seen as an impediment to the disbursement of some currently available ODA.[27] This notwithstanding, and while making ODA more effective is important, there is no substitute for substantially raising total ODA levels through increased contributions from traditional donors, as well as increasing the number of donors.

Heavily Indebted Poor Countries (HIPC) Initiative

As at November 2003, 27 countries had reached their “decision points” and had thereby begun to benefit from debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative. These 27 countries account for some 85 per cent of the total expected debt relief as measured in terms of net present value (NPV) for the 34 HIPCs for which data are available (41 countries were included in the list of potentially eligible countries for HIPC debt relief). With the provision of relief, the debt stocks of the 27 countries are expected to be reduced by about two thirds in NPV terms. Of the 27 countries, eight (Benin, Bolivia, Burkina Faso, Mali, Mauritania, Mozambique, United Republic of Tanzania and Uganda) had reached their “completion points” and exited the programme.

In the light of the fact that the HIPC programme began in 1996, the progress of eligible countries in reaching first the “decision point” and then the “completion point” has been slow. The delays in reaching the decision point have been attributed to problems that countries have in preparing Poverty Reduction Strategy Papers (PRSPs) or meeting fiscal targets. Reaching this phase of the initiative, where interim debt relief is provided, has been espe-

cially challenging for countries emerging from conflict situations or having protracted arrears, including Liberia, Somalia and the Sudan. Moreover, it has been questioned whether countries that have reached the "completion point" have achieved debt sustainability, especially where their ability to service their debts has been undermined by lower world market prices for their commodity exports and generally weak world economic conditions.

Many participants in the High-Level Dialogue on Financing for Development called for, *inter alia*, revisions in debt sustainability criteria, increased efforts to develop innovative debt relief mechanisms and more expeditious delivery of HIPC financial commitments by donors.[28] During the Dialogue, a number of creditor governments expressed their willingness to revisit the issue of "topping up", a mechanism to provide additional debt relief to a HIPC country that, at completion point, continues to suffer from an unsustainable debt situation. Participants at the Dialogue noted, however, that these proposals were only part of the solution and that, for many low income countries, maintaining debt sustainability required significantly increased financial assistance in the form of grants.

Surveillance and international standards and codes

Multilateral surveillance by IMF is a critical instrument of the international community for the prevention of financial crises, another one of the major concerns highlighted at the International Conference on Financing for Development. Reflecting changing views on the sources of instability, IMF surveillance is now focusing on structural and institutional policies, observance of various standards and codes, assessment of financial sector soundness and the improvement of debt sustainability and vulnerability assessments, in addition to the traditional macroeconomic policy areas. Increased attention is also being paid to surveillance of the policies of the major economies and to systemic issues, including exchange-rate policies, global imbalances and capital markets.

Along with expanded surveillance coverage, there have been efforts to increase the transparency and candour of the IMF's assessments of members. In June 2003, the Executive Board agreed to move, after 1 July 2004, from voluntary to presumed publication of IMF Article IV surveillance reports and programme documents, as well as reports on use of Fund resources by member countries. Also after July 2004, the publication of staff reports related to exceptionally large drawings on Fund resources would become a condition for approval of the arrangement.[29] The ongoing reforms to strengthen the framework for IMF surveillance, as well as possible additional measures to further improve its quality, effectiveness and consistency, will be considered in the context of the 2004 biennial review of surveillance.

The Basel Committee on Banking Supervision (BCBS), the source of the standards on banking supervision, met in Madrid, Spain, on 10 and 11 October 2003 to discuss the public comments on the proposed new Basel Capital Accord. After more than five years of work, the process of developing the new Accord (Basel II) has reached a critical stage of finalization. Critics argue, however, that the proposals are still too complex, procyclical, overly prescriptive and costly to implement. Another concern is that the transition to a more risk-sensitive framework may increase the cost and reduce the supply of bank lending to certain categories of borrowers, including small and medium enterprises in industrial economies and most developing countries. Also, the supervisory framework needs to be better aligned with converging accounting practices worldwide. The BCBS is committed to work to resolve the outstanding issues by mid-2004.[30] The implementation of the new Accord is scheduled to begin at the end of 2006.

Another new development in the area of international standards and codes was the issuance by the Financial Action Task Force (FATF) in June 2003 of its revised 40 recommendations to combat money laundering. The FATF has also revised the Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) assessment methodology, which is expected to be finalized by February 2004.[31]

There has also been an increased focus on corporate governance, accounting and auditing standards. In the post-Enron environment, there is broad acceptance that such standards should strengthen the functioning of markets, not just in emerging market economies but also in industrialized economies. Corporate governance concerns persist in the latter countries, with the latest indication being the trading abuses and unethical, or even illegal, management practices in some mutual funds in the United States. At its tenth meeting in September 2003, the Financial Stability Forum (FSF) reviewed progress in addressing weaknesses in market foundations and corporate governance.[32] The FSF emphasized that improvements in national governance standards should be reflected in the ongoing revision of the OECD Principles on Corporate Governance. Also, proposals to address conflicts of interest faced by financial analysts have been included in the Statement of Principles that the International Organization of Securities Commissions issued on 25 September 2003.[33]

The FSF welcomed the discussions between the International Federation of Accountants (IFAC) and the international regulatory community on audit-related standard-setting. These discussions are expected to lead to the establishment of a Public Interest Oversight Board after deliberations by the IFAC Council in November 2003. The FSF also hailed the progress made in the short-term convergence project between the International

Accounting Standards Board and the United States Financial Accounting Standards Board, while urging continued consultation on remaining issues.

In addition to these reformulations of particular standards, 2003 saw an increasing degree of implementation of internationally-recognized standards and codes, reflecting increased ownership by countries. India and Mexico are examples of emerging market countries that have made intensified efforts in this area. The continuing international focus on assessment and monitoring has also played an important role. To date, some one hundred developed, developing and transition economy countries have completed, in cooperation with IMF, reports on observance of at least one set of standards and codes.

Many developing and transition countries, however, have found some of the standards complex and their implementation challenging. These countries have continued to stress the need for flexibility without undermining the universal applicability of standards and codes and to urge gradual and differentiated implementation consistent with countries' needs and capacity. As the international standards require strong supervisory capacity and good information, which most developing and transition countries do not yet have, these countries need more international support and technical assistance to facilitate their implementation of the international standards.

Crises prevention and resolution

As well as better surveillance, precautionary commitments of financial support to use in the event of external shocks can help prevent crises. The Contingent Credit Line (CCL), introduced by IMF in 1999, was intended to achieve this objective. CCL gave pre-qualified borrowers a credit line on which they could draw with a high degree of automaticity during an emergency. However, the facility was never used, and it expired in November 2003. The key problem was that potential users were concerned that applying for the facility, let alone drawing from it, would be viewed as a sign of financial weakness by the market, thereby reducing, rather than strengthening, confidence in the economy. It is, however, vital that IMF has the capacity to respond quickly to the financial needs of member countries that have sound policies but are nevertheless challenged by the actions of the globally integrated capital markets. The IMF is therefore exploring other ways to achieve the objectives of the CCL.

Meanwhile, the financial crises of the 1990s reignited efforts to promote regional monetary cooperation to help achieve greater financial stability, a policy thrust that was also endorsed at Monterrey. Actions at the regional level are seen as important complements to the global cooperative framework. Regional groups offer opportunities for macroeconomic consultation and coordination, monitoring financial vulnerabilities and administering schemes for mutual assistance. The most noteworthy of such developments has been the growth of monetary and financial cooperation in East Asia. In May 2000, the ten member states of ASEAN, together with China, Japan and the Republic of Korea, decided to strengthen regional cooperation through an expanded network of swap facilities among their central banks. The "ASEAN+3" countries also considered strengthening the regional policy dialogue and cooperation in surveillance and monitoring, including of capital flows. Currently efforts are being made to develop early warning systems and to monitor short-term capital flows. Meanwhile, because of similar concerns, efforts are being made to define common goals for macroeconomic coordination within Latin American and Caribbean sub-regional integration processes. The development of such regional arrangements signals the interest of policy makers in developing countries in exploring a less centralized and more flexible international financial architecture.

Recent policy initiatives regarding the resolution of financial crises have been in the direction of inserting more clarity and certainty in the process for resolving unsustainable debt situations. Over the past several years, there has been a vigorous and constructive debate on ways to address this problem. The debate has been instrumental in developing a better understanding of the issues related to sovereign debt restructuring and advancing work in a number of areas to improve restructuring arrangements. In particular, a growing awareness of the need for a better process has overcome financial markets' resistance to the design and use of collective action clauses (CACs). CACs aim to prevent a small minority of bondholders from impeding restructuring of individual bond issues and specify the modalities of the restructuring process itself. Both Governments in the working group of the Group of 10 and private creditor associations have been drafting sets of model clauses. In 2003, these efforts resulted in an increase in the use of CACs in international sovereign bonds governed by New York law, which, unlike sovereign bonds governed by the laws of the United Kingdom and Japan, typically did not contain these clauses. Belize, Brazil, Guatemala, the Republic of Korea, Mexico, and South Africa were among the developing countries that issued bonds in 2003 governed by New York law and containing CACs. Many of these issues were oversubscribed and showed no evidence of an interest rate premium attributable to the CACs. CACs have also been included in the new bonds resulting from Uruguay's debt exchange, an initiative that rescheduled $5.4 billion, or half of Uruguay's total debt. Among developed countries, Italy recently launched bonds with CACs under New York law. Overall, CACs can be said to be winning broad market acceptance.

Some efforts are also under way to improve the process

of sovereign debt restructuring in the event of a debt crisis, with particular emphasis on how to strengthen the exchange of information between a government debtor and its creditors and to ensure comparability in the treatment of different creditors and in the overall adequacy of relief when the restructuring involves a large and diverse group of creditors. Some discussions have taken place between certain emerging market countries and private sector representatives on a voluntary Code of Conduct, which would broadly stipulate the roles that key parties would be expected to play in resolving a debt crisis. At its meeting in October 2003, the finance ministers and central bank governors of the Group of 20 (G-20) encouraged issuers and market participants to engage in further discussions of the issue, with G-20 members participating on a voluntary basis. They also asked G-20 deputies to review, at their next meeting in March 2004, the progress made.[34]

While the proposed Code of Conduct was an initiative of private creditors, the Paris Club of government creditors has also sought to reform its practices. In October 2003, the representatives of the creditor countries agreed on a new approach to deal with non-HIPC countries in debt difficulties, as had been requested by the finance ministers of the Group of 8 at their meeting in May 2003.[35] According to this approach, the Paris Club will break from its traditional practice of defining standard terms for particular classes of debtor governments and instead tailor its response to the specific financial situation of each country (see box II.2). Debt reduction for qualifying countries will be considered as an option, but accorded only in exceptional cases when the need is clearly demonstrated. The new approach also calls for better coordination between the Paris Club and private creditors to ensure comparability of treatment of their respective claims.

In contrast to the private sector and Paris Club initiatives, the effort by the IMF to develop a statutory approach to the comprehensive treatment of the debt of a country in crisis did not win enough support to advance further. The proposal, the Sovereign Debt Restructuring Mechanism (SDRM), aimed to enable a debtor in crisis

Box II.2. Paris Club reforms its approach to sovereign debt relief

The Paris Club, which brings together the major government creditors of developing and transition economies, agreed in October 2003 to change its approach to its treatment of the external debt of debt-crisis countries that are not covered by the international initiative for the heavily indebted poor countries (HIPCs).[a] While the Club has interpreted its policies flexibly in individual cases, the new policy outlines procedures that will facilitate flexibility in general. It also establishes a set of exceptional circumstances when it may agree to reduce the debt of countries that have previously been considered as essentially eligible only for postponement of debt servicing payments. It notably reflects the intention of the Paris Club to treat the debt of an insolvent country in a way that is more transparent and is easier to compare with the treatment by private banks and bondholders. The new approach is, however, complicated and could give the Paris Club a more central coordinating role in the overall restructuring of sovereign foreign debt, even when the Club itself is a minority creditor. Much attention will thus be paid to how the new approach is put into practice.

The new policy, called the "Evian Approach", puts into effect an agreement of the finance ministers of the Group of 8,[b] whose heads of state and government met in Evian-les-Bains, France, in June 2003. That agreement stemmed from recognition that the debt treatment granted by Paris Club creditors sometimes turned out to be inadequate. Members saw some of their agreements as having been excessively generous compared to the financing needs of the debtor country, while in other cases their inability to address sustainability considerations led to debtors requiring repeated resort to the Paris Club.

The new policy reflects willingness in the Paris Club to promote a more orderly, timely and predictable framework for crisis resolution, recognizing the widespread dissatisfaction with the way in which complex debt crises have been handled in recent years. Governments and civil society critics claimed that the overall relief left debtor countries with unsustainable debt burdens. Private creditors complained about the unfair apportionment of relief between themselves and official lenders and about the unstructured way in which multilateral institutions, the debtor government and the Paris Club interacted with them in seeking to resolve a debt crisis.

The International Monetary Fund (IMF) responded to those criticisms by leading an international effort to design a comprehensive debt restructuring process. While the Fund's central proposal, the "Sovereign Debt Restructuring Mechanism", did not win broad backing, the discussions about it highlighted shortcomings in both private and official debt restructuring. The Evian Approach aims to help address those shortcomings in the Paris Club operations, as the introduction of "collective action clauses" (CACs) has sought to do for bond restructuring.[c]

The main innovation in the Evian Approach is that the Paris Club has introduced a comprehensive mechanism for participating in an overall treatment of an unsustainable debt situation, which, by definition, is one that requires at least some of the creditors to accept a reduction in their claims on the debtor government; countries deemed to have a liquidity as opposed to a solvency crisis would receive the standard Paris Club treatment. The new mechanism differs from the HIPC initiative (which has no standard terms and no automaticity of debt relief and takes a case-by-case approach), although the two approaches have some common features.[d] The Paris Club proposes to apply a three-stage approach to according relief: first, an assessment of need is made and partial relief

and a qualified majority of its creditors to make a restructuring agreement binding on all creditors in all the covered classes of debt through a formal international process established through an amendment of the IMF Articles of Agreement. The consideration of the SDRM brought up several issues of general relevance to an orderly resolution of financial crises, including—but not limited to—comparable treatment of all creditors, full participation of all creditors in each creditor class and, most importantly, ensuring the overall adequacy of negotiated debt relief for the debtor country and its people. It is recognized that work should continue on all of these issues and on mechanisms that incorporate or build on the CAC approach, as they would be complementary.

Global financial governance

It has been increasingly acknowledged that developing and transition economies should have a greater role in decision-making in IMF and other multilateral financial institutions. In the Monterrey Consensus,[36] the Bretton Woods institutions undertook to enhance the voice of those countries in decision-making on international financial issues. Measures have been taken to enhance capacity in the Executive Directors' offices and in the capitals of these countries. Also, an Analytical Trust Fund to assist Executive Directors representing sub-Saharan African countries to undertake independent research and analysis on development issues has been proposed.[37]

However, the question of devising a new formula for assigning votes, quotas on borrowing and contributions to the Fund has not been resolved. Existing quotas for many countries may seem misaligned with global economic realities and fairness and, for a significant number of countries, present quota shares are lower or higher than they would be regardless of the alternative formula employed.[38] Progress requires being able to reach a political understanding that has thus far been elusive. Likewise, the required majority still does not exist for an increase in basic votes that would correct the erosion of

Box II.2 (continued)

of debt servicing is granted under a "flow treatment" for a period of one to three years if the country is found to be insolvent and on condition that it follows an IMF-supported adjustment programme; second, part of the "exit treatment" (debt reduction or other special arrangement) is granted during the period of a successor IMF programme; and third, the remainder of the "exit treatment" is given on successful completion of the IMF programme. The Paris Club thus would maintain the link between its relief and debtor-government policy performance, which include a satisfactory payment record with the Paris Club on obligations not waived or rescheduled during the monitored period. In addition, Paris Club creditors, expressing their willingness to tailor debt treatment to the specific situation of the debtor country, strongly insist on being able to adapt it over time, according to the evolution of the country's situation.

The Paris Club was also conscious of the need to better coordinate its relief with that of the private creditors, although the lengthy process under the new mechanism may be hard to reconcile with the one-off approach preferred by private creditors, especially bondholders. Moreover, the Paris Club would seek to include provisions to reduce the amount of its debt forgiveness in the event of an unexpected improvement in the debtor's situation over time. Such "claw backs" (as they were called in the 1980s) have not been a standard feature of private sector restructuring in recent years.

Typically in a bond restructuring, a new bond with a different payment schedule and a present value below the original face value is exchanged for the defaulted bonds (and defaulted bank loans may also be converted into such bonds). Holders of the new bonds are free to sell them on receipt, and a market in such bonds usually develops, with the result that the original creditor does not necessarily hold the new bond. In contrast, there is no market in Paris Club loans. In addition, Paris Club creditors typically have an incentive to delay budgetary consequences of having to reduce non-performing claims, whereas the immediate "mark-to-market" practices of private creditors give them an incentive to dispose of their non-performing assets.

Despite such differences, the Paris Club envisages that better communication with private creditors in any specific debt crisis, including early discussion of what might constitute "comparable treatment" of their respective claims, will facilitate reaching a settlement. Presumably, private and government creditors would also discuss the degree of overall relief required to move the debtor to a sustainable debt situation. The notion of debt sustainability is, however, a complex one. It may be expected that, while the Paris Club has reserved to itself the responsibility for deciding how much overall relief is required, in close coordination with the IMF, the view of both the private creditors and the government and people of the debtor country would also have to be taken into account. The Paris Club has not yet addressed that coordination question.

