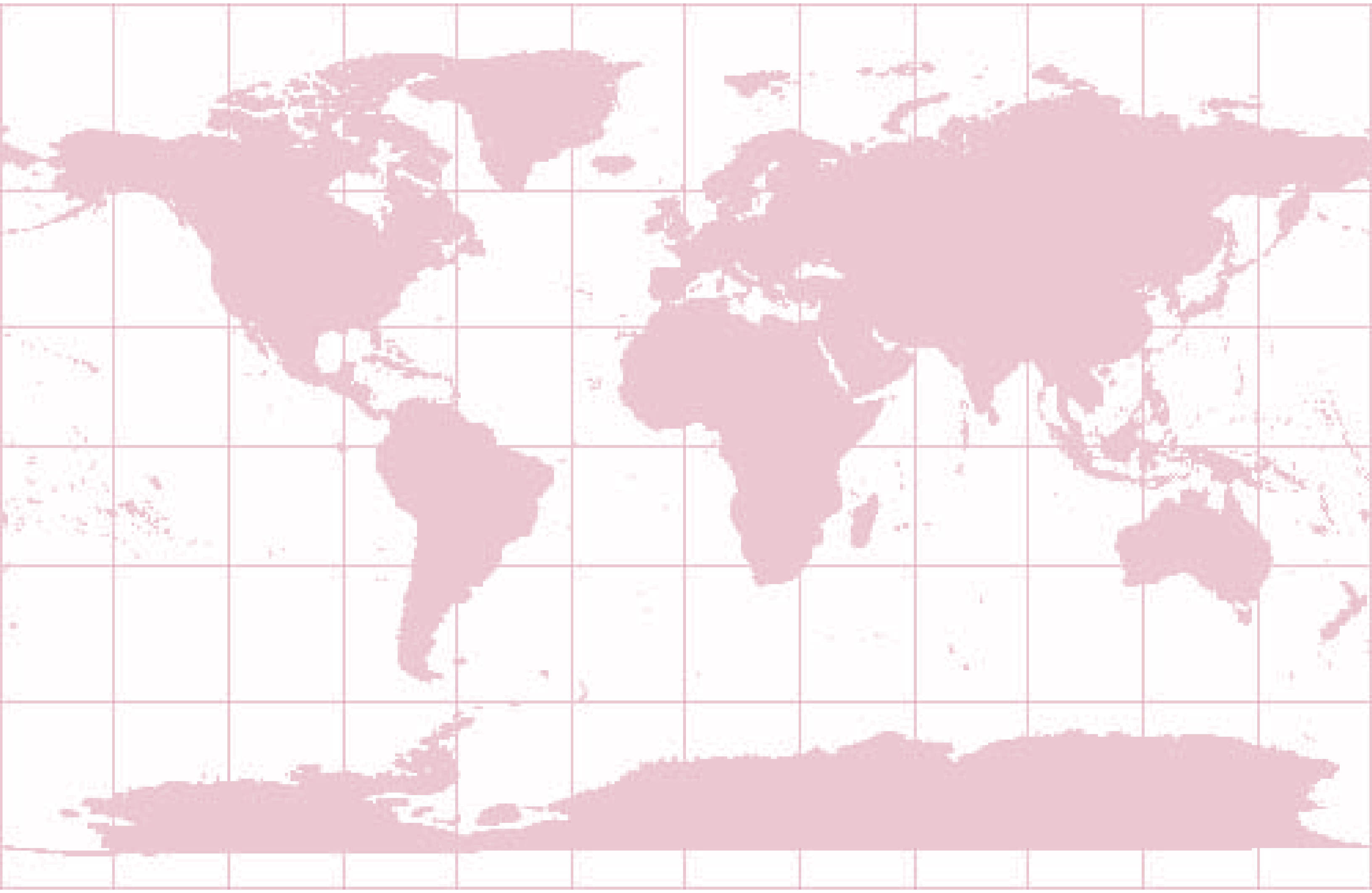
World Economic Situation and Prospects 2006



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This report is a joint product of the Department of Economic and Social Affairs (DESA), the United Nations Conference on Trade and Development (UNCTAD) and the five United Nations regional commissions (Economic Commission for Africa (ECA), Economic Commission for Europe (ECE), Economic Commission for Latin America and the Caribbean (ECLAC), Economic and Social Commission for Asia and the Pacific (ESCAP), and Economic and Social Commission for Western Asia (ESCWA)). It provides an overview of recent global economic performance and short-term prospects for the world economy and of some key global economic policy and development issues. One of its purposes is to serve as a point of reference for discussions on economic, social and related issues taking place in various United Nations entities in 2006.

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Executive Summary

The global outlook

Moderate world economic growth in 2006

World economic growth slowed noticeably in 2005 from the strong expansion in 2004. The world economy is expected to continue to grow at this more moderate pace of about 3 per cent during 2006.[1] This rate of growth is, nonetheless, the same as the average of the past decade. The United States economy remains the main engine of global economic growth, but the dynamic growth of China, India and a few other large developing economies is becoming increasingly important. Economic growth slowed down in most of the developed economies during 2005, with no recovery expected in 2006. Growth will moderate further to 3.1 per cent in the United States of America, while lacklustre performance will still prevail in Europe, with growth reaching a meagre 2.1 per cent in 2006. The recovery in Japan is expected to continue, albeit at a very modest pace of around 2 per cent.

Strong, yet insufficient growth in the poorest countries

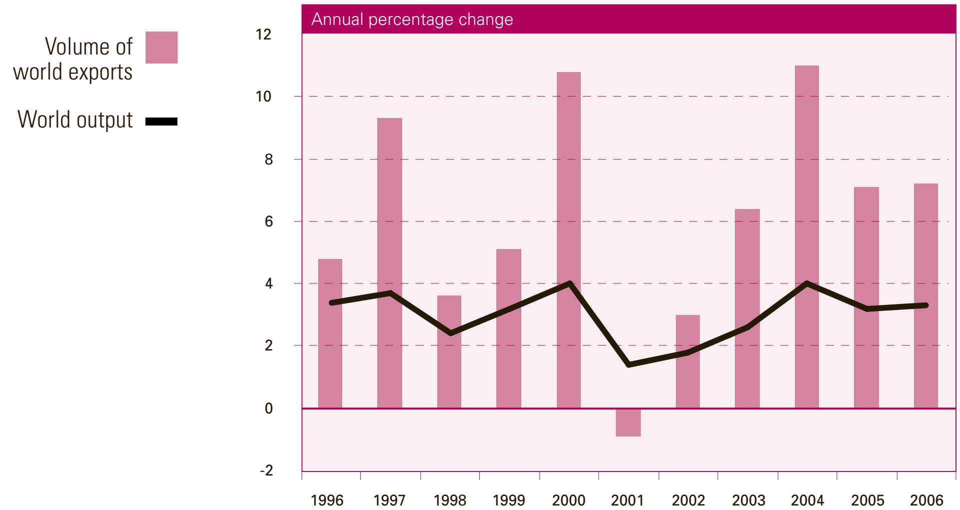
Generally, economic growth in most parts of the developing world and the economies in transition is well above the world average. On average, developing economies are expected to expand at a rate of 5.6 per cent and the economies in transition at 5.9 per cent, despite the fact that these economies may face larger challenges during 2006. While China and India are by far the most dynamic economies, the rest of East and South Asia is expected to grow by more than 5 per cent. Latin America is lagging somewhat behind, with growth of about 3.9 per cent, but African economic growth is expected to remain solidly above 5 per cent. Growing at 6.6 per cent, the least developed countries (LDCs) are faring even better, reaching the fastest average rate of growth they have had for decades. Even if these record levels are sustained, per capita income growth is still not strong enough in many of these countries to make sufficient progress towards the Millennium Development Goal of halving extreme poverty by 2015. Much of the economic buoyancy of developing countries has resulted from high export commodity prices, which may not be sustainable in the longer run. In contrast, developing countries and LDCs that are net importers of oil and agricultural products have been hurt by the high cost of oil and food imports.

Lacklustre employment growth worldwide

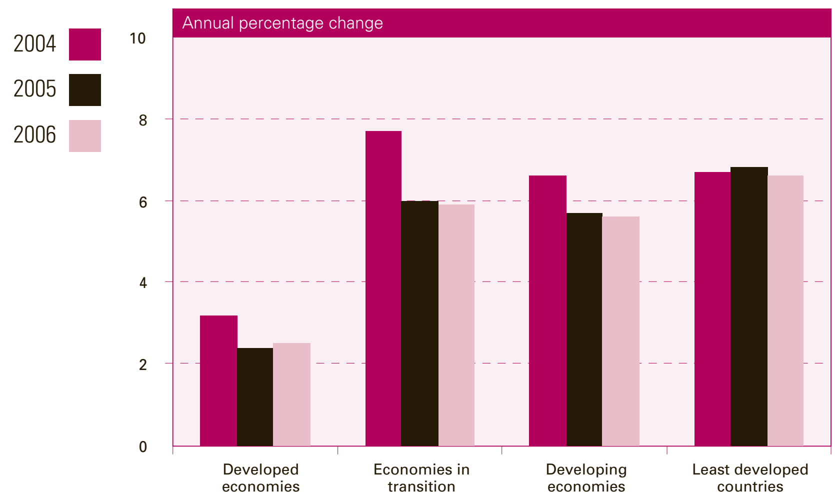
The employment situation worldwide remains unsatisfactory. The slowdown in growth partly explains this. More importantly, though, employment creation is falling short of the increment in labour supply in the majority of countries. Consequently, in a large number of countries, unemployment rates are still notably higher than the levels prior to the global downturn of 2000-2001. Despite strong growth performance, many developing countries continue to face high levels of structural unemployment and underemployment which limit the impact of growth on poverty reduction.

1 Growth is estimated at market prices. World output growth as measured with purchasing power parity-based weights is estimated at 4.3 per cent for 2005 and projected to reach 4.4 per cent in 2006.

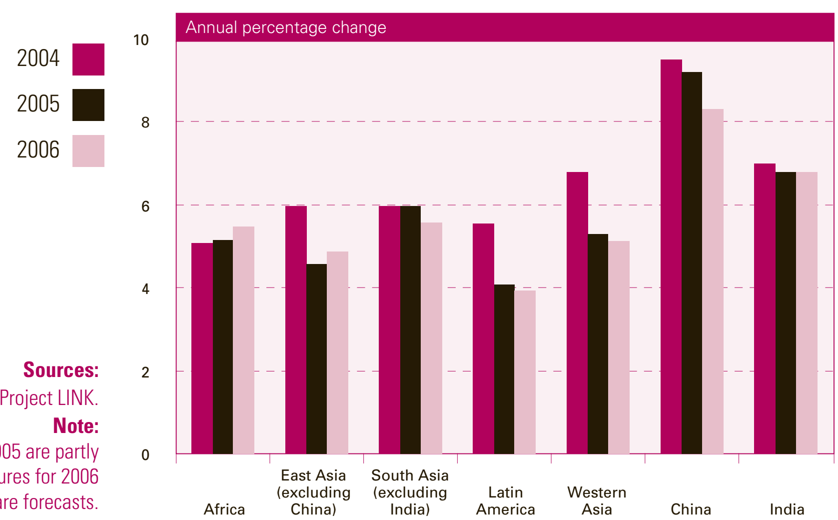
World economic growth slows down, but still robust for the decade



Growth in developing countries and economies in transition stronger than in developed countries



Slower growth in most developing-country regions, stronger growth in Africa



Sources: UN/DESA and Project LINK.

Note: Figures for 2005 are partly estimated. Figures for 2006 are forecasts.

Rising inflation, mainly due to oil price increases

Driven mainly by higher oil prices, inflation rates have edged up worldwide. Core inflation rates, which exclude such highly volatile components as the prices of energy and food, have been more stable, indicating that the pass-through of higher oil prices to overall inflation is limited. In most parts of the world, economic agents seem to expect inflation to remain low and stable. Worldwide inflation is forecast to remain tame during 2006. Nonetheless, certain inflationary pressures will need to be addressed, particularly if oil prices stay high.

The negative consequences of higher oil prices will be felt more

Higher oil prices are taking a greater toll in a growing number of oil-importing countries. Following the initial rise in oil prices, many countries adopted measures to protect domestic consumers by introducing or strengthening energy price controls and subsidies. These measures are becoming less and less viable as high oil prices persist and more of the price increases are passed on to consumers. For the longer run, policies in energy-importing countries should aim at improving their energy efficiency and at developing alternative energy sources. Oil-exporting countries continue to benefit from the higher oil prices, but at the same time the windfall gains from oil revenues are creating inflationary pressures and real exchange-rate appreciation. The macroeconomic policy challenge is to turn these gains into investments in future economic and human development.

Global imbalances constitute a downside risk

Global imbalances are widening further

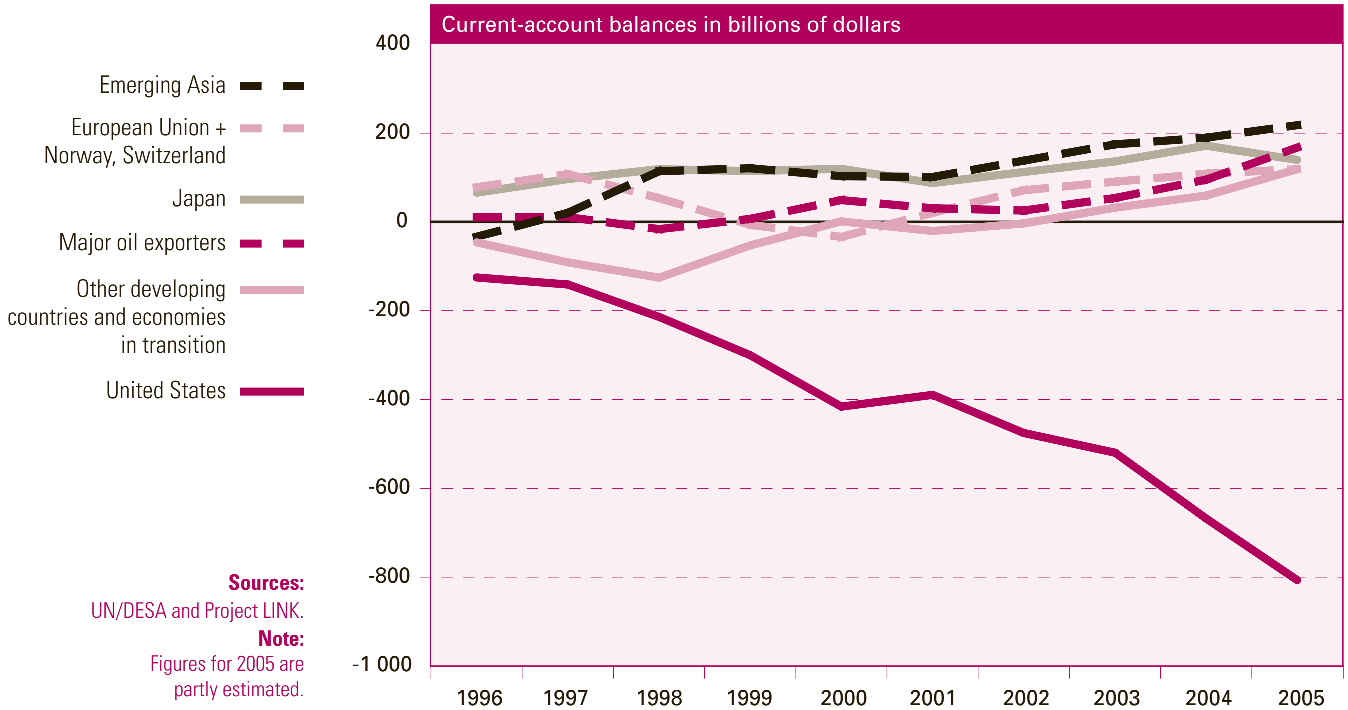
The projected growth and relative stability of the world economy are subject to some degree of uncertainty. The possibility of a disorderly adjustment of the widening macroeconomic imbalances of the major economies is a major risk which could harm the stability and growth of the world economy.

Global imbalances widened further during 2005. The current-account deficit of the United States surpassed $800 billion, matched by increased surpluses elsewhere, particularly in Europe, East Asia and oil-exporting countries. In several parts of the world, growing savings surpluses appear to be essentially caused by stagnating or reduced investment rates.

Investment has been 'anaemic' worldwide

The global investment rate has been on a long-term declining trend, reaching an historic low in 2002, with a very slight recovery thereafter, but remaining below 22 percent of world gross product. Accordingly, it may be inappropriate to speak of a "global savings glut", as some analysts have defined the macroeconomic condition of the world economy. Rather, investment demand has been "anaemic" in most of those countries running current-account surpluses, China being the notable exception among the largest economies. More specifically, since 2001, the growth of non-residential business investment has been remarkably weak in a large number of countries, regardless of their current-account balance position and despite

Widening global imbalances



Sources: UN/DESA and Project LINK.
Note: Figures for 2005 are partly estimated.

generally buoyant corporate profits and low interest rates worldwide. There are prospects that investment demand will pick up in 2006, which would strengthen economic growth. This will not take away the risk of a disorderly adjustment of the macroeconomic imbalances of the major economies, however.

Disorderly adjustment of global imbalances is a clear and present danger

Despite low interest rates worldwide and ample liquidity in global financial markets, there are strong reasons to be concerned about the sustainability of the global imbalances. The current-account deficit of the United States continues to increase at a rapid pace. The concomitant rise in the United States net foreign liability position could eventually erode the willingness of foreign investors to buy dollar-denominated assets. This could lead to a precipitous fall in the value of the United States dollar and an abrupt and disorderly adjustment of the global imbalances.

Exchange-rate realignment is not the solution

During 2005, exchange rates of the major currencies did not move in directions indicated by the global imbalances. The United States dollar rebounded strongly vis-à-vis the euro and Japanese yen. This has not helped to reduce the external deficit of the United States. In contrast, a depreciation of the dollar might achieve that, but, given the size and nature of the deficit, a very large devaluation would be needed. This in turn is undesirable, as orderly adjustment of the global imbalances should avoid a free fall of the dollar. A strong depreciation of the international reserve currency would imply large wealth losses for those holding dollar assets, undermining confidence in the dollar and triggering a swift retreat of foreign investors from such assets. The dollar did depreciate somewhat against the currencies of many developing countries during 2005, causing negative wealth effects, particularly for those holding large dollar reserves. None of this did much to prevent the global imbalances from widening, as was the case with the depreciation of the dollar against the euro and the yen in 2003 and 2004.

Policy dilemmas in managing exchange rates and reserves in developing countries

A number of developing countries have to deal with policy dilemmas in response to upward pressures on their exchange rates and increases in their foreign reserves. Many have opted for intervening in foreign-exchange markets to avoid further loss in competitiveness, while simultaneously undertaking active monetary policies to avoid that the expansion of the money supply due to reserve increases leads to inflationary pressures. Exchange-rate policies and management of reserves may face conflicting policy objectives. On the one hand, maintaining exchange-rate competitiveness is a crucial objective of macroeconomic policy in open economies and failure to do so can have important effects on economic growth and employment generation. On the other hand, the accumulation of reserves in these economies represents a transfer of resources to the countries issuing the reserve currencies at a price equivalent to the difference between the costs of their external borrowing and the (lower) returns from their holdings of foreign reserve assets. The challenge is to find the adequate balance between the desired degree of exchange-rate competitiveness and the cost of accumulating large foreign-exchange reserves.

Other downside risks

Oil prices are expected to remain high

The recent upward trend in oil prices has been mainly demand driven. As a consequence, the negative global welfare effects have been largely compensated by continued income growth worldwide. In the near term, though, the global oil market is expected to remain tight. Due to underinvestment in global oil-production capacity over the past decade, the oil market is nearing supply constraints. Oil prices should therefore be expected to remain high in the near future. Furthermore, they may prove highly vulnerable to shocks, such as natural disasters or terrorist attacks. World economic growth will be hit more severely if further oil price increases are caused by supply shocks, as was the case with the oil shocks of the 1970s and early 1980s. More recently, foreign direct investment (FDI) in the oil sector has increased worldwide and governments of many oil-exporting countries have announced new investment plans and production incentives. Over time, this should raise production capacity. If, in addition, oil importers take measures to reduce consumption of fossil energy structurally, the price of oil may come down in the medium run.

An end to the house price bubble?

A reversal in house prices in economies that have experienced substantial and prolonged appreciation in the value of houses could pose another downside risk to stable growth of the world economy. The booming housing sector has been a major driver of output growth in many of these countries, and significant wealth effects coming from housing appreciation have boosted household consumption. However, various housing indicators in these countries are at historical highs, and there are discernible signs of continuing speculative activities. A cooling of house prices will therefore lead to a moderation of overall economic growth, as already witnessed in Australia, the United Kingdom of Great Britain and Northern Ireland and several other European countries. Moreover, declining house prices will heighten the risk of default and could trigger bank crises. A number of these economies are also running large external deficits and have low household savings. A sharp fall in house prices in one of the major economies could, then, precipitate an abrupt and destabilizing adjustment of the global imbalances.

The cost of an avian influenza pandemic

The risks of an avian influenza pandemic should not be precluded. The recent outbreak of avian influenza in some countries has already caused significant economic losses and has claimed 70 lives worldwide. The world is not yet adequately prepared for an outbreak of pandemic proportions. The possible macroeconomic costs of such a pandemic could be enormous.

Policy challenges to address the global imbalances

International macroeconomic policy coordination is needed

To mitigate the risk of a disorderly adjustment in the global imbalances, the major economies should coordinate their macroeconomic policies over the medium run. It should be recognized that an orderly adjustment of the imbalances will take some time. This is so, firstly, because savings and investment patterns are not easily changed, and, secondly, because the adjustment of the widely divergent net foreign asset and liability positions will require a prolonged shift in the savings-investment balances of the major economies. Concretely, the adjustment will require measures that will stimulate savings in the deficit countries and investment, or, more generally, domestic spending in the surplus countries. More specifically, the United States should stimulate household savings and reduce public dissaving. Europe should keep interest rates down to stimulate private demand as room for fiscal expansion seems limited in most countries. More efforts should be made to revitalize investment, which the structural reform policies of recent years have failed to achieve. In Japan, financial sector reform should continue, and fiscal incentives to stimulate private investment demand should be strengthened further. Most Asian surplus countries should boost public and private investment rates, while China should boost broad-based consumption demand. Oil-exporting countries may increase social spending and investment in their oil production capacity as well as in the diversification of their production structures. Given its nature, the International Monetary Fund would provide the natural forum for international policy coordination.

Galvanizing financial resources for achieving the MDGs

In addition, all major economies should contribute to the mobilization of the additional financial resources to assist the poorest countries in achieving the Millennium Development Goals, in compliance with international agreements. To support an orderly and equitable global adjustment process, the major surplus countries in developed and emerging Asia and Europe, as well as the major oil-exporting countries, could further contribute to global development by channelling more of their excess savings to the developing countries, which are lacking adequate investment finance for their economic and social infrastructure needs.

International trade

World trade continues to expand, but non-oil commodity prices are likely to come down

International trade is still providing an important impetus to the growth of the world economy. Trade flows continue to expand at double the pace of world output. The larger developing countries, such as China and India, have seen sustained and strong export dynamics. A fair number of other developing countries have gained from substantial improvement in their terms of trade over the past few years, thanks largely to increases in the prices of oil and other commodities. However, a number of oil-importing countries that export agricultural commodities have suffered important terms-of-trade losses, because some of their export prices fell, because oil prices outpaced their export prices, or for both reasons. In general, prices of primary commodities seem to have reached a plateau, and the outlook for many non-oil commodities is for a decline in prices.

Little progress in multilateral trade negotiations…

Multilateral trade negotiations in the context of the Doha Round moved forward with the Sixth World Trade Organization (WTO) Ministerial Conference in Hong Kong Special Administrative Region (SAR) of China in December 2005. Contrary to low expectations, and even predictions of another failure, the results achieved could be qualified as very modest and marginal, but nevertheless positive. The ministerial commitment "to complete the Doha Work Programme fully and to conclude the negotiations launched at Doha successfully in 2006" will require considerable political will from the participants in order to make tough decisions and conclude negotiations within a very tight time frame.

The agreement reached at the Hong Kong Ministerial Conference represents a small step towards completing that agenda. First, a deadline was set to eliminate agricultural export subsidies in developed countries by 2013. This agreement, however, is conditional upon future agreements on full negotiating modalities as well as upon the establishment of multilateral discipline on export competition measures, such as export credits, export credit guarantees or insurance programmes, trade-distorting practices of State-trading enterprises and food aid. Despite these caveats, the agreement represents a substantial systemic advance by bringing agricultural trade further under the umbrella of general multilateral trade rules, which prohibit the use of export subsidies. Secondly, agreement was reached on a limited "development package" for LDCs. This consists of several commitments, including the permanent granting of duty-free and quota-free market access by developed countries and developing countries. In practical terms, the value of such treatment of exports from LDCs will directly depend on the inclusiveness of product coverage. If, for example, textiles and clothing (which account for roughly 20 per cent of LDC exports) are excluded by some developed countries, the gains of such a decision would be marginal. Some progress was achieved in developing the Aid for Trade initiative, which should provide additional assistance to developing countries, particularly LDCs, to improve their supply capacity and trade infrastructure in a manner which will allow them to benefit from the increased opportunities brought about by trade liberalization. Third, a decision was made by developed countries to eliminate all export subsidies for cotton in 2006. This decision is expected to have limited economic impact in the medium term. Domestic support measures for cotton producers in developed countries affect developing country cotton exporters much more strongly, particularly those in Western Africa. These trade- and price-distorting measures still have to be dealt with in the context of overall negotiations on agriculture.

… and trends towards renewed protectionism

Paralleling these advances, signs of increased protectionism and other distortions to world trade have emerged. In the aftermath of the expiration of the Agreement on Textiles and Clothing, the European Union and the United States introduced limits on imports of certain Chinese textiles. The use of non-tariff barriers has increased worldwide, partially offsetting the advances brought about by lower tariffs. Finally, there has been a mushrooming of regional and bilateral free trade agreements. These have eroded the scope of the application of most favoured nation tariffs and often exclude products of export interest to developing countries. Such trade policies may well hamper the successful completion of the Doha Round.

Finance for development

Despite more favourable financing conditions for developing countries…

Access to international finance has improved for developing countries over the past year. Private capital inflows to emerging market economies declined in 2005, yet market access continued to be favourable, and external financing costs dropped to historical lows. These conditions have favoured the emerging market economies in particular. Developments need to be followed with caution. The exceptionally low risk premiums for the external borrowing by these countries may risk financial market overexuberance. This could be followed by a sharp reversal of the capital flows in the future, causing costly destabilizing effects should the global adjustment process entail rising interest rates or substantial swings in the exchange rates of the major currencies.

…. net transfers flow from poor to rich

Despite growing private equity financing and foreign direct investment, developing countries transfer in the aggregate more resources to developed countries than they receive. This net transfer refers to the net inflow of financial resources less interest and other investment income payments. The pattern of negative transfers has lasted for about ten years and reflects the growing export surpluses of developing countries. The magnitude of these transfers has risen steadily from about $8 billion in 1997 to $483 billion in 2005. Net transfers to the poorest countries in sub-Saharan Africa are still positive, but also on the decline, reaching $2 billion in 2005, down from $7.5 billion in 1997.