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a See "Evian Approach", on the web page of the Paris Club (www.clubdeparis.org, under "Presentation").
b See Group of 8, "Finance Ministers' Statement," Deauville, France, 17 May 2003, Annex (www.g7.utoronto.ca/finance/fm030517_communique.htm).
c See *World Economic and Social Survey, 2003* (United Nations publication, Sales No. E.03.II.C.1), pp. 60-61.
d Unlike the HIPC Initiative, debt of non-HIPC countries owed to multilateral institutions will be excluded from comprehensive debt reductions.

the voting power of the smallest members. The Development Committee of the IMF and World Bank nevertheless remains committed to working on the issue and plans to consider a "road map" for reform at its meeting in April 2004. This is one avenue to focus political, as well as technical, attention on the matter of fairness, as well as on more effective management of the global financial system.

Lastly, in a potentially important step to strengthen global economic governance, the General Assembly agreed in December 2003[39] to re-establish a set of informal discussion processes that had worked effectively in the preparation of the International Conference on Financing for Development in bringing together experts from national governments, international trade and financial institutions, business and civil society organizations to develop ideas and proposals for what became the Monterrey Consensus. That is, the Assembly has requested the United Nations Secretariat to organize workshops and "multistakeholder consultations" to examine issues related to the mobilization of resources for financing development and poverty eradication. It also requested the Secretariat to convene activities involving various stakeholders to promote best practices and exchange information on implementation of the Consensus. These processes can be not only forums for vetting new ideas, but also mechanisms to build momentum on ideas that are found attractive to increasing numbers of stakeholders.

Notes

1 For a more detailed discussion of this issue, see Box I.1 and *World Economic and Social Survey 2003* (United Nations publication, Sales No. E.03.II.C.1), pp. 15-16.
2 Since 2001, the United States has imposed 29 per cent countervailing and antidumping duties on Canadian softwood lumber.
3 Czech Republic, Hungary, Poland, Slovakia and Slovenia.
4 Australia is also an important supplier of minerals and metals for China.
5 Commodities provided a higher return than equities during the equity bear market that began in March 2000 (see "Commodities are a big, new theme" in *Financial Times,* 18 September 2003).
6 Introduced into the Common Agricultural Policy (CAP) of the European Union in 1988, the set-aside scheme is a system of financial compensation to farmers for leaving a proportion of their land uncultivated for a specified period of time.
7 In October 2003, Chinese importers negotiated the most important buying contract since 1995 with American exporters, involving a volume of 488,300 bales (1 bale = 230 kilograms). Additionally, West African cotton producers are benefiting from increased Chinese demand: Burkina Faso, for instance, increased its exports to China threefold in October 2003 compared to the same month a year earlier. (Radio France Internationale and Les Echos, "La Chine fait flamber tous les produits de base", 27 October 2003).
8 For a detailed analysis of the outcome of the Cancún Ministerial Conference, see UNCTAD document TD/B/50/8.
9 See Cancún Ministerial Statement (WT/MIN (03)/W/24).
10 See General Assembly resolution 58/197 of 23 December 2003.
11 The other Central American country, Costa Rica, did not join this agreement because of its concerns relating to the telecommunications, insurance, agriculture and textiles sectors.
12 See *World Economic and Social Survey 2002* (United Nations publication, Sales No. E.02.II.C.1), Box II.2, "The controversy on the imposition of steel safeguards: a threat to international trade?" pp.46-47.
13 India dropped a claim in these areas in view of the insignificant trade involved.
14 Extensions of payments are allowed under the Fund's general policies governing such payment expectations, including policies under the Supplemental Reserve Facility (SRF), if repayment would cause undue hardship, provided the borrower is taking actions to improve its balance-of-payments situation.
15 The net transfer statistic adds together receipts of foreign investment income and financial inflows from abroad minus payments of foreign investment income and financial outflows, including increases in foreign reserve holdings. The net transfer of a country is thus the financial counterpart to the balance of trade in goods and services. A trade surplus corresponds to a net outward (negative) transfer and a trade deficit to a net inward (positive) transfer. A trade surplus means the total value of domestic production exceeds domestic consumption and investment, the excess being transferred abroad instead of being used within the economy, and vice versa for a trade deficit.
16 See *World Economic and Social Survey 2003* (United Nations publication, Sales No. E.03.II.C.1), pp. 41-42.
17 See International Monetary Fund, *World Economic Outlook, September 2003* (Washington, D.C., 2003), pp. 87-92.
18 In 2003, the number and value of cross-border M&As (deals involving the acquisition of more than 10 per cent of the equity of a company) fell 7 per cent and 25 per cent, respectively, to 4,200 and $270 billion, their lowest levels since 1998.
19 This is in line with the forecast by the Institute of International Finance which has predicted a 16 per cent increase in FDI flows to the 29 emerging market economies in 2004, to $119 billion from $103 billion in 2003. All regions, except for Africa/Middle East, are expected to receive increased FDI inflows. The reasons behind the increase, according to the Institute, include accelerating growth of emerging markets, the growing comfort of investors with the political climate and policy framework in some key emerging economies and a more favourable global economic situation (Institute of International Finance, "Capital flows to emerging market economies", 21 September 2003).
20 See Boris Kagarlitsky, "Comparing Khodorkovsky", *The Moscow Times*, 13 November 2003, p. 9 (http://www.themoscowtimes.com/stories/2003/11/13/009.html).
21 This section is based on material presented in the UNCTAD press release, "New FDI pattern emerging, says UNCTAD, reshaped by services economy, new industries" (UNCTAD/PRESS/PR/2003/105, 28 October 2003).
22 For example, 30 per cent of the foreign affiliates established by Japanese manufacturing TNCs by 2001 were in the services sector.
23 Trade-related activities account for one tenth of all Japanese outward FDI.
24 Business activities include real estate. In the case of Hong Kong SAR, it also includes holding companies.
25 See "Summary by the President of the General Assembly of the High level Dialogue on Financing for Development," 6 November 2003 (A/58/555), para. 28.
26 See letter dated 18 March 2003 from the Permanent Representative of Italy to the United Nations addressed to the Secretary-General transmitting the Rome Declaration on Harmonization (A/57/763).
27 See "Summary by the President of the General Assembly…", *op. cit.,* para. 29.
28 See "Summary by the President of the General Assembly…", *op. cit.*, paras. 32 and 33.
29 See "Report of the Managing Director to the International Monetary and Financial Committee on the IMF's Policy Agenda", IMF, 16 September 2003, p. 10 (www.imf.org).
30 See "Basel II: Significant Progress on Major Issues", BIS Press Release, 11 October 2003 (www.bis.org).
31 See Financial Action Task Force (FATF) News Release, New Anti-Money Laundering Standards Released, 20 June 2003 (www.oecd.org/fatf/ #Releases).
32 See statement by Roger Ferguson, Chairman of the Financial Stability Forum, at the International Monetary and Financial Committee (IMFC) meeting, 21 September 2003, Dubai. (www.fsforum.org).
33 Available at: http://www.iosco.org/news/pdf/10SCONEWS58.pdf
34 See "Morelia Communiqué", Fifth G-20 Finance Ministers' and Central Bank Governors' Meeting, Morelia, Mexico, 26-27 October 2003 (www.g20.org).
35 See "Paris Club creditors agree on the Evian Approach", Press Release, Paris Club, 29 October 2003 (www.clubdeparis.org).
36 See Monterrey Consensus, para. 63; in *Financing for Development, Building on Monterrey 2002* (United Nations publication, Sales No. E.02.II.A.S.), p. 11.
37 See Development Committee Communiqué, Dubai, United Arab Emirates, 22 September 2003 (http://www.imf.org).
38 See "IMF Executive Board Discusses Quota Distribution Issues", Public Information Notice (PIN) No. 03/106, 29 August 2003 (http://www.imf.org).
39 See General Assembly resolution 53/230 of 23 December 2003.

CHAPTER III: REGIONAL DEVELOPMENTS AND OUTLOOK

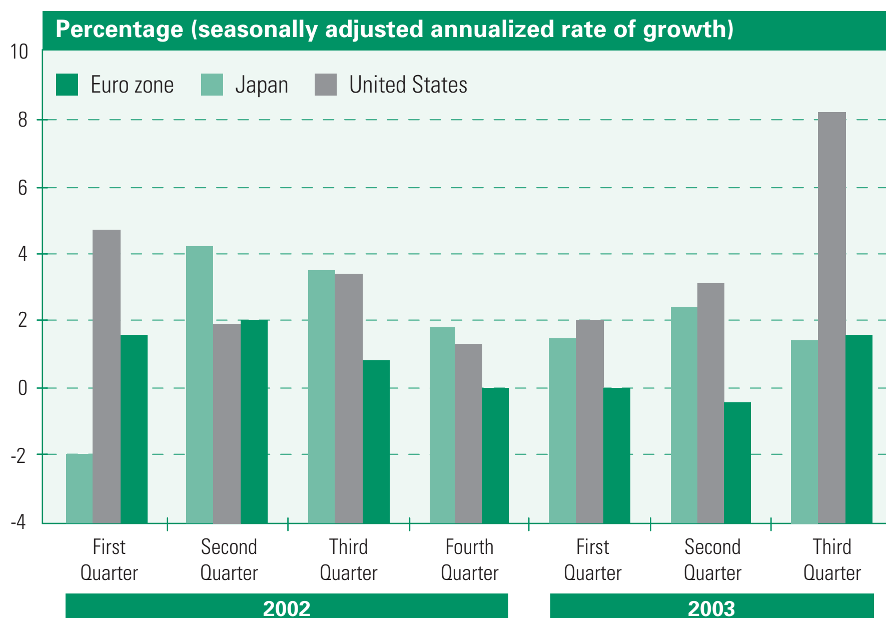
DEVELOPED ECONOMIES

There is increasing evidence that the recovery in the developed economies is both gathering momentum and broadening in scope. The United States continues to lead the upturn, with particularly robust growth in the third quarter of 2003 and with evidence that the recovery is on a more durable footing, as investment expenditure has finally begun to rebound. Japan appears to have emerged from its long period of stagnation, but growth remains dominated by exports, with far less vigour in domestic demand, and deflation has not ended. Western Europe has returned to growth, but investment continues to decline and the recovery is far from secure (see figure III.1).

Policy stimuli across the developed economies have varied, largely reflecting the constraints in their respective policy frameworks. In the United States, fiscal stimulus is a key factor explaining the acceleration in growth in 2003, but there are concerns over the sustainability of the resulting budget deficits. In Western Europe, fiscal policy is less supportive, coming mostly in the form of automatic stabilizers, as there has been pressure on government budgets in those countries with fiscal deficits close to or exceeding the limits specified by the Stability and Growth Pact (SGP). In Japan, the room for fiscal stimulus has been exhausted and consolidation is under way. In all cases, a rapid fiscal consolidation poses a risk of stalling the recovery. A cautious, but credible, medium-term fiscal adjustment would better balance the risks of losing the momentum of the recovery against the dangers of unsustainable fiscal deficits.

There are similar policy challenges in the monetary sphere. Currently, short-term interest rates are virtually zero in Japan, 1 per cent in the United States, and 2 per cent in Western Europe. However, because of inflation differentials, real short-term interest rates are negative—

Figure III.1.
SELECTED DEVELOPED COUNTRIES ECONOMIES: RATES OF REAL GDP GROWTH, FIRST QUARTER 2002-THIRD QUARTER 2003



Source: Table A.2.

and therefore the most expansionary—in the United States, zero in Western Europe and slightly positive in Japan. This reflects, on the one hand, the active strategy of the United States Federal Reserve (Fed) and, on the other, constraints faced by policy makers in Western Europe and Japan. In Japan, short-term rates hit the floor of zero early in the slowdown, so that non-traditional measures, in the form of direct injections of liquidity, had to be utilized but had limited effect. In Western Europe, inflation has not reflected the slowdown but has been aggravated by various supply shocks, notably the increase in oil prices, and has remained above the European Central Bank's (ECB) inflation target. This has made further monetary stimulus difficult to justify in terms of the policy mandate of the ECB. As economic activity continues to strengthen, policy will need to be tightened to a neutral stance. The timing and speed of this normalization will be critical. In this case also, care should be taken to ensure the durability of the recovery, which argues for caution in policy tightening.

A key challenge for the three major developed economies is the realignment of exchange rates that has been taking place. The United States dollar has declined significantly in trade-weighted terms, but mostly against the euro, starting 2003 at 1.05 to the euro but falling to 1.25 by the end of the year. Against the yen, the movement had been more muted, partially due to currency market interventions by the Bank of Japan (BoJ), but the fourth quarter of 2003 saw noticeable downward movement in the value of the dollar against the yen. The primary force behind the depreciation of the dollar is the United States current-account deficit, but the more active monetary policy of the United States has also led to interest rate differentials that are in favour of Europe. The countervailing pressures are that the outlook for growth in the United States is stronger than that for Europe and relative growth rates between the two areas have been a key reason for euro/dollar movements over the past few years.

The decline of the dollar can be expected to have a different impact on economic activity both within and among the developed economies. In the United States, the mix of activity should move in favour of exports and against domestic demand, whilst the reverse should be true in Western Europe and Japan. Among countries, depreciation of the dollar should boost growth in the United States and dampen it in Western Europe and Japan. Given that recovery is not assured in Western Europe and that growth in Japan still depends heavily on exports, this poses dangers. However, the within-country adjustments will result in more balanced activity, and the dangers, so long as the adjustment remains orderly, can be mitigated through appropriate policy adjustment.

North America: a solidifying recovery

Economic recovery in North America is gaining momentum, and the United States is taking the lead. With gross domestic product (GDP) growth above 8 per cent in the third quarter, the highest in almost two decades, the revival in the United States seems well balanced amongst all sectors, indicating that the long-awaited recovery is on a solid track (see table A.2). Although a large part of the current growth continues to be bolstered by policy stimuli, which remain crucial for sustaining the recovery in the near future, a shift is under way, suggesting a more sustained pattern of growth. Canada was hindered by a number of factors in much of 2003, such as the substantial appreciation of the Canadian dollar, the shocks from SARS, an electricity blackout and trade restrictions on some of its exports, but it has also shown signs of accelerating growth.

Household spending, which was resilient during the downturn and has led the recovery, remains strong in the United States. The reduction of the income tax, low interest rates, and, particularly, the substantial increase in house prices[1] have been the key factors supporting the growth in household spending. With house prices possibly peaking and mortgage rates rising, household consumption is expected to moderate in the outlook; however, an anticipated improvement in the labour market and continued recovery in equity markets will provide new support. In Canada, private consumption, supported by low interest rates, is also outpacing overall growth, but some moderation is expected in 2004, partly because of high consumer debt levels.

Meanwhile, the crucial transit from strength in household spending to growth in business spending has already begun in both economies. In the United States, there was a recovery in corporate equipment investment in the second quarter of 2003, which strengthened in the third quarter to a double-digit pace. Recovering corporate profits, higher equity prices and increasing demand for information and communication technologies (ICT) products have laid the foundation for further growth of business investment. Many businesses have not yet introduced state-of-the-art ICT technologies and are now expected to do so, causing continued innovation and diffusion of ICT to remain a driving force for economic growth.

An improvement in the labour market will be critical for stronger growth in 2004. Up to the third quarter of 2003, the recovery in the United States was characterized as "jobless", or even "job loss", growth. This lag between the recovery in output and the hiring of additional workers during an upturn may be particularly pronounced on this occasion because of low capacity utilization and strong productivity growth. Nevertheless, data in the fourth quarter of 2003 indicated that the labour market

was stabilizing, with payroll employment starting to rise. In addition, a strong rebound in the index of manufacturing activity suggests a recovery in manufacturing employment, which has been weak over the past few years. The unemployment rate in the United States is, however, not expected to decline significantly in 2004. The unemployment rate in Canada has always been about two percentage points higher than the United States, but Canada achieved a 2 per cent growth in employment for 2003, although slower employment growth is projected for 2004.

The net contribution of the external sector to GDP growth in the United States has been negative for many years and is expected to remain so in the near term. After a decline for more than two years, real exports rebounded by 9 per cent in the third quarter of 2003, led by capital goods, such as aircraft and computers. Meanwhile, real imports, which recovered earlier than exports, continued a modest upward trend. In the United States, the growth of both exports and imports is expected to accelerate in 2004. On the other hand, a major factor behind the weak overall performance of Canada in 2003 was the loss of Canadian exports to the United States (see Chapter II). As industrial production and import demand in the United States recover, Canadian exports are expected to grow in 2004.

Despite the depreciation of the dollar vis-à-vis other major currencies, the United States current-account deficit swelled further in 2003, reaching an estimated $550 billion, or 5 per cent of GDP. The weak dollar and a recovery in the rest of the world will eventually curb the external deficit, but not in the next few years when the deficit is forecast to grow.[2]

Inflation in both economies edged up slightly during 2003, mainly because of a rise in the prices of commodities, particularly food and energy, but the annual increases in consumer prices in both countries were still below 3 per cent. Inflation rates are forecast to retreat to below 2 per cent.