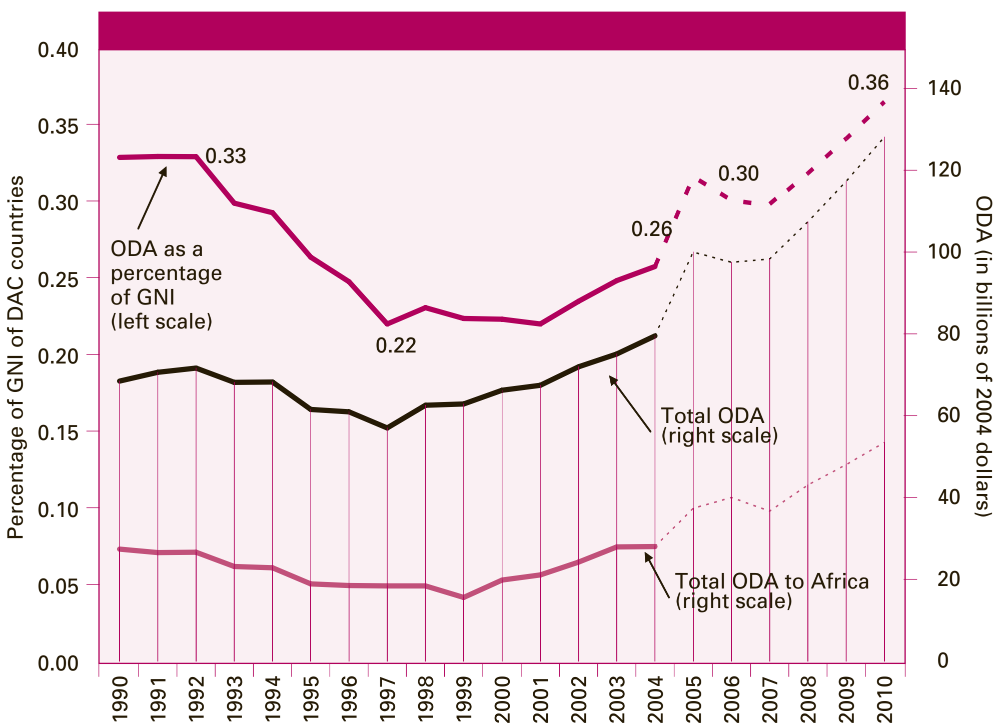
More aid, but still not enough

Official development assistance has recently increased in nominal terms, but the amount of aid received by the LDCs in recent years, after excluding resource flows for emergency assistance, debt relief and reconstruction, was only marginally higher than a decade ago. More encouraging, however, is the prospect of development aid over the medium term as significant progress has been made on commitments by major donors to deliver increased and more effective aid. Nonetheless, even with these commitments, the share of ODA in the gross national income (GNI) of Development Assistance Committee (DAC) countries would reach 0.36 per cent, still far short of the 0.7 per cent target reaffirmed in the 2005 World Summit Outcome, and hence is also short of the estimated needs to finance actions by developing country Governments in order to meet the Millennium Development Goals.

Enhanced South-South cooperation

New commitments have been made to strengthen and widen cooperation among developing countries, or South-South cooperation, the United Nations being at the forefront of efforts to foster such cooperation. Besides technical cooperation, other forms of South-South cooperation have been flourishing, such as monetary and financial cooperation, debt relief and grant assistance.

Increasing, but insufficient official development assistance (ODA)



Source: OECD/DAC.
Note: Data for 2005-2010 are projections based on pledges by DAC member states.

Slow progress has been made in the implementation of the HIPC debt-relief initiative

The implementation of the Heavily Indebted Poor Country (HIPC) Initiative for debt relief continues to move forward, albeit slowly. Most debt indicators of developing countries are improving. However, the HIPCs continue to face difficulties in reconciling the objectives of achieving and maintaining debt sustainability, promoting long-term growth and reducing poverty, as some of them have to engage in borrowing to meet the increased needs for financing their poverty reduction strategies. Unless they receive additional grant financing, many of these countries would have to rely on new borrowing to fund their poverty reduction expenditures, creating the possibility of a new cycle of large-scale external borrowing and unsustainable debt.

Rising to the challenge of poverty reduction

The recent improvement in the growth of many poor countries is still not strong enough to enable them to achieve the Millennium Development Goal of halving poverty by 2015 or to meet the other internationally agreed development goals. At the 2005 World Summit, the world's leaders reiterated their political commitments already expressed at the previous high-level international meetings on development issues, particularly the commitments contained in the Millennium Declaration and the Monterrey Consensus. The challenge for all countries is to live up to these commitments at the agreed level and within the agreed time frame.

Contents

Annex

Boxes

Figures

Tables

Explanatory Notes

The following symbols 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" ($) indicates United States dollars, unless otherwise stated.

Reference to "tons" indicates metric tons, 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 and 2005 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)
AD anti-dumping
AfDB African Development Bank
AfDF African Development Fund
ADB Asian Development Bank
AGOA African Growth and Opportunity Act (United States)
AIG Accord Implementation Group
AoA Agreement on Agriculture
APEC Asia-Pacific Economic Cooperation
APF Africa Partnership Forum
APRM African Peer Review Mechanism
ASEAN Association of Southeast Asian Nations
ATC Agreement on Textiles and Clothing
BIS Bank for International Settlements
BoJ Bank of Japan
bpd barrels per day
BTA bilateral trade agreement
CACs collective action clauses
CAFTA Central American Free Trade Agreement
CCL Contingent Credit Line (IMF)
CDB Caribbean Development Bank
CGES Center for Global Energy Studies
CIS Commonwealth of Independent States
COM common organization market
CPI consumer price index
CTG Council on Trade in Goods
CVM countervailing measures
DAC Development Assistance Committee (of OECD)
EBRD European Bank for Reconstruction and Development
EC European Community
ECA Economic Commission for Africa
ECB European Central Bank
ECE Economic Commission for Europe
ECLAC Economic Commission for Latin America and the Caribbean
EMBI Emerging Markets Bond Index
EMU European Monetary Union
ESM Emergency Safeguard Measures (GATS)
EU European Union
EURIBOR Euro Interbank Offered Rate
FDI foreign direct investment
Fed United States Federal Reserve
FSAP Financial Sector Assessment Programme (IMF)
FSI Financial Stability Institute
FSF Financial Stability Forum
FTA free trade agreement
GATS General Agreement on Trade in Services
GATT General Agreement on Tariffs and Trade
GCC Gulf Cooperation Council
GDP gross domestic product
GNI gross national income
GNP gross national product
GSP Generalized System of Preferences
HICP Harmonized Index of Consumer Prices
HIPC heavily indebted poor countries
IADB Inter-American Development Bank
IASB International Accounting Standards Board
IBRD International Bank for Reconstruction and Development

IBSA	India-Brazil-South Africa (Dialogue Forum)
ICAC	International Cotton Advisory Committee
ICF	Investment Climate Facility for Africa
ICO	International Coffee Organization
ICT	information and communication technologies
IDA	International Development Association
IEA	International Energy Agency
IF	Integrated Framework for Trade-Related Technical Assistance for the Least Developed Countries
IFAD	International Fund for Agricultural Development
IFIs	international financial institutions
IFRS	International Financial Reporting Standards
IIF	Institute of International Finance
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
IPMA	International Primary Market Association
IPNs	international production networks
IT	information technology
ITCB	International Textiles and Clothing Bureau
LDCs	least developed countries
LME	London Metal Exchange
M&As	mergers and acquisitions
mbpd	million barrels per day
MCA	Millennium Challenge Account
MCC	Millennium Challenge Corporation
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MFN	most favoured nation
MRAs	mutual recognition agreements
MTS	multilateral trading system
NAMA	non-agricultural market access
NGLs	natural gas liquids
NPV	net present value
NTBs	non-tariff barriers
NYBOT	New York Board of Trade
ODA	official development assistance
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of the Petroleum Exporting Countries
OPT	Occupied Palestine Territory
PA	Palestinian Authority
pb	per barrel
PPP	purchasing power parity
PRGF	Poverty Reduction and Growth Facility (IMF)
Project LINK	international collaborative research group for econometric modelling, coordinated jointly by the Development Policy and Analysis Division of the United Nations Secretariat, and the University of Toronto
PRS	poverty reduction strategy
PRSPs	Poverty Reduction Strategy Papers
PSI	Policy Support Instruments
PTA	preferential trade agreement
QIS	Quantitative Impact Studies
R&D	research and development
RMG	ready-made garment
RTAs	regional trade agreements
SARS	severe acute respiratory syndrome
SCM Agreement	Agreement on Subsidies and Countervailing Measures
SDRs	special drawing rights (IMF)
SDT	special and differential treatment
SGP	Stability and Growth Pact (EU)
SIDS	small island developing States
SOEs	State-owned enterprises
SPS/TBT	Sanitary and Phytosanitary Measures and Technical Barriers to Trade
TCMCS/ TRAINS	Coding System of Trade Control Measures/ Trade Analysis and Information System
TDI	Trade and Development Index (UNCTAD)
TNCs	transnational corporations
TQ	tariff quota
TRADE Act of 2005	Tariff Relief Assistance for Development Economies Act of 2005
TRIPs	trade-related intellectual property rights
UN/DESA	Department of Economic and Social Affairs of the United Nations Secretariat
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund
UNFPA	United Nations Population Fund
WGP	world gross product
WHO	World Health Organization
WIDER	World Institute for Development Economics Research (UNU)
WFP	World Food Programme
WTO	World Trade Organization

Data presented in this publication incorporate information available as of 15 December 2005.

For analytical purposes, the following country groupings and subgroupings have been used:[a]

Developed economies (developed market economies):
European Union, Iceland, Norway, Switzerland Canada, United States of America, Australia, Japan, New Zealand.

Major developed economies (the Group of Seven):
Canada, France, Germany, Italy, Japan, United Kingdom of Great Britain and Northern Ireland, United States of America.

European Union:
Austria, Belgium, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, United Kingdom of Great Britain and Northern Ireland.

EU-10:
Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia.

EU-8:
All countries in EU-10, excluding Cyprus and Malta.

Economies in transition:

South-eastern Europe:
Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Romania, Serbia and Montenegro, The former Yugoslav Republic of Macedonia.

Commonwealth of Independent States (CIS):
Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Republic of Moldova, Russian Federation, Tajikistan, Turkmenistan, Ukraine, Uzbekistan.

Net fuel exporters:
Azerbaijan, Kazakhstan, Russian Federation, Turkmenistan, Uzbekistan.

Net fuel importers:
All other CIS countries.

Developing economies:
Latin America and the Caribbean, Africa, Asia and the Pacific (excluding Japan, Australia, New Zealand, and the member States of CIS in Asia).

Subgroupings of Latin America and the Caribbean:

South America:
Argentina, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, Uruguay, Venezuela (Bolivarian Republic of).

Mexico and Central America:
Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Mexico.

Caribbean:
Barbados, Cuba, Dominican Republic, Guyana, Haiti, Jamaica, Trinidad and Tobago.

Subgroupings of Africa:

North Africa:
Algeria, Egypt, Libyan Arab Jamahiriya, Morocco, Tunisia.

Sub-Saharan Africa, excluding Nigeria and South Africa (commonly contracted to "sub-Saharan Africa"):
All other African countries except Nigeria and South Africa.

Subgroupings of Asia and the Pacific:

Western Asia:
Bahrain, Iraq, Israel, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, Syrian Arab Republic, Turkey, United Arab Emirates, Yemen.

East and South Asia:
All other developing economies in Asia and the Pacific (including China, unless stated otherwise). This group is further subdivided into:

South Asia:
Bangladesh, India, Iran (Islamic Republic of), Nepal, Pakistan, Sri Lanka.

East Asia:
All other developing economies in Asia and the Pacific.

For particular analyses, developing countries have been subdivided into the following groups:

Oil-exporting countries:
Algeria, Angola, Bahrain, Bolivia, Brunei Darussalam, Cameroon, Colombia, Congo, Ecuador, Egypt, Gabon, Iran (Islamic Republic of), Iraq, Kuwait, Libyan Arab Jamahiriya, Mexico, Nigeria, Oman, Qatar, Saudi Arabia, Syrian Arab Republic, Trinidad and Tobago, United Arab Emirates, Venezuela (Bolivarian Republic of), Viet Nam.

Oil-importing countries:
All other developing countries.

Least developed countries:
Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, Cape Verde, Central African Republic, Chad, Comoros, Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, Lao People's Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Maldives, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Samoa, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, Sudan, Timor-Leste, Togo, Tuvalu, Uganda, United Republic of Tanzania, Vanuatu, Yemen, Zambia.

Landlocked developing countries:
Afghanistan, Armenia, Azerbaijan, Bhutan, Bolivia, Botswana, Burkina Faso, Burundi, Central African Republic, Chad, Ethiopia, Kazakhstan, Kyrgyzstan, Lao People's Democratic Republic, Lesotho, Malawi, Mali, Moldova (Republic of), Mongolia, Nepal, Niger, Paraguay, Rwanda, Swaziland, Tajikistan, The former Yugoslav Republic of Macedonia, Turkmenistan, Uganda, Uzbekistan, Zambia, Zimbabwe.

Small island developing States:
American Samoa, Anguilla, Antigua and Barbuda, Aruba, Bahamas, Barbados, Belize, British Virgin Islands, Cape Verde, Commonwealth of Northern Marianas, Comoros, Cook Islands, Cuba, Dominica, Dominican Republic, Fiji, French Polynesia, Grenada, Guam, Guinea-Bissau, Guyana, Haiti, Jamaica, Kiribati, Maldives, Marshall Islands, Mauritius, Micronesia (Federated States of), Montserrat, Nauru, Netherlands Antilles, New Caledonia, Niue, Palau, Papua New Guinea, Puerto Rico, Samoa, Sao Tome and Principe, Seychelles, Singapore, Solomon Islands, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, Timor-Leste, Tonga, Trinidad and Tobago, Tuvalu, U.S. Virgin Islands, Vanuatu.

Heavily Indebted Poor Countries (countries that have reached their Completion Points or Decision Points):
Benin, Bolivia, Burkina Faso, Burundi, Cameroon, Chad, Democratic Republic of the Congo, Ethiopia, Gambia, Ghana, Guinea, Guinea-Bissau, Guyana, Honduras, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Uganda, United Republic of Tanzania, Zambia.

The designation of country groups in the text and the tables is intended solely for statistical or analytical convenience and does not necessarily express a judgement about the stage reached by a particular country or area in the development process.

a For definitions of country groupings and methodology, see *World Economic and Social Survey, 2004* (United Nations publication, Sales No. E.04.II.C.1, annex, introductory text).

Chapter I
Global outlook

Macroeconomic prospects for the world economy

Moderation of world economic growth expected

After a slowdown in 2005, moderate growth is expected in 2006

World economic growth slowed in the course of 2005 and is expected to continue at a moderate pace in the near term. World gross product (WGP) is projected to expand by about 3 per cent in 2006, thereby maintaining the pace estimated for 2005. This recent trend is noticeably below the exceptionally strong and broad-based expansion during 2004, yet still robust when compared with the longer-term trend (see table I.1). Part of the global slowdown has resulted from the maturing of the cyclical recovery in a number of economies from recessions in the early years of the new century and from the associated unwinding of the earlier policy stimuli (see box I.1). While varying in degree, several exogenous shocks, including a number of natural disasters and terrorist incidents, have also left their imprint on the current pace of growth in the world economy. Moreover, a number of downside risks could seriously affect world economic growth in the near future, particularly with oil prices even higher than currently anticipated, a disorderly unwinding of the macroeconomic imbalances of the major economies and a reversal in policy stances towards severe tightening of monetary policies.

Growth in most developing countries will be stronger than in developed countries

Economic growth will remain notably stronger in developing than in developed economies, but both groups of countries will experience a slowdown from 2004. Developed economies are expected to grow at 2.4 per cent in 2005 and 2.5 per cent in 2006, down from 3.2 per cent in 2004, while growth in developing countries will slow from 6.6 in 2004 to about 5.7 per cent in 2005 and 2006. The still rather robust performance in the developing world relies in part on very strong and sustained growth in China and India. However, there has been less divergence in the growth performance among developing countries than in previous years of the decade. High commodity prices have been an important factor in spurring growth in many of the net exporters of oil and other primary commodities. The group of the least developed countries (LDCs), to which the United Nations pays special attention, has benefited from those favourable circumstances and its overall growth performance has been better than average. Nonetheless, not all countries in this group have been able to gain, as some were hurt rather than favoured by booming commodity prices, suffered from weather shocks adversely affecting agriculture or could not cope with the end of the Agreement on Textiles and Clothing (ATC) or continued to incur economic damage owing to relentless civil strife and conflict (see box I.2). In the outlook for the global economy, growth rates among these countries will vary discernibly owing to country-specific conditions as well as their different capacities in coping with high oil prices, expected exchange-rate realignments and shifts in global capital flows (see chapter IV for a detailed regional economic outlook).

Table I.1.
Growth of world output, 1996-2006

Annual percentage change	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[a]	2006[b]
World output[c]	3.4	3.7	2.4	3.2	4.0	1.4	1.8	2.6	4.0	3.2	3.3
of which:											
Developed economies	2.9	3.3	2.7	3.0	3.5	1.1	1.2	1.9	3.2	2.4	2.5
Economies in transition	-2.5	1.0	-3.2	4.0	8.3	5.7	5.1	7.1	7.7	6.0	5.9
Developing economies	5.9	5.4	1.9	3.6	5.6	2.4	3.6	4.9	6.6	5.7	5.6
of which:											
Least developed countries	5.5	5.1	4.6	5.3	4.8	5.9	6.2	6.5	6.7	6.8	6.6
Memorandum items:											
World trade	4.8	9.3	3.6	5.1	10.8	-0.9	3.0	6.4	11.0	7.1	7.2
World output growth with PPP-based weights	4.3	3.9	2.8	3.8	3.3	2.4	3.2	4.5	4.7	4.7	4.4

Source: Department of Economic and Social Affairs of the United Nations Secretariat (UN/DESA).

a Partly estimated.

b Forecasts, based in part on Project LINK, an international collaborative research group for econometric modelling, coordinated jointly by the Development Policy and Analysis Division of the United Nations Secretariat and the University of Toronto.

c Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2000 prices and exchange rates.

Box I.1

Major assumptions for the baseline global economic forecast for 2006

The United Nations global forecast is based on detailed information regarding trends in world commodity and financial markets, policy intentions and economic prospects in a large number of countries and on an analysis of global linkages, using the LINK world econometric modelling system. The baseline outlook depends on a number of assumptions regarding policies in the major economies and key commodity prices. The principal assumptions are as follows:

- The United States Federal Reserve is expected to raise the Federal Funds interest rate to 4.5 per cent in the first quarter of 2006 and maintain it at that level for the rest of the year. The European Central Bank (ECB) is assumed to keep interest rates unchanged in 2006, while the Bank of Japan (BoJ) is expected to maintain the policy interest rate at zero in 2006 and to become less stimulatory in terms of its quantitative target for monetary policy.
- The assumptions regarding fiscal policy in individual countries are based mainly on official budget plans or policy statements. In general, fiscal policy worldwide is expected to be less expansionary in 2006 than in the previous year, with the exception of a few economies.
- The price of Brent crude oil is expected to average $59.00 per barrel in 2006, up from an estimated average of $54.70 per barrel for 2005.
- The dollar is expected to depreciate slightly during 2006 to an average of $1.22 per euro. The yen-dollar rate is expected to be around yen 110 per dollar in 2006.

Box I.2

Prospects for the least developed countries

The least developed countries (LDCs) have sustained robust growth rates, averaging more than 6 per cent per year since 2001. Growth performance varied widely within the group, however. The number of LDCs (only 41 out of 50 LDCs have data to monitor) that managed to register a per capita GDP growth of above 3 per cent increased from 15 in 2004 to 19 in 2005 and 18 in 2006. Meanwhile, 4 LDCs are expected to suffer a decline in per capita GDP in 2006, 5 countries fewer than in 2005. In 2005-2006, sustained high oil exports earnings and stronger public spending are expected to support strong GDP growth rates in a number of oil-exporting countries, such as Angola, Chad and the Sudan. Some other LDCs that export minerals and metals are also expected to see terms-of-trade gains.

In the majority of LDCs, however, economic growth depends mainly on agricultural production, which is vulnerable to weather conditions. Most LDCs enjoyed good harvests in 2005, with the exception of those adversely affected by drought, food shortages and related inflationary pressures. Lesotho, Malawi, Niger and Zambia were hardest hit by drought and food deficits. The competitiveness of the manufacturing sector in most LDCs is weak, and, with a few exceptions, this sector contributes little to export growth. The loss of trade preferences associated with the Agreement on Textiles and Clothing (ATC) in 2005 hit some LDCs, including Lesotho, Madagascar and Malawi, hard. Bangladesh is an exception, weathering the shock well and managing to expand textile production and exports. The most vulnerable LDCs are the net oil importers that suffer from high oil prices, do not gain from higher, non-oil, primary commodity prices and have limited access to external financing. Those and other adverse factors have constrained economic growth in countries such as the Central African Republic, Guinea, Guinea-Bissau and Togo.

Political stability and sound macroeconomic policies continue to be crucial for growth in the LDCs. Improved political and economic governance have directly contributed to sustained growth rates of above 5 per cent during the past three years in countries such as Cape Verde, Madagascar, Mozambique, Senegal, the United Republic of Tanzania and Zambia. Meanwhile, the ongoing civil conflicts in Côte d'Ivoire (which is not an LDC) and the Darfur region of the Sudan remain of great concern, not only because of the consequences for the inhabitants of those countries, but in view of the potentially destabilizing effects on neighbouring countries.

Many LDCs will continue to pursue relatively cautious monetary and fiscal policies. LDCs that experienced lower export earnings and higher import costs will have to rely on additional official development assistance (ODA) and debt-relief to avoid a major recession. The new plans announced by the European Union (EU) and G-8 in 2005 to substantially increase aid flows to Africa and to improve the coordination of bilateral aid programmes and policies of the member States, when fully implemented, are expected to enhance the prospects for many LDCs in the region to achieve the Millennium Development Goals (MDGs). The G-8 proposal to write off multilateral debt owed by heavily indebted poor countries (HIPC), if acted upon promptly, is also expected to facilitate long-term debt sustainability in many LDCs.

A large number of developing countries can attain a per capita GDP growth rate of 3 per cent or higher

Economic growth is an important, though not sufficient, condition for reducing poverty. Leaving aside issues of redressing income inequality within countries, one (admittedly crude) rule of thumb is that developing countries should try and achieve a growth rate of gross domestic product (GDP) per capita of at least 3 per cent per year in order to make a substantial contribution to the international goals set for poverty reduction. On average, developing countries are expected to do better than that. In the outlook, the per capita income of developing countries will grow by about 4 per cent in 2005 and 2006. Not all countries, however, are expected to perform that well. As shown in table I.2 and figure I.1, about half (51) of the 107 developing countries for which data were available managed to register per capita growth above 3 per cent in 2005, 19 reached the benchmark, but the rest (36) did not. Only two dropped out of the category of countries with adequate growth rates as compared

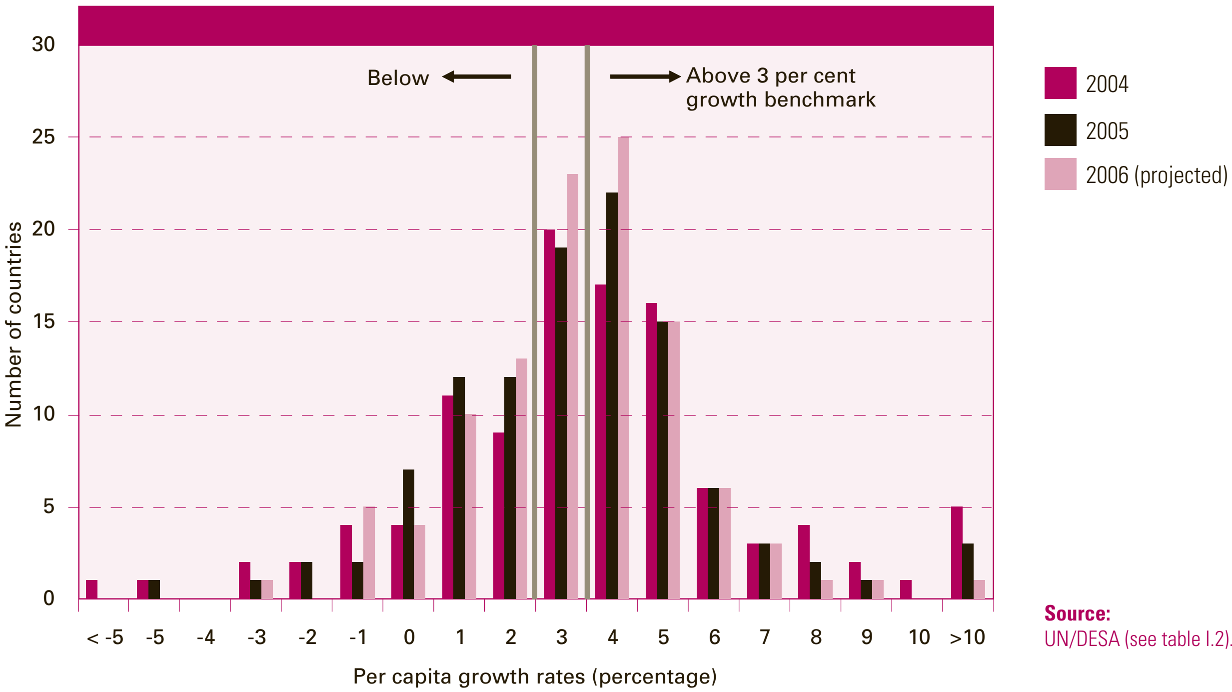
Table I.2.
Frequency of high and low growth of per capita output, 2003-2006

	Number of countries monitored	Decline in GDP per capita				Growth of GDP per capita exceeding 3 per cent			
		2003	2004	2005[a]	2006[b]	2003	2004	2005[a]	2006[b]
		Number of countries							
World	159	34	14	14	9	64	89	83	88
of which:									
Developed economies	33	4	0	0	0	10	18	14	14
Economies in transition	19	0	0	0	0	14	17	18	19
Developing countries	107	30	14	14	9	40	54	51	55
of which:									
Africa	51	17	10	8	6	18	20	22	25
East Asia	13	1	1	2	1	6	11	9	11
South Asia	6	0	0	1	0	5	5	5	5
Western Asia	13	4	1	1	1	7	8	6	5
Latin America	24	8	2	2	1	4	10	9	9
Memorandum items:									
Least developed countries	41	15	9	9	4	14	15	19	18
Sub-Saharan Africa[c]	44	17	10	8	6	13	15	18	18
Landlocked developing countries	26	7	3	4	1	9	11	12	14
Small island developing States	17	7	3	4	2	5	7	7	7
	Share[d]	Percentage of world population							
Developed economies	15.5	0.5	0.0	0.0	0.0	1.4	7.9	2.2	2.2
Economies in transition	5.6	0.0	0.0	0.0	0.0	4.6	5.2	5.1	5.2
Developing countries	78.9	9.3	1.8	2.2	1.2	59.3	68.0	62.6	68.5
of which:									
Africa	13.2	2.9	1.2	1.2	0.8	5.6	7.2	7.2	10.9
East Asia	31.0	0.1	0.0	0.1	0.0	28.0	30.5	28.3	30.3
South Asia	23.4	0.0	0.0	0.4	0.0	23.3	23.4	23.5	23.6
Western Asia	2.8	0.9	0.3	0.4	0.4	1.6	1.8	1.4	1.6
Latin America	8.5	5.5	0.2	0.2	0.0	0.8	5.1	2.2	2.2
Memorandum items:									
Least developed countries	10.7	2.8	1.2	1.8	0.6	5.5	6.8	8.1	8.0
Sub-Saharan Africa[c]	8.2	2.9	1.2	1.2	0.8	2.3	3.7	5.7	5.6
Landlocked developing countries	4.9	2.0	0.6	1.0	0.2	1.1	2.6	2.7	2.9
Small island developing States	0.8	0.4	0.2	0.3	0.0	0.1	0.3	0.4	0.4

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 Forecast, based in part on Project LINK.
c Sub-Saharan Africa, excluding Nigeria and South Africa.
d Percentage of world population for 2000.

Figure I.1.
Distribution of per capita GDP growth among developing countries



Source: UN/DESA (see table I.2).

with 2004 when the world economy witnessed the most broad-based expansion (in the sense of benefiting most countries) in decades. At the other extreme, there are 14 countries whose per capita GDP declined in 2005. Overall, the distribution of per capita GDP growth rates across developing countries in 2005 remained similar to that of 2004 (see figure I.1). Thus, while a large number of countries have registered satisfactory growth, others remain below the benchmark from the perspective of achieving the internationally agreed poverty reduction goals.

Moderate deceleration is expected to continue in the United States; Japan's modest recovery is sustained

In *developed countries*, the deceleration of growth in the economy of *the United States of America* during 2005 is expected to continue into 2006, as it is increasingly challenged by a number of structural macroeconomic weaknesses. These include the extremely low (and even negative) household savings rate and the large and growing external deficit and associated indebtedness. The probability of a cooling down of buoyant house prices, sustained high prices of energy and rising interest rates constitute important downside risks. The *Canadian* economy is expected to grow at a pace near its potential, aided by high commodity export prices and relatively flexible monetary policies. The growth outlook for *Western Europe* remains lacklustre, particularly for Germany, Italy and the Netherlands. The fall of the euro against the United States dollar in the past year, low interest rates and favourable corporate finances provide some potential for positive impulses to growth. Investment rates, however, are stagnant and uncertainty remains over public finances and, in particular, over the trade-off between the needs for more fiscal stimulus during the present economic cycle and more fiscal savings to cope with future rising costs of pension and social security schemes. Further fiscal tightening could halt the weak recovery that is under way. Structural weaknesses in the labour market also remain unresolved. In contrast, growth of the economies of the *new European Union members* is expected to strengthen as a result of stronger exports and increased long-term investment. The *Japanese* economic expansion is expected to continue, as the prolonged adjustment in excess capacity and employment by many firms has come to fruition, with the benefits gradually spreading to the household sector. Progress continues in corporate financial restructuring, but dealing with the large public debt remains a major challenge. *Australia* and *New Zealand* continue to witness moderate growth, with the former economy being held back because of a sharp cooling of the housing boom, and in the latter, traded goods production suffering because of the appreciation of the domestic currency.

Growth in the transition economies remains robust

Among the *economies in transition*, growth in the group of *Commonwealth of Independent States* (CIS) is expected to remain robust. It is benefiting from higher commodity prices, in particular for oil, gas and metals, and domestic demand expansion owing to rising real wages and expansionary policies. In the Russian Federation, rising production costs, the continued real appreciation of the ruble, and inadequate investment levels give cause for concern about growth prospects. Institutional and structural weaknesses and the need to reduce dependence on oil and primary commodities will continue to constitute key policy challenges for the region as a whole. Growth in *South-eastern Europe* is expected to remain strong, but to decelerate somewhat. More restrictive macroeconomic policies, to stave off an expected overheating of these economies, may marginally affect private consumption. Investment growth will nevertheless remain dynamic as a result of continued FDI inflows directed to both new investments and the recapitalization of privatized State enterprises, the modernization of existing firms and ongoing public infrastructure projects.

The outlook for Africa is optimistic, although subject to some risks

Among the *developing countries*, the growth outlook for *Africa* remains optimistic, though subject to both economic and political risks. GDP growth is expected to remain at around 5 per cent (for the continent as a whole, as well as for sub-Saharan Africa, excluding Nigeria and South Africa). This upward trend is supported by a strong expansion of oil and non-oil primary exports and by robust domestic demand in many countries in the region. Not all have seen an equal amount of welfare gains as civil and political conflicts have lessened growth in a number of countries in the region. Growth is also slower among net oil importers and some agricultural exporters (see also box I.2). Economic growth in *East Asia* remains strong in the outlook, although the downside risks have increased, particularly in view of higher oil prices. Meanwhile, China continues to see a strong economic expansion driven by exports and investment. Import demand, though, has decelerated significantly. The renewed outbreak of avian influenza will pose certain risks for some countries in the region. In *South Asia,* only a marginal slowdown is expected for 2006. The agricultural sector has benefited from normal monsoon rains in 2005, and the growth in industrial production and in the service sector has remained strong, particularly in the textiles and ready-made garment (RMG) sector, especially in India, Pakistan, Sri Lanka and Bangladesh. The major impediment to growth in the region continues to be higher oil prices. Growth in *Western Asia* is expected to maintain its robust pace into 2006, based on the expectation that oil prices remain high and oil production stays at roughly existing levels, close to full capacity. Many of the oil-importing countries in the region have benefited from spillover effects via trade, tourism and financial flows from the region's oil exporters. The region remains, however, extremely vulnerable on the security and political fronts and subject to potential disruptions to the oil industry's infrastructure. Growth in *Latin America and the Caribbean* is expected to slow down modestly in 2006. Many economies, particularly those in South America, continue to gain from higher commodity prices and strong external demand. Mexico and Central American countries face increasing pressure in their manufacturing sectors from international competitors. The economies of the region remain vulnerable to any worsening of external conditions.

China and India will sustain a strong growth

Stabilizing international economic environment for developing countries

The auspicious international economic environment is expected to become more challenging for developing countries

Higher commodity prices and greater availability of foreign capital have benefited many developing countries. The international economic environment, however, is expected to become more challenging in the near future. The key risks in the outlook are associated with persistently high oil prices and large global imbalances. High oil prices affect developing countries in diverse ways. A disorderly adjustment of global imbalances could significantly worsen the external conditions facing many developing countries (see below, as well as chapters II and III, for a more detailed look at international trade and finance).

Growth of world *merchandise trade* has slowed in line with the deceleration of global output growth. The drop in the growth rate of trade flows has been widespread, but even at the slower rate the exports of developing countries continue to grow faster than those of developed countries, thereby increasing their share in the world market. This increase is particularly evident for some of the most dynamic developing countries, such as China and India, whose exports continue to increase at an annual rate of 20 per cent or more.

International trade flows are expected to rebound slightly

Subject to important uncertainties, the outlook is for a rebound of business investment in many countries from the weakness of the past few years. This rebound may be assisted by low interest rates and sound corporate profitability, and it would increase global demand for capital goods, thereby raising the exports of major developed countries such as the United States and Germany. Meanwhile, continued robust growth in a few large developing countries should sustain strong international trade flows of energy and raw materials.

Little progress is made at WTO negotiations

The momentum for growth of international trade will depend in part on the progress in multilateral trade negotiations. Some positive developments emerged towards the end of the year. The adoption of the permanent amendment of the Agreement on Trade-Related and Intellectual Property Rights (TRIPS) of the World Trade Organization (WTO) to facilitate access to essential medicines for countries with no or limited production capacities was one of them. Moreover, negotiations at the Sixth WTO Ministerial Conference in Hong Kong Special Administrative Region (SAR) of China in December 2005 were fruitful in the sense that another impasse in these trade negotiations was avoided and a more concrete agenda has been set for further talks. The more difficult task ahead will be to complete all the items on the Doha agenda by the end of 2006. Though marginal, some progress was made in meeting certain developing country needs, specifically for the LDCs, regarding duty-free and quota-free access to developed country markets and the abolition of all forms of cotton export subsidies by developed countries in 2006 (see chapter II). The immediate effects on trade will nevertheless be limited. By avoiding a collapse of multilateral negotiations, however, recent tendencies towards renewed protectionism outside the WTO framework may be stalled.

Oil prices remain high…

Oil prices increased sharply in 2005, particularly since May, as a result of tight supply, growing demand (though more slow than in 2004), geopolitical concerns, a series of disruptions to production and refining capacities caused by natural disasters and other incidents. Global oil demand is estimated to have grown about 1.5 per cent in 2005, markedly lower than the 3.7 per cent increase registered in 2004. In 2006, global oil demand is expected to grow by 2 per cent. Global oil supply remains tight. Some spare production capacity exists, but it mainly consists of heavy and sour crude that does not match existing refining capacity. In Iraq, recovery of oil production continues to be impeded by the security situation. Oil prices are expected to remain high in the near term, and the impact on growth and inflation will vary from country to country.

...but prices of non-oil commodities may flatten

The *prices of non-energy primary commodities* displayed divergent movements in 2005, along a generally upward medium-term trend. While the prices of minerals and metals increased substantially, most agricultural commodity prices, except coffee, softened. The outlook is for demand for most commodities to expand at the current pace and in line with the projected GDP growth in major economies, particularly in China and India. Nonetheless, prices are expected to remain flat or even drop in the near term because of an expansion in supply and a build-up in inventories.

Is the improvement in the terms of trade for many developing countries sustainable?

Many commodity-exporting developing countries have witnessed *terms-of-trade* gains in varying degrees over the past few years and/or benefited from increases in export volumes. The question is whether the upward trend is sustainable. Continued strong demand for primary commodities stemming from the robust growth in manufacturing in China, India and some other developing countries might support a continued upward trend in commodity prices in the short run. In view of the past history of high volatility in commodity markets, primary commodity exporters should be aware of the risk of a sharp reversal in prices.

Net transfers continue to flow from poor to rich countries...

Private capital flows to emerging market economies continued to be strong in 2005. The momentum is, however, expected to taper off in 2006, as most of the favourable conditions that bolstered capital flows over the past two years seem to have played themselves out. Despite buoyant private capital markets, the net transfer of financial resources to developing countries is increasingly negative; there is a rising flow of capital—net of interest and other investment income—moving from developing to developed countries (see chapter III), which reflects a variety of causes, positive and negative. Net transfers are still positive for sub-Saharan Africa, but declining. This flow of resources from poor to rich countries has been going on for the past ten years. It is closely associated with the widening external deficit of the United States, which is absorbing the major share of those transfers. For many developing countries, the pattern of resource flows is not a very desirable state of affairs, and, moreover, as discussed further below, is putting the world economy at risk.

...yet private capital flows to emerging market economies are strong

FDI flows continued to recover in 2005, although they remain concentrated in a small number of countries. The level of FDI is expected to remain steady, as many transnational corporations (TNCs) continue to expand their operations in major developing countries that are experiencing high growth. FDI flows concentrate in natural resources, electrical and electronic products, and services sectors. Meanwhile, South-South FDI flows have increased rapidly. So too has the outward investment by developing countries, as companies based in those economies aim to gain access to overseas technology and management expertise, as well as to natural resources.[1]

All other types of private capital flows to emerging market economies also increased in 2005, with an especially rapid expansion in bond issues. The improvement of certain macroeconomic fundamentals in many developing countries—including low inflation, current-account surpluses, large capital inflows, and strong build-up of reserves—in conjunction with low yields in developed markets, have generated strong demand for emerging market assets. This demand also applies for lower-rated credits, despite historically high prices. Meanwhile, favourable financing terms have allowed emerging market economies to adjust their debt structures, with some of them accelerating their borrowing programmes planned for 2006. Several Latin American countries managed to issue local-currency-denominated bonds in international markets.

1 See UNCTAD, *World Investment Report 2005* (United Nations publication, Sales No. E.05.II.D.10).

The exceptionally low spreads for emerging market economies may not be sustainable

The external financing costs for emerging market economies have declined: the spreads in the Emerging Markets Bond Index (EMBI) reached an all time low in September 2005, reversing only slightly subsequently. The current level of spreads, however, may not be sustainable, as debt ratios in some countries are reaching critical points of sustainability. As a response to perceived risks of accelerating inflation, the major developed countries may further tighten monetary policies by increasing their policy interest rates.

Lacklustre employment growth

The employment situation worldwide remains unsatisfactory

The employment situation worldwide remains unsatisfactory. During the recent phase of global recovery, employment creation has lagged behind output growth, reflecting a rise in labour productivity. Job creation, however, is falling short of the expansion of the labour supply in the majority of countries, and consequently unemployment rates are still notably higher than their levels prior to the global downturn of 2000-2001 (see tables A.7, A.8 and A.9). At the same time, many developing countries are also facing high levels of structural unemployment and underemployment which are left unresolved by current growth patterns. These employment conditions limit the impact of growth on poverty reduction.

A gradual cyclical recovery in employment continues in developed countries...

A gradual but mild recovery in employment continues in most developed countries. In the United States, the average monthly increase in wage employment is still below the pace needed to prevent the unemployment rate from rising. The displacement of labour caused by the hurricanes led to an additional increase in the unemployment rate during 2005. Labour demand in the manufacturing sector continued to stagnate and the total number of jobs in this sector is still far below the level of 2000. In Western Europe, unemployment rates are still about one percentage point above their low levels of 2001, but a gradual improvement is discernible. The cyclical increase in unemployment during the first years of the century did not fully reverse the more structural downward trend in unemployment achieved by labour market reforms enacted throughout Europe over the past decade. In many European countries, more restrictive wage policies have kept domestic demand down, which, along with productivity growth, has led to lower capacity utilization and higher cyclical unemployment. The unemployment rate in Japan has been declining steadily in 2005, but is still above the levels of the lacklustre 1990s. A few other developed economies, such as Australia, Canada and New Zealand, are exceptions to this overall picture. Their unemployment rates have reached historic lows owing to a prolonged period of high output growth, and, even with the more recent deceleration of growth, unemployment has remained low.

...but the unemployment situation in developing countries and economies in transition is more pressing

The unemployment situation in developing countries and economies in transition is more pressing, both in cyclical and structural terms. Official open unemployment data, which often only cover urban areas, in general, underestimate by a large margin the severity of the unemployment and, particularly, the underemployment situation in most developing countries. Nonetheless, even by the open unemployment measure, only a small number of countries in Asia, Latin America and in the group of economies in transition registered a reduction in unemployment rates. Unemployment rates for most Asian economies are still far above their levels prior to the Asian financial crisis of the 1990s, and, despite some improvement, unemployment rates in most Latin American countries and economies in transition are still high—above 10 per cent in many of them. In China and many Asian economies, where rural areas still account for a large share of the population, surplus labour and high rates of underemployment remain a long-term policy concern. In South Asia, for example, the formal sector is unable to absorb a rapidly growing workforce and unemployment is highest among the young—which is also the case for many other developing countries.

Structural unemployment and underemployment problems are particularly harsh in Africa despite its recent growth recovery. Official rates of unemployment are 10 per cent or higher in some of those economies. Structural unemployment problems have occasionally been aggravated by special circumstances. For example, the short-term impact of the decline in African textile exports owing to the ending of the ATC in 2005 has included the loss of thousands of jobs in Kenya, Lesotho, Madagascar, Malawi, Mauritius, Swaziland and South Africa.

Impact of higher oil prices on inflation and income

Higher oil prices transfer incomes across countries

An obvious effect of the rise in oil prices has been the transfer of income from consumers to oil producers and from oil-importing countries to oil-exporting countries. Other important effects of higher oil prices include the impact on inflation and the consequences for GDP growth in individual economies and for the world economy as a whole. Some of those effects are less obvious as they are entangled with other factors, and their magnitude varies from country to country, depending on the economic structure as well as policy measures.

Negative welfare effects have so far been offset by the continued income growth at the global level

Thus far, world economic growth has not been visibly affected by the higher oil prices because the recent upward trend in oil prices has been mainly driven by a strong increase in global oil demand. Negative welfare effects from higher costs for producers and consumers have been offset by the continued growth in income. Should the push no longer come from the demand side, but rather from restrictions on the supply side—as was the case with the oil shocks of the 1970s and early 1980s—world output growth could be hurt substantially.[2] The risk of such a supply-side shock to oil prices is certainly present, given the current tightness in global oil production capacity, itself a result of underinvestment in the energy sector over the past two decades. New investment plans and policy incentives to redress this situation have been announced in several oil-exporting countries, but these solutions will only raise production capacity in the medium term. In the short run, major supply disruptions could well be caused by various unforeseen factors, including geopolitical tensions and natural disasters. In any case, the significant upward movement in the prices of long-run oil futures reflects the expectation in the market that existing production capacity will remain constrained for some time to come.

Oil-exporting countries continue to enjoy rising income and improving macroeconomic balances

Oil-exporting countries continue to benefit from the higher oil prices, which have boosted income and improved macroeconomic balances. Those countries have been recycling oil revenues into the global economy via their growth in imports, accumulation of foreign assets and, particularly, their reduction in both external and internal public debt. At the same time, the windfall gains from oil revenues have created inflation pressures and resulted in real exchange-rate appreciation. The latter is undermining the competitiveness of other traded-goods activities, which for oil exporters with important manufacturing sectors (such as Mexico and the Bolivarian Republic of Venezuela) will pose future adjustment problems when oil prices drop again.

More oil-importing countries will see growing adverse effects of higher oil prices

Until recently, most oil-importing countries managed to deal reasonably well with the adverse effects of higher oil prices. A growing number of them, however, particularly low-income countries, are now showing signs of deteriorating economic conditions in

2 See Pingfan Hong and others, "The impact of higher oil prices on the global economy—A tale of two different cases", Working Paper (2004), Social Science Research Network, available from http://www.ssrn.com/.

the form of rising inflation, worsening external and fiscal balances, and declining profits in some sectors.

Oil-importing developing countries are affected by higher oil prices to different degrees. Considering covariant movements between oil and other commodity prices, three discernible patterns exist.[3] First, countries with a dominant share of exports of minerals and mining products (for example, Chile, Niger, Peru, Zambia and a few other Latin American and African countries) have witnessed positive terms-of-trade shifts as the prices of their exports have surpassed the increases in oil prices. Second, agricultural exporters show mixed terms-of-trade gains and losses. Cotton exporters, such as Benin and Burkina Faso, have been hit by falling cotton prices and hence by significant terms-of-trade losses. Similarly, Malawi's terms of trade declined dramatically because of weak prices for tobacco and sugar. Cuba, on the other hand, another exporter of tobacco and sugar, has seen an improvement in its terms of trade as it also exports nickel, whose price has risen sharply. A third group of oil-importing developing countries with a high share of manufactured exports has suffered from worsening terms of trade in the past few years, as a result of the higher prices of oil and raw materials and a decline in the prices of their manufactured exports. Also within this group, the impact of the higher oil price has been diverse. Several countries, particularly those in East and South Asia, including China and India, could easily cope with the terms-of-trade shock, given the strong export dynamics of their manufacturing sectors. Others face greater difficulty. Pakistan, for example, suffered very severe terms-of-trade losses as a result of an export structure dominated by labour-intensive clothing products facing heavy international competition and falling world market prices and a higher-than-average share of oil in total imports.

Oil prices drive up headline inflation, but core inflation remains tame

Headline *inflation* rates have edged up markedly in a majority of countries, driven mainly by higher oil prices. Core inflation rates, which exclude such highly volatile components as the prices of energy and food, have been much more stable, indicating that the pass-through of higher oil prices into overall inflation is limited. Economic agents worldwide seem to expect inflation to stay low. With such well-anchored inflation expectations, fears of a return to high inflation seem ill-founded.

The effects of higher oil prices on overall inflation in an economy will work through various channels in different stages

Nonetheless, certain inflationary pressures need to be addressed, particularly those associated with higher oil prices. The effects of higher oil prices on overall inflation in an economy will work through various channels in different stages. In the first round, the transmission of higher international oil prices (measured in United States dollars) into domestic oil prices and the prices of oil products such as gasoline is mostly direct in many countries, although the effects may not be so straightforward for some countries. Government controls on domestic energy prices, tax relief on oil products and changes in exchange rates can all shield, to some extent, domestic oil prices from higher international oil prices. For example, domestic oil prices in the euro area did not change much in 2004 because of the offsetting effect of an appreciating euro against the dollar. Prices measured in euros were much higher in 2005, however, when the European currency depreciated. In Asia, a number of economies have managed to contain the rise in domestic oil prices compared with the increase in international oil prices by various measures, including subsidies that in turn have put pressure on fiscal balances. Such measures to smooth spikes in global oil prices can only be temporary, given the magnitude of the oil price increases and difficulties in sustaining large fiscal deficits. As those countries reduce these measures, stronger first-round effects of higher oil prices are expected, as is already the case in Indonesia and a few other economies.

3 See UNCTAD, *Trade and Development Report* 2005 (United Nations publication, Sales No. E.05.II.D.13).

The change in oil prices measured in domestic currency will add to the overall consumer price index, wholesale price index and other measures of inflation, according to the weight of oil consumption in those indices. The effects in the second round will depend on how much firms can pass the increase in their energy costs through to the prices of their products and services and, more importantly, how consumers and firms together will adjust their inflation expectations, as well as their wage and price setting.

Pass-through of higher oil prices is weak

So far, most firms find it difficult to pass the increase in oil prices through to the prices of their products and services, mainly because of a very competitive environment. Meanwhile, the dynamic relocation of energy-intensive manufacturing activity worldwide observed in recent years has allowed the increase in energy prices to be absorbed mostly in the developing countries before the final consumer goods are shipped to the developed countries. Among developing countries, the absorption is made possible partly by the growth in labour productivity (as labour moves from low-productive sectors to high-productive sectors) and partly by squeezing wages. Thus, the transfer of real income to oil producers comes about to the extent that wages are not indexed to inflation and real wage growth does not follow productivity growth.

Real wages are affected by higher oil prices

Labour markets and wage formation play key roles in determining the second-round inflation effects of higher oil prices. With a weak employment situation in most countries, labour has little bargaining power and the once popular wage-indexation mechanism is found today in few economies.

In some cases, higher oil prices can even have a dampening effect on core inflation. If higher oil prices are temporary, households facing lower real income may reduce their savings to maintain their real consumption. If higher oil prices persist, however, consumers may have to cut their spending on other goods and services, leading to lower prices for those goods and services. Precisely how these effects work themselves out varies from country to country, but so far no country has reported strong second-round effects.

Core inflation rates in most developed countries are between 1 to 3 per cent, below the upper bound of inflation targets set by those countries. In contrast, high inflation rates of around 10 per cent can still be found elsewhere. More specifically, inflation is accelerating in economies in transition. In Latin America, inflation decelerated in most countries. In Africa, high inflation rates are mostly related to structural problems rather than to the increase in oil prices. Meanwhile, Hong Kong SAR has just emerged from a period of deflation and Japan also seems close to doing so.

Increased international competition has played a key role in curbing global inflation

Increased international competition has played a key role in curbing global inflation over the past decade. In this regard, rising protectionism may be of more concern than higher oil prices. Rising protectionism could be part of a disorderly adjustment of global imbalances (see below), reducing competition in markets for manufactures and reversing the downward trend in industrial prices.

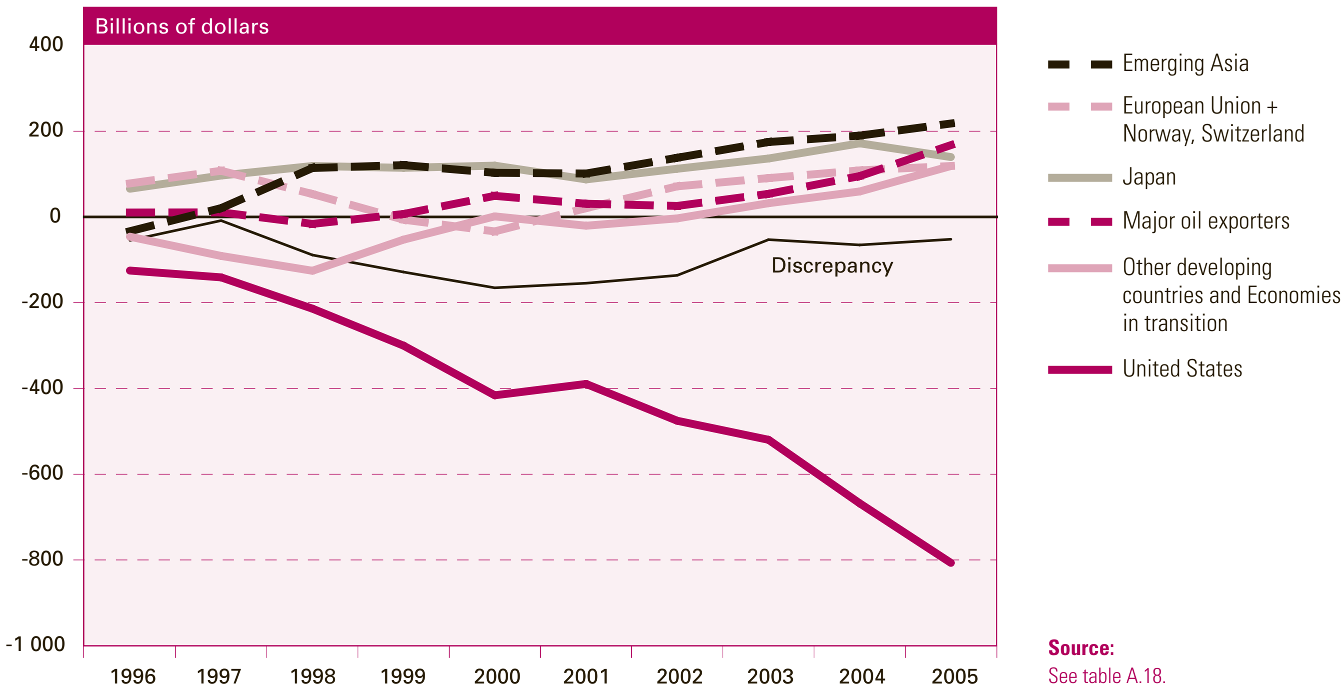
Widening global imbalances

The macroeconomic prospects as delineated above are subject to a number of uncertainties and downside risks. One particular risk is associated with the widening macroeconomic imbalances of the major economies and the possibility of a disorderly global adjustment.

Global imbalances widened further during 2005

Global imbalances widened further during 2005. The current-account deficit of the United States surpassed $800 billion, matched by increased surpluses elsewhere, particularly in Europe, East Asia and in oil-exporting countries (see figure I.2).

Figure I.2.
Global current-account imbalances, 1996-2005



Source:
See table A.18.

There are contrasting views on the causes as well as the sustainability of the external and internal deficits of the United States, on the one hand, and the surpluses in the rest of the world, on the other. A large number of developing countries are running current-account surpluses. This is not only the case in East Asia, where savings rates traditionally have been high, but also in a number of Latin American countries. This creates additional uncertainty regarding the implications of a rebalancing of the disequilibrium for world financial markets and global economic growth.