Monetary policy in the United States has been markedly expansionary. The Fed is expected to keep its policy interest rate at the current level, the lowest in four decades, until mid 2004, tightening gradually thereafter. On the other hand, monetary conditions in Canada have been tightening as a result of policy moves by the Central Bank of Canada (CBC) and the appreciation of the Canadian dollar. In 2004, the CBC is expected to keep policy interest rates at the current level of 2.75 per cent, 175 basis points higher than the corresponding rates in the United States.

Fiscal policy in the United States has been stimulatory, with income tax cuts and growth of federal spending of about 8 per cent in real terms in 2003 offsetting the restrictive effects of the budgets of many states and local governments. Fiscal policy is expected to be less expansionary in 2004. The budget deficit of the United States is estimated to have been more than $350 billion in 2003 and is forecast to increase to above $450 billion in 2004. In contrast, the fiscal stance in Canada has been slightly restrictive and is expected to remain so in 2004, with the budget remaining in small surplus.

The major caveats and downside risks for the outlook relate mostly to the large and growing twin deficits of the United States and their implications for the exchange rate of the dollar and for the financial markets. The possibility of a bubble in housing prices and the high debt level of consumers are also worrisome. On the geopolitical front, the situation in Iraq remains far from stabilized. In the medium run, the crowding-out effects of the large fiscal deficit and increased military spending may dampen potential growth of the United States.

Developed Asia and Pacific: is this recovery sustainable for Japan?

The economy of *Japan* improved measurably over the course of 2003, due largely to the more auspicious international economic environment in the second half of the year, some tangible progress in domestic structural reform and certain policy effects. GDP growth in 2003 is estimated at 2.5 per cent, one of the best performances for several years, and is projected to be above 2 per cent in 2004 (see table A.1). After a decade of stagnation, including three failed recoveries, this may mark a turning point for the economy to finally move on to a sustained growth path. However, many formidable challenges remain: historically high unemployment, the large amount of non-performing loans (NPLs), the large government deficit and the high level of public debt, the continued need for corporate restructuring and, to some extent as a result of the above, lingering deflationary pressures.

The recovery is being led by private sector demand, particularly business investment, which recovered from the decline of the previous two years. Since its stabilization at the beginning of 2003, business sentiment has continued to improve, accompanied by a rise in projections of capital spending. According to surveys, the business sentiment of large manufacturing firms has turned positive for the first time since 2000 and that of other firms has also improved. A key supporting factor for investment has been a recovery in corporate profits, coinciding with a recovery in equity prices, but increased exports, the replenishment of inventories and the reduction of taxes in 2003 have all provided stimulus. Business investment is estimated to have grown by about 5 per cent in 2003 and is forecast to strengthen further in 2004, although persistent excess capacities may continue to be a dragging factor. In contrast, housing investment remains sluggish, and

public investment is expected to decline further.

While household consumption remains weak, consumer confidence has begun to improve. The deteriorating employment and income situation of the past few years has been a major factor behind depressed consumer sentiment and weak private consumption. The labour market has shown some signs of improvement: the unemployment rate improved in the third quarter of 2003 (see table A.2), although it remains historically high; the ratio of job offers to applicants and the number of new job offers have gradually moved upward; and finally, the protracted decline in wages and compensation seems to be stabilizing. However, the pace of improvement is still modest and household spending will therefore likely remain muted, continuing to be the major hurdle for the sustainability of the overall recovery.

Real net exports contributed positively to the recovery in 2003. After stagnating in the first half of the year, real exports moved higher in the second half, boosted by sales of capital goods and ICT-related products to East Asia. Real exports are expected to remain strong in 2004 as global demand improves. However, the appreciation of the yen, particularly if continued, may be a dampening factor. Imports are expected to increase with the rise in domestic production and investment. In 2003, the divergence in the performance of imports and exports increased Japan's nominal trade surplus, one of the global counterparts of the United States trade deficit. This surplus is expected to increase further in 2004.

Deflation in Japan continues, although it decelerated in 2003. Equity prices dropped to their lowest levels in two decades early in the year, but subsequently rebounded steadily, while real estate prices, both commercial and residential, continue on a decade-long slide. Mild deflation is expected in 2004.

Monetary policy was accommodative during 2003 as the BoJ used various measures to inject more liquidity into the economy: it expanded bank reserves both to stabilize financial markets during the war in Iraq and to smooth the end-of-fiscal-year adjustment; it increased purchases of stocks from banks; and it bought securities issued by small and medium-sized firms. More quantitative monetary easing in the same vein is expected in 2004. BoJ also purchased United States dollars in the foreign exchange market in an effort to prevent the yen from appreciating, but the currency nevertheless appreciated by more than 10 per cent in 2003. The overnight call rate continues to be virtually zero, but there remains a large gap between the growth of the monetary base and of the broad measure of the money supply, reflecting weaknesses in the commercial banking system and compromising the efficacy of monetary easing for boosting real economic activity. Trammelled by large NPLs and other problems, lending from commercial banks continues to decrease, despite the low interest rates and the high growth in the monetary base. There has been some progress in the disposal of NPLs, but revitalization of the banking system remains a challenge.

The fiscal position in Japan continues to deteriorate. Fiscal policy has been restrictive, although there was an increase in the government budget for fiscal year 2003, mainly reflecting higher debt service and higher social spending. Official budget projections suggest that a revenue gap will have to be met by new bond issuances in fiscal year 2004 or by an increase in taxes.

Australia and *New Zealand*, which fared well despite the global slowdown, experienced a moderation in growth during 2003, but an acceleration is expected in 2004. The domestic sector in both economies has remained robust, in particular the housing sector, which has been the key source of strength for the past few years. The possibility of a speculative element in housing prices is a policy concern, because of the risks for economic stability, although the New Zealand housing boom seems to be supported by strong inward migration.

Australia's worst drought in 100 years is estimated to have caused a loss of 1 percentage point of GDP in 2002-2003. With the end of the drought, a rebound in farm output will contribute substantially to growth in GDP in 2004. Farm income in New Zealand has also been falling, but mainly because of a weakness in exports. Both economies suffered weak exports in 2003, due to the appreciation of their currencies by more than 20 per cent vis-à-vis the United States dollar, the SARS shock and a general weakness in external demand. As a result, current account balances in both economies deteriorated further in 2003, to about 6 per cent of GDP.

Inflation remains under the targeted range in both economies, and unemployment rates have declined further, reaching historical lows. Nevertheless, Central Banks in both economies faced challenges. On the one hand, soaring house prices accompanied by rapidly growing housing credit, above-trend growth of domestic demand and strong imports call for monetary tightening, but weak external demand and large currency appreciation suggest the need for relatively low interest rates on the other. In Australia, for example, the appreciation of the currency implies a significant tightening in monetary conditions, but this form of tightening has no direct impact on housing demand, whereas it adversely affects the weakest part of the economy—exports. Furthermore, appreciation is putting downward pressure on inflation: import prices fell by over 10 per cent in 2003. With external demand for Australia's commodity exports improving and the drought having eased, the Central Bank raised its policy interest rate in November 2003. Any tightening in the two countries in 2004 is expected to be limited.

Western Europe: is a recovery finally at hand?

There are increasing signs of economic recovery in Western Europe. Initially, these were almost entirely in the form of improving confidence and expectations rather than in measures of prevailing economic conditions.[3] A similar situation occurred in the first four months of 2002 and, in that case, the heightened expectations did not materialize into stronger growth. To the contrary, growth was weak, and negative in most of the major economies, in the first half of 2003. However, first estimates for the third quarter of 2003 displayed broad evidence that an upturn was under way. Germany, Italy and the Netherlands, which had been in technical recession, and France, which had slumped in the second quarter, all returned to growth, while the United Kingdom maintained its more robust pace (see table A.2). Despite this, the outlook remains fragile. Short-term high-frequency data, such as industrial production and retail sales, have been extremely volatile and have yet to demonstrate a sustained upturn. The continuing appreciation of the euro will also put pressure on exports, while high rates of unemployment may lead to caution by consumers. On the other hand, strengthening world demand will provide a boost. GDP for the EU is forecast to grow by over 2 per cent in 2004 after less than 1 per cent in 2003 (see table A.1).

Despite the appreciation of the euro, the resurgence in global demand has overcome the weak growth in exports that was a key to the poor performance in early 2003. However, the deterioration in competitiveness as a result of the depreciation will dampen exports, making overall growth more dependent on the strengthening of domestic demand that is expected in 2004. Private consumption will be driven by increases in real disposable income, supported by a fall in inflation (induced in part by the strengthening euro), low interest rates (which reduce debt burdens) and continued improvements in wealth as equity markets strengthen. However, unemployment is expected to remain high, leading to consumer caution and higher rates of saving. Government spending continues to be a positive factor, but will be become more restrained due to budgetary pressures. Investment has been another drag on growth, but is expected to gradually turn around. Strengthening foreign demand should boost investment, and financing conditions are also expected to continue to improve—interest rates are expected to remain low, balance sheet constraints are diminishing as equity prices rise and the banking sector is improving.

Inflation, as measured by the Harmonised Index of Consumer Prices (HICP), fell below 2 per cent in mid 2003 but rose marginally towards the end of the year, and remains above the ECB definition of price stability.[4] There had been a general expectation that price increases would decelerate throughout the year, given slow growth and an appreciating currency, but this proved incorrect because of higher-than-anticipated energy and food prices and the slow feed-through of the currency appreciation. Inflation rates varied substantially across the region. In October, for example, HICP inflation for the euro area was 2 per cent, but it was close to 1 per cent for three countries and close to 3 per cent for four countries. More importantly, the inflation differential between two of the major economies in the region, France and Germany, was a full percentage point, indicating significant differences in economic conditions. Inflation is still expected to diminish gradually: the sustained appreciation of the euro should eventually provide downward pressure; the forecast decline in oil prices should also contribute; and the slowness of the recovery, with output reaching potential only in 2005, should reduce the possibility of inflationary pressure.

Unemployment has not deteriorated to the extent that it did in previous downturns. During the slowdown of the early 1990s, unemployment rates in many European countries increased by about three percentage points, and reached almost 11 per cent for the euro zone as a whole. In the present case, unemployment is expected to exceed its low in the first half of 2001 by only about 1 percentage point. This reduced deterioration can be attributed, in part, to the labour market reforms being undertaken in a number of countries. However, the rate is still high when compared to other developed countries, or even to some countries within the region. In addition to the lagging nature of movements in employment over the course of a business cycle, the output gap is not expected to close sufficiently in 2004 to generate strong labour demand: unemployment is expected to increase marginally before decreasing towards the end of the year.

Fiscal policy through the free play of automatic stabilizers, some discretionary measures, as well as spending overruns, has been supportive during the period of slow growth, but at the expense of deteriorated fiscal positions. In a number of countries, deficits have been well in excess of the limit of 3 per cent of GDP enshrined in the SGP. Germany and France both exceeded the limit in 2002 and are estimated to have had record deficits of nearly 4 per cent of GDP in 2003, with only minor improvements likely in 2004. Portugal, having exceeded the limit in 2001, is estimated to have done so again in 2003, while Italy, the Netherlands and the United Kingdom have seen slippages putting them close to the boundary. These pressures eliminated the possibility of the active use of discretionary fiscal policy for many countries in 2003. Consequently, the overall fiscal policy stance in the euro zone, as measured by the cyclically adjusted primary balance, was broadly neutral. In addition, the need to deal with countries that were in breach

of the SGP led to a decision that was interpreted by many as a suspension of the SGP. Regardless of how this issue is ultimately resolved, the immediate priority should be to support the recovery; further fiscal consolidation should be postponed until economic activity has returned to a more solid footing.

Monetary policy in the region continues to be moderately stimulative. Short-term interest rates in the euro zone have been at 2per cent since the last rate cut in June 2003 and, with inflation hovering at 2 per cent, real short-term rates are zero. However, this stimulus is offset to some extent by the appreciation of the currency, together with some upward movement in long-term interest rates. In addition, the large differences in rates of inflation across the region result in equivalently large differences in real rates of interest, and thus different degrees of monetary stimulus. This has had the paradoxical result that Germany, with one of the weakest growth performances, has one of highest real rates of interest.

With mounting evidence that recovery is under way, the likelihood of further monetary easing has receded, and the challenge has become the timing of the return to a more neutral policy stance. The United Kingdom raised its short-term policy rate by 25 basis points (bps) to 3.75 per cent in early November 2003. However, for most other countries, there are reasons for this change in policy direction to be delayed. The recovery remains tentative, the appreciation of the euro has already resulted in a more restrictive monetary environment and the expected decline in inflation will yield higher real interest rates. ECB policy is forecast to remain unchanged until the fourth quarter of 2004, at which point short term rates will be increased by 25 bps.

While the outlook for Western Europe is one of gradually improving performance, there are risks. Of primary concern is further rapid euro appreciation. This would have a strong negative impact on export performance, perhaps pushing some countries back into recession. However, within bounds, further euro appreciation could be managed through policy action, and could yield a better balance between domestic and foreign demand. Lowering interest rates in the face of the on-going appreciation would be maintaining constant monetary conditions and would boost domestic demand, particularly investment, as well as reduce the interest differential that is contributing to the euro's strength. A stronger currency would also provide impetus to consumption expenditure through improved terms of trade.

A second risk lies in the fiscal arena and concerns the SGP and sustainable public finances. The current situation demonstrates the need for an active countercyclical policy in the euro zone. At the same time, any perceived weakening of the commitment to fiscal sustainability is dangerous and may already have contributed to the increase in long-term interest rates. Further weakening could provoke a stronger market response. In addition, the looming demographic impact on pensions and other social benefits will require substantial fiscal leeway in the future.

Finally, there continues to be uncertainty over the pace and durability of structural reforms. Progress has been made, but reforms of the labour market, pensions and healthcare expenditures are far from complete, particularly in light of the looming ageing problem. The uncertainty surrounding the adoption of the reforms has contributed to the cautious behaviour of economic agents and hence to the slow growth in the region.

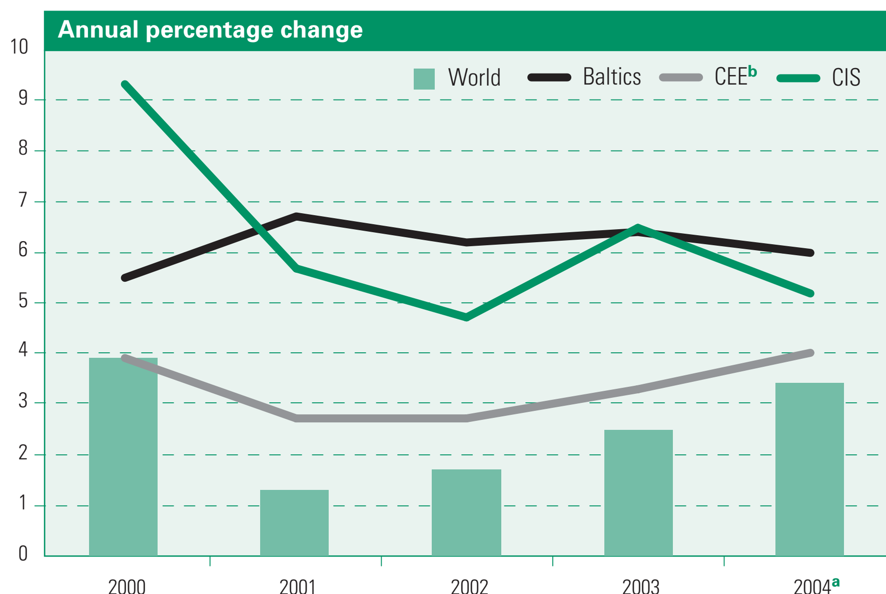
ECONOMIES IN TRANSITION

Growth in the economies in transition accelerated to about 5 per cent in 2003, outpacing the world economy (see figure III.2). The dynamism within the group was more pronounced in the Baltic countries, where it was driven by domestic demand, and in the economies of the Commonwealth of Independent States (CIS), where a surge in world oil prices and investment boosted growth in many countries (see table A.3). Growth in Central and Eastern Europe improved in 2003 and is forecast to strengthen further in 2004 with the recovery of Western European import demand and as five Central and Eastern European countries join the EU. Economic activity in the CIS is expected to slow as oil prices weaken and domestic demand decelerates but will remain robust. Maintaining sustainable growth in the CIS depends on continued reforms to reduce these economies' high dependency on natural resources and on adjusting macroeconomic policies, including adopting more flexible exchange rates.

Central and Eastern Europe: a modest recovery

Economic growth in the Central and Eastern European region accelerated to 3.3 per cent in 2003 and is expected to strengthen to 4 per cent in 2004. The improvement in 2003, however, was mostly due to a rebound in Poland where it was export-led; in almost all other economies, GDP growth moderated, in spite of strong private consumption in many countries and strong export performance in a few cases. Given their high degree of integration of trade and production with the EU, these countries had limited room for counter-cyclical policy action in response to the continuing weakness of EU markets. Investment in Central Europe stagnated and this may adversely affect medium-term prospects and the speed of convergence of the new members in the EU.

Figure III.2.
ECONOMIES IN TRANSITION: GROWTH OF REAL GDP, 2000-2004



Source: UN/DESA.

a Forecasts.
b Central and Eastern Europe.