The nominee for the chairmanship of the United States Federal Reserve Board, Ben Bernanke, for instance, holds that United States government policies to reduce its fiscal deficit will not be effective in dealing with the current-account deficit as the latter is mainly caused by what has been going on in the rest of the world. According to this view, global imbalances reflect a worldwide ‘savings glut’, as is evident from two coinciding trends: a number of countries with high savings rates, mainly in Asia, seem to have enlarged their positive saving-investment gaps over the past few years, and long-term interest rates worldwide have been at exceptionally low levels.[4] Under those conditions, it seems relatively easy to finance the large external deficit of the United States. Therefore, adjusting the global imbalances through a reduction in the fiscal deficit and a concomitant increase in domestic savings in the United States would not seem to be the first relevant or necessary step to take. While Bernanke does recognize that reducing the fiscal deficit of the United States is “a good idea”, in his view effective global adjustment should start elsewhere, specifically with emerging market economies’ becoming net borrowers again.

4 Ben Bernanke, “The Global Saving Glut and the U.S. Current Account Deficit”, Sandridge Lecture (10 March 2005), Virginia Association of Economists, Richmond, Virginia.

Other commentators, in contrast, consider current global imbalances to be almost exclusively rooted in policy decisions in the United States, which allowed the fiscal position to deteriorate and monetary policies to be expansionary. Those policies caused the sharp drop in national savings through increases in the government deficit and in housing wealth, which combined to push down household savings.[5] Proponents of this view argue that changing macroeconomic policies in the United States is the key to reversing global savings-investment imbalances.

Both positions seem to be overemphasizing what has happened to savings and to miss two crucial points. First, investment rates have fallen to historical lows and have failed to rebound to pre-recession levels despite a sharp restoration of corporate profits and low borrowing costs. Second, the United States has been running rising twin deficits (and, since the private sector has entered into deficit as well, there is now a triplet of deficits) over a prolonged period of time, which has led to a corresponding widening of the net foreign asset positions of the world's largest economies. The situation has reached a point at which exchange-rate adjustment has not only become ineffective in reducing the imbalances, but also at which any major realignment would be likely to disrupt global financial markets.

Global investment anaemia, not a savings glut

There is no global savings glut...

It seems paradoxical to speak of a savings 'glut' when global savings and investment rates are below 22 per cent of WGP and have been persistently on the decline since the 1970s, reaching an historical low point in 2002. They are still at the lowest level since 1983, despite rebounding modestly from 2003 (see figure I.3). The recent increase in savings in some parts of the world is mainly due to increased *corporate savings* in Japan and fast-growing East Asia (caused in part by corporate restructuring following the financial crisis) and increased *public savings* in Europe (partly explained by tight fiscal policies related in part to concerns over future sustainability of pension schemes and social security systems) and in oil-exporting countries (fueled by higher oil prices). Corporate savings in the United States are also up following the decline in stock market prices. Aggregate savings are down, however, owing to ever-lower household savings and the lack of fiscal adjustment, which keeps public savings low. The overall trend has been towards a declining global savings rate. It is hard to argue that there is too much savings in the world economy, as the recent increase followed a prolonged period of a declining global savings rate.

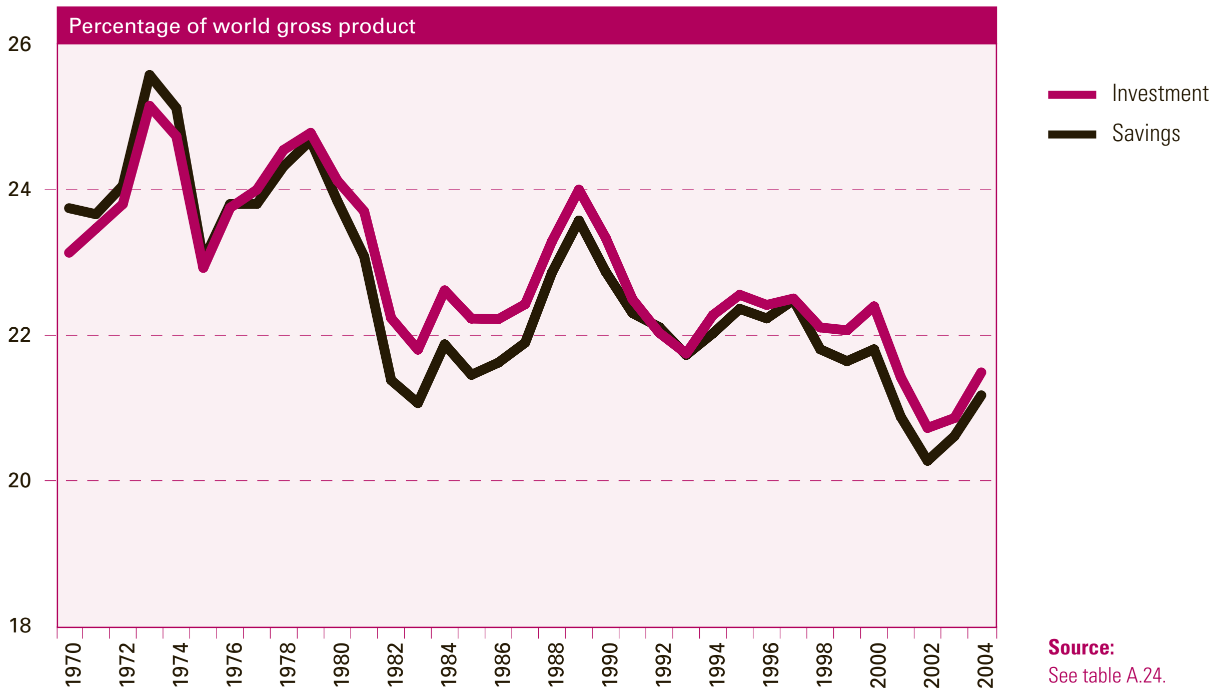
...but a global investment anaemia

Further, by basic national income accounting rules, global savings must equal global investment, such that there can be no excess savings ex post, meaning also that the current-account balance for the world must add to zero.[6] This accounting identity is not fully reflected in the data, as can be observed from figures I.2 and I.3, owing to statistical discrepancies, and thus some caution is required when studying those data. Global income accounting rules, however, imply that savings surpluses of some countries are determined by

5 See, for instance, Wynne Godley, "Imbalances looking for a policy", *Policy Note* 2005/4 (2005), Annandale-on-Hudson: The Levy Economics Institute at Bard College; and Nouriel Roubini and Brad Setser, "Will the Bretton Woods 2 regime unravel soon? The risk of a hard landing in 2005-2006" (2005), available from http://www.stern.nyu.edu/globalmacro.

6 For an elaboration of the global accounting rules and an analysis of the sources of the statistical discrepancies, see, for example, Rob Vos, "Accounting for the World Economy", *Review of Income and Wealth*, vol. 35, No. 4 (1989), pp. 389-408; and Rob Vos and Niek de Jong, "Trade and financial flows in a world accounting framework. A balanced WAM for 1990", *Review of Income and Wealth*, vol. 41 (1995), pp. 139-59.

Figure I.3.
Global savings and investment rates, 1970-2004



Source:
See table A.24.

the external deficits and hence savings gaps of other economies. Hence, to focus solely on the world's major economy is to overlook specific conditions which are driving up savings surpluses elsewhere in the world. The recent increases in oil prices are a cyclical part of the story, driving up savings surpluses in the economies of oil exporters which typically have low absorptive capacity. Fast growth in Asia has pushed up savings rates more than investment. Savings surpluses of oil exporters and emerging Asia may not seem very large as a share of world output (about 0.3 per cent of WGP for each grouping; see table A.21), but are large enough to make an impact on financial markets, pumping dollar liquidity back, mainly to the financial markets of the major deficit country. Notably, much of the excess liquidity is going into dollar-denominated assets, particularly United States government bonds, pushing down interest rates. In China and other emerging market economies many of these assets are managed within official reserves (see below). Most oil exporters have found other uses for their savings surpluses. In particular, West Asian oil exporters have been using an important part of their current financial surpluses to pay off their large internal and external public debts and to fuel fiscal stabilization funds. The remainder is believed to go primarily into dollar assets. Hence, because oil is traded in dollars and the debt of oil exporters is also mainly dollar-denominated, the use of petrodollars and Asian official reserve accumulation alike have been supporting the value of the dollar and sustaining the inflow of capital to the United States.

Investment demand is weak in surplus countries

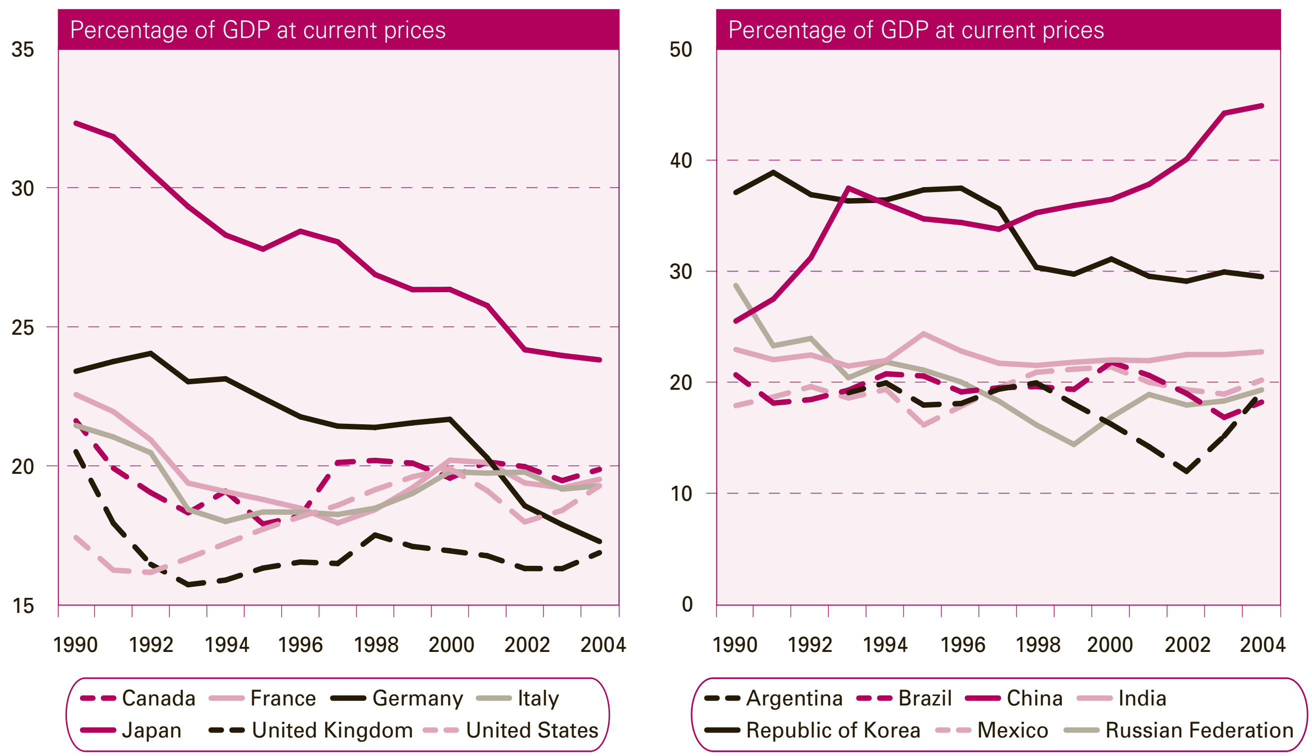
More importantly, a proper look at the data shows that the increased savings surpluses in most major economies in Europe and Asia are primarily due to a weakening of investment growth. Fixed investment rates are down in almost all large developed and developing economies, and this holds for both total and (non-residential) business investment (see figures I.4a and I.4b as well as table A.23).[7] Declining or stagnant investment rates also

7 The data in figures I.4 (a) and (b) show investment rates only as shares of GDP at current prices. While not shown here, investment volumes have also been stagnant.

Figure I.4.
Fixed investment rates in major developed and developing economies, 1990-2004

(a) G-7: Fixed investment rates

(b) Major developing countries and the Russian Federation: fixed investment rates



Source: See table A.23.

characterize recent trends in the dynamic Asian economies as well as other large emerging market and developing country economies. China is one of the few large economies that does not fit this pattern. Not only are investment rates down, investment volumes are stagnant in the major developed and developing economies. Thus, instead of defining the current global macroeconomic condition as a 'glut' in savings, it seems more appropriate to speak of a global investment 'anaemia', which has a low global savings rate as its counterpart.

Understanding the current global imbalances thus requires an explanation of the weak investment demand that is particularly present in the private corporate sector of the principal surplus countries. The data clearly show that corporate investment is not picking up in the major economies, such as Germany, Japan and the United States, despite low interest rates and remarkably buoyant corporate profits and savings (see table A.23). Also, in several dynamic Asian countries with robust growth, such as India and the Republic of Korea, business investment is significantly down from levels of the late 1990s.

A number of complex factors are behind the weakening global trend in business investment

A number of reasons could explain the weakening trend in business investment around the globe. Investment rates are down in virtually all *developed countries*, but most starkly in Japan and the euro area. The lower rates partly reflect a cheapening of the cost of capital (through low interest rates and productivity growth in capital goods industries) keeping investment down in nominal terms.[8] Yet, as indicated, non-residential private investment has also come down in volume terms, though more modestly, despite high corporate profits. Several factors

8 See IMF, *World Economic Outlook, September 2005: Building Institutions* (Washington, D.C., International Monetary Fund, 2005).

could explain this behaviour. In Japan and Europe, aggregate demand and consumer confidence have been weak. Major firms across the globe have gone through processes of balance-sheet restructuring and have become more cautious about expanding production capacity in the aftermath of the 2000 recession. Meanwhile, the excess liquidity in the global system has led private investors as well as pension and insurance funds to adjust their portfolios by increasing holdings of financial assets, such as United States government bonds, as well as riskier equities, such as emerging market stocks and bonds, real-estate backed debt and commodity funds. All of this has been to the detriment of production capacity-enhancing business investment. A different, yet compounding factor behind depressed global investment demand is the rise in capital productivity worldwide as a result of the information and communication technology (ICT) revolution.

In many *East Asian economies* (excluding China), lower investment rates are in part the result of the adjustment process following the 1997 financial crisis, characterized by postponing new investment projects and maximizing the use of existing production capacity. In addition, investment growth has been curbed further by the ongoing relocation of some manufacturing bases from those economies to China. Despite high growth, India's investment rate has been virtually stagnant since 1990. The volume of investment has continued to rise, however, though at a slowing pace since 2000. Corporate business investment was driving investment growth in India during most of the 1990s, but since 1998, the dynamics of investment has shifted towards non-residential investment by household-owned businesses, which might suggest output growth is becoming more broadly based. Compared to the 1990s, investment rates have continued to be lower or stagnant in most *other major developing countries* and emerging market economies, including Argentina, Brazil, Malaysia, Mexico, the Republic of Korea, the Russian Federation and Turkey. In some of these cases (Argentina, Mexico and the Russian Federation) there has been a rebound more recently, though rates are still below those achieved in the 1990s.

The implications of weak investment for world economic growth and global adjustment could be rather ambiguous

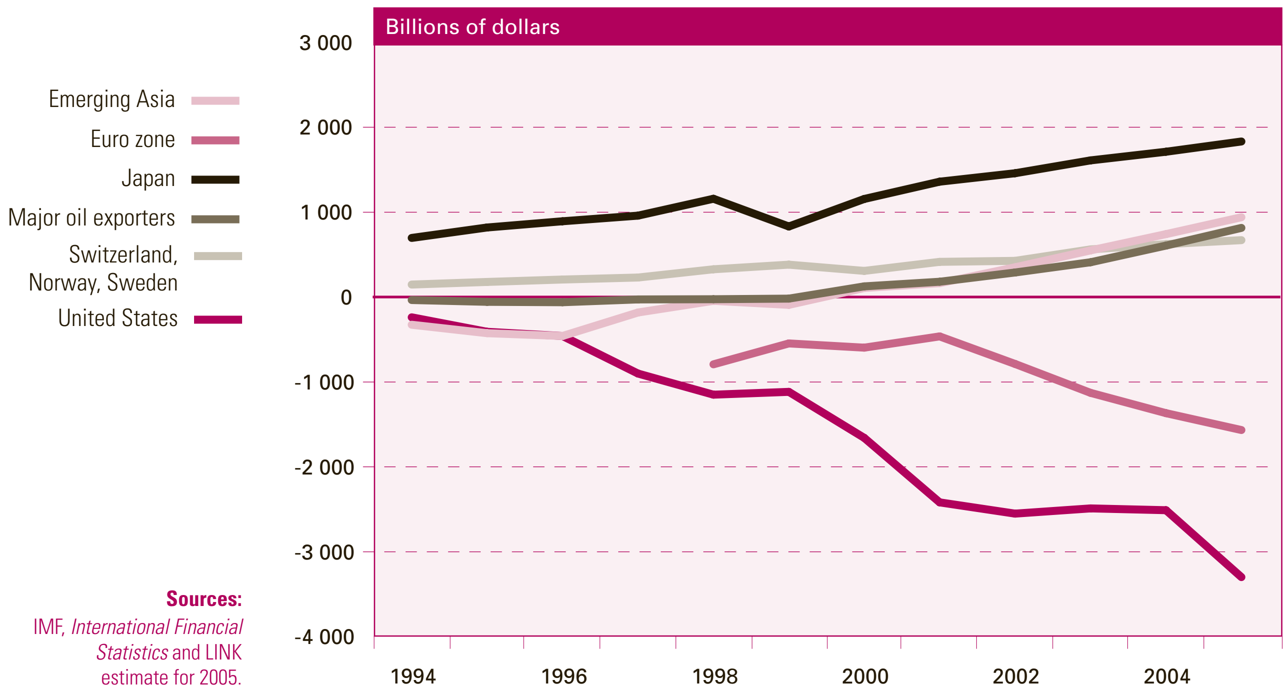
The upshot for world economic growth and global adjustment of all these factors underlying weak investment demand could be ambiguous. In the short run, they signal meagre demand prospects that could further slow down global growth. On the other hand, they also signal the potential for strengthened long-term growth as current growth is reaching production capacity limits. This could lead to a rebound of investment as long as uncertainties about global macroeconomic stability can be dampened and consumer confidence is strengthened by more accommodating monetary and fiscal policies. Should no portfolio adjustment take place towards productive assets, however, investors will continue to pile into more liquid assets as they are attracted by the low risk premiums. Some analysts see the low yield spreads as indicative of another episode of irrational exuberance in financial markets and growing build-up of liquid financial asset and liability positions. As liability positions mount, investors will demand higher risk premiums, raising the cost to borrowers, which would eventually hurt growth and increase the risk of financial crises.

Widening net foreign asset positions and exchange-rate adjustment

Sustainability of the global imbalances depends on the net foreign asset position of the major economies

The portfolio choices analyzed above imply that the sustainability of the present global imbalances should not only be judged from the savings-investment and current-account positions, but, perhaps more importantly, from the net foreign asset positions of the major economies and the preferences of investors around the globe to continue holding dollar-denominated assets. Net foreign liabilities of the United States have increased to over $3 trillion (see figure I.5), which is

Figure I.5.
Net foreign asset positions of major economies, 1994-2005



Sources: IMF, *International Financial Statistics* and LINK estimate for 2005.

mirrored by growing positive net foreign asset positions of Japan, the oil exporters in Western Asia, emerging Asia (particularly China) and several European countries. In recent years, the Asian surplus countries and the oil exporters have become the strongest sustainers of the external liabilities of the United States. The net foreign liability position of the United States now amounts to about 25 per cent of its GDP.

The Asian surplus countries and the oil exporters have become the strongest sustainers of the growth in external liabilities of the United States

Normally, to sustain external liabilities as a percentage of GDP, a debtor country must run a surplus on its external current account, excluding net investment income, assuming the interest rate it has to pay on its liabilities exceeds its long-term growth rate. Further increases in the net debt ratio could trigger expectations of exchange-rate depreciation, and foreign investors will be less interested in holding assets of the debtor country, unless compensated through a higher interest rate. The case of the United States is not normal, however. First, the status of the United States dollar as the international reserve currency gives investors an incentive to hold dollar-denominated assets. Second, specific circumstances have led to the peculiar situation that, despite being the world's largest net debtor country, income earned on foreign assets held by United States agents is higher than what the country pays on its foreign liabilities. Rates of return on United States direct investment abroad appear to be substantially higher than on United States based assets. This has slowed the growth of the debt-to-GDP ratio, despite strongly widening trade deficits. In addition, the depreciation of the dollar against other major currencies has increased the value of United States foreign holdings and contained the rise in the value of its liabilities.

Looking ahead, however, the net investment income balance is expected to revert to a deficit in 2006 as a result of the rising interest rate and further debt increases. A further depreciation of the dollar could help dampen the increase in the net foreign liability position. Over time, however, the weakening of the dollar will erode confidence in the major reserve currency and the willingness of foreign investors to hold assets in the United States unless compensated by higher interest rates. Such higher rates, however, will complicate adjustment of the current account, as net investment income will become more negative. This negative wealth effect will have a contractionary impact on those economies where agents hold large amounts of dollar-denominated assets, which in turn may spill over to the United States economy.

The wealth effects of dollar depreciation may well outweigh the relative price effect on trade balances

Given the widening of net foreign assets positions, the wealth effects of a dollar depreciation may well outweigh the relative price effect on trade balances. A strong devaluation of the dollar would form the prelude to a disorderly adjustment of global imbalances, as it would undermine confidence in the dollar and likely trigger a swift retreat from dollar assets. Looked at from the trade side, a very large depreciation would be needed to reduce the deficit in a major way, given the large size of the trade deficit in relation to traded goods production in the United States. The other side of the coin will be correspondingly large exchange-rate appreciations in Europe and Japan. As mentioned above, an exchange-rate realignment of that magnitude will likely shock asset markets and trigger a rather disorderly global adjustment process, with strong negative consequences for world economic growth.

A substantial devaluation of the United States dollar would also lead to significant negative wealth effects for many other developed and developing countries holding dollar-denominated assets, and depress aggregate demand in those countries and in the world economy as a whole.[9] Therefore, restoring the global imbalances solely through major exchange-rate realignment seems neither an adequate nor an efficient path.

Diverging exchange-rate movements

In practice, the movement of exchange rates in 2005 has been characterized by two diverging trends. On the one hand, the United States dollar has managed to rebound measurably vis-à-vis the euro and Japanese yen after it had depreciated substantially in the previous few years. On the other hand, currencies in many developing countries have appreciated steadily against the dollar, along with a move towards more flexible exchange-rate regimes in some developing countries, most notably China. Such a dichotomy implies, among other factors, a shift in the potential burden of adjusting the global imbalances away from Europe and Japan to developing countries.

International reserves increased strongly in many developing countries

International reserves in a large number of emerging market economies in Asia, Latin America and a group of oil-exporting countries elsewhere have increased significantly in the past few years. By various measures for reserve adequacy, such as the ratios of reserves to imports, to short-term debt and to money supply, reserves in most of those economies are all at historical highs, leading many analysts to believe that reserves in many of those countries are above the levels required by economic fundamentals.

Some of those economies registered surpluses in both their current and capital accounts to build up ample foreign reserves, while others have done so on either the current or capital account. For example, in China, of the surge of about $200 billion adding to its reserves in 2004, the current-account surplus and FDI accounted for about $60 billion and $55 billion respectively. The rest of the surge—some $70-$80 billion—came from other types of capital inflows, including “hot money” for speculating on a revaluation of the Chinese renminbi. A slightly lower accumulation of reserves is estimated for 2005, with more originating from the current-account surplus and much less from short-term inflows. In Mexico, net capital inflows offset a deficit in the current account. In general, most Asian economies

9 This point has been emphasized also in *World Economic and Social Survey 2004: Trends and Policies in the World Economy* (United Nations publication, Sales No. E.04.II.C.1) and *World Economic Situation and Prospects 2005* (United Nations publication, Sales No. E.05.II.C.2). See also Hans Genberg and others, *Official Reserves and Currency Management in Asia: Myth, Reality, and the Future,* Geneva Reports on the World Economy 7 (London, Centre for Economic Policy Research, 2005).

have a relatively larger current-account surplus than Latin American economies, although a number of the latter have also experienced tangible surpluses in their current accounts for the first time in many years as a result of the higher prices of and strong external demand for their primary commodities exports.

Managing reserves along with other policy objectives is a challenge

The efficient management of foreign-exchange reserves, and dealing with the associated excess liquidity in a manner compatible with a stable exchange rate, low inflation and stronger economic growth, are major policy challenges for many developing countries. Pressures for real exchange-rate appreciation tend to emerge as a consequence of rising foreign reserves. In response, many countries have been intervening in foreign-exchange markets with several objectives in mind, not all of them easily reconcilable. Some have focused on keeping the exchange rate stable and competitive, most notably the Asian exporters, and China in particular. In addition, those countries wish to avoid an erosion of the value of their dollar-denominated assets. Latin American countries, in contrast, seem to have given greater priority to keeping inflation down and to preserving financial stability. For example, Brazil intervened when its currency depreciated, but allowed pressures for an appreciation to take effect, thereby making it easier to reach its inflation target. Some of the countries in the region, like Chile and, more recently, Colombia, have been or are becoming more concerned with preserving a competitive exchange rate, or at least avoiding further appreciation. Because of different degrees of foreign-exchange market intervention, the observed relationship between foreign reserve accumulation and real exchange-rate appreciation is not very strong (see figure I.6a).

Sterilization of excess liquidity is more intense in Asia than in Latin America

To prevent the emergence of inflationary pressures, there will be a need for sterilization of the excess liquidity created by persistent one-way foreign-exchange market interventions in the form of buying up foreign exchange and thereby increasing base money. In addition, countries little inclined to intervene may need to sterilize in order to mop up the excess liquidity generated by external account surpluses. Countries have sterilized to different degrees as there will be both costs and benefits associated with the implied monetary adjustment and with further accumulation of foreign reserves. While sterilization is reportedly more intense in most Asian economies than in Latin America, there are some exceptions. Measured by the difference between the contribution to reserve money growth through the change in net foreign assets held by monetary authorities and the change in reserve money, the accumulative sterilization in the past few years has reached more than 10 per cent of the money supply (M2) in economies such as Malaysia, Singapore, Taiwan Province of China and Thailand, while the measure for China, the Philippines and the Republic of Korea ranged from 5 per cent to 10 per cent.[10] Little evidence of sterilization is, however, found in Hong Kong SAR, particularly in the years before 2005, as the economy was suffering from deflation, with the expansionary effects of foreign exchange intervention being perfectly auspicious for reflating the economy (the same was true in Japan, where foreign-exchange intervention was used to inject additional liquidity into the economy to attack deflation). On the other hand, Argentina, in contrast to its Latin American neighbours, sterilized intensively, and actively intervened in the foreign exchange market. Yet, despite these attempts at sterilization, in most countries money supply growth has expanded in tandem with reserve accumulation (see figure I.6b).

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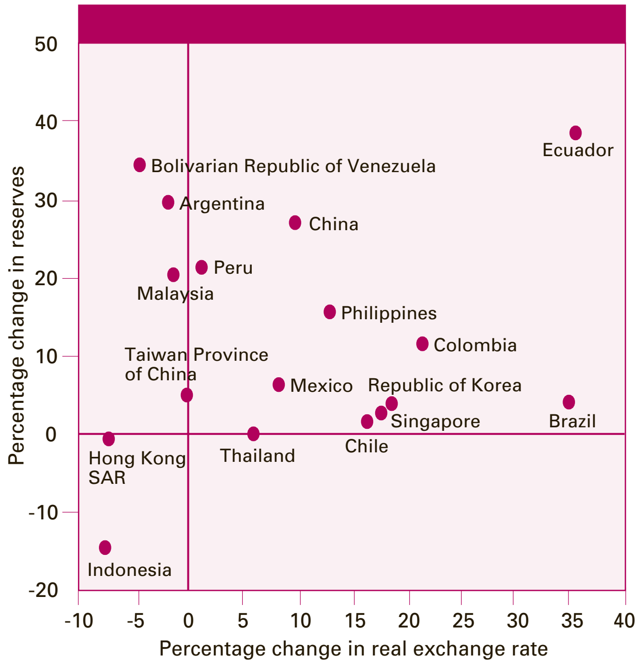
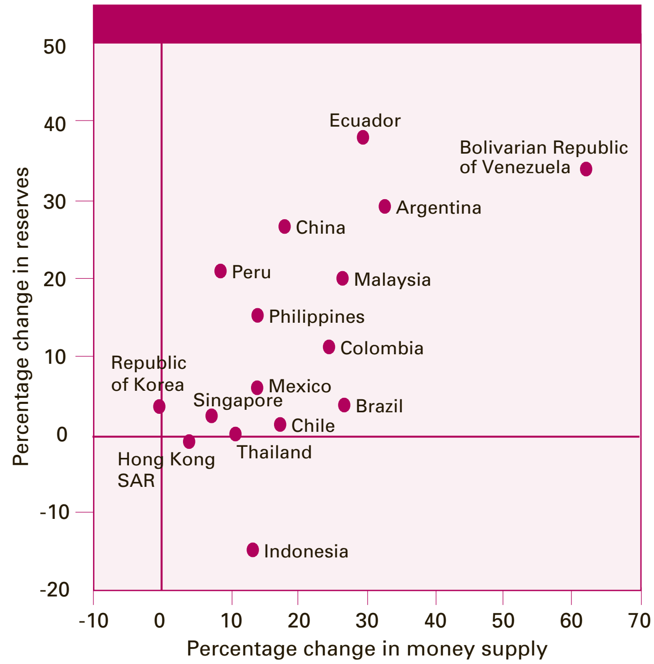
10 See Phil Garton, "Foreign reserve accumulation in Asia: Can it be sustained?", Australian Government, The Treasury, 2004, available from http://www.treasury.gov.au/documents/930/PDF/01_Foreign_Reserve.pdf.

Figure I.6a.
Reserve accumulation and real exchange rates in Asia and Latin America, 2004-2005



Sources: Percentage change in reserves is for 2004-2005 (annual data in dollars) based on data from ADB; IMF *International Financial Statistics*; and JPMorgan. Percentage changes of real effective exchange rates refer to November 2005 compared to January 2004 and are calculated from data of JPMorgan.

Figure I.6b.
Reserve accumulation and money supply growth in Asia and Latin America, 2004-2005



Sources: Percentage change in reserves is for 2004-2005 (annual data in dollars) based on data from ADB; IMF *International Financial Statistics*; and JPMorgan. Percentage changes in money supply (M1 plus quasi-money) refer to most recent available month in 2005 compared to January 2004. Data are from IMF, *International Financial Statistics*.

In all, under current global conditions, exchange-rate policies in emerging market economies require subtle management of reserves. On the one hand, exchange-rate competitiveness is a crucial objective of macroeconomic policy in open economies and can have important effects on economic growth and employment generation. On the other hand, the accumulation of reserves in those economies represents in effect a transfer of resources to the country in whose currency reserves are held (mainly the United States) at a price equivalent to the difference between the cost of their external borrowing and the (lower) returns to their holdings of foreign reserve assets. Countries may consider that the benefits of accumulating certain amounts of foreign reserves to slow down the pressure for exchange-rate appreciation outweigh such costs. The challenge is to find the ‘optimal’ level of the reserve holdings in line with the desired degree of exchange-rate competitiveness.

The costs of sterilized intervention must also be evaluated

The costs of sterilized intervention must also be evaluated. There are two main concerns. The first is associated with the interest-rate differential between domestic financial assets and foreign assets (the higher the differential, the higher the costs). The second concern stems from uncertainties about the effectiveness of the intervention: sterilization by issuing more domestic bonds may push up domestic interest rates, which in turn will attract additional foreign capital inflows, creating further pressures for appreciation and requiring additional intervention and sterilization. To avoid surges in capital inflows undermining exchange-rate management and monetary policy, capital account regulation could be called for.[11] In this regard, the costs of sterilization are in general lower in many Asian economies than in Latin American economies, as domestic interest rates in the former are usually lower than in the latter. The costs of sterilization for Asian economies in the past few years have been estimated to range from zero to 0.5 per cent of GDP.[12] Moreover, the relatively lower costs of sterilization combined with the benefits of maintaining competitive exchange rates explain why Asian economies have in general been more active in foreign exchange intervention than Latin American economies.

Developing countries thus stand to gain from a narrowing of global imbalances and the reduction of pressures arising from the huge accumulation of foreign reserves. A large swing in the exchange rate of the reserve currency would lead to large asset revaluation and hence a major monetary shock. An orderly adjustment of the global imbalances will require weighing the risks to developing countries, since, given the amount of outstanding reserves, large shocks to these economies will feed back into global financial markets.

Downside risks of the global outlook

Disorderly adjustment of imbalances

A disorderly adjustment of the global imbalances will lead to recession and destabilization of global financial markets

All of these factors suggest that there is a looming risk of a disorderly adjustment of *global imbalances* leading to a worldwide recession and destabilization of global financial markets. The worst-case scenario would be an abrupt retrenchment in the spending of households and businesses in the major deficit country, the United States, triggered by a sharp erosion of the willingness of the surplus countries to hold dollar-denominated assets and thereby continue financing the deficits of the United States. In such a scenario, the rebalancing would generate a substantial contraction, not only in the United States, but also in the world economy as a whole, accompanied by a precipitous change in exchange rates and a detrimental shock to financial markets. For instance, as quantified in an earlier simulation using the LINK global model system[13] and in other studies, cutting the external deficit of the United States in half through a contraction in private domestic demand would come at a price of a drop in GDP of the United States of 4.6 percentage points and of about 2 percentage points in world GDP. By contrast, a benign rebalancing process engendered by both a gradual adjustment in the United States and necessary policies in the surplus countries to boost their domestic demand would produce much smaller adverse effects. Such a benign rebalancing would require, however, international macroeconomic policy coordination and cooperation, for which there is currently no adequate framework in place. This situation heightens the risk of the worst-case scenario, as the global imbalances continue to widen.

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11 See, for instance, *World Economic and Social Survey 2005: Financing for Development* (United Nations publication, Sales No. E.05.II.C.1); as well as José Antonio Ocampo, "Capital account and counter-cyclical prudential regulations in developing countries" and John Williamson, "Proposals for curbing the boom-bust cycle in the supply of capital to emerging economies", both in Ricardo Ffrench-Davis and Stephany Griffith-Jones, eds., *From Capital surges to Drought: Seeking Stability for Emerging Economies* (Basingstoke: Palgrave, 2003).

12 See Genberg and others, op. cit.

13 See Pingfan Hong, "Global implications of the United States trade deficit adjustment", DESA Discussion Paper No. 17 (ST/ESA/2001/DP.17), 2001, available from http://papers.ssrn.com/.

Additional oil price shocks

The rise in oil prices is mainly caused by demand, but…

The uncertainties related to *oil prices* emanate from the tight global oil production capacity. It has now become evident that the rise in oil prices over the past few years is quite different from the price hikes associated with the two major oil crises in the 1970s and 1980s. The difference is both in terms of the causes of the increases in oil prices as well as the impact on the world economy. The current situation has mainly been driven by an upward shift in the demand curve (as well as some supply-side factors, such as geopolitical uncertainty and natural disasters), while the crises in the past were essentially a downward shift in the supply schedule caused by large-scale disruptions in oil supply.

… concerns about supply have recently moved to the forefront

Nevertheless, concerns about supply-side constraints have recently increased. In this regard, there are two kinds of uncertainties. First, barring any disruptive shocks to global oil production, there is the question of to what level oil prices must rise in order to balance oil demand and supply and what the implications of this equilibrium price level would be for global economic growth. Second, given the tight capacity, there is uncertainty regarding the effect of a large-scale disruption in global oil production on oil prices and world economic growth. While both of these questions are crucial for the outlook of the world economy, the second one seems to encompass greater downside risks.

End of the housing market bubble

Possible burst of the house price bubble foreseen in some countries

The vulnerability of the global economy is also derived from the possible burst of the *house price* bubble in some countries. A number of economies have experienced substantial appreciation in house prices over the past decades, with the appreciation particularly strong in recent years. Various housing indicators in those countries, such as the affordability ratio, price-to-rent ratio, mortgage loans-to-GDP ratio, and ownership ratio are at historical highs, suggesting a peak in the value of houses relative to the underlying economic fundamentals. Moreover, indications of possible bubbles in house prices, at least in some countries, are also visible from the increase in speculative activities. For example, in the United States, turnover in housing markets has increased, the share of investment-oriented house purchases has risen and novel mortgage products such as interest-only loans, innovative forms of adjustable rate mortgages and the allowance for a limited amount of negative amortization have been proliferating, thus enabling many marginally qualified and highly leveraged borrowers to purchase homes at inflated prices.

Meanwhile, the booming housing sector has been a major driver for GDP growth in many developed countries. For example, in the United States, home equity extraction, namely cash taken out during refinancing, has financed 30 to 40 per cent of the increase in consumer spending in recent years, accounting for one percentage point or more of total real GDP growth, with the residential building sector contributing another 0.6 of a percentage point. Part of the housing boom in recent years can be attributed to various country-specific features, but low interest rates and easier access to mortgage loans seem to be the common factors for most of these countries. Therefore, an increase in interest rates can lead to a flattening or reversal in the growth of house prices, turning the positive growth contributions of the housing sector into negative ones. As an example, the recent notable growth moderation in Australia and the United Kingdom of Great Britain and Northern Ireland was unambiguously attributable to a cooling down of the housing sector. At the same time, house prices have a substantial impact on the banking sector, as mortgage loans account for a sizable proportion of total bank loans. Declining house prices will heighten the risk of default and can trigger bank crises, as has happened in a number of countries in the past.

For the global economy, the risks associated with the housing sector are serious, not only because of the large size of the economies concerned, but also because of an inextricable linkage between the increase in house prices and global imbalances. A number of economies that have seen a substantial appreciation in house prices are also running large external deficits (relative to their GDP) and experiencing a decline in household savings to very low levels. In that regard, the housing boom in those countries has been to some extent financed by borrowing from the high-saving countries running external surpluses. Therefore, a burst in house prices is likely to lead to an abrupt and contractionary adjustment of the global imbalances.

Other risks

Other risks include the threat of international terrorism and an avian influenza pandemic

Other downside risks, such as international terrorism and an avian influenza pandemic, can also not be precluded. The recent outbreak of avian influenza, or bird flu, has already caused prodigious economic losses and may have claimed more than one hundred lives worldwide. There is no evidence yet that the virus or some variant could actually be transmitted from one human being to another, making it more uncertain whether it will turn out to be a pandemic. So far the damage has been concentrated mainly in several Asian countries (see box IV.3), but the virus has also spread to some European countries. As the world is not yet adequately prepared, there is a risk that it could become a global pandemic.[14] The macroeconomic costs of a possible pandemic are difficult to estimate. Based on similar outbreaks in the past, however, including the post-First World War pandemic or Spanish influenza, but with a particular reference to the outbreak of severe acute respiratory syndrome (SARS) a few years ago, the World Bank has estimated that the overall costs could be as high as $800 billion, equivalent to 2 per cent of the world gross product.[15] Such a colossal loss would entail the death of millions of people and illness for many more, along with disruptions of trade, tourism and other economic activities, shocks to housing and financial markets, and erosion of consumer and business confidence. Many countries, individually and collectively, have begun to intensify preventive measures. But even if those measures were to mitigate the risks for a global pandemic significantly, their costs would be substantial (though lower than those of a pandemic) and would still entail growth costs for the world economy, as resources may be deflected from productive economic activity.

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14 See World Health Organization (WHO), "Avian influenza: frequently asked questions" (2005), available from http://www.who.int/csr/disease/avian_influenza/avian_faqs/en/index.html#pandemic2.

15 See World Bank, "Spread of avian flu could affect next year's economic outlook" (2005), and other related articles, available from http://siteresources.worldbank.org/INTEAPHALFYEARLYUPDATE/Resources/EAP-Brief-avian-flu.pdf.

Policy challenges and the case for international macroeconomic policy coordination

Current macroeconomic policy stance

Macroeconomic policies are becoming less synchronized worldwide

Facing various challenges, macroeconomic policies and, in particular, monetary policies have become less synchronized worldwide in 2005, in contrast to 2004 when many economies were unwinding the policy stimuli injected in earlier years. While central banks in some countries have continued to raise policy interest rates, those in other countries have reduced interest rates or maintained their policy stance for several months.

Among the developed countries, the United States Federal Reserve Board has so far raised interest rates by a total of 325 basis points from mid-2004, pushing up the Federal Funds rate to 4.25 per cent. Its recent policy statements imply that it will likely continue to increase interest rates until the Federal Funds rate reaches 4.5 per cent in 2006, with the real interest rate reaching about 2 per cent, a neutral position on the long-run average. No further monetary tightening is expected in the euro area, even though it is not clear whether the ECB's interest rate increase in late 2005 will be the beginning of a more prolonged restrictive monetary stance. Signals from the Bank of Japan are more clearly in the direction of maintaining the policy framework of quantitative easing, creating an environment where short-term interest rates stay very close to zero. The central banks in other developed countries will likely keep their policy stance at the current levels.

In the developing countries and economies in transition, further monetary tightening is expected, although in measured steps. This strategy holds in particular for most Asian economies, along with continued intervention in foreign-exchange markets and sterilization. In contrast, in Latin America, room for easing remains in several countries with high interest rates and relatively low growth, such as Brazil and Mexico, as inflation is contained within the target range. Governments of other economies in that region, including those facing appreciation pressures, are expected to adopt a policy mix of tightening, foreign exchange intervention and sterilization. While most African countries will maintain a cautious monetary policy stance, many economies in West Asia are likely to raise interest rates. Meanwhile, monetary policy in most economies in transition will remain accommodative.

Fiscal policies are even more country-specific. Broadly speaking, fiscal policy in the United States should become slightly more expansionary because of the expected increase in government spending on post-hurricane reconstruction. The countries of the euro area need to reach the targets established by the Stability and Growth Pact (SGP) and will have to undertake contractionary fiscal policies. Other European countries can maintain a neutral-to-mild expansionary stance, while Japan should be expected to continue its fiscal consolidation. Among the developing countries and economies in transition, most countries in Latin America, Africa and East Asia are likely to adopt more restrictive or cautious fiscal policies.

These current policy stances are not well focused on redressing the global imbalances

The current policy stances are not well focused on redressing the global imbalances. This lack of concerted policy action is reflected in the baseline assumptions used for the global outlook, according to which the projected world economic growth of 3.3 per cent would be accompanied by a further widening of global imbalances. The budget and current-account deficits of the United States are expected to increase further. Increasing differentials in the policy interest rates among the major developed economies will provide continued incentives for an increase in financial flows from Europe and Asia to the United States. In the baseline scenario, developing countries will continue to seek their own paths to adjust to the uncertain global environment, but none of these paths add up to an internationally consistent policy framework, further increasing the already large uncertainty.

Dealing with higher oil prices and inflated house prices

Oil prices and house prices pose particular challenges for monetary policy

Meanwhile, the risks associated with oil prices and house prices, as discussed in the previous section, pose particular challenges for *monetary policy*.

Although the two episodes of oil crises in the 1970s and 1980s have been extensively studied, views are still split over the implications for monetary policy in dealing with the inflationary risks associated with higher oil prices. It is generally agreed that monetary policy should ignore the effects of short-term fluctuations in oil prices, particularly if they are caused by temporary supply-side shocks. There is also some consensus that, even if there is a permanent rise in oil prices, it will either be unnecessary or impossible for monetary policy to offset the first-round effects on overall inflation, and that monetary policy should focus on the second-round effects in the medium run, namely, a notable pass-through of higher oil prices to wages and overall inflation. Some analysts would argue, however, that by the time the second-round effects are actually ascertained, it would be too late to activate a monetary tightening, as it would take months or longer for monetary policy to show any effects on the economy. Others would suggest that policy makers should differentiate between demand-driven higher oil prices and supply-driven ones: a monetary tightening would exacerbate the already contractionary effects of supply-driven higher oil prices. Meanwhile, even in the case of higher oil prices driven by strong global demand, as in the current situation, monetary tightening in individual countries would have only limited effects, unless the major economies initiate a coordinated tightening in monetary policy.

So far, monetary authorities in most countries have refrained from aggressive tightening, partly because of an expectation that oil prices will fall back in the medium term and mainly because of the fact that overall inflation remains stable and low. Some nascent signs appear to indicate an upward movement in the core inflation rate, however, so that, if higher oil prices persist, central banks will be faced with more difficult policy choices. It is important to note that, according to some studies, most of the contractionary impact on the real economy of past oil price shocks was attributable to monetary policy tightening in a context where pre-shock inflation was already on the rise.

Monetary authorities in countries with substantially appreciated house prices are also facing a significant quandary. The link between house prices and aggregate demand suggests that monetary policy should take into account the fluctuation in house prices. In practice, however, house prices are not included in overall inflation indices. Meanwhile, the combination of strong inflation in house prices and low inflation in goods and services, as witnessed in recent years in many economies, generates a conflict: monetary tightening consistent with stability in the housing market may trigger deflation in the goods market, while low interest rates will continue to fuel the surge in house prices and the increase in household indebtedness. This situation heightens the risks for a housing bubble, making future adjustment more difficult when the bubble bursts.

Redressing imbalances through coordinated policies

Coordinated action is required for restoring global imbalances

While dealing with higher oil prices and possible housing bubbles poses certain challenges for macroeconomic policies in individual countries, redressing the global imbalances requires a broader perspective.

Rebalancing the global pattern of growth and that of savings and investment will require recognition by policy makers worldwide that an orderly global adjustment will be a lengthy process and that coordinated action is required. The adjustment will take time primarily because savings and investment patterns are not easily shifted owing to structural and institutional factors. In addition, a substantial reduction of the widely diverging net foreign asset and liability positions across nations requires a prolonged shift in savings-investment balances. Furthermore, an exclusive focus on regions or countries that have a trade deficit is likely to end in excessive contractionary adjustment, as experience has shown. Surplus and deficit countries alike will have to share the burden of adjustment.

Global adjustment will require measures stimulating savings in deficit countries and investment in surplus countries

Viewed from this perspective, coordinated global adjustment will require measures that will stimulate savings in the deficit countries and investment in the surplus countries. The major deficit country, the United States, will need to stimulate private (household) savings and reduce public dissaving. The current direction of gradual increases in the interest rate might help to encourage private savings to some extent in the short run, although additional measures (for example, through fiscal incentives) may be needed to increase the private savings rate in the long run. Fiscal policies need to take a less expansionary stance. The policy adjustments may come at the cost of lower growth in the short run as the fiscal and monetary stimulus is reduced. Expansionary macroeconomic policies in the surplus countries may compensate for the growth loss and stimulate United States exports and investment in export sectors. If there is no such expansion, business savings may decline, and it is not certain that national savings will increase. The direction of adjustment would then be a decline of investment and growth.

In Europe, economic stimulus should come primarily from keeping interest rates down in an effort to stimulate private demand. Room for fiscal expansion is more limited in most countries. Yet more should be done to revitalize consumption and investment demand. Structural reform policies of recent years have thus far not been able to create such a stimulus. The focus on trying to promote international competitiveness has stimulated export growth but has contained real wage increases and increased job insecurity, having a negative impact on domestic demand. Remaining excess private savings should be redirected towards domestic investment.

In Japan, continued financial sector reform and fiscal incentives to stimulate private investment demand should combine to reduce domestic savings and trade surpluses. Asian surplus countries should try to boost public and private investment rates, or, if these are considered sufficiently high such as in China, boost broad-based consumption demand, particularly by redressing growing income inequality.

All major economies should contribute to the additional financial resources for the MDGs

All major economies should contribute to the mobilization of the additional financial resources to assist the poorest countries in achieving the Millennium Development Goals in compliance with international agreements. To support an orderly and equitable global adjustment process, the major surplus countries in developed and emerging Asia and Europe, along with the major oil-exporting countries, could further strengthen their contribution to global development by channelling some more of their excess savings to those developing countries with insufficient investment finance for economic and social infrastructure.

A broad platform for international macroeconomic policy coordination is required

When implemented in a timely and coordinated fashion, a cooperative policy approach could avoid a contractionary and/or disorderly adjustment of the global imbalances. Such an approach would require a substantial degree of international macroeconomic policy coordination involving a much broader forum of countries than the major economies of the G-8. Unfortunately, the interest in international macroeconomic policy cooperation and coordination has diminished since the 1980s, partly because of the dubious success of that decade when the adjustment of large global imbalances ended with a considerable shock to the world economy. The unsatisfactory policy coordination of the 1980s was, however, precisely due to the unwillingness of the major economies to sacrifice their national interests for the sake of international coordination. Since then, the key players on the international stage have been shunning the subject, arguing that the best policy for the world economy, in terms of cost-benefit trade-offs, is for individual countries to adopt policies that fit best their own needs. Given the systemic risks associated with the global imbalances and the existence of externalities in national approaches to resolving the imbalances, there should be a net gain from a cooperative policy approach. Such an approach will also be needed to address the global investment anaemia with a coordinated fine-tuning of macroeconomic policies involving tightening fiscal and monetary policies in the major deficit countries and more accommodating policies in the surplus countries to avoid a collapse in global demand and a deterioration of future investment prospects.

IMF should play a key role in surveillance of international policy coordination

Given its nature, the surveillance of international policy coordination would be a natural task for the International Monetary Fund (IMF). The role of the IMF in such matters, however, has eroded over the past two decades or so. The Fund should remain the central institution charged with fostering global financial stability and growth, even though there may be no consensus yet on how exactly it would achieve those targets. The member states of the IMF have recognized the need for a more balanced voice and participation of all members, particularly those from developing countries.

In its enhanced role, a politically rebalanced IMF should assess the responsibility of major countries and country groupings for adjusting the large global imbalances, with special attention to exchange-rate developments and their impact on global financial stability. In doing so, the Fund should go far beyond analysis of the problem and play a pro-active role to bring about collaborative efforts among countries for an orderly adjustment, as discussed above. Increasing the coordination of the economic policies of the major industrialized countries is not an easy task for the IMF, since those countries do not have IMF support programmes and can easily disregard its advice. As a result, some observers have suggested that the IMF surveillance function become fully independent of its lending and other activities. It has also been suggested that there should be increased transparency, candour and more specificity in its surveillance activities, as well as a change in the focus of multilateral surveillance from a bottom-up to a top-down approach. This surveillance would involve starting with an evaluation of the needs and objectives of the international monetary system and then proceeding to an assessment of how the policies of systemically important countries can be made compatible with this evaluation. Improving the efficiency of multilateral surveillance, however, can only be achieved if the larger economies accept the Fund’s advice.

Galvanizing aid, trade and finance for achieving the MDGs

Growth rates in many poor countries are still not strong enough to enable them to reach the MDGs

Despite a notable strengthening of economic conditions, as well as of the external economic environment for the developing countries over the past two years, the growth rates in many poor countries are still not strong enough for them to fulfil the Millennium Development Goal of halving poverty by 2015, or to meet the other internationally agreed development goals. They therefore require more official flows and development assistance. As detailed in chapter III, ODA has recently increased in nominal terms, but the amount of aid received by the LDCs in recent years, excluding resource flows for emergency assistance, debt relief and reconstruction, was only marginally higher than that of a decade ago. Some progress has been made in official development cooperation between donor and recipient countries. The international community has reiterated that improving the quality of aid is as important as mobilizing more aid. Meanwhile, developing countries, particularly in Africa, have continued their efforts to forge a multi-actor and multi-dimensional partnership with the developed countries, focusing on efforts at capacity-building, establishing and maintaining peace and security and building an enabling climate for business investment.

New commitments exist to strengthen South-South cooperation

There are also new commitments to strengthen and widen cooperation among developing countries, as reflected in the Second South Summit in Doha in 2005 and several other meetings, with the United Nations at the forefront of efforts to foster South-South development cooperation. The major form continues to be technical cooperation, with more initiatives being taken by countries such as China, India and a number of others. Other forms of South-South cooperation have also been flourishing in such areas as monetary and financial cooperation, debt relief and grant assistance. One area that requires more attention is the transmission of remittances among developing countries.

Implementation of the HIPC Initiative progresses only slowly

A few more countries have reached the completion point in 2005 under the Heavily Indebted Poor Country (HIPC) Initiative, with its implementation continuing to progress slowly. As a result of debt relief under the HIPC Initiative, most debt indicators of developing countries have improved, with their debt-service ratios declining. Poverty-reducing expenditures of the Governments for the 28 decision point countries have recently increased relative to their debt-service payment, with the former at four times the latter. HIPC countries continue, however, to face difficulties in reconciling the objectives of achieving and maintaining debt sustainability, promoting long-term growth and reducing poverty, as some of them have to engage in borrowing to meet the increased needs for financing poverty reduction strategies. In the absence of additional grant financing, many of those countries would have to rely on new borrowing to fund their MDG expenditures, creating the danger of a new cycle of excessive borrowing and unsustainable debt.

Slow progress is seen in improving the multilateral trading system

As reaffirmed at the 2005 United Nations World Summit, a universal, rule-based, open, non-discriminatory and equitable multilateral trading system, as well as meaningful trade liberalization, can substantially stimulate development worldwide, benefiting countries at all stages of development. In practice, however, the prevailing global trading system is far from such an ideal state, with many developing countries, particularly LDCs, in a disadvantageous and unequal position compared with most developed countries. While the agenda for the multilateral trade negotiations under the Doha Round finally gave priority to the development dimension in order to enable more developing countries to benefit from trade, progress has been extremely slow.

Completing the Doha Round remains a major challenge

After a few years of impasse, the Sixth WTO Ministerial Conference in Hong Kong SAR concluded with some, although only marginal, progress. Among the substantive decisions, an agreement was made to eliminate all forms of agricultural export subsidies by the end of 2013, in a progressive and parallel manner. Although the agreement is conditional upon many future unknown factors and has no immediate economic effects, it represents a substantial systemic advance by bringing further agricultural trade liberalization under the umbrella of general multilateral trade rules. Another achievement is a limited “development package” for LDCs consisting of several decisions. The most substantive one among them is the decision to provide duty-free and quota-free market access by developed countries and developing countries declaring themselves in a position to do so on “a lasting basis” for all products originating from all LDCs by 2008, or no later than the start of the implementation period, in a manner that ensures stability, security and predictability. Meanwhile, a decision was made to eliminate all forms of export subsidies for cotton by developed countries in 2006 and to grant duty- and quota-free access for cotton exports from LDCs by developed countries from the commencement of the implementation period (see chapter II for more details). On the other hand, more formidable work remains to complete all the items on the Doha agenda by the end of 2006, in such areas as more market access in agriculture, a reduction of tariffs and non-tariff barriers in manufacturing, and new rules for trade in services, as well as investment and intellectual property issues.