The economies of the region are expected to rebound in 2004, in line with the expected pick-up in the EU, lower oil prices and stronger foreign direct investment (FDI) inflows into Central Europe following the EU enlargement. Increased competition within the EU is expected to contribute to GDP growth over the medium-term by raising productivity, but it may also create difficulties for some domestic producers. Transfers from the EU to the new member states should have a beneficial effect, in particular for the financing of public infrastructure, although these additional resources will increase productive capacity only if they are carefully managed. The overall short-term macroeconomic impact of EU membership on the new members, however, is uncertain, because accession and the implementation of EU rules will constrain the macroeconomic policies of acceding countries. In addition, new members will have an obligation to contribute to the EU budget and to co-finance funds received from the EU; the latter may hamper delivery of EU assistance and impose a fiscal strain.

The momentum of regional growth in 2003 shifted from Central to South-eastern Europe, which became an important destination for FDI inflows. Growth was supported by investment, driven by FDI, by increased credit to the private sector, and by private consumption, strengthened by higher real wages. However, the situation in many of the former Yugoslav states remained difficult. Stronger regional integration and a reduction in the barriers to intraregional trade are required to attract foreign capital to upgrade these economies.

One of the characteristics of 2003 was a low-inflation environment in the region, with a number of inflation targets being undershot. This was partially attributable to the stronger euro, which most of the region's currencies implicitly shadow, and the consequential nominal appreciation against the dollar, as well as low food prices in parts of Central Europe. In 2004, inflation in the region is expected to accelerate slightly due to stronger economic activity, price deregulation, energy market liberalization and changes in such taxes as value added tax (VAT) and excise tax prior to EU entry. At the same time, further disinflation is expected in the region's high-inflation countries. Since joining the European Monetary Union (EMU) is not an immediate possibility for the new EU members, economic growth will probably have priority over attaining inflation levels consistent with the euro zone entry criteria.

In response to the low-inflation environment, monetary policy was generally relaxed in 2003, in some cases in line with the ECB, in an effort to weaken currencies and revive exports. A further relaxation of monetary policy in the region is unlikely in 2004, given the expected acceleration in inflation. For the new EU members, the challenge for monetary policy will be to bring down inflation while allowing for adjustment in relative prices and to manage the exchange rate, so that it is not at an inappropriate level when they join the EU Exchange Rate Mechanism II (ERM II).

Fiscal policies have remained pro-cyclical and most of the countries in the region have high and largely structural budget deficits. The ratio of fiscal revenues to GDP has decreased in recent years, due to ineffective tax collection and the large number of exemptions, while expenditures have remained the same or even increased; off-budget

spending was reduced only recently. In order to balance budgets, a reform of public finances is needed, including changes in the pension system. Many governments have adopted plans to reduce their deficits in order to prepare for the adoption of the euro in several years. The implementation of these plans may be difficult, and even targeted budget deficits for 2004 are high in Central Europe. The fiscal situation is better in some countries of South-eastern Europe, where there are stand-by agreements with the International Monetary Fund (IMF).

There was some improvement in the employment situation in Bulgaria and Slovakia in 2003, but not in other countries of the region, due to growing labour productivity in the industrial sector, increased real wages and the low mobility of the population. The highest rates of unemployment are in Poland and most of the former Yugoslav states. Since a number of loss-making state-owned enterprises are still to be privatized in the most advanced countries of the region, little progress in reducing unemployment is expected in the short term. The largest problem is that unemployment in the region is structural and does not fall significantly with the growth of output.

Current accounts in the region remain in deficit. Strong import demand, driven by private consumption in the Czech Republic and Hungary and by growth of investment in Bulgaria and Romania, overshadowed exports in 2003. Tourism receipts failed to grow and the repatriation of profits from the region put a further strain on current accounts. Adverse weather conditions in South-eastern Europe may increase imports of grain and fuel during the winter period. Exports are expected to strengthen in 2004, but the strong growth in imports is also expected to continue because of EU membership, the implementation of public infrastructure projects, the recovery of domestic demand and continued strong growth in investment. In the past, current-account deficits were fully covered by FDI inflows, but the future may see external borrowing if entry into the EU is not followed by continued strong FDI.

The main policy challenge for the countries joining the EU in 2004 is to finalize preparations for the accession and to work out a comprehensive post-enlargement strategy, ensuring that the application of EU rules and regulations does not have an adverse impact on their economies. The largest risk to the region is prolonged stagnation and weaker business confidence in the EU, the impact of which may, however, be mitigated if some EU production is relocated to the region as a cost-cutting measure.

Commonwealth of Independent States: sustaining fast growth

Economic growth in the CIS accelerated in 2003, supported by favourable external conditions and increased investment in many countries. Regional GDP growth of over 6 per cent is projected to moderate slightly in 2004 as a result of a deceleration in domestic consumption and weakening oil prices (see table A.3). Real incomes are growing due to real wage and pension increases in many countries, albeit from a very low base. Policy reforms in many countries have boosted consumer and investor confidence and will continue to bolster economic growth in 2004. The divergence in economic performance among countries is still heavily determined by the initial conditions of the transition, the pattern of reforms and, most notably, their implementation and progress, all of which create different prospects for sustained growth in the medium term.

Economic growth in the region is driven mainly by the Russian Federation. Fostered by the surge in oil prices and robust domestic demand, Russian GDP grew by over 6 per cent in 2003, but growth is expected to moderate to about 5 per cent in 2004. The key elements behind this growth are strong increases in consumption, fixed capital formation and exports, mostly of oil, natural gas and non-ferrous metals. FDI more than doubled in the first half of 2003 and is expected to grow further with the liberalization of currency controls while the upgrading of Russian sovereign debt to investment grade has improved the prospects for other capital flows. However, these inflows are causing a real appreciation of the ruble, which is adversely affecting the competitiveness of manufacturing and, combined with increased imports of final goods, is hindering industrial diversification. Real wage increases are outpacing productivity growth, putting additional pressure on costs. These tendencies, if they continue, will make a shift to competitive non-oil sector activities difficult, widening the gap between the oil sector and the rest of the economy.

Growth in Ukraine and Belarus has benefited from spillover effects from the Russian Federation. Supported by strong increases in exports, private consumption (due to real wage increases) and gross fixed capital formation, their growth will remain robust in 2004. Rising oil prices and increasing hydrocarbon investments boosted economic activity in the Caspian region in 2003, and further investment will continue to support growth in the future.

For the energy-exporting countries, such as the Russian Federation, Azerbaijan and Kazakhstan, future growth depends heavily on their ability to transfer accumulated export revenues into a broader investment framework, in particular to strengthen investment in non-energy sectors. Large-scale projects, like the construction of the Baku-Tbilisi-Ceyhan oil pipeline, are boosting investment in some non-oil-producing countries while political tensions and uncertainties about future economic development are key factors in Georgia.

Labour market conditions in the region are difficult to

evaluate due to the highly unreliable data. In the Russian Federation, for which data are available, the unemployment rate rose marginally in 2003, while the sectoral reallocation of labour improved labour productivity, most notably in oil and coal production. The number of unemployed fell in Kazakhstan, but increased in Azerbaijan, Belarus, Moldova and Ukraine. In many CIS countries, unemployment is particularly acute in rural regions. In Armenia, for example, unemployment is around 9 per cent, with the majority of the unemployed being in rural regions.

External imbalances pose a risk for many of the energy-importing countries, although the external situation of the region as a whole improved in 2003 as a result of higher fuel prices. The region's current-account balances are likely to deteriorate because of weak exports and strong imports driven by domestic demand, demand by foreign investors and currency appreciation in many countries. However, some improvements in the invisible components of the balance of payments, such as transit payments from Russian oil and gas exporters and remittances, will have a positive effect on external balances.

Despite higher oil prices, the average inflation rate for the region continues to decline (see table A.3), but remains higher than in other regions of the world. The large differences in inflation rates across the region are due to different policies and price controls on utilities. Monetary policy is geared to price stability and its tightening has helped to curb inflation in many countries of the region. The instrument used to control liquidity is the interest rate, but priority has often been given to smoothing exchange-rate fluctuations rather than price volatility. Taking into account the limited instruments for absorbing liquidity, large capital inflows could compromise the efficiency of monetary instruments and have an inflationary outcome. On the other hand, monetary policy in many countries of the region is hindered by underdeveloped financial intermediaries and distortions in the economy, preventing changes in policy interest rates from being transferred to financial markets.

For the Russian Federation, inflation is determined by the tight control over administered prices on the one hand and, on the other, by the monetary efforts of the Central Bank (TsBR) to prevent faster nominal appreciation of the ruble. Because of the high and persistent current account surplus and reduced capital flight, the TsBR's official policy to limit real appreciation and smooth the exchange rate has increased the monetary base, expanding the supply of money and credit. Such a policy may not be sustainable or consistent with the targeted inflation rate of 10 per cent for 2004. Weakening global energy prices and prudent fiscal and monetary policies in the region are expected to reduce the average inflation rate in 2004.

On the fiscal side, most countries in the region had deficits in 2003, with the Russian Federation and Ukraine being exceptions. In the Russian Federation, the government budget is in surplus for a fourth consecutive year and is expected to remain so in 2004. In Ukraine, a small deficit is anticipated, due to a reduction in taxes and because difficulties in securing multilateral finance are likely to increase domestic borrowing. Elsewhere in the region, further changes in tax systems, progress in pension reform and prudent budgetary and debt management policies are necessary to address the fiscal deficits. More important, however, is ensuring that fiscal expenditures have a positive effect on GDP and real income growth. In high-deficit low-income countries, such as the CIS-7 (Armenia, Azerbaijan, Georgia, Kyrgyz Republic, Republic of Moldova, Tajikistan and Uzbekistan), public sector spending is characterized by poor governance, which is adversely affecting investment. Achieving an appropriate balance between macroeconomic stability and restructuring in pursuit of sustainable growth will be crucial to the region's development.

Baltic countries: fastest growing region

The economies of the Baltic States continue to grow vigorously, outpacing the Central and Eastern European countries and remaining largely unaffected by the weakness in Western Europe (see table A.3). Their relatively stable growth is based on domestic demand, supported by structural reforms. EU accession will provide an additional stimulus to these countries because of the inflows of grants, the opportunities for further integration and the consolidation of reforms. At the same time, EU membership will make the prospects of these economies more dependent on the euro area. Growth is expected to remain buoyant but will moderate to about 6 per cent in 2004.

Average inflation in the group is increasing, mainly because of increases in administered prices and higher import prices in Latvia. Because its currency is pegged to the special drawing rights (SDR), which gives significant weight to the US dollar, Latvia experienced changes in prices that were correlated with the dollar depreciation. The dollar depreciation will continue to create uncertainty, not so much for inflation but for the country's trade balance.

The region's fiscal deficits are growing because of rising expenditures to co-finance EU projects and to manage EU funds and, in the case of Lithuania, because of subsidies to agriculture. Large current-account deficits pose another risk for these economies. Inflows of FDI cover a large part of these deficits, but external loans are increasing. These large external deficits and the high and persistent unemployment are the key macroeconomic challenges for these countries. Unemployment in the region was above 8 per cent in 2003 and is likely to remain high due to ongoing enterprise restructuring and labour market rigidities.

DEVELOPING ECONOMIES

Growth improved only marginally in developing countries in 2003, as a difficult external environment in the first half of the year and policy constraints in several economies limited economic activity and led unemployment to increase in several cases. The somewhat better outcome in 2003 largely reflected developments in Latin America and in South Asia (see table A.5). Faster growth in the former was mostly due to the recovery in Argentina, as most economies in the region either decelerated, stagnated or contracted further, whereas growth in the latter reflected improved economic conditions in almost all economies. Growth also accelerated in China, which contributed to sustaining economic activity not only in East Asia but also in other regions.

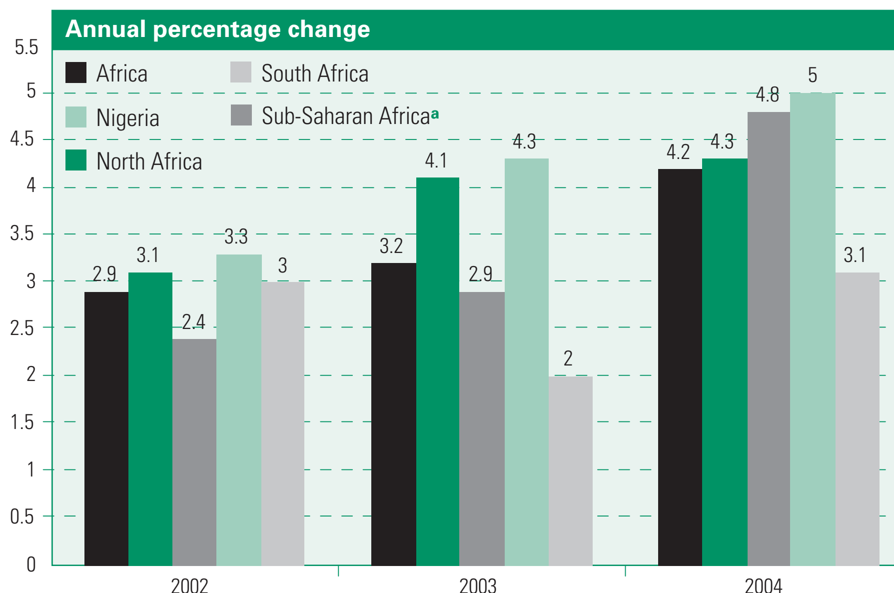
With the strengthening of the global economy in 2004, constraints on developing economies will be relaxed somewhat and growth is expected to accelerate to 5 per cent on average. Divergent regional outcomes will often be determined primarily by the performance of individual, often large, economies in each specific region. Although only a few are able to make use of countercyclical policies, the majority of developing countries will persist with their efforts to improve governance and macroeconomic management. Nevertheless, most will remain vulnerable to changes in foreign investor sentiment, external demand conditions, volatile commodity prices and changes in international interest rates.

Africa: a favourable outlook

GDP growth in Africa is expected to accelerate to 4¼ per cent in 2004, compared with an estimate of 3.2 per cent in 2003 and an average growth of 3 per cent for the past ten years. The improved outlook is based on continued progress in political and economic governance and in macroeconomic stability, as evidenced in recent years by prudent fiscal and monetary policies and stable exchange rates in many countries. Meanwhile, a number of positive factors in 2003, such as increased agricultural output in most countries (due to improved weather conditions), a rise in industrial and manufacturing output, higher consumer demand, and more investment, including substantial FDI in a few countries, are also expected to continue in 2004. Sub-Saharan African countries, nevertheless, continue to register lower growth rates than required to meet poverty reduction and other social development goals and targets (see figure III.3). It has been estimated, for example, that the number of people in Africa living in absolute poverty will increase by the year 2015—rather than decline by half, as called for in the Millennium Declaration—if present trends continue.

In North Africa, GDP growth in 2003 was driven mainly by increases in oil-export revenues in the major oil-exporting countries, which boosted private and public consumption expenditures. Growth was also supported by increased domestic investment and FDI aimed at infrastructure development and expansion of manufacturing capacity. Improved tourism also contributed to GDP

Figure III.3.
AFRICA: RATES OF GROWTH OF REAL GDP, 2002-2004



Sources: UN/DESA.

[a] Excluding South Africa and Nigeria.

growth in Egypt and Tunisia, recovering from the disruptions caused by the prospects of conflict in Iraq, whereas the Moroccan tourism sector suffered a serious setback after a terrorist bombing in Casablanca in May 2003.

Economic growth in sub-Saharan Africa is expected to accelerate from 2.9 per cent in 2003 to 4¾ per cent in 2004-2005. A few countries will achieve high growth as a result of either successful political and economic reforms (Ghana, Mauritius, Mozambique, United Republic of Tanzania and Uganda) or increased oil output, either as new producers (Chad, Equatorial Guinea and Sudan) or as a result of substantial investment to increase production capacity (Angola). Substantial South African private sector investment in infrastructure development and increased industrial capacity in minerals and metals processing for the export market will continue to underpin growth in Namibia, Mozambique and several other countries in southern Africa. Countries that have emerged from recent conflicts (for example, the Democratic Republic of the Congo and Madagascar) are also expected to register high rates of growth.

In most sub-Saharan African countries, however, growth is expected to be based primarily on increased agricultural output and on manufacturing and distributive trades linked to the agricultural sector. These countries will also continue to benefit from increased export opportunities brought about by incentives provided by the United States African Growth and Opportunity Act (AGOA).

Burundi, the Central African Republic, Côte d'Ivoire, Ethiopia, Guinea Bissau, Seychelles and Zimbabwe suffered economic contraction in 2003. Growth is anticipated to resume in all these economies in 2004, except in Seychelles and Zimbabwe, where severe economic decline is expected to continue, although the contraction will likely be less severe than in the past four years.[5]

Among the larger economies in sub-Saharan Africa, growth in 2003 was disappointing in South Africa despite strong domestic demand driven by lower inflation, increased investment spending and a moderately expansionary fiscal stance. In Nigeria, GDP growth was sustained by higher oil-export revenues and increased private consumption. The country's election in 2003 was taken as a strong mandate for the Government to introduce economic reforms, including deregulation of the petroleum-product industry to relieve shortages. These shortages had led to severe capacity underutilization in the manufacturing sector because of unreliable and inadequate electricity generation and frequent bouts of civil unrest.