Aid for Trade

While further trade liberalization under the WTO negotiations is expected to bring considerable long-term benefits, developing countries are facing short-term adjustment costs, including tariff revenue losses, reduction in preferential access to major markets, and the forgoing of tariffs. A key question is how the developing countries can develop production and export supply capabilities to take advantage of further market opening. The latest WTO agreement in Hong Kong SAR recognized the importance of Aid for Trade to help developing countries, particularly the LDCs, to improve supply-side capacity and trade-related infrastructure in order for them to implement and benefit from WTO agreements and to cope with short-term adjustment costs associated with trade liberalization.

All countries should live up to the commitments towards the international development agenda

The prospects for ODA in the medium term are encouraging, boosted by the commitments made during the meeting of the Heads of State of the G-8 developed economies in 2005, along with proposals for more debt relief for some HIPC countries. More importantly, at the 2005 World Summit, world leaders reinforced the political commitments expressed at previous high-level international meetings on development issues, particularly the commitments contained in the Millennium Declaration and the Monterrey Consensus. The challenge for all countries is to live up to those commitments at the agreed level and within the agreed time frame.

Chapter II
International trade

Trade flows: trends and outlook

Growth of world trade decelerated in 2005...

Along with global output, growth of world merchandise trade decelerated moderately in 2005. After peaking at a growth rate of 11.0 per cent in 2004, the expansion in the volume of merchandise exports slowed to 7.1 per cent in 2005.[1] In dollar value terms, world trade increased by 12.9 per cent in 2005. Prices of merchandise exports grew by 5.5 per cent, mainly reflecting higher prices for primary commodities, as the average price of traded manufactures remained flat in the year.

...with marked divergence across countries

The deceleration of international trade was particularly evident in the developed economies. In contrast, many developing countries and economies in transition recorded relatively fast growing trade, albeit also in their case at a slower pace than in 2003 and 2004. According to the outlook, such divergences are expected to be reduced in 2006. Yet, the share of developing country exports in world trade will continue to increase. With the world economy anticipated to maintain its growth rate in the near future, the volume of world exports is expected to grow at the same pace in 2006 as in 2005—at 7.2 per cent (see table A.17). The growth in the volume of exports from developed countries is expected to strengthen to 6.0 per cent (up from 4.5 per cent), mainly owing to the anticipated rebound in business investment (see chapter I), which will increase global demand for capital goods. Demand for primary commodities will remain strong given sustained high output growth in a few large developing economies, particularly in East and South Asia. Growth in the volume of total merchandise exports of developing countries is expected to slow down to 8.7 per cent in 2006 from 10.9 per cent in 2005.

The ratio of the rate of growth of trade to the rate of growth in gross world product—estimated at 2.2 for 2005—is comparable to the average observed in the period 2001-2004. Yet, it continues to be below the average of 3 recorded during the 1990s, suggesting some moderation in the dynamics of the globalization process.

The United States merchandise trade deficit increased in 2005 and is forecast to expand further in 2006

The growth in the volume of imports decelerated in the United States of America as the economy slowed with the maturing of the economic cycle in 2005. Nonetheless, the merchandise trade balance of the United States recorded another record deficit despite faster export volume growth. The rising deficit is explained both by higher oil prices and an increase in the deficit in the non-petroleum trade balance. The oil trade deficit increased by $46 billion at the end of the third quarter of 2005 compared with the same period in 2004, while the non-oil trade deficit deepened by $42 billion. In the outlook, the expected weakening of the dollar in relation to the currencies of a few developing countries and the strengthening of investment (see chapter I) will sustain export growth by the United States, while import growth is likely to moderate further. The value of imports by the United States now doubles that of exports. As a consequence, exports must grow much faster than imports to make a dent in the trade deficit (see figure II.1). With the expected growth rates, the trade deficit will widen further in 2006.

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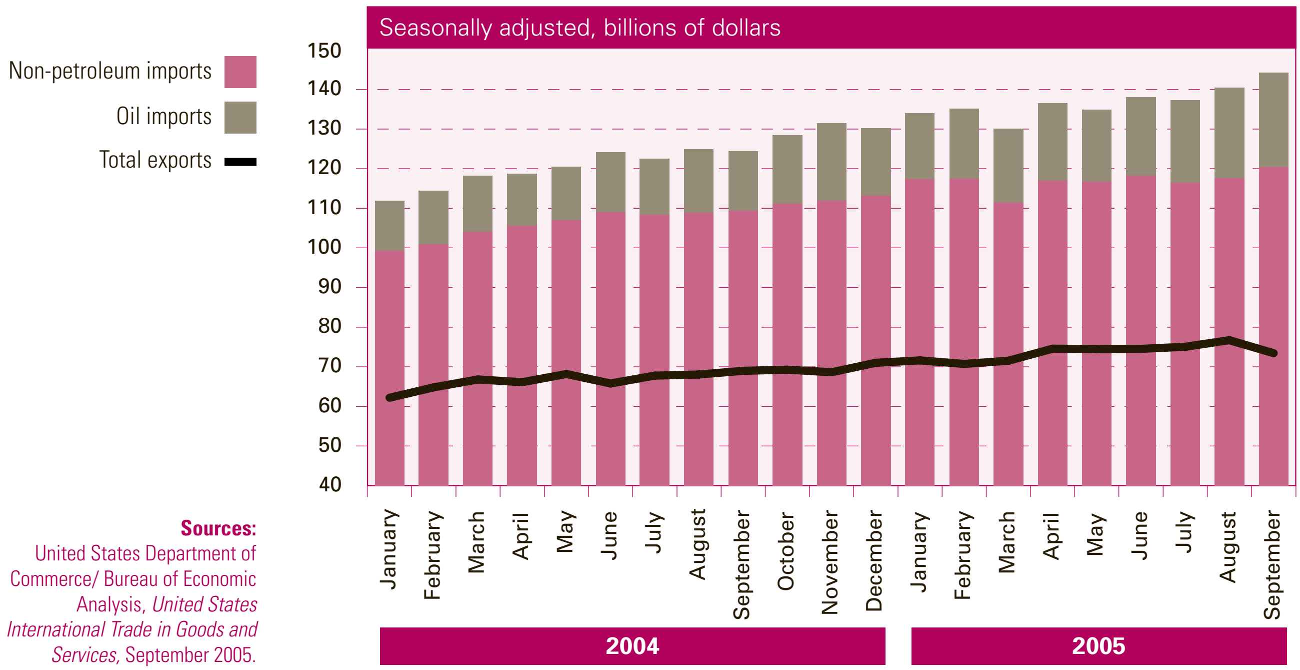
1 Unless otherwise specified, trade figures refer to the merchandise exports. As can be seen from table A.17, growth rates for world imports and exports show some discrepancy owing to measurement errors in international trade. The discussion here is restricted to merchandise trade because of a lack of systematic and sufficiently detailed data on services trade worldwide.

Figure II.1.
United States: Merchandise exports, petroleum and non-petroleum imports, January 2004-September 2005



Sources: United States Department of Commerce/ Bureau of Economic Analysis, *United States International Trade in Goods and Services,* September 2005.

China has become a major player in international trade, absorbing about 6 per cent of world imports in 2005, up from 3.3 per cent in 2000. Dependence on Chinese markets is increasing on a worldwide basis. It is chiefly noticeable in East and South Asia, Japan, and in the least developed countries (LDCs) (see figure II.2). For the latter group of countries, China has become an important market for raw materials, notably crude oil.

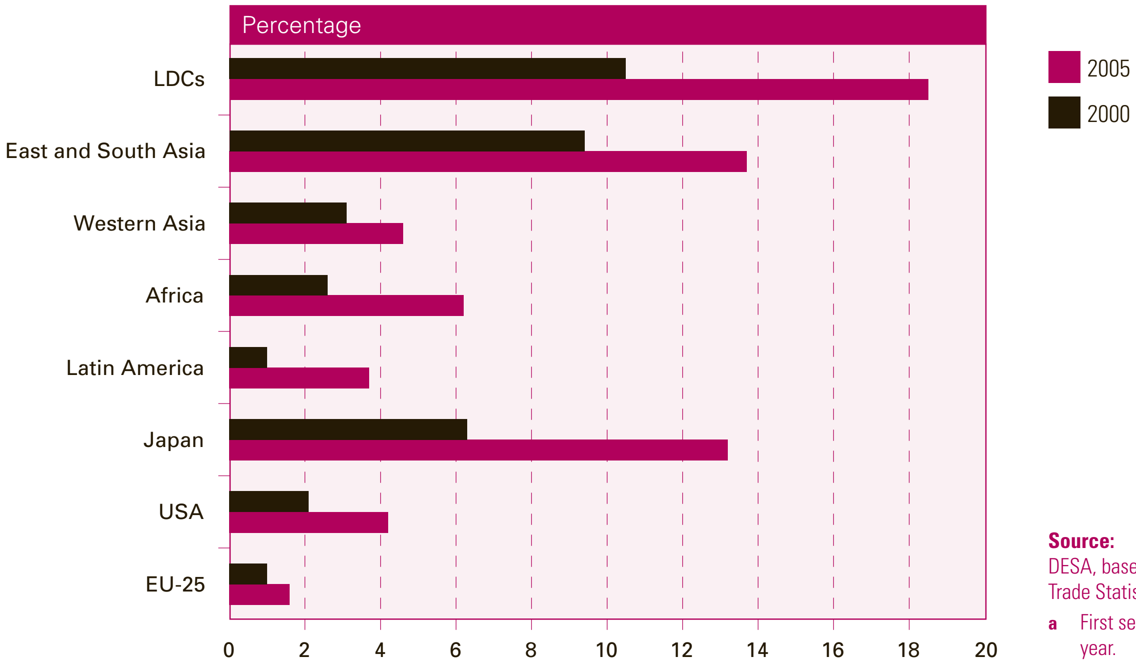
Import growth decelerated in China affecting intra-Asian trade

China's annual import growth declined in real terms from 31 to 18 per cent between 2004 and 2005. This deceleration was mainly due to weaker growth of investment in fixed assets and expectations of an appreciation of the renminbi, which led importers to delay purchases. Moreover, new manufacturing capacity came on stream, thus slowing imports of new machinery and equipment. Imports of raw materials held up better. Additionally, owing to China's insertion in international production networks (IPNs), a considerable share of the country's import demand is linked to final demand elsewhere. The deceleration of global demand thus also slowed the import demand of China. The pace of growth of intra-Asian trade moderated alongside that of China, particularly for trade in manufactures and/or semi-processed goods. The exports of Japan also felt the slowdown, as 13 per cent of the goods it ships abroad go to China.

Weak domestic demand conditions underpinned modest import growth in Western Europe

Western Europe absorbs about 40 per cent of world imports. Import demand decelerated in the euro zone in 2005, despite the boost brought about by the strength of the euro in the first half of the year. The deceleration in import volume growth in Europe was largely due to weak domestic demand in 2005 (see chapter IV). Import volumes are expected to pick up in 2006 as domestic demand strengthens in the course of the year. Japan registered similar—albeit somewhat less acute—developments with imports slowing down in real terms in 2005.

Figure II.2.
Selected regions and economies: share of merchandise exports to China in total merchandise exports, 2000 and 2005[a]



Source: DESA, based on IMF, Direction of Trade Statistics.

a First seven months of the year.

Import demand by oil exporters accelerated and helped to sustain growth in world trade

Partially offsetting the above trends, import demand by oil exporters such as Norway, OPEC members and the Russian Federation, among others, helped to sustain growth in trade. For example, African oil exporters increased imports as infrastructure investment and industrial projects were launched. Similarly, Venezuelan imports continued to swell as public investment grew. Meanwhile, imports by CIS countries accelerated in real terms because of the relaxation of the foreign exchange constraint, the rapid expansion of domestic demand and the appreciation of the currency in several economies. This notwithstanding, it seems that some governments have become more cautious than in the previous oil boom about how they spend the extra revenues. In the case of Western Asian oil exporters, a substantial amount of these resources is now going into stabilization funds and/or being used to reduce the public debt (see chapter IV). In the case of Norway, additional fiscal rules have been established according to which higher oil revenues are not allowed to lead to consumption increases but should add to public savings which have to be invested abroad.[2]

Among developing countries, import growth outpaced export growth in Latin America and South Asia in 2005, though the rate of growth was lower than in the previous year. The healthy gross domestic product (GDP) growth of South Asia led to increased import demand. Post-disaster reconstruction needs were also a factor, as in Sri Lanka after the December 2004 tsunami. Similarly, in Pakistan, reconstruction-related imports are expected to expand in 2006, after the earthquake in October 2005. African imports also increased strongly in real terms (at 11 per cent, up from 10 per cent in 2004) thanks to robust GDP growth, increased food imports in drought-affected countries and rising demand for capital goods.

2 Torbjørn Eika and Mette Rolland, *Country Report: Norway*. Paper presented at Project LINK meeting, Geneva, 31 October-2 November 2005, available from http://www.chass.utoronto.ca/link/meeting/ctryrep/norway200510.pdf.

Some economies, however, were able to sustain robust export growth

Despite slower import demand in major markets, a number of economies were able to record robust export growth, albeit with some deceleration from 2004. Exports of the new European Union (EU) members continued to grow in real terms at a relatively fast pace in 2005. This was in part due to solid gains in productivity and product quality following many years of strong foreign direct investment (FDI) inflows, relocation of production from the EU-15 to Eastern Europe and continued market diversification. Intraregional trade among the new members increased, as the remaining trade barriers fell in 2004 and their trade with South-eastern Europe and the Russian Federation also increased. Conversely, manufactured exports by the Caribbean, Central America and Mexico suffered from slower demand in the United States. Increased competition by China in the United States market has also played a role. Meanwhile, the strength of the euro contributed to restraining export growth for the euro area countries, with the region as a whole losing market shares. With only a modest upward drift in the euro assumed in the outlook, the currency is expected to be less of a drag to EU export performance in 2006.

China continued to be a formidable competitor in international markets, with its exports growing by 26 per cent in real terms in 2005. Exports of machinery and electronic products were strong for the year, while the country also gained market shares in clothing and textiles as a result of the termination of the Agreement on Textiles and Clothing (ATC). The impulse brought to Chinese exports by the ATC termination will likely lose steam in 2006 because of export restraints negotiated with major importers. Overall, export growth is anticipated to drop to 12.6 per cent in real terms in 2006 (see table A.17). The exchange-rate policy is also a factor underlying the forecast. The expectation of exchange-rate appreciation had encouraged Chinese firms to accelerate exports in order to maximize their profit margins. The incentive to further step up export growth, however, has weakened with the recent changes in the exchange-rate regime of China and the continued emphasis by policy makers that any further change will be measured.

Higher commodity prices underpinned growth of export revenues in developing countries

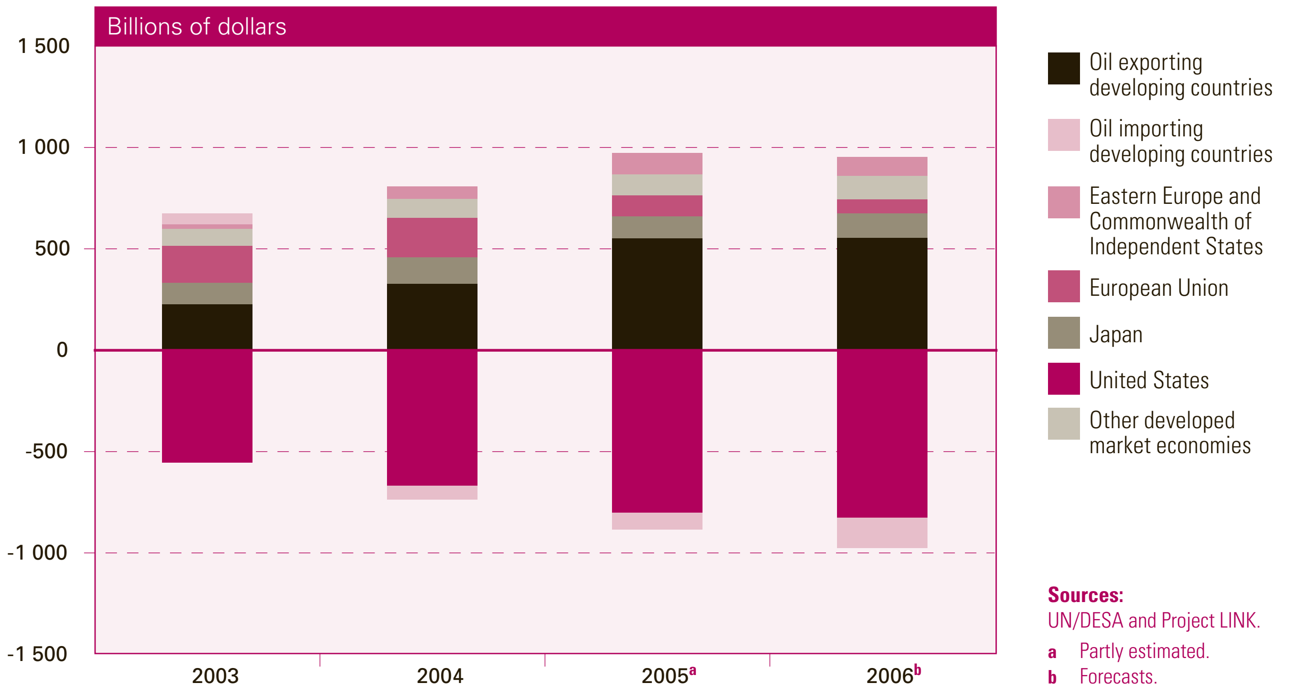
Commodity prices continued to increase in 2005, thereby boosting the export revenues of commodity exporters worldwide. Major gains were observed in the prices of metals and minerals and—to a lesser extent—in agricultural raw materials, while food prices, on average, registered modest increases. For example, export growth of Africa was largely driven by increased exports of minerals and metals in the Democratic Republic of the Congo, Ghana and Mali. Sustained demand for commodities and higher prices underpinned Latin American export performance, with exports by the South American subregion growing faster than elsewhere in the region. Developed countries such as Australia, Canada and New Zealand, and several of the CIS economies also benefited from the positive developments in commodity markets. In contrast, several non-fuel commodity exporters suffered terms-of-trade losses as oil price increases were higher than those of other commodities

Exports by Western Asian net fuel exporters expanded by almost 50 per cent in value terms. Volume growth was modest owing to the low rate of expansion of oil output as Gulf countries reached the limits of their production capacity. Similarly, higher oil prices supported growth in the value of exports by the Russian Federation. Meanwhile, Russian export volume growth decelerated because of lower output growth and increased export duties. In the outlook, growth in the value of exports from net fuel exporters will likely decelerate as oil prices stabilize (see below).

Higher oil prices contributed to widening trade imbalances across countries

Higher oil prices imply a transfer of income from fuel importers to fuel exporters and have contributed to changes in trade balances across countries. The aggregate trade surplus of net fuel exporters increased further in 2005, while net fuel importers saw a widening of their deficit (see figure II.3). In fact, the aggregated trade balance for developing

Figure II.3.
Selected economies: merchandise trade balance, 2003-2006



Sources: UN/DESA and Project LINK.
a Partly estimated.
b Forecasts.

country oil importers as a group switched from surplus to deficit after 2003. In the outlook, fuel prices are anticipated to remain high and cause a further widening of trade imbalances across countries.

World prices of manufactures remained flat in 2005

In contrast to developments in commodity markets, the average price of manufactures did not increase during the year. This was likely caused by a combination of three factors: an increasingly competitive environment, exchange-rate developments and lower growth in aggregate demand. Prices of some products dropped. For instance, semiconductor prices declined after sales had peaked by the end of 2004, and the market for microchips decelerated sharply in early 2005. A recovery seemed to be under way later in the year. Weakness in the global electronics market imposed a toll on the exports of some Asian countries, such as the Republic of Korea, Malaysia and Taiwan Province of China, among others. In the case of the latter, however, the relocation of production capacity to China—induced by lower labour costs—weakened export growth. Japanese exports were also affected by the downturn in the global electronics market. As a result, the rate of growth of Japanese real exports was cut in half in 2005 as compared to 2004 (see table A.17).

The end of the ATC led to changes in the textile and garment markets

The termination of the ATC brought considerable changes to the textile and apparel market. Many producers had not prepared themselves to cope with the end of trade preferences, despite the ten-year grace period (see below). The full liberalization of the textile and clothing markets led to increased competition in the sector, with the more productive producers gaining market shares at the expense of the less productive ones (see table A. 18). For instance, China managed to increase its share in import markets for articles of apparel and clothing accessories in both the EU and the United States. In the EU, China's share in total imports of textiles and apparel had jumped from 21.6 per cent in the period January-September 2004 to 30.1 per cent in the same period in 2005. In the United States, China's share went from 19 per cent to 27 per cent. India also increased its shares in both markets.

With few exceptions, LDCs and other low-income countries receiving preferential treatment faced difficulties in adjusting to the new regime

In general, high-cost producers such as Canada, Japan, Hong Kong Special Administrative Region (SAR) of China, the Republic of Korea and Taiwan Province of China suffered from the abolition of quotas and lost shares in both markets. It is also likely that these high-income economies, however, had already shifted productive capacity elsewhere and that their companies were exporting from new, less costly, locations. African textile exporters, including those receiving LDC preferential treatment, had more problems in coping with the new regime. Despite duty-free access, market shares were lost in both the United States and the EU, with only a few exceptions. African, Caribbean and Pacific (ACP) countries, which also receive preferential treatment, saw their exports to the EU market drop by over 20 per cent in both value and volume terms.

Other countries had different outcomes in different markets. For instance, Bangladesh and Sri Lanka held up well in the United States, increasing both the value and volume of their garment exports, but did not do so well in the EU market, where exports contracted slightly. This divergent outcome is probably caused by differences in quota allocation prevailing before 2005, as well as in product lines exported.

Many expected that the abolition of quotas would cause a sharp reduction in prices, especially for products from countries with tight quota restrictions, because of the elimination of costs associated with the quota system and the limited competition in the sector. Contrary to these expectations, the rate of growth of the total value of textile and garment imports was faster than the corresponding growth in volumes, thus indicating an increase in unit prices in both the United States and the EU. This was largely owing to the fact that, after the abolition of quotas, the export mix of various countries changed towards products that generally commanded higher prices, thereby increasing the average price. In fact, unit prices generally declined for the products that were imported in large quantities and were heavily restricted by quotas, such as cotton knit shirts for men and boys.[3]

Commodity prices and markets

Non-oil commodities

Non-fuel commodity prices continued to increase in 2005...

Commodity prices continued on an upward trend in 2005. After an increase of 20 per cent in 2004, non-fuel commodity prices, as measured by the UNCTAD commodity index, rose by a further 10 per cent, on average, during the first 10 months of 2005. Higher nominal prices were supported by demand from Asia, in particular from China, and emerging supply constraints in some commodity markets. In the course of 2005, however, the pace of price increases decelerated (see table A.15). In the outlook, non-fuel commodity prices are expected to stabilize, if not decline somewhat, as new productive capacity is brought on stream.

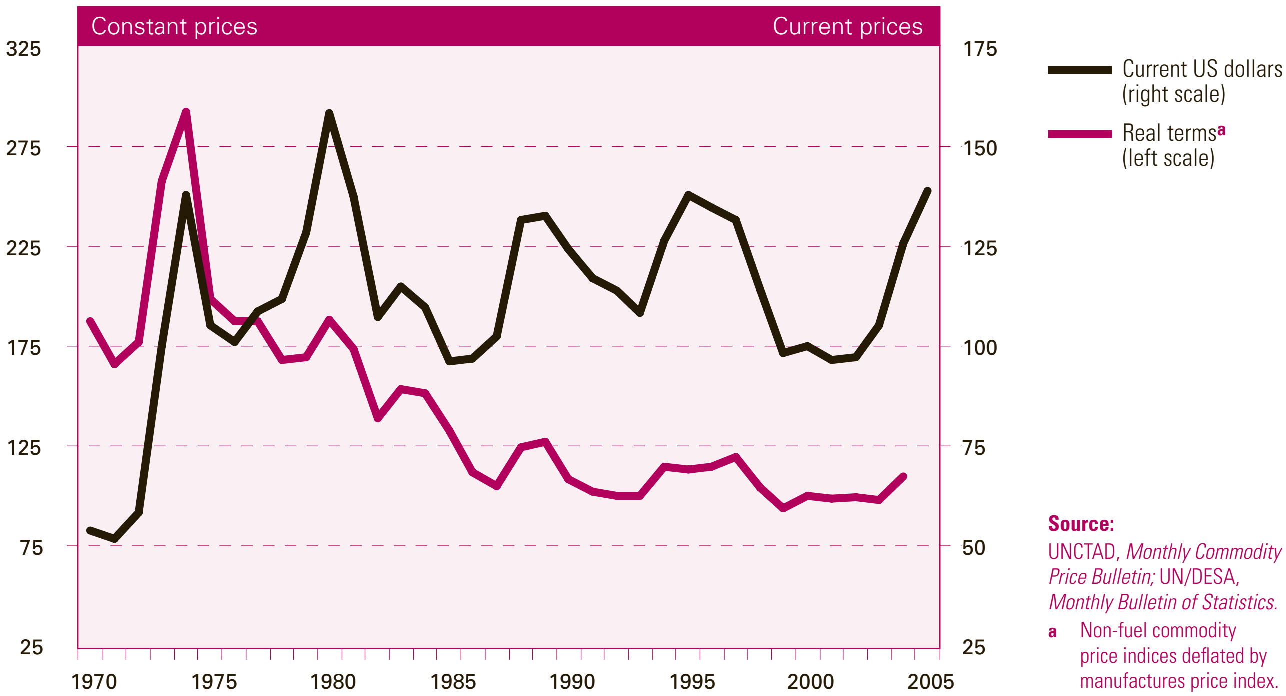
...but not enough to offset past price declines

The recent increases in commodity prices, however, have not been enough to offset the severe declines prices had suffered in the past. In the case of coffee, for instance, the rise in international prices has not been sufficient to make up for the fall in prices following the 1997 crisis. Expressed in current United States dollars, non-fuel commodity prices are still lower than what they were in the early 1980s (see figure II.4). In real terms, by the end of 2005, commodity prices were about 30 per cent lower than the average for the period 1975-1985.

Commodity price increases are also much less impressive when expressed in terms of other currencies, as the United States dollar depreciated during the period. When

3 For instance, the drop in export unit values was prominent for both Pakistan (13 per cent) and Bangladesh (8 per cent) in the EU market during the first three quarters of 2005.

Figure II.4.
Non-fuel annual average commodity price indices, 1970-2005 (2000 = 100)



Source: UNCTAD, *Monthly Commodity Price Bulletin;* UN/DESA, *Monthly Bulletin of Statistics.*

a Non-fuel commodity price indices deflated by manufactures price index.

measured in special drawing rights (SDRs), for instance, non-fuel commodity prices increased by just 13 per cent from 2002 to 2004, compared to an increase of 30 per cent when measured in dollars. Recently, however, the rebound of the dollar has reduced this gap (see table A.15).