At the regional level, the trend towards lower inflation in recent years was interrupted by sharp increases in inflation to double-digit rates in some economies in 2002 and 2003; these were caused primarily by higher food prices due to drought, higher oil-import prices and currency depreciation in several countries. The continuing and rapid acceleration of inflation in Zimbabwe had a negative impact on average inflation for the region in 2003 and on its projected further acceleration in 2004 (see table A.5).[6]

The outlook for African economies rests on continued improvements in political and economic governance and the maintenance of macroeconomic stability. Increased agricultural output is expected to continue in 2004 due to improved weather conditions. Normal rainfall and growing patterns have returned to many countries in eastern and southern Africa most severely affected by drought in recent years. Industrial and manufacturing output will also continue to increase in several countries as a result of lower inflation, increased consumer demand and higher investment, including FDI.

Africa's improved economic performance in 2004 also depends heavily on the anticipated recovery of external demand for African exports in industrial countries, particularly in Europe, increased market access for agricultural exports and firmer international prices for the major export commodities of the region. The fulfilment of commitments made by the international community to support Africa's social and economic development through increased official development assistance (ODA), debt relief and FDI will also be important.

Earlier fears of instability and unrest in North African countries as a result of conflicts in the Middle East were lessened by the quick invasion phase of the Iraqi conflict. Isolated and largely unpredictable geopolitical incidents, such as the May 2003 terrorist bombing in Morocco, are among the few downside risks that should be weighed against the generally optimistic outlook for North Africa. The continuing conflict in Côte d'Ivoire and its adverse contagion effects present similar downside risks to several neighbouring countries in West Africa.

East Asia and China: strong recovery interrupted

The recovery of East Asian economies, affected by a slowdown in the first half of 2003, continues and is expected to strengthen further in the near term. For 2003 as a whole, however, economic growth—estimated at 5.3 per cent—was lower than in 2002 (see table A.5). Except for China, Malaysia, Thailand and Viet Nam, growth decelerated in most economies of the region. In 2004, growth is expected to consolidate and broaden in line with improved external and domestic demand. Countries' performances are anticipated to be less uneven, and the region is expected to grow by 6¼ per cent. This outcome, however, is partly influenced by the growing weight of the Chinese economy in the region. Excluding China, East Asia is forecast to grow by 5 per cent in 2004.

Most of the newly industrialized economies (NIEs)[7] slowed in 2003. In Singapore and Taiwan Province of China, this was largely attributable to the adverse impact of the SARS epidemic; in the Republic of Korea, it was mainly due to tightened household credit early in the year, labour unrest, adverse weather conditions and heightened political uncertainty.

A rebound in both exports and domestic demand underpinned the recovery in the region. Export growth has picked up in recent months and is likely to accelerate in 2004 in line with the strengthening of global demand. The continuing recovery of ICT exports, the upturn in demand in the United States and vibrant intraregional trade bode well for the region's exports.

The Chinese economy rebounded strongly after the SARS crisis, supported by policy stimuli. While the recovery has been well balanced across all sectors, it was led by domestic spending on housing, cars and ICT products and by China's booming international trade. Nevertheless, maintaining its rapid growth will require China to address the fragilities in its financial system, and especially in its banking sector, particularly because of the low efficiency and high rates of NPLs in four major state-owned banks.[8] The Government has announced a major plan of reforms for the banking sector to be implemented in 2004, involving an injection of public funds to recapitalize these four banks, the transfer of additional NPLs to asset management companies and ownership restructuring, including an eventual public listing of these banks in either domestic or overseas stock markets.[9] The success of this plan will be crucial for China to sustain robust growth in the longer run, but it also involves some risks for the stability of the economy and for the soundness of the government fiscal position.

Domestic demand in the region is expected to continue to improve into 2004, supported by expansionary policies, rising exports, higher stock prices, softening oil prices and improving confidence. In Hong Kong Special Administrative Region (SAR) of China, the Philippines and Thailand, respectively, the surge in tourist inflows from China (if continued), large inflows of remittances and high rural income due to firmer agricultural prices and rural support programmes should also boost domestic demand. Conversely, in Indonesia and the Philippines, ongoing fiscal consolidation and, in Taiwan Province of China and Singapore, high unemployment and weak (albeit mildly improving) property markets weigh on demand expansion. In the Republic of Korea, the positive effects from fiscal stimuli appear to be partially offset by heightened political uncertainty, restrictions on the real estate market and large household debts.

The labour market situation, after worsening in the first half of 2003 improved in line with the recovery of the region's economies. In the coming months, employment will continue to increase in most economies as growth picks up, but the improvement will be gradual and the unemployment rate will remain relatively high. In the NIEs, employment in the manufacturing sector continues to be restrained by corporate retrenchment. In these economies, the youth unemployment rate is extremely high and is a cause of concern. Similarly, in China, continuing layoffs by state-owned enterprises undertaking restructuring, the large amount of surplus labour in rural areas and the annual addition of about 10 million people to the labour force means that unemployment remains a major policy challenge.

Inflation has been subdued in the region (see table A. 5), allowing for relaxed monetary policy stances. After a period of deflation, China has been experiencing a modest increase in consumer prices (see table A.6), partially attributable to increases in food prices. The latter were brought about by an upward trend in the international prices of commodities as well as by a reduction in the sowing area for some agricultural products. The rise in food prices will raise overall inflation, but a further acceleration of inflation is not foreseen.

Counter-cyclical policies continue to play an important role in the region. Due to weaker domestic demand and heightened uncertainty, monetary policy was relaxed further in several East Asian economies in the first half of 2003 and is expected to remain accommodative for the next several months to ensure the recovery. As the recovery becomes secure, inflationary pressures edge up and international interest rates rise, countries are expected to shift their policy to a less expansionary stance, possibly by mid-2004. The policy change, however, is likely to be gradual.

Fiscal policy in most economies (except for Indonesia and the Philippines) turned more expansionary in the first half of 2003 to support domestic demand. Many economies introduced relief packages to offset the adverse impact of SARS; these, together with the economic slowdown, led to a deterioration in fiscal balances. Fiscal policy will remain expansionary in most countries for the next several months, but is then expected to be tightened. This, combined with stronger growth, will result in improved fiscal positions, although countries may not achieve their original fiscal targets. Later in the year, rising exports, reduced uncertainty and improved market sentiment, combined with lower oil prices, will continue to sustain domestic demand as policy support is gradually withdrawn. In China, macroeconomic policies will likely become similarly less stimulatory, but in this case the aim will be to pre-empt overheating in certain sectors of the economy. Concerns about deflation over the past few years have recently been replaced by worries about possible bubbles, particularly in real estate, and the associated risks for future macroeconomic stability. In

all, domestic demand will continue to be buoyed by policy stimuli through early 2004.

Prospects for the region remain generally positive. First, export growth will be supported by the recovery in world demand although, in a number of economies, the appreciation of local currencies against the dollar may dampen exports. Second, global ICT markets, which are crucial to the region's export recovery, are expected to rebound in 2004. On the other hand, domestic demand and production may be constrained by high unemployment and low capacity utilization and, in a number of economies, by large household debts, tightened restrictions on the real property sector and geopolitical uncertainty. Policy support will also begin to wane in the second half of 2004. In the NIEs, corporate retrenchment owing to the relocation of production facilities to China and other low cost neighbours will also continue to weigh on investment, employment and growth.

South Asia: sustaining growth amidst fiscal imbalances

Growth in South Asia began to rebound in the first half of 2003 and continued to strengthen and broaden during the year. The spillover from the invasion of Iraq and SARS was relatively modest in the region. Growth is expected to continue at a comparable pace in 2004 (see table A.5). In addition to normal weather conditions and rising exports, the region's broad-based recovery will be underpinned by low interest rates, softer oil prices, improved non-oil primary commodity prices, continuing foreign financial assistance and investment and overall improvements in the security situation.

Growth in the region in 2003 was supported by favourable agricultural production and rising domestic and external demand. Low interest rates, rising incomes and improved consumer and investor confidence boosted domestic demand. On the supply side, a strong rebound in agricultural production—excluding Sri Lanka, which suffered heavy rain damage—was a major contribution to the broad-based recovery.

Industrial production reacted positively to these developments, while the service sector has benefited from the overall strengthening of economic activity in the region. In India, a bumper harvest in this crop cycle, due to adequate rainfall during summer, will boost rural incomes and consumption for the next several months. Moreover, the country's service sector will continue to grow, supported by booming ICT-related services. In Sri Lanka, the opening up of northern and eastern districts as a result of the ceasefire has facilitated the recovery of the service sector, especially distribution and transportation. In Nepal, the tourism sector has benefited from rising tourist inflows from India. Nepalese growth, albeit experiencing some recovery in 2003, continued to be well below the region's average, and may be adversely affected by the recent breakdown of the ceasefire between the Government and the insurgents.

Export growth has been robust and, except for Pakistan, is expected to accelerate further in 2004 in line with the stronger global demand. Import growth is likely to increase in 2004 as well (see chapter 2). Continuing large remittances from expatriate workers in several countries, a rebound in tourist inflows and, in India, booming ICT-related service exports should contribute to a current-account balance.

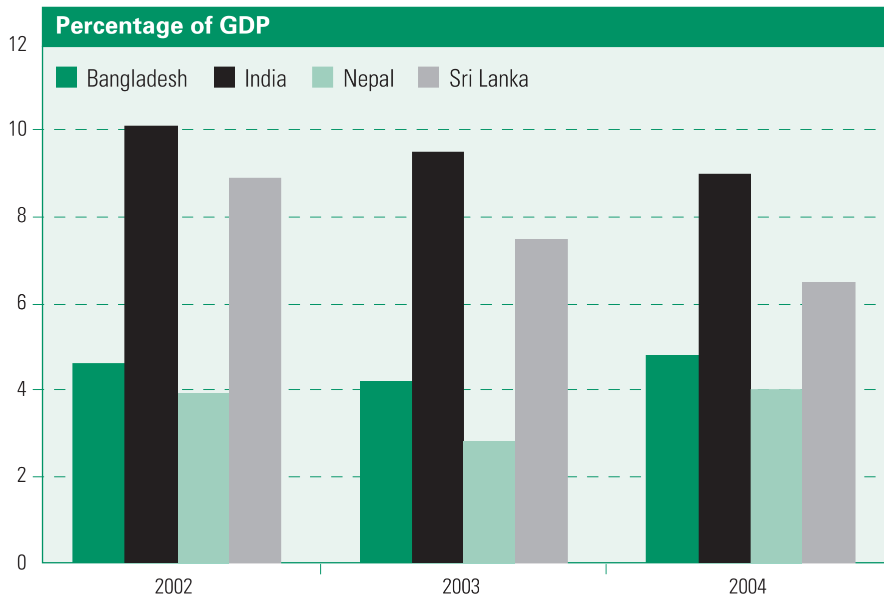
Inflation remains relatively low and stable in the region (see table A.5), which enables most countries to maintain their soft monetary policy well into 2004 to ensure the recovery as well as to maintain exchange-rate stability. Nevertheless, as inflationary pressures build up in line with stronger demand, countries are expected to gradually raise interest rates, possibly in the second half of 2004. The extent of their monetary tightening will also depend on the increase in international interest rates, government borrowing requirements and exchange-rate movements.

On the fiscal front, most countries continue to pursue fiscal consolidation but also continue to face large budget deficits (see figure III.4). Deficit reduction is likely to fall short of their respective targets due to either overspending or revenue shortfalls. In India, the budget for fiscal 2003/04 already included tax cuts in the run-up to the general election due by October 2004; overspending is also likely to occur. In Pakistan, the good fiscal performance in the previous year is unlikely to be repeated, largely due to tax incentives to support growth and an increase in civil servants' salaries and pensions. In Sri Lanka, widespread tax evasion and inefficient revenue collection will hamper efforts at deficit reduction. In these countries, successful fiscal consolidation is crucial for their longer-run financial viability and growth sustainability, although it may restrain demand expansion in the short term.

Western Asia: mixed growth prospects

GDP growth in Western Asia is projected to increase to 4 per cent in 2004 from 2.6 per cent in 2003. This forecast, however, depends critically on positive developments in Iraq.[10] Business and consumer confidence remained depressed in the region in 2003 due to the build-up to war in Iraq, the invasion and its aftermath, as well as to the persistence of the Israeli-Palestinian conflict. Reconstruction efforts in Iraq and the overall stabilization of the country should have positive spillover effects throughout the region, notably through expanded trade opportunities and the reduction of political tensions. For example, Jordan will benefit from the return of normalcy

Figure III.4.
SELECTED SOUTH ASIAN ECONOMIES: OVERALL DEFICIT OF CENTRAL GOVERNMENT, 2002-2004



Source: Asian Development Bank, *Outlook 2003 Update.*

and faster economic growth in Iraq, although it will suffer from the phasing out of its Iraqi oil subsidy. The economy of the Islamic Republic of Iran should also benefit from greater trade and travel as a result of increasing stability in the region.

Meanwhile, in many oil-exporting countries in the region, the boost to growth brought about increases in oil output (see figure III.5), and higher prices in 2003 will be reversed. In addition to lower oil prices (see chapter 2), adherence to lower Organization of Petroleum Exporting Countries (OPEC) quotas in 2004, as well as ongoing fiscal consolidation, will reduce public consumption and investment and have a negative impact on private consumption. GDP growth, therefore, is expected to decelerate in most of these countries in 2004.

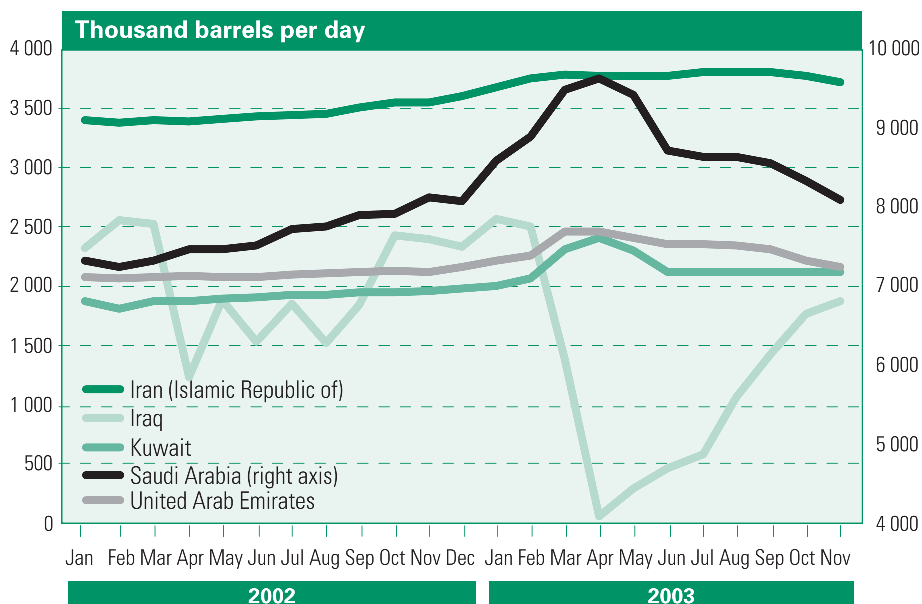
Downside risks surrounding the forecast are, however, high. In the case of Iraq, with the exception of oil facilities, much of its infrastructure has been damaged or destroyed by the war and subsequent looting and sabotage. Continuing instability and lack of law and order have impaired reconstruction efforts. At the end of 2003, conditions were not conducive to a fast return to normalcy.

Oil production has resumed (see figure III.5), but not at the speed anticipated by the Coalition Provisional Authority (CPA). Nonetheless, after three consecutive years of decline and over a decade of sanctions and related difficulties for the economy, Iraq's GDP is anticipated to increase in 2004. Growth is expected to be brought about by the gradual resumption of oil production and exports, enabled by the rehabilitation of the country's infrastructure and the revamping of its oil facilities. This improvement should have positive effects on domestic demand, with the non-oil sector also expected to start to recover, supported by international assistance and reconstruction.

Financing reconstruction of Iraq is one of the challenges facing the country and the international community. The cost of the reconstruction has been estimated at about $56 billion over the period 2004-2007. According to a United Nations/World Bank assessment, this includes some $36 billion for physical reconstruction, technical assistance and training needs as well as operational maintenance costs related to new investments in non-oil sectors.[11] Additionally, the CPA estimates that $20 billion would be required for other sectors, including oil and security. A Donor Reconstruction Conference was held in Madrid in October 2003 and some $32 billion (including $18.6 billion from the United States) in aid and loans were committed over the next four years. This leaves a shortfall of about $24 billion to be funded.

There are also substantial financial claims facing Iraq, including a large external debt (estimated at some $120 billion, including interest arrears)[12] and compensation claims originating from the invasion of Kuwait.[13] Taken together, the servicing of these obligations may be beyond the country's capacity to pay (at least in the short to medium term) and this debt overhang acts as a disincentive for investors, creditors and donors. The share of Iraqi oil revenues set aside to service the compensation claims was reduced from 25 per cent to 5 per cent in May 2003, but dealing with Iraq's external debt remains complicated by many factors.

Figure III.5.
SELECTED WESTERN ASIAN COUNTRIES: CRUDE OIL PRODUCTION,[a] JANUARY 2002-NOVEMBER 2003



Source: U.S. Department of Energy/Energy Information Agency, *International Petroleum Monthly.*

[a] Including lease condensate.

In oil-importing countries, growth is expected to rise from 4.2 per cent in 2003 to 4½ per cent in 2004 (see table A.5). This outcome is also surrounded by downside risks, in particular any further deterioration in the Israeli-Palestinian conflict because of the negative spillover effects on the region's tourism, transit-trade revenues and FDI inflows.

After two years of economic contraction, growth in Israel recovered to almost 1 per cent in 2003, driven by increased government spending, monetary easing and a slight rebound in external demand. This momentum is expected to be sustained into 2004. On the other hand, growth is forecast to decelerate in Turkey due to limited increases in real wages and incomes, as well as the constraints placed on public spending by public debt. Interest payments on this debt were estimated at about 77 per cent of tax revenues during the first nine months of 2003.

Unemployment remains a major economic and political concern, both in the major oil-producing countries, such as Saudi Arabia, as well as in the more diversified economies, such as Jordan, Lebanon, and the Syrian Arab Republic. In the conflict-riddled economies of Iraq and the Palestinian West Bank and Gaza, mass unemployment has deleterious effects not only on aggregate demand and production but also on the social fabric and prospects for peace. At the same time, mass unemployment in both countries is also a legacy of war, sanctions and occupation. The challenge of breaking the vicious circle of mass unemployment and unrest is compounded by the fact that the region has one of the world's most rapid rates of growth of labour supply.

After two years of decline, inflation in the region is expected to pick up in 2004, reflecting increased import costs (see table A.5). Fiscal consolidation and exchange-rate appreciation helped Turkey to contain inflation in 2003 (see table A.6), but the country is unlikely to meet its inflation target in 2004, as local elections may undermine fiscal discipline and the impact of currency appreciation wanes. Inflation is also expected to pick up in both Jordan and Lebanon as a result of the depreciation of the United States dollar, the lifting of subsidies in Jordan and the introduction of VAT in Lebanon. On the other hand, weak domestic demand in Israel will offset the inflationary pressures resulting from the pass-through of earlier increases in commodity prices; consumer inflation is expected to be negligible in 2004.

Declining inflation in the last two years has allowed for the introduction of accommodative monetary policies in both Turkey and Israel, while fiscal policy remained expansionary in the latter due to increased security spending. Despite recording a primary surplus of about 4 per cent of GDP in 2003, Turkey's fiscal situation is fragile, and its fiscal policy is expected to remain tight. In the oil-exporting economies, strong oil revenues in 2003 improved fiscal balances and overall growth, but anticipated lower oil revenues will likely reduce fiscal stimuli in 2004.

Latin America and the Caribbean: better conditions for growth in 2004

Economic growth in Latin America and the Caribbean is anticipated to accelerate to about 3½ per cent in 2004, due to improving external and domestic conditions after

growth of only 1.4 per cent in 2003 (see table A.5). The recovery in 2004 will be generalized throughout the subregions, in contrast to 2003 when results were more disparate.

The forecast continuing recovery in external demand, particularly of the United States, will finally provide a boost for the region's exports. The Mexican economy is expected to grow by close to 4 per cent in 2004, twice as fast as in 2003, led by a recovery in industrial output, which is directly linked to the United States manufacturing sector. Improved external financing conditions and relatively high oil prices will also support growth.

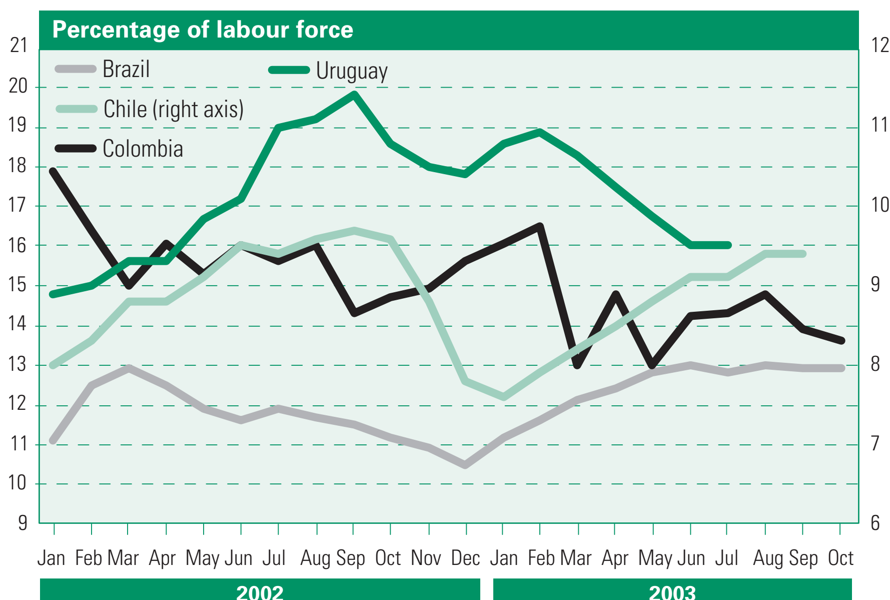
The Caribbean countries recorded modest but positive rates of economic growth in 2003, as tourist flows continued to recover from the negative performance in 2002. The economies in this subregion will benefit from the regional and global recovery, as tourist inflows will likely increase in 2004. Some countries, such as Cuba and Jamaica, experienced a significant increase in the number of arrivals in 2003.[14] In the Dominican Republic, however, increased tourist inflows were not enough to offset negative trends elsewhere in the economy. The collapse of the country's third largest bank triggered contagion in the banking system, requiring massive intervention from the Central Bank in 2003. This created short- and longer-term fiscal problems, sharp depreciation of the currency and increased inflation. Investment fell and the economy experienced its first contraction since 1990. In 2004, the Dominican economy should recover along with the rest of the region, albeit at a low rate.

The depreciation of the United States dollar is anticipated to contribute positively to growth in the region on average, although its impact may not be uniform across the subregions. On the external front, a weaker dollar may contribute to increased exports by the United States and its manufacturing sector which, due to existing production linkages, should revive the export sectors of Mexico and the Central American countries. Another positive impact of the weak dollar, reinforced by increased demand and production cuts (particularly of metals and minerals), has been the rise in price of some commodities, which benefits such exporters as Chile. On the other hand, a continued weak dollar may have a negative impact on exports by countries whose products compete either with United States goods or with goods produced in countries whose exchange rate is pegged to the dollar. Finally, a lower dollar may contribute to a continued decline in inflationary pressures in the region. In the case of Argentina, the depreciation of the dollar contributed to the stabilization of the peso, after its sharp devaluation in 2002, and allowed for some easing of monetary and fiscal policies in 2003.

Unemployment continues to be a concern in the region despite the fact that there have been some improvements in such economies as Colombia and Uruguay. Nonetheless, at the regional level, improved labour conditions in these countries were dampened by higher unemployment in Brazil and other countries (see figure III.6). With the expected increase in economic activity, unemployment will continue to decrease in 2004.

In several Latin American countries, austere macroeconomic policies curbed demand and growth in 2003 but

Figure III.6.
SELECTED LATIN AMERICAN COUNTRIES: UNEMPLOYMENT RATES, JANUARY 2002-OCTOBER 2003



Source: Table A.6.

Note: Reflecting national definitions and coverage. Not comparable across economies.

led to increased control over public finances, stabilization of the exchange rate and lower inflation. Additionally, these policies contributed to increased trade surpluses, which were necessary due to the limited capital inflows into the region during the year. Preliminary estimates indicate that the region generated, for the first time in decades, a small current-account surplus in 2003. This was mostly due to surpluses in Argentina, Brazil and Venezuela, which had large trade surpluses.[15]

Lower inflation and more stable currencies will allow for a further easing of monetary policy in 2004. The monetary authorities in Brazil and Mexico will continue their expansionary policies to rekindle their subdued industrial sectors. In Brazil, the inflation targets for 2004 and 2005 have been adjusted upwards which, while maintaining inflation at relatively low levels, will allow for further reductions in interest rates. Brazilian monetary authorities expect private consumption and investment to react positively to the lower rates. Growth is thus anticipated to be generated by the recovery of the domestic demand, as the contribution of net exports will decline due to increased imports. Similarly, a more stable Mexican peso and lower inflationary expectations will allow additional cuts in interest rates, rekindling domestic demand, in particular private consumption and investment.

Fiscal discipline is helping lift investor confidence but will continue to limit the public sector's contribution to aggregate demand. The majority of the countries in continental Latin America are strengthening efforts to achieve fiscal consolidation in both the short- and medium-term by adopting such structural measures as the modification of tax laws, fiscal responsibility laws, public expenditure ceilings, etc. Mexico, for instance, has one of the lowest levels of tax revenues in the region, since it has traditionally relied on revenues from Pemex (Petróleos de México, S.A), the state-owned enterprise. Accordingly, Mexican authorities are planning to increase tax revenues by increasing the efficiency of tax collection and broadening the tax base.

Similarly, fiscal consolidation will continue in Brazil. Due to its relatively large public debt (some 57 per cent of GDP in October 2003), the country is obliged to run a substantial primary surplus to maintain debt sustainability and investor confidence in the economy. An enormous effort has been required from the economy as a considerable share of the public debt is linked to either the dollar or the official interest rate. As the currency depreciated and interest rates shot up, the debt burden increased and required additional fiscal measures so that the nominal deficit (and therefore public debt) would remain manageable. With the stabilization of the exchange rate and cuts in the interest rate, the fiscal position improved, but it remains a source of concern.

Argentina's goods-producing sectors, especially agriculture, manufacturing and construction, recorded robust growth during 2003, favoured by a more stable exchange rate. The economy will sustain its recovery in 2004 as these sectors continue to benefit from the devaluation of the peso in 2002, but at a more moderate pace than in 2003, as the exchange rate has stabilized. Higher tax revenues are anticipated for 2004. This will permit an expansion of social expenditures, which has absorbed a substantial part of the burden of the financial crisis. In addition, Argentina rescheduled its obligations with the IMF in September 2003. This extension will allow the government more space to pursue its medium-term economic plan, which emphasizes growth, employment and social objectives, strengthening of the shattered banking system and institutional reforms to support its debt restructuring. However, there are some risks presented by the reaction of creditors to Argentina's proposal to restructure its defaulted debt, which represents about half of its total debt (see chapter 2). The anticipated recovery of the two largest economies in the Southern Cone should also benefit the other members of the Southern Common Market (MERCOSUR), Paraguay and Uruguay.

After three consecutive years of stagnation, due to slow growth in Colombia and Mexico as well as the political and economic crisis in Venezuela, the net oil-exporting countries are expected to recuperate in 2004, growing at an average rate of almost 4 per cent. Despite political uncertainties, growth should return to Venezuela as oil production has recovered and positive spillover effects should spread throughout the economy. The crisis in Venezuela affected Colombia's external sector, but the country was able to partially offset the negative impact of weaker demand by its neighbour—and second largest trading partner—due to improved domestic demand. The Venezuelan recovery will likely support growth in Colombia in 2004. In contrast, internal demand in Ecuador lost momentum in 2003, after an original surge created by improved confidence in the economy due to the introduction of dollarization and increased investment boosted by the construction of a new oil pipeline.[16] Aggregate demand is expected to recuperate in 2004, mostly led by greater net exports. Meanwhile, the return to relative normalcy after a politically and socially tumultuous year in Bolivia should support a mild economic recovery in 2004.

Notes

1 It is estimated that households have realized $500 billion from refinancing and equity loans each year in the past two years.

2 For a detailed discussion on the effects of the dollar depreciation on the adjustment of the trade deficit, see *World Economic and Social Survey 2003* (United Nations publication, Sales No. E.03.II.C.1), pp. 15-16.

3 For example, the rise in the German IFO survey of business conditions since April has been driven by its expectations component, while the current conditions component has yet to turn up convincingly.

4 The ECB refined its definition of price stability in May 2003. Price stability is defined, as before, as a year-on-year increase in the HICP of below 2 per cent. The refinement is that, in the pursuit of price stability, the Governing Council will aim to maintain inflation close to 2 per cent. The previous goal, while not explicitly stated, was generally thought to be a target of 1.5 per cent, with upper and lower bounds of 2 per cent and 0 per cent, respectively (see http://www.ecb.int/about/monetarypolicy.htm).

5 GDP contracted by over 50 per cent in Zimbabwe during the period 1999-2003.

6 Average annual inflation in Zimbabwe was estimated at some 140 per cent and 380 per cent in 2002 and 2003, respectively, and forecast to be above 700 per cent in 2004.

7 Hong Kong Special Administrative Region (SAR) of China, Republic of Korea, Singapore and Taiwan Province of China.

8 The official estimate of NPLs is about 20 per cent of the total loans. Estimates by other sources, however, are much higher.

9 Due to China's commitments to joining the World Trade Organization (WTO), some liberalization of the Chinese financial sector is anticipated, and competition from foreign banks is expected to increase markedly in the next few years.

10 Excluding Iraq, forecast GDP growth in Western Asia would decline from an estimated 4.3 per cent in 2003 to 3½ per cent in 2004.

11 The sectors included in the United Nations/World Bank assessment include: education, health, employment creation, water and sanitation, transport and telecommunications, electricity, housing and land management, urban management, agriculture, water resources, food security, finance, state-owned enterprises, investment climate, mine action and government institutions. For details, see United Nations/World Bank, *Joint Iraq Needs Assessment*, October 2003.

12 See M. Abdel-Fadil, "Issues of Economic Reconstruction of Iraq" in ESCWA, *Reconstruction of Iraq: an Arab Economic and Social View*, Report of the workshop on Iraq and the region after the war, Beirut, 9-11 July 2003, E/ESCWA/SDPD/2003/9, 27 October 2003.

13 As of 10 November 2003, there were $28 billion in claims awarded compensation by the United Nations Compensation Commission but still to be paid, while additional claims totalling $96 billion were still awaiting a decision.

14 See World Tourism Organization, World Tourism Barometer, 29 October 2003 (http://www.world-tourism.org/newsroom/Releases/2003/october/ barometer.htm).

15 Based on preliminary estimates by the Economic Commission for Latin America and the Caribbean.

16 See *World Economic and Social Survey 2003* (United Nations publication, Sales No. E.03.II.C.1), box III.3, "Ecuador and El Salvador: a tale of two dollarizations", pp. 103-105.

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Table A.1.
DEVELOPED MARKET ECONOMIES: RATES OF GROWTH OF REAL GDP AND RATES OF INFLATION AND UNEMPLOYMENT, 2002-2004

Annual percentage change

	Growth[a]			Inflation[b]			Unemployment[c,d,e]		
	2002	2003[f]	2004[g]	2002	2003[f]	2004[g]	2002	2003[f]	2004[g]
Developed economies	1.2	2.0	3	1.3	1.5	1¼	6.8	7.0	7
United States	2.2	3.0	4	1.6	2.3	1½	5.8	6.0	6
Canada	3.3	2.0	3¼	2.2	2.7	1	7.7	7.7	7½
Japan	-0.4	2.5	2½	-0.9	-0.9	-¼	5.4	5.2	5¼
Australia	3.5	2.6	3½	3.0	2.8	3	6.3	6.0	6¼
New Zealand	3.8	2.5	3	2.3	1.8	2½	5.2	4.9	5
EU-15	1.0	0.9	2¼	2.3	2.0	2	7.7	8.1	8¼
Euro zone	0.9	0.7	2	2.4	1.9	1¾	8.4	8.9	9
Austria	1.1	0.9	2	1.8	1.3	1½	4.3	4.4	4¼
Belgium	0.7	0.8	1¾	1.6	1.5	1½	7.3	8.2	8¼
Finland	1.4	1.3	3	1.7	-0.7	0	9.1	9.3	9¼
France	1.2	0.5	1¾	1.9	2.0	1¾	8.8	9.4	9¾
Germany	0.2	0.0	2	1.3	0.6	½	8.6	9.6	10¼
Greece	3.6	4.1	4¼	3.6	3.6	3½	10.0	9.5	9¼
Ireland	6.9	1.6	3¾	3.6	3.1	3	4.4	5.8	5½
Italy	0.5	1.0	2	4.7	4.5	4	9.0	8.7	8½
Luxembourg	1.3	0.7	3	2.1	2.0	1¾	2.8	3.6	3½
Netherlands	0.2	0.0	1	3.5	2.0	1½	2.8	4.4	6
Portugal	0.4	-0.8	1	3.5	3.2	2½	5.1	6.6	7¼
Spain	2.0	2.3	3	3.1	2.3	1¾	11.3	10.6	9¼
Other EU	1.8	1.8	2¾	1.8	2.7	2½	5.0	5.2	5¼
Denmark	2.1	0.8	2	2.4	2.1	1¾	4.5	5.5	5¼
Sweden	1.9	1.3	2½	2.4	2.0	¾	4.9	5.6	5½
United Kingdom	1.7	2.0	3	1.6	2.9	3	5.1	5.1	5
Other Europe	0.9	-0.2	1¾	0.9	1.3	½	3.4	4.2	4½
Iceland	-0.5	1.7	3¼	5.2	2.4	2¾	3.1	3.3	3
Malta	1.2	1.5	2	2.2	1.1	1½	5.2	5.2	5¼
Norway	1.0	-0.1	3	1.3	2.7	1	3.9	4.5	4½
Switzerland	0.9	-0.3	1	0.6	0.6	0	3.1	4.1	4½
Memorandum item:									
Major developed economies	1.2	2.1	3	1.1	1.4	1	6.8	7.0	7

Sources: Source: UN/DESA, based on IMF, *International Financial Statistics*, and OECD.

a Data for country groups are weighted averages, where weights for each year are the previous year's GDP valued at 1995 prices and exchange rates in U.S. dollars.
b Data for country groups are weighted averages, where weights for each year are 1995 GDP in U.S. dollars.
c Unemployment data are standardized by OECD for comparability among countries and over time, in conformity with the definitions of the International Labour Office (see OECD, *Standardized Unemployment Rates: Sources and Methods* (Paris, 1985)).
d Data for country groups are weighted averages, where labour force is used for weights.
e Greece and Malta are not standardized.
f Partly estimated.
g Forecast.