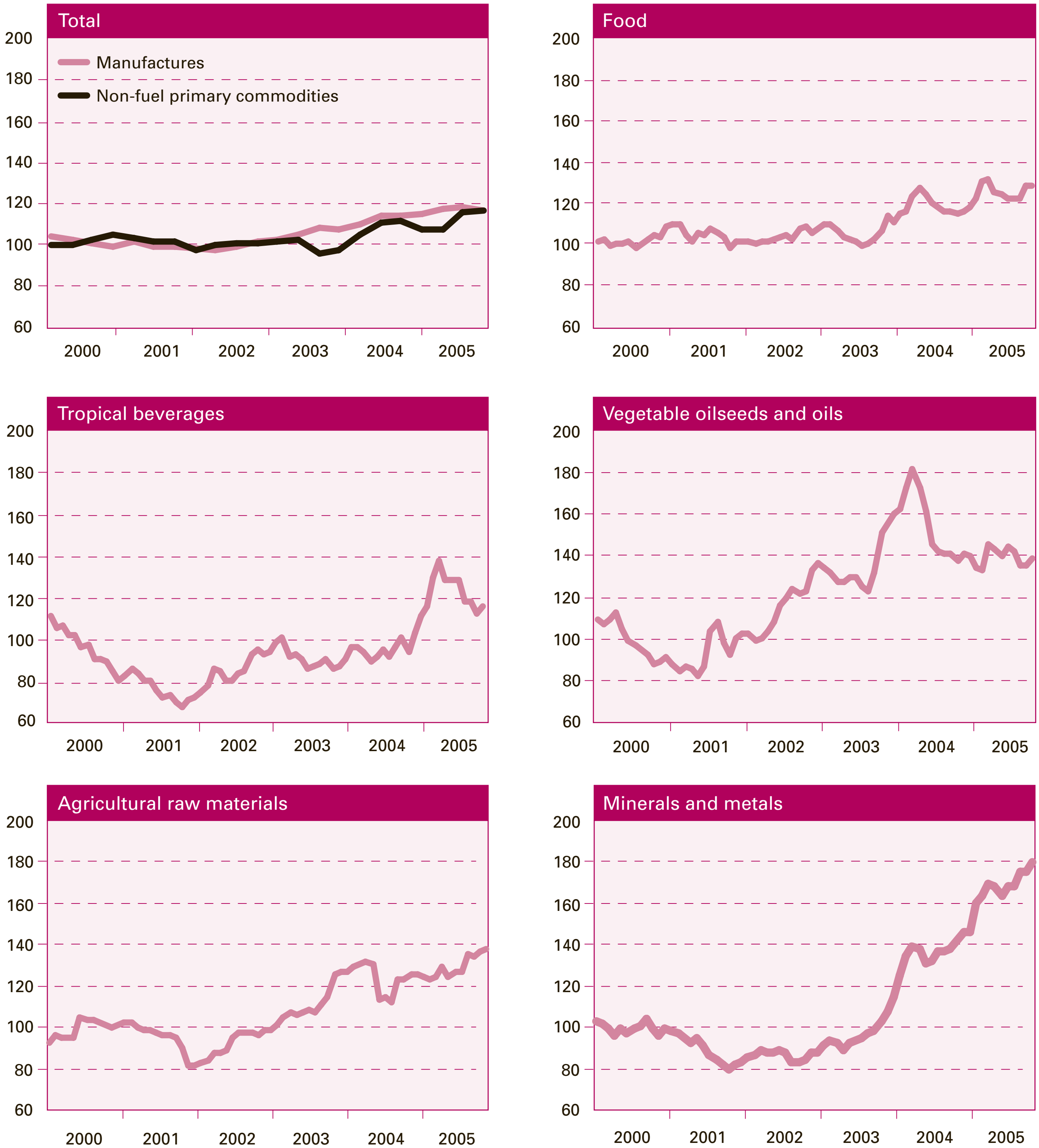
A large share of imports (including inputs to commodity production) of commodity exporting countries, especially in Africa, is paid in euros. These countries have been unable to take full advantage of increases in dollar prices. Lacking adequate access to risk management instruments, many countries have been unable to protect themselves against adverse exchange-rate movements. In the case of non-oil commodity sectors in Cameroon, for instance, the country would have earned an additional €37 million and €182.5 million in 2002 and 2003, respectively, had it been able to keep its dollar exchange rate at the 2001 level. The foregone export earnings in 2002 and 2003 correspond, respectively, to about 2.5 and 15 percent of the country's total merchandise export revenues

There was noticeable divergence in price trends across commodity groups

As is often the case, average price increases conceal considerable diversity across commodity groups. Most of the increase in non-fuel commodity prices in 2005 was driven by developments in the markets of minerals and metals. From December 2004 to October 2005, the prices of metals increased by 22.4 per cent. Prices of agricultural raw materials, food and tropical beverages also increased in 2005 but at more modest rates than metals and minerals (10.5 per cent, 9.3 per cent and 3.5 per cent, respectively). On the other hand, the price of vegetable oilseeds, which started to decline in 2004, remained relatively flat during 2005 (see figure II.5).

In fact, among the various non-fuel commodity groups, minerals and metals sustained the largest nominal increases, with prices doubling, on average, between January 2003 and October 2005. The increased demand brought about by the fast industrialization of China

Figure II.5.
Prices of primary commodities and manufactures, 2000-2005
(Indices of US dollar prices, 2000=100)



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

and the recovery of manufacturing production worldwide caused this buoyant performance. Limited capacity to expand supply in the short- to medium-term was a factor for several metals as, for instance, in the case of nickel. Speculation also contributed to higher metal prices. During 2005, speculation was also a factor in the nickel market, where prices increased sharply during the first half of the year but retreated later on.[4]

Average prices of agricultural raw materials increased by 37 per cent between January 2003 and October 2005. Strong growth in demand from China was an important factor behind this upward trend. Among the various specific commodities that compose this group, natural rubber experienced significant price increases during the period (about 95 per cent). Next to excess demand, higher oil prices were also a factor in driving up the price of rubber as consumers switched from synthetic products to natural rubber. Tropical beverages increased by some 23 per cent in the same period. Yet, while the price of coffee recovered during the period and had regained some ground since its latest crisis in 1997, the price of cocoa declined by almost 30 per cent. Meanwhile, the recovery of food prices was relatively subdued, as prices increased by 18 per cent in the period January 2003-October 2005. It also started later than in the other commodity groups (except for tropical beverages, see figure II.5) owing to relatively weaker demand and continued supply overhangs in the early part of the global economic recovery.

A more detailed review of individual commodity market developments and prospects is presented in the annex to this chapter.

Institutional factors will also affect future price trends

The results of dispute settlement processes in the World Trade Organization (WTO) and the ensuing changes in trade policies and practices of major importing and/or producing economies will likely have an impact on prices of specific commodities and affect export earnings prospects of many countries. Of particular importance are the rulings on sugar and bananas that will generate changes in preferential access to the EU market by ACP countries, as well as the ruling on cotton subsidies (see box II.1). In the cases of sugar and bananas, ACP countries will be negatively affected, particularly the less competitive among them. The changes will benefit producers that had limited access to the EU market before. Losses in export earnings for the ACP producers have been estimated at around $500 million in the case of sugar and $100 million in the case of bananas.[5] The affected countries will require additional assistance to support their diversification efforts and help finance social adjustment costs.

Trends in the various commodity markets vary as they are driven by different factors. For instance, as indicated, rubber, and to some extent also cotton prices, are influenced by developments in the oil market owing to substitution effects between natural and synthetic products. Meteorological conditions and trade policies have influenced supply conditions for other cash crops. Global economic conditions also affect different markets in different ways from the demand side. For instance, the rapid pace of industrialization and income growth in China and elsewhere in Asia, has had a much stronger impact on the prices of industrial raw materials, particularly metals, than on food prices. This difference is likely to persist in the short-to-medium term, although food imports by China are likely to increase in the longer term, raising the likelihood of future price increases for agricultural commodities. It is unlikely, however, that the growing imports of primary commodities into Asia will lead to

4 Nickel prices increased by about 23 per cent during the period January-May 2005.

5 See Ian Gillson and others, “Report on Forthcoming change in the EU banana/sugar markets: A menu of options for an effective EU transitional package”, Overseas Development Institute, 2005, available from http://www.odi.org.uk/iedg/Projects/EU_banana_sugar_markets/SUGARreport.pdf.

Box II.1

WTO dispute settlement and commodities

Bananas: Preferences for bananas from the African, Caribbean and Pacific (ACP) countries have existed in the European Union (EU) since its origin and are historically accountable for the growth of the banana industry in the Caribbean. The EU import regime essentially consisted of a concessionary tariff quota (TQ), initially of 2 million tons per year (originally at ECU 100 per ton), open to imports of bananas from all origins. The tariff for imports outside the quota was set at a prohibitive level. A fixed quantity of the TQ (up to 857,700 tons) was reserved for the duty-free import of bananas from the ACP States that had traditionally supplied the EU. Maximum quantities were allocated to each traditional ACP supplier on a historical basis. Specific shares of the TQ (49.4 per cent, collectively) were subsequently allocated to four Latin American countries that had challenged the regime, and 90,000 tons out of the TQ open to third country (dollar) bananas[a] were reserved for the duty-free import of ACP bananas.

The system was found to be incompatible with WTO rules, as the EU had allocated shares of its market to some banana suppliers, while not providing such access to others with similar or greater historical levels of trade. The EU licensing procedures were also found to be discriminatory under the General Agreement on Trade in Services (GATS) in that, even though there was no formal discrimination, de facto advantages were created for European operators while discriminating against service suppliers from Latin America. The dispute was resolved in 2001 through understandings with Ecuador and the United States. The understandings committed the EU to eliminate quotas and establish a tariff-only regime no later than 1 January 2006. The new import regime will include a duty-free annual quota of 775,000 tons for ACP bananas and a new import tariff of €176 per ton for most favoured nation (MFN) suppliers.

a Banana imports from any non-ACP source are known as "third country" bananas or "dollar" bananas since they primarily originate in the dollar zone (Latin America). See The EU banana regime, GATT/WTO challenges, and the evolving policy framework, available from http://r0.uncatd.org/infocomm/anglais/banana/ecopolicies.htm.

Cotton: On 27 September 2002, Brazil requested consultations with the United States regarding alleged prohibited and actionable subsidies provided to United States producers, users and/or exporters of upland cotton. The disputed measures included direct payments decoupled from production, assistance provided to producers in order to make up for losses sustained as a result of low commodity prices, payments to domestic users and exporters of domestically produced upland cotton when certain United States cotton pricing benchmarks were exceeded, and three types of export credit guarantee programmes for agricultural products.

Under the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement), the dispute settlement panel concluded the following: the export credit guarantee programmes and the price-contingent measures targeting exporters per se constituted prohibited export subsidies; price-contingent measures directed to domestic processors were import-substitution subsidies and therefore prohibited; and the mandatory price-contingent subsidy measures led to significant price suppression in the world market, constituting serious prejudice to the interests of Brazil. In the light of those conclusions, it was recommended that the United States eliminate the prohibited subsidies without delay and take appropriate steps to remove the adverse effects of the above mentioned price-contingent measures.

This case sheds light on the constraining impact of WTO law and jurisprudence on the design and implementation of domestic policy measures in the commodity sector. It is interesting to note in this respect that agricultural policy reform in both Europe (reform of the European Common Agricultural Policy) and the United States (the 1996 and 2002 Farm Acts) are heading in the direction of decoupled payments, that is to say, green box support, which is exempted from reduction commitments under the Agreement on Agriculture (AoA).

Cotton has also become a special issue in the Doha negotiations. Benin, Burkina Faso, Chad and Mali called for the speedy elimination of cotton subsidies and for compensation for the export earning losses caused by those subsidies. A Subcommittee on Cotton was created to look at cotton as a special issue within the framework of agriculture negotiations in WTO. At the Hong Kong Ministerial Conference, it was agreed that cotton export subsidies, which constitute only a small fraction of distortions affecting the sector, would be eliminated in 2006, and developed countries would give duty- and quota-free access to cotton exports from the least developed countries (LDCs). Duty- and quota-free access, however, is already available in some major

Box II.1 (cont'd)

markets (for instance, under the EU Everything But Arms and the Canadian Market Access initiatives), while Western African countries currently do not export cotton to the United States market.

It was also agreed that trade-distorting domestic support on cotton production would be cut deeper and faster than other trade-distorting subsidies. The Ministerial Declaration, however, does not specify either the amount or the schedule for the implementation of such cuts.

Sugar: The sugar case concerned the export subsidies provided by the EU in the framework of its common organization of the market for the sugar sector. The EU intervention price system guaranteed a minimum market price (three times higher than world market prices) for sugar produced within different production quotas (A and B quotas). The intervention price was valid for the domestic market and as a guaranteed minimum price to be paid by EU purchasers for (duty-free) imports of sugar from ACP States and India. Sugar produced in excess of the A and B quotas (so-called C sugar) could not be sold internally in the year in which it was produced: it had to be exported or carried over to fulfil the production quotas of the following year.

The complainants alleged that the domestic support provided to A and B beet sugar had the incidental effect of "cross-subsidizing" exports of C sugar, in excess of the EU reduction commitments' level. Another aspect of the dispute had to do with ACP and Indian sugar imported annually into the Community. The complainants maintained that the EU should have included the amount of ACP/Indian sugar that was then refined in Europe and re-exported to third countries in its export subsidy calculations. The panel concluded that the EU, through its sugar regime, had acted inconsistently with its obligations under the AoA by providing export subsidies in excess of the quantity commitment level and the budgetary outlay commitment level specified in its schedule of reduction commitments.

As a result, changes were introduced in the EU sugar policy. Major provisions include the following: the guaranteed price for white sugar will be cut by 36 per cent over a period of four years starting in 2006/07; farmers will be compensated on average 64.2 per cent of the price cut by a decoupled payment; the intervention price will be replaced by a reference price; ACP countries will be eligible for an assistance plan amounting to €40 million in 2006. The offer of assistance, while welcome, is only a fraction of the preferences enjoyed by ACP countries (see main text). Finally, it should be noted that a safeguard mechanism was drawn up for cases in which developing country exports to the EU jumped by more than 25 per cent a year.

a reversal of the long-term decline in real commodity prices.[6] More importantly, however, is that a sustained increase in the demand for commodities by these countries will continue to provide additional opportunities for increased commodity exports by developing countries.

World oil markets

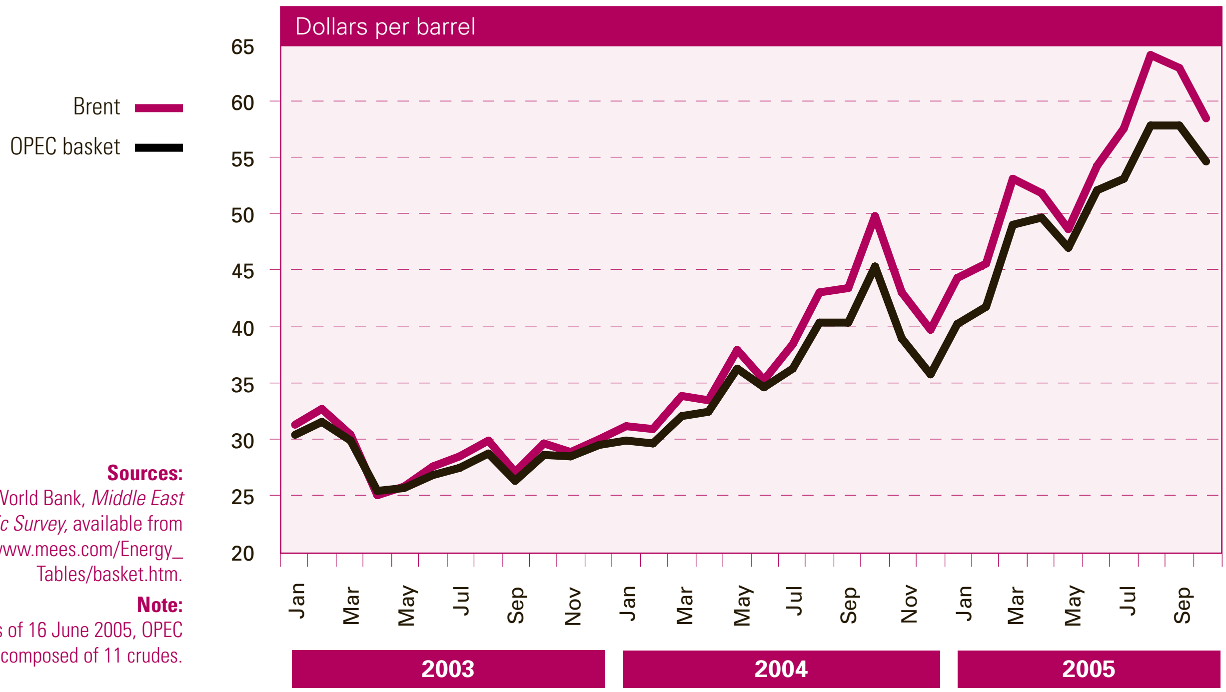
After reaching a peak in August 2005, oil prices declined. This decline reflected a deceleration of oil demand in 2005. Brent, one of the two key market references for light, sweet crude, was priced at $55 per barrel (pb) in late November 2005, down from $63 pb in late August, when Hurricanes Katrina and Rita provoked serious disruptions in an already tight market (see figure II.6).

Oil prices are expected to remain above a floor of $50 per barrel in 2006

Despite the recent decline, oil prices are still expected to stay above a floor of $50 pb during 2006 as global demand is expected to keep growing in 2006 and beyond, even though more moderately than in the recent past. Supply is expected to remain tight, with global spare production capacity staying low despite expectations of a modicum of growth in the medium run. In sum, high oil prices and potential supply disruptions may still pose a significant risk to global economic prospects in the medium run.

6 UNCTAD, *Trade and Development Report, 2005* (United Nations publication, Sales No. E.05.II.D.13), p. 76.

Figure II.6.
Oil prices, January 2003-October 2005



Sources: World Bank, *Middle East Economic Survey,* available from http://www.mees.com/Energy_Tables/basket.htm.

Note: As of 16 June 2005, OPEC basket is composed of 11 crudes.

Trends and outlook for world oil demand

Following strong growth of 3.8 per cent in 2004, the growth of world oil demand decelerated to 1.3 per cent in 2005, or by 1.1 million barrels per day (mbpd) in 2005.[7] This deceleration results largely from a slowing in oil demand growth in the United States, continued stagnation in Western Europe, as well as a strong deceleration in China. Global oil demand is expected to pick up moderately in 2006, growing by 2.0 per cent or 1.7 mbpd (see table A.16).

Demand growth decelerated in major markets in 2005...

Several factors were behind the slower growth in oil demand in the United States in 2005. These include the impact of the late summer hurricanes on the oil infrastructure, an apparent demand adjustment to sustained higher prices, as well as unusually mild weather at the start of the winter in the country's north-east. Yet, some of these factors are temporary, whereas there is little evidence of sustained shifts towards greater oil efficiency.

Oil import demand in China moderated in 2005, following steep growth in 2004. There are indications, however, that this slowdown may be somewhat artificial and temporary. Local refiners, which were facing lower profit margins as a consequence of controlled domestic prices, have apparently been exporting a growing share of their production, thereby artificially depressing net fuel imports. This effect may tend to disappear as domestic prices are gradually increased. This notwithstanding, there are signs that some of the factors underlying the surge in oil demand in 2004 faded in 2005 owing to an easing of electrical power shortages and more restrictive economic policies. A prolonged drawdown of domestic stocks

7 International Energy Agency (IEA), *Oil Market Report,* October 2005, available from http://www.omrpublic.iea.org/omrarchive/11oct05full.pdf .

in 2005, which were purchased at lower prices, was also a factor.[8] Thus, stock replenishment will support growth of oil demand in 2006 and beyond. Chinese oil demand is expected to increase by 7.6 per cent in 2006, accounting for around 28 percent of global growth, up from 3.1 per cent in 2005.

…but is expected to grow relatively quickly over the medium run

Throughout much of developing Asia, oil demand is expected to continue to grow in the medium run, albeit at a significantly slower pace than in 2004. Although governments in the region are adopting measures to bring domestic energy prices more in line with global prices (see chapter IV), prices remain relatively low. In addition, fast output growth will continue to support oil demand in the medium term.

Developments affecting supply

Higher prices reflect tight supply conditions in oil markets and strong demand. Low spare production capacity, including mismatches in available global refining capacity, is anticipated to remain a key factor affecting oil markets in the medium term.

Supply remains constrained by limited spare capacity…

Global spare capacity is expected to increase somewhat by end-2006, while Saudi Arabia announced plans to increase its production capacity by 1.5 mbpd by the year 2009.[9] Nonetheless, spare capacity will likely remain low in the medium run, particularly in the context of current growth in demand.

…geopolitical uncertainties…

The production of the Organization of the Petroleum Exporting Countries (OPEC) is also subject to uncertainties stemming from the continued inability to obtain substantial increases in Iraqi production because of the acute conflict and insecurity affecting production and exports in that country, as well as growing political uncertainties in the Islamic Republic of Iran. Furthermore, the crude production of the Bolivarian Republic of Venezuela remains below the levels prior to the 2002-2003 strike and lower-than-expected investments in recent years may compromise faster output growth in the near future.

Several factors will constrain faster growth in supply by non-OPEC producers. The impact of the 2005 hurricane season on output will be felt for a while as production of crude oil and refining in the United States Gulf Coast are not expected to fully recover to pre-hurricane levels until well into 2006. Meanwhile, production continues to decline in mature areas such as the North Sea. Furthermore, the increased uncertainty about the environment for investment and production and high taxes on extraction and exports have diminished the chances of any substantial production growth in the medium and long term in the Russian Federation. Finally, anticipated medium-term production levels in a number of Asian and African producers were recently revised downwards.[10]

…and limited investment in the sector in the past

Overall, the global oil sector is currently suffering from reduced investment in both upstream and downstream activities in the 1980s and 1990s, when prices were at an historical low in real terms. New upstream investment is constrained by the limited availability of drilling infrastructure, tightness in the specialized labour market and rapidly increasing costs throughout the entire production chain. Moreover, output capacity remains constrained in the refining sector worldwide, caused by low investment over the past decades as well as environmental considerations. This has resulted in high utilization rates of existing refineries, particularly the more sophisticated ones needed to refine heavy types of crude. In fact, the

8 Robert Kaufman, "The forecast for world oil market", paper presented at Project LINK meeting, Geneva, 31 October-2 November 2005, available from http://www.chass.utoronto.ca/link/meeting/papers/1031pm_rk.pdf.

9 Center for Global Energy Studies (CGES), *Oil Market Prospects,* vol. 10, No.10 (October 2005).

10 IEA, *Oil Market Report,* op. cit.

premium on the price of light crudes over heavier types increased significantly as markets became tighter, particularly since the end of 2004 (see figure II.7).

During much of 2005, the approach of OPEC was to steadily increase production. This in turn allowed for a build-up in crude oil stocks in OECD countries. By the end of 2005, total OECD stocks stood at somewhat higher levels than a year earlier. Stocks are probably still seen as insufficient in current market conditions, however, as spare supply capacity is at historical lows.

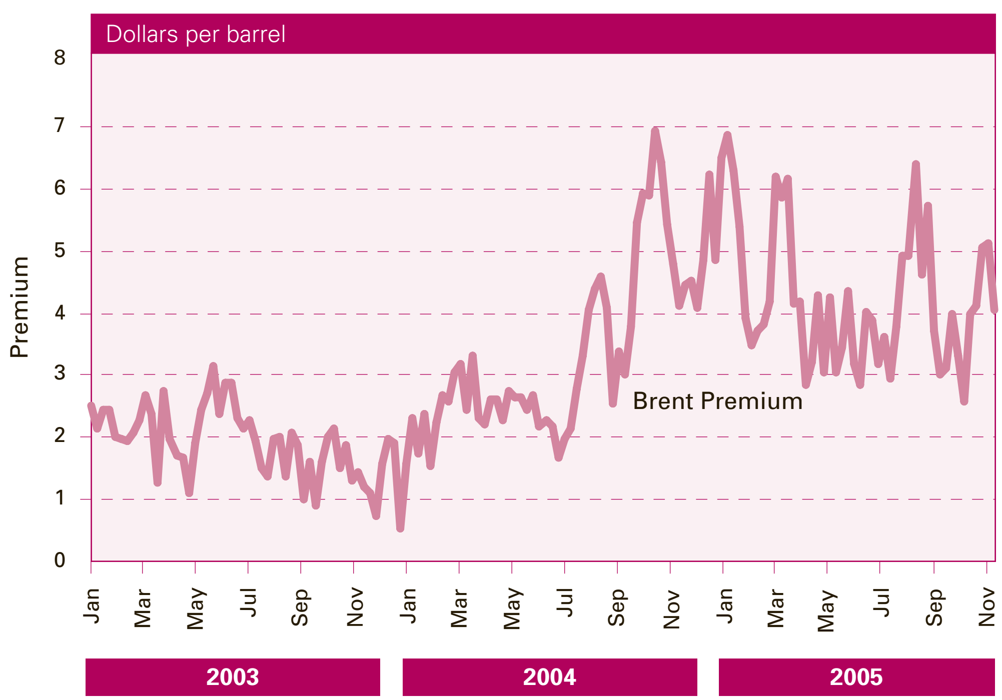
The outlook for oil prices

The decline in oil prices during the last quarter of 2005 largely reflects the response of the market to the deceleration in global demand growth. Yet, several factors point towards continued tight fundamentals that call for prices to remain above a floor of $50 pb over the outlook period. Oil demand is still growing at a significant pace, in spite of the recent moderation, particularly in some developing countries, while existing supply constraints will only ease off gradually. As a result, Brent oil prices will remain robust, but may lower somewhat over the forecast period, that is from an average of $54.7 pb estimated for 2005 to $59 pb in 2006.

Uncertainties surround the outlook for oil prices

The current outlook for prices is subject to uncertainties. On the upside, any major disruption of crude production or refining facilities because of adverse weather or political developments, which are difficult to forecast by their very nature, could have a considerable impact on prices for relatively extended periods. On the downside, uncertainties include the possibility of a stronger-than-expected correction of global oil demand growth—in response to high prices or as a result of a surge in inflation in the developed countries—and a faster-than-expected recovery of Iraqi oil production.

Figure II.7.
Brent oil: premium over OPEC basket, January 2003-November 2005



Source: United States Energy Information Administration.

Trade policy developments and trends

Doha negotiations: keeping the Round alive

The July package had renewed hopes the Round was back on track...

The adoption of the framework agreement of 1 August 2004 (the "July package")[11] brought renewed hope to the multilateral trade negotiations under the WTO Doha Work Programme. There was an overall perception that the negotiations were back on track after a number of delays. The package set out general frameworks for future negotiations in five core areas: agriculture, market access of non-agricultural products, services, development issues and trade facilitation. Negotiations would proceed to produce a package of detailed and specific negotiating modalities (an "end-game document") as the basis for negotiating outcomes to be adopted at the Sixth WTO Ministerial Conference in Hong Kong SAR in December 2005. The Round was set to be completed by the end of 2006. These developments have raised expectations that the development objectives of the Doha Ministerial Declaration, including substantial trade liberalization in areas of primary export interest to developing countries, would be delivered in time for making a positive contribution to achieving the Millennium Development Goals (MDGs) by 2015.