Table A.2.
MAJOR DEVELOPED ECONOMIES: QUARTERLY INDICATORS OF GROWTH, UNEMPLOYMENT AND INFLATION, 2001-2003

Annual percentage change

	2001 quarters				2002 quarters				2003 quarters		
	I	II	III	IV	I	II	III	IV	I	II	III
	Growth of gross domestic product[a] (percentage change in seasonally adjusted data from preceding quarter)										
Canada	0.6	0.3	-0.5	2.9	5.8	3.8	2.7	1.6	2.0	-0.7	1.1
France	2.1	0.0	1.9	-1.0	2.4	2.7	1.0	-0.6	0.8	-1.4	1.6
Germany	3.6	-0.1	-0.8	-0.4	0.8	0.8	0.4	-0.2	-1.0	-0.6	0.9
Italy	2.7	0.0	0.8	-0.8	0.8	0.9	1.1	1.7	-0.4	-0.4	2.0
Japan	1.5	-4.5	-3.8	-2.0	-2.0	4.2	3.5	1.8	1.5	2.4	1.4
United Kingdom	3.1	1.6	1.2	1.6	1.2	1.6	3.1	2.3	0.8	2.3	3.1
United States	-0.2	-0.6	-1.3	2.0	4.7	1.9	3.4	1.3	2.0	3.1	8.2
Memorandum items:											
Major developed economies	1.2	-1.3	-1.3	0.3	2.0	2.3	2.5	1.1	1.2	1.8	4.3
Euro zone	2.8	0.0	0.8	-0.4	1.6	2.0	0.8	0.0	0.0	-0.4	1.6
	Unemployment rate[b] (percentage of total labour force)										
Canada	6.9	7.0	7.2	7.7	7.8	7.6	7.6	7.6	7.4	7.7	7.9
France	8.6	8.5	8.5	8.5	8.6	8.7	8.9	9.0	9.2	9.3	9.5
Germany	7.8	7.8	7.8	7.9	8.0	8.1	8.7	8.9	9.2	9.4	9.4
Italy	9.7	9.5	9.4	9.2	9.1	9.0	9.0	8.9	8.9	8.7	8.5
Japan	4.8	4.9	5.1	5.5	5.3	5.4	5.4	5.4	5.4	5.4	5.2
United Kingdom	5.0	4.9	4.1	5.1	5.1	5.1	5.2	5.0	5.0	5.0	5.0
United States	4.2	4.5	4.8	5.6	5.6	5.9	5.8	5.9	5.8	6.2	6.1
Memorandum items:											
Major developed economies	5.6	5.8	5.9	6.4	6.4	6.5	6.6	6.6	6.6	6.8	6.7
Euro zone	8.4	8.3	8.0	8.0	8.1	8.2	8.5	8.6	8.7	8.8	8.8
	Growth of consumer prices[c] (percentage change from preceding quarter)										
Canada	0.9	6.9	0.3	-3.5	2.7	6.1	4.3	2.1	5.4	-0.5	1.5
France	-0.1	5.3	0.4	0.3	2.7	3.2	0.9	1.8	3.7	1.4	1.1
Germany	4.3	4.1	0.6	-1.7	4.5	0.8	0.6	-0.4	3.7	-0.4	1.2
Italy	3.4	3.5	1.4	1.3	3.5	3.0	1.9	2.7	3.3	2.9	2.1
Japan	-1.2	-0.3	-1.1	-1.5	-2.8	1.8	-0.7	-0.4	-1.6	1.8	-0.7
United Kingdom	-0.5	5.1	0.2	-0.5	0.2	5.1	1.4	3.6	2.3	4.9	1.0
United States	3.9	4.2	0.5	-1.1	1.4	4.4	1.7	1.3	4.1	1.5	2.0
Memorandum items:											
Major developed economies	2.0	3.2	0.1	-1.1	0.9	3.2	1.0	0.9	2.4	1.6	1.1
Euro zone	1.5	6.1	0.4	1.1	2.9	4.0	0.4	14.7	3.1	2.1	0.7

Sources: UN/DESA, based on data of IMF, *International Finacial Statistics;* OECD and national authorities.

a Expressed at annual rate (total is weighted average with weights being annual GDP valued at 1995 prices and exchange rates).
b Seasonally adjusted data as standardized by OECD.
c Expressed at annual rate.

Table A.3.
ECONOMIES IN TRANSITION: RATES OF GROWTH OF REAL GDP AND RATES OF INFLATION AND UNEMPLOYMENT, 2002-2004

Annual percentage change

	Growth[a]			Inflation[b]			Unemployment[c]		
	2002	2003[d]	2004[e]	2002	2003[d]	2004[e]	2002	2003[d]	2004[e]
Economies in transition	3.9	5.1	4¾	10.8	8.1	7½	..	..	..
Central and Eastern Europe and Baltic States	2.9	3.4	4	5.1	3.1	3½	..	..	..
Central and Eastern Europe	2.7	3.3	4	5.2	3.2	3½	..	..	..
Albania	4.7	6.0	6	5.5	3.0	3	15.8	14.2	14
Bulgaria	4.8	4.5	4¼	5.8	2.3	3	16.3	14.0	14
Croatia	5.2	4.5	4¼	2.3	2.0	2½	21.5	20.0	19
Czech Republic	2.0	2.5	4	1.8	0.0	2	9.8	10.0	9
Hungary	3.3	2.9	3½	5.3	4.8	6	8.0	6.0	5
Poland	1.4	3.2	3¾	1.9	0.8	1½	18.1	18.0	17½
Romania	4.9	4.5	4¾	22.5	11.0	8	8.1	11.0	11
Serbia and Montenegro[f]	4.0	2.0	4	19.2	12.0	8	32.0	34.0	30
Slovakia	4.4	4.0	4½	3.3	8.6	7	17.8	15.0	14
Slovenia	2.9	2.5	3½	7.5	5.0	4	11.6	11.0	11
The former Yugoslav Republic of Macedonia	0.7	2.8	3½	1.8	2.0	2½	45.3	40.0	40
Baltic States	6.2	6.4	6	1.6	1.7	2¼	..	..	..
Estonia	5.6	4.5	5½	3.6	2.0	2¾	6.8	6.5	5¾
Latvia	6.1	7.0	6¼	1.9	3.3	3	8.5	8.0	7¼
Lithuania	6.7	7.0	6¼	0.3	0.3	1½	10.9	9.2	8½
Commonwealth of Independent States	4.7	6.5	5¼	14.8	11.7	10¼	..	..	..
Armenia	12.9	11.0	8	1.0	4.0	3½	..	..	..
Azerbaijan	10.6	10.0	9	2.8	3.0	3½	..	..	..
Belarus	4.7	6.0	5	42.8	30.0	25	..	..	..
Georgia	5.3	8.0	5	5.7	4.5	5	..	..	..
Kazakhstan	9.5	9.0	8	6.0	6.5	6½	..	..	..
Kyrgyzstan	-0.5	6.0	4	2.1	3.5	4	..	..	..
Republic of Moldova	7.2	5.5	5	5.3	12.0	8	..	..	..
Russian Federation	4.3	6.3	5	16.0	12.0	10	..	..	..
Tajikistan	9.1	7.0	6	12.2	17.0	15	..	..	..
Turkmenistan	19.3	16.0	12	15.0	11.0	12	..	..	..
Ukraine	4.8	6.5	5	0.8	5.0	8	..	..	..
Uzbekistan	4.2	4.5	3	24.2	22.0	19	..	..	..

Sources: UN/DESA and Economic Commission for Europe (ECE).

a Data for country groups are weighted averages, where weights for each year are the previous year's GDP valued at 1995 prices and exchange rates in United States dollars.
b Data for country groups are weighted averages, where weights for each year are 1995 GDP in United States dollars.
c Owing to comparability problems, data for the Commonwealth of Independent States are not given.
d Partly estimated.
e Forecast.
f As of 4 February 2003, "Serbia and Montenegro" became the official name of the Federal Republic of Yugoslavia.

Table A.4.

MAJOR ECONOMIES IN TRANSITION: QUARTERLY INDICATORS OF GROWTH AND INFLATION, 2001-2003

Annual percentage change

	2001 quarters				2002 quarters				2003 quarters		
	I	II	III	IV	I	II	III	IV	I	II	III
	Rates of growth of gross domestic product[a]										
Belarus	2.4	5.4	5.3	5.4	3.7	5.6	4.2	5.4	5.3	4.8	7.4
Czech Republic	3.5	3.4	3.0	2.5	2.6	2.1	1.7	1.5	2.4	2.1	..
Hungary	4.2	4.1	3.9	3.3	2.9	3.0	3.5	3.7	2.7	2.4	2.9
Kazakhstan	11.4	13.1	15.3	12.6	10.7	7.7	9.5	10.7	10.4	14.1	4.4
Poland	2.2	0.9	0.8	0.2	0.5	0.9	1.8	2.2	2.2	3.8	1.6
Romania	4.5	5.2	6.2	5.6	3.2	5.6	4.4	5.4	4.4	4.2	..
Russian Federation	4.4	5.3	6.0	4.3	3.0	4.1	4.6	5.2	6.8	7.2	6.2
Ukraine	7.7	11.2	11.3	9.0	7.4	4.9	6.8	-3.0	7.9	9.3	3.4
	Growth of consumer prices[a]										
Belarus	83.3	70.6	55.0	46.3	47.2	44.6	43.1	37.4	30.8	28.3	28.3
Czech Republic	4.2	5.1	5.4	4.3	3.8	2.3	0.8	0.6	-0.3	0.2	0.0
Hungary	10.4	10.6	8.7	7.2	6.3	5.6	4.8	5.0	4.8	4.1	4.9
Kazakhstan	9.1	9.7	8.3	7.0	5.7	5.5	6.4	6.4	7.2	6.5	5.8
Poland	6.8	6.6	4.8	3.8	3.5	2.0	1.1	0.8	0.3	0.3	0.8
Romania	40.1	36.9	31.8	30.5	26.8	24.2	21.3	18.5	16.7	14.9	15.1
Russian Federation	22.3	24.5	21.1	18.9	18.0	15.8	15.1	15.1	14.6	14.0	13.5
Ukraine	19.4	14.5	8.9	6.1	3.7	0.8	-0.9	-0.5	2.2	4.5	6.5

Sources: UN/DESA and Economic Commision for Europe (ECE).

[a] Percentage change from the corresponding period of the preceding year.

Table A.5.
DEVELOPING COUNTRIES: RATES OF GROWTH OF REAL GDP AND RATES OF INFLATION, 2002-2004

Annual percentage change

	Growth[a]			Inflation[b,c]		
	2002	2003[d]	2004[e]	2002	2003[d]	2004[e]
Developing countries[f]	3.2	3.8	5	6.8	7.4	6½
of which:						
Latin America and the Caribbean	-0.7	1.4	3½	10.5	12.9	7¾
Net fuel exporters	-0.2	0.2	4	..	..	..
Net fuel importers	-1.0	1.9	3¼	..	..	..
Africa	2.9	3.2	4¼	8.4	12.6	16¾
Net fuel exporters	3.5	3.8	4	..	..	..
Net fuel importers	2.5	2.8	4¼	..	..	..
Western Asia	2.4	2.6	4	16.3	10.5	12½
Net fuel exporters	1.3	1.5	3¾	..	..	..
Net fuel importers	4.3	4.2	4½	..	..	..
Eastern and Southern Asia	5.6	5.4	6¼	2.1	2.5	2¾
of which:						
East Asia	5.9	5.3	6¼	1.7	2.1	2½
South Asia	4.5	5.9	6	4.2	4.4	4¾
Memorandum items:						
Least developed countries	3.9	3.8	5	11.1	13.2	11½
East Asia (excluding China)	4.6	3.3	4¾	2.8	2.6	2¾
Major developing economies						
Argentina	-10.9	7.0	3½	25.9	15.7	8
Brazil	1.5	0.2	3	8.4	15.9	8
Chile	2.1	3.0	4	2.5	3.2	3
China	8.0	8.5	8½	-0.7	1.0	1
Colombia	1.8	2.5	3	6.3	7.3	6
Egypt	3.0	1.8	3	2.7	4.0	3½
Hong Kong SAR[g]	2.3	2.5	4¼	-3.8	-2.7	1
India	4.5	6.1	6¼	4.1	4.2	4½
Indonesia	3.7	3.9	4½	11.9	7.0	6¾
Iran (Islamic Republic of)	7.6	5.9	3½	14.3	16.0	15½
Israel	-1.2	0.9	2½	5.6	0.8	1
Korea, Republic of	6.3	2.7	5	2.7	3.5	2¾
Malaysia	4.1	5.0	6¼	1.8	1.4	2
Mexico	0.9	1.6	3¾	5.0	4.7	3½
Nigeria	3.3	4.3	5	12.9	11.7	10½
Pakistan	4.4	5.5	5¼	3.3	4.5	5¼
Peru	5.2	3.5	4	0.2	2.3	2
Philippines	4.4	3.9	4¼	3.1	3.2	3¾
Saudi Arabia	1.0	3.9	1½	-0.5	-0.3	¼
Singapore	2.2	1.0	4½	-0.4	0.6	1
South Africa	3.0	2.0	3	9.2	6.8	4¾
Taiwan Province of China	3.6	3.1	4	-0.2	-0.3	½
Thailand	5.3	5.8	5¾	0.6	1.7	1¼
Turkey	7.8	6.4	5¾	45.0	25.8	32½
Venezuela	-8.9	-11.0	6½	22.4	32.9	30

Source: UN/DESA, based on IMF, *International Financial Statistics*.

a Data for country groups are weighted averages, where weights for each year are the previous year's GDP valued at 1995 prices and exchange rates in United States dollars.
b Data for country groups are weighted averages, where weights for each year are 1995 GDP in United States dollars.
c For Africa, the Democratic Republic of the Congo is excluded.
d Partly estimated.
e Forecast.
f Covering countries that account for 98 per cent of the population of all developing countries.
g Special Administrative Region of China.

Table A.6.
MAJOR DEVELOPING COUNTRIES: QUARTERLY INDICATORS
OF GROWTH, UNEMPLOYMENT AND INFLATION, 2001-2003

Annual percentage change

	2001 quarters				2002 quarters				2003 quarters		
	I	II	III	IV	I	II	III	IV	I	II	III
	Rates of growth of gross domestic product[a]										
Argentina	-2.0	-0.2	-4.9	-10.5	-16.3	-13.5	-9.8	-3.4	5.4	7.6	8.7
Brazil	3.9	2.1	0.6	-0.8	-0.6	1.0	2.4	3.7	2.0	-1.1	-1.5
Chile	3.3	4.0	3.0	2.0	1.3	1.7	2.4	3.2	3.6	2.7	2.9
China	8.1	7.7	7.1	6.7	7.6	8.0	8.1	8.1	9.9	6.7	9.1
Colombia	1.6	1.7	0.9	1.4	0.0	2.3	2.0	2.4	3.8	2.2	4.0
Ecuador	7.8	4.7	4.7	3.3	1.3	3.9	5.0	3.5	2.7	0.8	-2.3
Hong Kong[b]	2.3	1.5	-0.5	-1.1	-0.6	0.8	3.4	5.1	4.5	-0.5	4.0
India	1.9	4.4	5.1	6.3	6.3	5.3	5.2	2.3	4.9	5.7	..
Indonesia	4.0	4.2	3.8	1.7	2.7	3.9	4.3	3.8	3.4	3.8	3.9
Israel	1.2	1.2	-3.3	-2.5	-2.3	-1.8	0.1	0.7	1.2	0.6	0.8
Korea, Republic of	4.3	3.0	2.1	3.5	6.2	6.6	5.8	6.8	3.7	1.9	2.3
Malaysia	2.8	0.5	-0.7	-0.4	1.3	4.0	5.8	5.4	4.6	4.5	5.1
Mexico	2.0	0.1	-1.5	-1.6	-2.2	2.0	1.8	1.9	2.3	0.2	0.4
Philippines	3.6	4.2	4.5	5.6	3.8	4.1	3.8	5.8	4.5	4.0	4.4
Singapore	5.0	-0.5	-5.4	-6.6	-1.5	3.8	3.8	3.0	1.7	-4.2	1.7
South Africa	2.3	2.6	1.8	3.2	3.0	3.8	2.9	2.4	1.5	1.1	..
Taiwan Province of China	0.6	-3.3	-4.4	-1.6	0.9	3.7	5.2	4.5	3.5	-0.1	4.0
Thailand	1.6	1.9	1.8	2.5	3.9	5.1	5.8	6.2	6.7	5.8	6.5
Turkey	-1.0	-9.8	-7.5	-10.3	2.1	8.9	7.9	11.4	8.1	3.9	..
Venezuela	4.0	3.1	3.3	0.9	-3.8	-9.1	-5.6	-16.7	-27.6	-9.4	-7.1
	Unemployment rate[c]										
Argentina[d]	..	16.4	..	18.3	..	21.5	..	17.8	..	15.6	..
Brazil	..	..	..	11.3	12.2	12.0	11.7	10.9	11.6	12.7	12.9
Chile	8.8	9.7	10.1	7.9	8.8	9.5	9.7	9.6	7.9	8.8	9.3
Colombia	16.7	14.7	14.7	13.8	16.4	15.8	15.3	15.1	15.2	14.0	14.3
Hong Kong[b]	4.5	4.7	5.5	6.5	7.2	7.7	7.2	7.3	7.9	8.6	8.2
Indonesia	8.1	..	8.1	..	8.1	..	9.1	..	..	..	..
Israel	8.6	8.8	9.6	10.4	10.4	10.3	10.4	10.2	10.8	10.6	10.7
Korea, Republic of	4.9	3.6	3.3	3.3	3.7	3.0	2.8	2.9	3.6	3.3	3.3
Malaysia	4.0	3.7	3.3	3.7	3.7	3.8	3.2	3.2	3.8	4.0	..
Mexico	2.4	2.4	2.4	2.5	2.8	2.6	2.9	2.5	2.8	3.0	..
Philippines	11.3	13.3	10.1	9.8	10.3	13.9	11.2	10.2	10.6	12.2	12.7
Singapore	2.0	3.4	3.0	4.9	3.7	5.2	3.8	4.7	3.7	5.4	4.9
Taiwan Province of China	3.7	4.2	5.1	5.3	5.1	5.0	5.3	5.2	5.1	5.0	5.1
Thailand	4.8	3.5	2.6	2.4	3.2	2.9	1.8	1.8	2.9	2.5	..
Turkey	8.6	6.9	8.0	10.6	11.8	9.3	9.6	11.0	12.3	10.0	9.4
Uruguay	14.4	15.5	15.6	15.2	14.7	15.4	17.6	19.2	18.6	16.8	16.1
Venezuela	14.2	13.3	13.4	12.1	15.5	15.8	16.5	16.2	..	..	..

Table 6 (continued)

	2001 quarters				2002 quarters				2003 quarters		
	I	II	III	IV	I	II	III	IV	I	II	III
	Growth of consumer prices[a]										
Argentina	-1.4	-0.1	-1.1	-1.6	4.2	23.3	36.0	40.3	35.7	14.5	5.2
Brazil	6.2	7.0	6.6	7.5	7.6	7.8	7.6	10.6	15.6	16.9	15.2
Chile	4.0	3.6	3.6	3.0	2.4	2.2	2.4	2.9	3.8	3.7	2.7
China	1.4	0.5	-1.0	-1.0	-0.6	-1.1	-0.8	-0.6	0.1	0.8	0.8
Colombia	8.1	7.9	8.0	7.8	6.6	5.9	6.0	6.8	7.4	7.6	7.1
Ecuador	67.6	39.6	28.9	24.1	14.7	13.2	12.4	9.9	9.7	8.2	7.5
Hong Kong[b]	-2.0	-1.4	-1.1	-2.0	-2.6	-3.1	-3.4	-3.0	-2.0	-2.5	-3.7
India	2.9	2.7	4.7	4.4	5.1	4.5	4.0	4.0	3.8	4.5	4.1
Indonesia	10.3	12.1	13.0	12.5	14.1	11.5	10.5	10.0	7.2	6.5	5.7
Israel	0.3	0.9	1.7	1.6	3.8	5.7	6.5	6.7	5.5	0.9	-1.8
Korea, Republic of	4.0	5.0	4.2	3.4	2.5	2.7	2.6	3.3	4.1	3.3	3.1
Malaysia	1.5	1.6	1.4	1.2	1.4	1.9	2.1	1.8	1.3	0.9	1.0
Mexico	7.5	6.9	6.0	5.2	4.7	4.8	5.2	5.3	5.4	4.7	4.1
Philippines	6.7	6.6	6.4	4.7	3.6	3.4	2.8	2.6	2.9	3.0	3.1
Singapore	1.7	1.7	0.8	-0.2	-0.8	-0.4	-0.4	0.1	0.7	0.2	0.4
South Africa	6.4	4.8	4.3	5.7	7.7	10.4	12.8	10.7	7.8	4.7	4.7
Taiwan Province of China	0.6	0.1	0.0	-0.6	-0.1	0.0	-0.2	-0.5	-0.2	-0.1	-0.6
Thailand	1.4	2.5	1.7	1.1	0.6	0.2	0.3	1.4	2.0	1.8	1.9
Turkey	52.3	58.6	67.5	70.3	47.0	39.5	31.6	27.6	30.0	25.1	25.1
Venezuela	12.6	12.4	12.7	12.4	14.6	18.9	24.8	30.6	35.5	34.2	29.5

Sources: IMF, *International Financial Statistics* and national authorities.

[a] Percentage change from the corresponding quarter of the previous year.
[b] Special Administrative Region of China.
[c] Reflecting national definitions and coverage. Not comparable across economies.
[d] Data is reported in May and October each year.

Table A.7.
WORLD TRADE: RATES OF GROWTH OF VOLUMES AND VALUES, 2002-2004

Annual percentage change

	Volume of exports[a]			Volume of imports[a]		
	2002	2003[b]	2004[c]	2002	2003[b]	2004[c]
World	3.8	5.1	7¼	2.3	4.2	7¾
Developed economies	0.8	1.7	6	1.4	2.8	6½
of which :						
North America	-1.2	0.6	7	2.9	4.3	7
Western Europe	0.4	1.4	5¾	0.4	1.9	6¼
Japan	8.0	6.0	5	1.9	5.0	5¼
Economies in transition	6.9	7.2	6¼	8.2	9.1	9¾
Central & Eastern Europe and Baltic States	5.7	6.9	7	5.9	6.7	7¼
Commonwealth of Independent States	9.9	8.2	6	17.4	19.8	18½
Developing Countries	9.7	11.6	9¾	3.7	6.6	11
Latin America and the Caribbean	1.7	1.4	7½	-8.2	-1.2	9¾
Africa	1.4	2.0	4½	2.5	3.0	5
Western Asia	2.5	5.8	-7	6.9	3.5	7
Eastern and Southern Asia[d]	13.6	15.7	12½	8.1	10.5	12¾
China	23.6	25.0	16½	25.0	30.1	14¾
	Value of exports[a]			Value of imports[a]		
	2002	2003[b]	2004[c]	2002	2003[b]	2004[c]
World	5.0	13.4	9¼	3.3	12.4	9¼
Developed economies	2.8	12.4	8½	2.4	12.2	8½
of which :						
North America	-3.0	5.0	7	2.1	7.2	7¾
Western Europe	4.8	16.3	9¾	3.3	15.9	9½
Japan	3.9	4.1	3¼	-5.7	2.5	-1¼
Economies in transition	11.5	19.6	9¾	10.2	19.3	11¼
Central & Eastern Europe and Baltics States	12.8	22.4	12½	9.2	21.9	12
Commonwealth of independent States	9.3	14.9	5¼	12.8	13.3	9½
Developing Countries	9.2	14.6	10¾	4.2	11.6	11
Latin America and the Caribbean	1.6	4.0	5¾	-6.3	2.4	7½
Africa	2.9	6.4	6	4.9	4.6	6
Western Asia	6.8	11.7	7½	6.1	12.5	10½
Eastern and Southern Asia[d]	12.2	18.2	12½	7.9	15.5	12½
China	22.3	28.0	15	21.2	35.0	15

Sources: United Nations and IMF, *International Financial Statistics.*

a Growth of country groups are weighted average, where weights for each year are the previous year's trade valued at 1995 prices and exchange rates in United States dollars.
b Partly estimated.
c Forecast, partly based on Project LINK.
d Excluding China.

Table A.8.
COMMODITY PRICES, 2001-2003

Annual percentage change

	2001	2002 quarters				2003 quarters		
		I	II	III	IV	I	II	III
Combined index, non-fuel commodities								
Dollar	-2.9	-9.7	-3.9	-1.0	8.8	11.1	4.7	3.7
SDR	0.0	-6.4	-5.3	-5.4	3.5	0.9	-4.3	-1.3
Food and tropical beverages	0.0	-10.0	-4.6	-2.6	8.8	10.0	0.0	-3.7
Tropical beverages	-22.0	-6.6	0.0	15.2	29.1	19.1	9.0	2.0
Cocoa	22.7	37.6	54.3	98.4	65.0	43.7	8.8	-20.5
Coffee	-28.5	-9.7	-5.0	0.5	16.8	7.1	1.0	9.7
Food	5.0	-10.6	-5.5	-5.5	5.6	8.4	-1.7	-4.7
Bananas	38.8	-14.1	3.7	-25.8	1.1	-0.4	-46.6	-39.0
Maize	1.0	-1.1	11.7	15.3	13.3	13.9	12.3	-3.8
Rice	-15.2	5.1	19.4	13.1	7.1	3.8	1.2	3.3
Sugar	5.6	-28.7	-31.6	-20.0	4.4	21.1	15.7	0.1
Wheat	9.2	-3.8	-3.3	33.3	42.3	18.5	9.6	-13.6
Vegetable oilseeds and oils	-8.5	17.6	30.7	18.3	32.5	30.4	17.5	4.3
Palm oil	-7.7	34.5	52.8	22.9	40.2	32.8	11.3	-0.4
Soybeans	-7.5	-6.4	6.1	9.5	26.2	28.6	25.0	7.3
Agricultural raw materials	-1.9	-16.0	-9.7	-5.7	4.2	14.4	13.8	12.0
Cotton	-19.0	-28.4	-16.0	11.4	33.0	37.5	42.0	27.5
Rubber	-14.1	4.4	22.9	46.0	63.4	58.7	37.1	22.6
Tropical logs	6.3	-20.5	-13.5	-10.6	4.7	19.9	22.4	14.9
Minerals, ores and metals	-9.9	-9.9	-4.4	0.6	5.9	7.2	4.3	13.6
Aluminium	-6.8	-12.4	-9.7	-5.0	2.6	1.1	1.8	9.6
Copper	-13.0	-11.7	-2.5	3.0	9.0	6.9	1.8	15.7
Iron ore	4.5	-1.0	-1.0	-1.0	-1.0	8.5	8.5	8.5
Lead	4.9	-0.3	-1.8	-8.4	-9.3	-6.5	0.4	18.8
Nickel	-31.2	-5.3	4.0	24.4	40.5	34.5	20.5	37.1
Phosphate rock	-4.5	-4.7	-2.5	0.0	-6.0	-7.3	-7.3	-7.3
Tin	-17.5	-25.5	-15.4	1.5	7.6	19.0	12.4	19.4
Zinc	-21.5	-22.1	-16.3	-7.3	1.2	-1.1	-1.0	7.2
Memorandum items:								
Manufactured export prices of DME	-3.4	-5.7	1.2	4.8	6.0	11.0	9.4	5.7
Real prices, non-fuel commodities	0.6	-4.2	-4.9	-5.6	2.6	0.2	-1.9	-1.3
Crude oil (Brent)	-13.8	-18.5	-8.2	6.7	38.2	49.2	4.5	5.8

Sources: UN/DESA and UNCTAD, *Monthly Commodity Price Bulletin.*

Table A.9.
OUTWARD STOCK OF FOREIGN DIRECT INVESTMENT, BY SECTOR AND MAIN COUNTRY GROUPS, 1990 AND 2001

Billions of dollars

Sector/industry	1990[a]			2001[a]			
	Developed countries	Developing economies[b]	World	Developed countries	Developing economies	Economies in transition	World
Total	1 356	14	1 371	4 775	473	3	5 251
Primary	122	1	123	314	2	0	316
Agriculture, hunting, forestry and fishing	4	0	4	3	0	0	4
Mining, quarrying and petroleum	118	0	119	311	2	0	312
Secondary	601	5	605	1 448	61	1	1 509
Food, beverages and tobacco	57	0	58	158	1	0	159
Textiles, clothing and leather	15	0	15	67	1	0	69
Wood and wood products	16	0	16	52	1	0	53
Publishing, printing and reproduction of recorded media	2	-	2	7	-	0	7
Coke, petroleum products and nuclear fuel	31	-	31	21	0	0	21
Chemicals and chemical products	114	1	115	321	2	0	323
Rubber and plastic products	11	0	11	16	0	0	17
Non-metallic mineral products	10	0	10	12	0	0	12
Metal and metal products	51	0	51	144	1	0	145
Machinery and equipment	32	0	32	60	0	0	60
Electrical and electronic equipment	74	1	75	143	6	0	149
Precision instruments	10	-	10	21	0	0	21
Motor vehicles and other transport equipment	46	0	46	232	1	0	232
Other manufacturing	27	0	27	44	0	0	44
Unspecified secondary	105	3	108	149	48	0	197
Tertiary	631	9	640	2 996	379	2	3 377
Electricity, gas and water	7	-	7	83	-	0	83
Construction	14	0	14	22	4	0	26
Trade	106	1	107	270	49	0	319
Hotels and restaurants	5	-	5	41	7	- 0	48
Transport, storage and communications	30	0	30	349	29	0	379
Finance	302	5	308	1 393	57	1	1 450
Business activities	41	1	42	657	226	1	883
Education	0	-	0	5	-	-	5
Health and social services	1	-	1	0	-	0	0
Community, social and personal service activities	2	-	2	7	0	0	7
Other services	84	0	85	65	7	0	72
Unspecified tertiary	38	-	38	103	-	-	103
Unspecified	3	0	3	17	32	0	48

Source: UNCTAD, FDI database.

Note: Data cover 23 economies in 1990 and 33 economies in 2001. They account for around four fifths of world outward stock in 1990 and 2001. Approval data were used for Taiwan Province of China. The world total in 1990 does not include the countries of Central and Eastern Europe.

a Or latest year available.
b As many home developing countries are not covered due to unavailability of data, the figures are underestimated.

Table A.10.
INWARD STOCK OF FOREIGN DIRECT INVESTMENT, BY SECTOR AND MAIN COUNTRY GROUPS, 1990 AND 2001

Billions of dollars

Sector/industry	1990[a]			2001[a]			
	Developed countries	Developing economies	World	Developed countries	Developing economies	Economies in transition	World
Total	1 222	247	1 469	3 473	1 618	72	5 163
Primary	121	18	139	199	107	4	310
Agriculture, hunting, forestry and fishing	3	3	6	6	16	0	22
Mining, quarrying and petroleum	119	13	131	193	91	3	288
Unspecified	-	-	2	2	-	-	-
Secondary	496	120	616	1 141	630	26	1 797
Food, beverages and tobacco	56	8	64	93	25	6	124
Textiles, clothing and leather	19	4	23	33	10	1	44
Wood and wood products	16	4	20	42	20	2	64
Publishing, printing and reproduction of recorded media	12	0	12	36	0	0	36
Coke, petroleum products and nuclear fuel	43	5	47	23	17	2	42
Chemicals and chemical products	96	36	133	246	68	2	317
Rubber and plastic products	10	2	12	18	5	0	23
Non-metallic mineral products	13	3	16	33	10	2	45
Metal and metal products	40	13	52	90	28	2	120
Machinery and equipment	37	8	45	71	19	2	92
Electrical and electronic equipment	57	14	71	183	50	2	235
Precision instruments	9	-	9	11	1	0	12
Motor vehicles and other transport equipment	38	6	44	145	15	2	162
Other manufacturing	15	3	17	36	8	0	44
Unspecified secondary	35	15	50	81	352	3	437
Tertiary	598	107	704	2 107	816	41	2 964
Electricity, gas and water	5	2	8	55	40	3	98
Construction	13	4	17	22	26	1	49
Trade	159	15	174	425	98	10	533
Hotels and restaurants	17	2	19	34	15	1	49
Transport, storage and communications	13	9	21	232	66	12	310
Finance	220	60	281	657	140	9	806
Business activities	89	4	93	482	386	5	873[b]
Public administration and defence	-	-	-	-	0	0	0
Education	0	-	0	0	0	0	0
Health and social services	1	-	1	6	3	0	10
Community, social and personal service activities	11	0	11	21	3	0	25
Other services	58	10	67	40	26	0	66
Unspecified tertiary	11	1	12	133	12	0	145
Unspecified	7	3	10	27	65	1	93

Source: UNCTAD, FDI database.

Note: Data cover 48 economies in 1990 and 60 economies in 2001. They account for over four fifths of world inward stock in 1990 and 2001. Approval data were used for Sri Lanka in 1990 and Malaysia in 2001. In the case of Cambodia, China, Indonesia, Lao People's Democratic Republic, Mongolia, Myanmar, Nepal, Taiwan Province of China and Viet Nam, the actual data were estimated by applying to approval data for 2001 the historical implementation ratio of realized FDI to approved FDI (33% in 1994 for Cambodia, 68% in 2001 for China, 45% in 2001 for Indonesia, 10% in 1990 and 7% in 1999 for Lao People's Democratic Republic, 15% in 1990 and 44% in 2001 for Mongolia, 39% in 1990 and 55% in 2001 for Myanmar, 41% in 1990 and 47% in 1999 for Nepal, 74% in 1990 and 65% in 2001 for Taiwan Province of China and 15% in 1990 for Viet Nam). The world total in 1990 does not include the countries of Central and Eastern Europe. Data are as of 24 September 2003. The data therefore do not necessarily correspond to those reported in other UNCTAD documents.

[a] Or latest year available.

[b] A considerable share of investment in this industry is in Hong Kong Special Administrative Region (SAR) of China, accounting for 60% of developing economies and 27% of the world total. Hong Kong SAR data include investment holding companies.

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