...but negotiations proved difficult on the road to Hong Kong SAR

Moving the negotiations forward has proven to be difficult, however. Despite visible efforts undertaken by participants throughout the year, it was finally recognized in November 2005, that progress was slow in all negotiating bodies. Moreover, the breadth of issues under negotiations and their complexity and sensitivity to different countries would not allow forging a consensus on negotiating modalities. The Hong Kong Ministerial Conference thus necessitated a "recalibration of expectations".

There were, however, some positive developments related to the attention given to concerns of developing countries in the area of intellectual property that contributed to a more favourable political environment leading to the Conference. The decision to extend the transitional period for LDCs for full implementation of the Agreement on Trade-Related Intellectual Property Rights (TRIPs) is a case in point. Another relevant decision was to amend the TRIPs Agreement to facilitate access to essential medicines for countries with no or limited production capacities.[12]

The Hong Kong Ministerial Conference

Results achieved were modest

The Sixth WTO Ministerial Conference concluded with the approval of the Ministerial Declaration.[13] Against the low expectations and even predictions of another failure, the results achieved could be qualified as modest and marginal, but nevertheless positive. The explicit commitment taken at this Conference "to complete the Doha Work Programme fully and to conclude the negotiations launched at Doha successfully in 2006", however, will require

11 World Trade Organization (WTO), Doha Work Programme: decision adopted by the General Council on 1 August 2004 (Document WT/L/579), 2 August 2004. For a discussion of the "July package", see *World Economic Situation and Prospects 2005* (United Nations publication, Sales No. E.05.II.C.2), pp. 33-37.

12 Some concerns were raised during the Conference. In particular, the WHO pointed out that in order to achieve "full public health benefits", it would be necessary to have a simple and workable approach in the interpretation of this amendment. See *World Health Organization (WHO), Statement Circulated by the WHO* (Document WT/MIN(05)/ST/52), 15 December 2005.

13 WTO, Ministerial Conference, Sixth Session, Doha Work Programme, *Draft Ministerial Declaration. Revision* (Document WT/MIN(05)/W/3/Rev.2), 18 December 2005.

considerable political will from the participants to make tough decisions and conclude negotiations within a very short time frame.

Ministers established new deadlines for 2006 as follows:

- 30 April: for establishing full negotiating modalities on agriculture and industrial market access;
- 31 July: for submitting draft schedules of concessions and commitments, including a revised offer in services, and recommendations on issues relating to the implementation of WTO Agreements;
- 31 October: for producing final draft schedules of commitments in services; and,
- 31 December: for concluding the Doha Round as a whole.

Among the main substantive decisions reached, three can be characterized as central in contributing to a positive outcome. These are:

- An agreement to eliminate all forms of agricultural export subsidies by the end of 2013 in a progressive and parallel manner. A substantial part of this elimination is to be realized by the end of the first half of the implementation period. This agreement, however, is conditional on a future agreement on full negotiating modalities, as well as on establishing multilateral disciplines on other forms of export competition measures, such as export credits, export credit guarantees or insurance programmes, trade-distorting practices of State-trading enterprises and food aid. Despite these caveats, this represents a substantial systemic advance by bringing further agricultural trade under the umbrella of general multilateral trade rules, which prohibit the use of export subsidies.
- A limited "development package" for LDCs consisting of several decisions, including the provision of granting duty-free and quota-free market access by developed countries and developing countries declaring themselves in a position to do so on "a lasting basis". The preferences would extend to all products originating from all LDCs by 2008 or no later than the start of the implementation period in a manner that ensures stability, security and predictability. Preference-granting countries will have the flexibility to exclude from such benefits up to 3 per cent of products originating from LDCs, defined at the tariff level. In practical terms, the value of such treatment of exports from LDCs will directly depend on the inclusiveness of product coverage. If, for example, textiles and clothing (that is to say, products accounting for roughly 20 per cent of LDC exports) are excluded by some developed countries, the gains of such a decision could be marginal.
- A decision to eliminate all forms of export subsidies for cotton by developed countries in 2006 (see also box II.1). Moreover, developed countries agreed to grant duty- and quota-free access for cotton exports from LDCs from the beginning of the implementation period. This decision is expected to have limited economic impact in the medium term. Trade and production-distorting effects of domestic support measures in developed countries—the most important issue for Western African cotton producers—will be addressed in the context of overall negotiations on agriculture. Yet, the possibility of more ambitious cuts in these subsidies over a shorter period of time than would be generally applicable has not been ruled out.

Much detail is still to be negotiated

Some of the advances made in the main areas still need to be confirmed by a future agreement on full negotiating modalities. Regarding market access for agricultural products, for example, four sets of tariff bands were adopted for structuring tariff cuts, with deeper cuts expected to be applied to the higher tariff bands. Members, however, still have to agree on thresholds defining such bands and on the range of tariff cuts to be applied to each band. Moreover, there is still need to agree on the treatment of "sensitive products", that is to say, products subject to Tariff Rate Quotas, with some developed country members arguing that a percentage should be subject to lower tariff cuts. Negotiators indicated that developing countries will have the flexibility to designate "an appropriate number" of Special Products which will be exempt from tariff cuts in a manner to be agreed upon.[14] On domestic support, three bands were adopted to guide overall cuts in trade-distorting subsidies by developed countries, with the higher linear cuts in the higher bands. Again, although there has been some convergence on the range of cuts, negotiators are still to agree on the level of such reductions as well as on the schedule of their implementation.

With respect to the upcoming negotiations, an additional complicating factor is the introduction of an explicit link between negotiations on agriculture and non-agricultural market access (NAMA) products. The Declaration specifically instructs negotiators "to ensure that there is a comparably high level of ambition in market access for agriculture and NAMA", but in a balanced manner and consistent with the principle of special and differential treatment.[15]

On NAMA, a "Swiss tariff-cutting formula" was explicitly confirmed for the first time. The Swiss formula reduces higher tariffs more than lower ones. It will lead to larger cuts by developing countries which, on average, impose higher tariffs than developed countries on industrial products. All relevant details (for example, the magnitude and number of coefficients, treatment of unbound tariffs, concrete flexibilities for developing countries and so on) are still to be identified in the full negotiating modalities.

In contrast to the agreement on agriculture and NAMA, ministries expressed their determination to intensify negotiations on services under given guidelines and specific deadlines. While bilateral request-offer negotiations will remain the main method of negotiation, the negotiations should also be pursued on a plurilateral manner and their results extended on a most favoured nation (MFN) basis. Additional objectives for expanding the sectoral and modal coverage of future commitments were mentioned, including delinking offers on Mode 1 (cross-border trade, which includes outsourcing) and some categories of Mode 4 (presence of natural persons) from commercial presence.

Meaningful progress is still required for the Round to achieve its development objectives

In view of the developments highlighted above, difficult negotiations are still ahead and need to be pursued with renewed political will in order to guarantee a meaningful and equitable outcome of the Round. It is worth reiterating that the fulfillment of the declared development objectives of the Round requires meaningful progress to be made in all areas of these negotiations. This holds in particular for trade in agricultural products, where politically painful actions left over for decades are to be taken and implemented, mostly by developed countries in eliminating export and trade-distorting domestic subsidies. Enhanced and stable market access for the agricultural and industrial exports of developing countries should also be achieved by effectively reducing trade barriers worldwide, with full account taken of the General Agreement on Tariffs and Trade (GATT) rule providing "less-than-full reciprocity" for developing countries. Rapid progress must also be made to unleash the considerable development potential of trade in services by liberalizing the temporary supply of labour services and the cross-border supply of services via outsourcing and offshoring.

14 Special products refer to those agricultural products that are vital for food security, livelihood and rural development.

15 WTO, Ministerial Conference, Sixth Session, Doha Work Programme, *Draft Ministerial Declaration. Revision* (document WT/MIN(05)/W/3/Rev.2), 18 December 2005, para. 24, p. 5.

Flexibilities are needed for developing countries

The outcome of the Doha negotiations should be equally instrumental in treating any of the inherent and continued asymmetries in the WTO Agreements concerning developing countries, including differential supply capacity, economic size and power, and ability to subsidize economic sectors, through the provision of operational and commercially meaningful rules for special and differential treatment (SDT). These new rules should permit developing countries to undertake complementary policies (trade, production, technology, financial and social policies) that are considered essential to strengthen supply capacities, develop competitive networks of enterprises, innovate and improve the technology content of exports and expand employment opportunities. Furthermore, a meaningful Aid for Trade package (see below) would go a long way in enabling developing countries, especially LDCs, to meet adjustment costs, build trade-related infrastructure and supply capacity in order to benefit from opportunities that would be opened up by the Doha Round.

In all, a balanced outcome from the Round is urgently necessary not only to allow trade to contribute to growth and development worldwide but also to safeguard the health of the multilateral trading system and the interests of all countries in view of the increasing number of bilateral and regional free trade agreements (discussed below). These agreements have created a complex web of overlapping trading systems, which may not necessarily be in accordance with the goals and principles of multilateralism.

Accessions to the WTO

Out of WTO accession negotiations of 31 countries, those of Saudi Arabia and Tonga were concluded either before or during the Hong Kong Ministerial Meeting, thus making a further step towards the universal membership of the WTO. The accession terms of these countries are described in box II.2.

Box II.2

The accession of Saudi Arabia and Tonga to WTO

Saudi Arabia

Saudi Arabia became the 149th member of WTO on 11 December 2005, thus enabling it to participate as a WTO member in the Hong Kong Ministerial Conference.

Saudi Arabia had been negotiating its membership since July 1993. As a result of the negotiations, it agreed to undertake several important commitments to further liberalize its trade and investment regimes. Among the systemic commitments and obligations undertaken by Saudi Arabia are the following:

- The WTO Agreement will be applied uniformly throughout the customs territory of Saudi Arabia.
- Termination, no later than 31 December 2007, of the current practice that requires notarization, authentication or consularization of trade documents, including the fee charged for those services on all exports to Saudi Arabia.
- Elimination of any non-tariff measures that cannot be justified under WTO rules. The country maintains the right, however, to restrict the importation and exportation of a certain number of goods and services in order to safeguard the legitimate interests of the country. The list of banned imports is to be reviewed at least once a year.
- No export subsidies on agricultural products.
- Saudi Arabia will ensure that its producers and distributors of natural gas liquids (NGLs) will operate on the basis of normal commercial considerations, based on the full recovery of costs and a reasonable profit.

Box II.2 (cont'd)

- Full application, from the date of accession, of the provisions of the Agreement on Trade-Related Intellectual Property Rights (TRIPs), the Agreement on Technical Barriers to Trade, and the Agreement on Sanitary and Phytosanitary Measures.[a]

In the area of goods, Saudi Arabia has bound all tariffs levied on imports, with appropriate flexibility for the staged reduction of import tariffs—over a period of 10 years—for some products. At the end of the 10-year implementation period, average bound tariff levels will decrease to 12.4 and 10.5 per cent for agricultural and non-agricultural products, respectively. The individual tariff rates for agricultural products will range from 5 to 200 per cent, with the highest rates being applied to tobacco products and dates. Some 11 per cent of non-agricultural products will be imported duty-free, whereas the highest tariff rate will affect wood, as well as iron and steel products. Most tariffs (92.6 per cent) will be set at their final bound rates at the date of accession. The remainder will be implemented mostly in 2008 and 2010, but in no case later than 2015.

In service sectors, Saudi Arabia has undertaken a number of substantive commitments as follows:

- **Insurance:** Foreign insurance companies will be permitted to open and operate direct branches in Saudi Arabia. Commercial presence will also be permitted for insurers who establish a locally incorporated cooperative insurance joint-stock company, in which foreign participation is limited to 60 per cent. A three-year transition period will be given to existing foreign insurance providers to convert to either a Saudi cooperative insurance company or to a direct branch of a foreign insurance company.
- **Banking:** The commercial presence of banks will be permitted in the form of a locally incorporated joint-stock company or as a branch of an international bank. The foreign-equity cap for joint ventures in banking will be increased to 60 per cent. While financial services can be provided only by commercial banks, asset management and advisory services may also be provided by non-commercial banking financial institutions.
- **Telecommunications:** Within three years from accession, the commitments of Saudi Arabia will allow up to 70 per cent foreign equity ownership in the telecommunications sector. These commitments apply to both basic telecommunications services and value-added telecommunications services. Public telecommunications services will have to be provided by a joint-stock company.
- **Distribution:** Foreigners will be allowed to engage in wholesale and retail trade, including franchising, subject to some limitations: Foreign equity is to be limited to 51 per cent upon accession and to 75 per cent after three years from the date of accession. In the case of franchising, the foreigner should be authorized in his own country to practice franchising or be a partner in an authorized company for a period of no less than five years without interruption.

Tonga

The Sixth WTO Ministerial Conference approved Tonga's accession package on 15 December 2005, paving the way for Tonga to become the 150th WTO member. Tonga will have to ratify the accession terms and will become a full member 30 days after it has informed the WTO of its ratification. Tonga agreed to do this by 31 July 2006.

Tonga agreed to undertake a series of important commitments. In the goods area, Tonga committed itself to lowering its tariffs by 1 January 2007. All tariff lines will have an upper bound of 15 or 20 per cent. Similarly, Tonga committed itself to liberalizing all 11 sectors under the WTO services classification.

These constitute very far-reaching measures for a small island developing country, but are consistent with WTO rules (the so-called systemic obligations). Tonga will apply all mandatory WTO agreements, with only a few exceptions, from the date of accession and within short time limits. Tonga has been granted transition periods to implement the Customs Valuation Agreement and the Agreement on Trade-Related Aspects of Intellectual Property Rights until 1 January 2008 and 1 June 2008, respectively.[b]

a World Trade Organization, *Report of the Working Party on the Accession of the Kingdom of Saudi Arabia to the World Trade Organization* (document WT/ACC/SAU/61), 1 November 2005; WTO, *Schedule of Concessions and Commitments on Goods* (document WT/ACC/SAU/61 Add.1), 1 November 2005; WTO, *Schedule of Specific Commitments in Services, List of Articles II NFM Exemptions* (document WT/ACC/SAU/61 Add. 2), 1 November 2005.

b WTO, *Report of the Working Party on the Accession of Tonga to the World Trade Organization* (document WT/ACC/TON/17), 2 December 2005; WTO, *Schedule of Concessions and Commitments on Goods* (document WT/ACC/TON/17 Add.1), 2 December 2005; WTO, *Schedule of Specific Commitments in Services, List of Article II MFN Exemptions* (document WT/ACC/TON/17 Add.2), 2 December 2005.

Aid for Trade

Trade opening has been a key element in development strategies for the last 20 years, and further liberalization as a result of the WTO negotiations is generally seen to bring considerable long-term benefits. Trade liberalization, however, does not automatically translate into higher growth and development. The experience with the termination of the ATC discussed above demonstrates that trade liberalization may produce both winners and losers. In order to reap the benefits from greater trade opportunities, development policies need to complement changes in the trade regime.

Trade liberalization brings opportunities but also costs

Structural unemployment is perhaps the major social cost of adjusting to trade reforms. Most developing countries, however, do not have well-developed social safety nets, such as unemployment benefits, retraining programmes and portable pensions to address these problems. Other adjustments induced by liberalization include the need to deal with the fiscal cost of lower tariff revenues as protection is reduced; the likely losses of preferences in overseas markets as special rates for MFNs are lowered under multilateral liberalization; and intra- and intersectoral reallocation of resources in response to changes in the levels of protection.[16] Furthermore, liberalization *per se* will not necessarily lead to an expansion in trade. Developing countries should be able to translate improved market access and entry conditions into actual exports on the basis of improved and diversified supply capacity.

There is need to address adjustment costs and enhance the supply capacities of developing countries

The multilateral trade agreements of GATT/WTO were traditionally silent on the issue of adjustment. This approach is about to change, however, as the idea that multilateral trade agreements should be complemented by specific measures to deal with adjustment costs and supply capacity in LDCs and other vulnerable developing countries is gaining ground.

Recent proposals include the establishment of a temporary "Aid for Trade Fund", as proposed by the Task Force of the UN Millennium Project.[17] Additionally, Mr. Peter Mandelson, the EU Trade Commissioner, proposed in February 2005 the establishment of a special Trade Adjustment Fund to "help the poor to trade more effectively and ease the social costs of adjustment". Similar ideas were contemplated in the "Africa Commission Report" of the Government of the United Kingdom. This was followed by the 2005 Gleneagles G-8 Summit commitment for Africa and the announcement by the G-7 Finance Ministers in early December 2005 that spending on aid for trade would increase to $4 billion.

Aid for Trade gained prominence at the Sixth WTO Ministerial Conference

The Ministerial Declaration of Sixth WTO Ministerial Conference in Hong Kong SAR recognized that Aid for Trade should aim to help developing countries, particularly LDCs, to build the supply-side capacity and trade-related infrastructure that they need to assist them in implementing and benefiting from WTO Agreements, and more broadly, to expand their trade. It was also emphasized that Aid for Trade could not be a substitute for the development benefits that would result from a successful conclusion of the Doha Round, particularly on market access. It could be, however, a valuable complement to the outcome of these negotiations. If adequately funded and put into effect, it could help developing countries in the implementation of the new commitments made in the Doha Round and assist them in building up the required capabilities to take advantage of the new trade opportunities to be created upon completion of the round.

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16 For a detailed discussion of adjustment issues, see *Developing Countries in International Trade, 2005* (United Nations publication, Sales No. UNCTAD/DITC/TAB/2005/1), available from http://www.unctad.org/en/docs/ditctab20051_en.pdf.

17 UN Millennium Project, Task Force on Trade. *Trade for Development* (London: EARTHSCAN for United Nations Development Programme, 2005).

The Director-General of WTO was invited to create a Task Force that should provide recommendations on how to operationalize Aid for Trade. The Task Force would provide these recommendations to the General Council by July 2006. The Director-General would also consult with WTO members as well as with the IMF and World Bank and relevant international organizations, and the regional development banks, with a view to reporting to the General Council on appropriate mechanisms to secure additional financial resources for Aid for Trade, where appropriate, through grants and concessional loans.

There is a need to systematically monitor development gains from international trade

Trade plays an increasingly important role in shaping the economic and social performance and prospects of countries around the world, especially developing and least developed countries. The degree to which countries gain from trade varies depending on local circumstances, and the benefits of further trade liberalization are not always immediately clear. Trade negotiations and decision-making about commercial policies could benefit if informed by a more systematic monitoring of the development gains from international trade. The *Trade and Development Index* (TDI) of UNCTAD could be one useful step in that direction. It provides a quantitative measure of trading conditions and development performance of countries worldwide (see box II.3).

Box II.3

Monitoring development gains from trade: UNCTAD's Trade and Development Index

The Trade and Development Index (TDI), developed by the UNCTAD secretariat in response to the São Paulo Consensus, provides an integrated measure of country performance based on trade and development indicators.[a] It aims to serve as a diagnostic and policy tool for trade and development strategies. The TDI is a weighted composite of 11 components. These components comprise a total of 29 indicators. The eleven components are: human capital, physical infrastructure, financial environment, quality of institutions, environmental sustainability, economic structure, openness to trade, effective foreign market access, economic development, social development and gender equity. Each of these components and the underlying indicators are analysed and weighted through principal component analysis to allow for their aggregation into the TDI.

Out of a sample of 110 countries, the 20 countries with the highest TDI are all developed ones, except for Singapore, which has a ranking of 15. Denmark is at the head of the list, followed by the United States and the United Kingdom. Only three developing countries are in the top 30. These are, besides Singapore, the Republic of Korea (rank 25) and Malaysia (rank 28). At the other extreme, all of the bottom 20, excepting Pakistan and Papua New Guinea, are either least developed countries (LDCs) or African countries, or both. Only two African countries, South Africa (rank 41) and Mauritius (rank 47) are among the top 50 scorers.

An analysis by component shows that openness to trade contributes most to the TDI, explaining almost 15 per cent of the overall TDI score on average. Good performance on development indicators is strongly associated with trade performance. East Asian countries score highest among developing countries on the TDI, particularly owing to strong performance indicators for physical infrastructures and financial environment and, to a lesser extent, owing to relatively high market access indicators. Sub-Saharan African countries lag behind other regions for most components of the TDI. The region shows low scores for social development, financial environment, institutional quality and physical infrastructure. Weak performance in these areas appears to impede good trade performance and hamper countries from benefiting from greater trade openness.

Another important finding is that countries with high scores also show much less variability over time in the contribution of individual components to the TDI than those with low scores. This negative correlation is statistically highly significant and indicates that a reduction in the volatility in gains from trade is closely associated with a stable performance of structural development factors. This would suggest that trade policies should be developed hand in hand with long-term development policies.

a *Developing Countries in International Trade, 2005* (United Nations publication, Sales No.UNCTAD/DITC/TAB/2005/1), also available from http//www.unctad.org/en/docs/ditctab20051.en.pdf.

Bilateral and regional trade agreements

The proliferation of bilateral and regional trade agreements (RTAs) since WTO was established in 1995 has eroded the scope of application of MFN tariffs.[18] As originally conceived in the GATT, Article XXIV (which contains disciplines and provisions on RTAs) was not meant to cover exemptions from the MFN principle at the present unprecedented scale. Currently, trade between RTA partners makes up nearly 40 percent of total global trade.

The proliferation of RTAs has intensified recently

By the end of November 2005, the number of RTAs notified to the WTO amounted to 186.[19] Notification was unusually intense during the period January 2004-February 2005, when 43 RTAs were notified, making this period the most prolific in RTA history.[20] In addition, around 35 agreements were signed and awaited entry into force, while some 70 RTAs were in the negotiation/proposal stage. Although common to all regions, the proliferation of RTAs was especially noticeable in the Western Hemisphere and in the Asia-Pacific region.

New trends include interregional agreements and…

The new wave of RTAs bears some distinct features. Breaking with the past, when RTAs were often signed between countries of the same geographic region, there has been a noticeable rise in the number of interregional RTAs. Furthermore, North-South RTAs have become more common. A substantial number of developing countries have already entered into or signed RTAs with a developed country partner.

…reciprocal free trade agreements between developing and developed countries

In several instances, non-reciprocal trade preferences between developed and developing countries are being transformed into reciprocal free trade agreements. The ACP-EU negotiations for an Economic Partnership Agreement under the Cotonou Agreement and the Central American Free Trade Agreement (CAFTA) are cases in point.[21] These agreements have the advantage of "locking in" preferential treatment, thereby eliminating the uncertainties related to the renewal of such benefits. Yet, the granting of reciprocal treatment may imply additional challenges for concerned developing countries. These include the design of an appropriate package of trade liberalization reforms and the protection of prerogatives such as SDT, including the Enabling Clause, available under the WTO. In this context, a certain asymmetry of commitments and obligations, based on different levels of development, should be a crucial element in the architecture of North-South RTAs. Finally, in the case of trade disputes, the RTAs should recognize the supremacy of the WTO dispute settlement mechanism.

Liberalization is often beyond WTO agreements while agriculture is frequently excluded or partially liberalized

Another feature of North-South RTAs is their partial liberalization. Typically, most non-agricultural tariffs are drastically reduced or eliminated. On the other hand, many agricultural products are excluded; their liberalization is delayed or tariff changes are made dependent on developments at the multilateral level. Moreover, these agreements are often silent about agricultural domestic support measures. Therefore, the commercial benefits and development gains for developing countries from these agreements may be limited. Additionally, developed countries often want to go beyond market access. North-South RTAs

18 Luis Abugattas,, "Swimming in the spaghetti bowl: challenges for developing countries under the 'New Regionalism'", *Policy Issues in International Trade and Commodities Study Series,* No. 27 (UNCTAD, Geneva, 2004).

19 A complete list of RTAs notified to the GATT/WTO is available from http://www.wto.org/english/tratop_e/region_e/region_e.htm.

20 Jo-Ann Crawford and Roberto V. Fiorentino, "The changing landscape of regional trade agreements", *Discussion Paper,* No. 8, (Geneva, WTO, 2005).

21 CAFTA is an FTA between the United States, the Central American countries (Guatemala, El Salvador, Honduras, Nicaragua and Costa Rica) and the Dominican Republic, which participated in the Caribbean Basin Initiative. By the end of 2005, Costa Rica was the only integrating country that had not yet ratified CAFTA.

may thus include a selective list of liberalization commitments and disciplines beyond those agreed at the multilateral level ("WTO-plus") and agreement on areas such as government procurement, labour standards and competition policies that are not necessarily trade–related or disciplined by WTO agreements. The Free Trade Agreement of the United States with Chile and Singapore are cases in point. Only a handful of such RTAs (for example, Canada-Chile), however, take a radical approach in traditional areas, for example, by abolishing contingency protection measures such as anti-dumping.

As a result, two tracks of trade liberalization emerge

The inclusion of disciplines beyond those recognized by WTO can have serious systemic implications in as much as trade liberalization and policy reform under RTAs may not be coherent or consistent with what is the norm for the multilateral trading system (MTS).The practice also raises questions about the interrelationships between the two tracks of trade liberalization and points to the need for ensuring a coherent approach towards development and non-trade issues (for example, environment and labour standards) in both RTAs and WTO multilateral negotiations. Another concern refers to imbalances in bargaining power when such agreements are negotiated between partners having different levels of development.

A complex system of overlapping agreements is created

It is probable that the recent mushrooming of RTAs is associated with frustration with the slowness of the Doha Round and multilateral trade liberalization in general. RTAs however, create, an extremely complex system as a result of overlapping trade regulations, which is difficult to manage, particularly for developing countries. Each agreement has different tariff schedules and rules of origin, different periods of implementation, and may have different coverage extending to specific areas. The current pace, magnitude and growing complexity of RTAs in the absence of effective multilateral rules to govern them—and with unknown development implications—pose a big challenge for the future of MTS and for the interests of third countries. Multilateral liberalization is a simpler and better option with a far greater positive impact on development than RTAs. In this context, at the recent Asia-Pacific Economic Cooperation (APEC) Summit, it was agreed for the first time that only "high-quality" RTAs constituted important avenues to achieve free and open trade and investment and that transparency and broad consistency in RTAs should be pursued.[22]

Non-tariff barriers: a rising trend in world trade

The use of NTBs increased as tariffs declined

The decline of tariff rates as a result of eight multilateral trade negotiations raised the relative importance of non-tariff barriers (NTBs) both as protection and regulatory trade instruments. For instance, besides traditionally applied NTBs, such as anti-dumping (AD) and countervailing measures (CVM), government-mandated testing and certification requirements increased by seven times worldwide in the period 1994-2004.[23] NTBs imply significant additional costs for producers and exporters. They also have the potential to discourage trade as exporters are unable to meet legal, technical and sanitary requirements.

According to UNCTAD's Coding System of Trade Control Measures/Trade Analysis and Information System (TCMCS/TRAINS), technical measures as well as quantitative measures increased considerably during the period 1994-2004. The nature of most NTBs as actually applied, however, changed. The so-called "non-core measures"—largely

22 *Thirteenth Meeting of APEC Economic Leaders, Busan Declaration,* Busan, Republic of Korea, 18-19 November 2005, available from http://www.apecsec.org.sg/apec/leaders__declarations/2005.html.

23 UNCTAD, Report of the Expert Meeting on Methodologies, classification, quantification and development impacts of non-tariff barriers (TD/B/COM.1/EM.27/3), 8 November 2005.

intended to protect local consumers— increased, while "core measures"—meant to protect local producers—declined (see figure II.8). Among non-core measures, the use of technical measures increased, which suggests that behind-the-border measures will likely become the dominant means for restraining trade in the future.

A wide range of measures are used and several sectors are affected

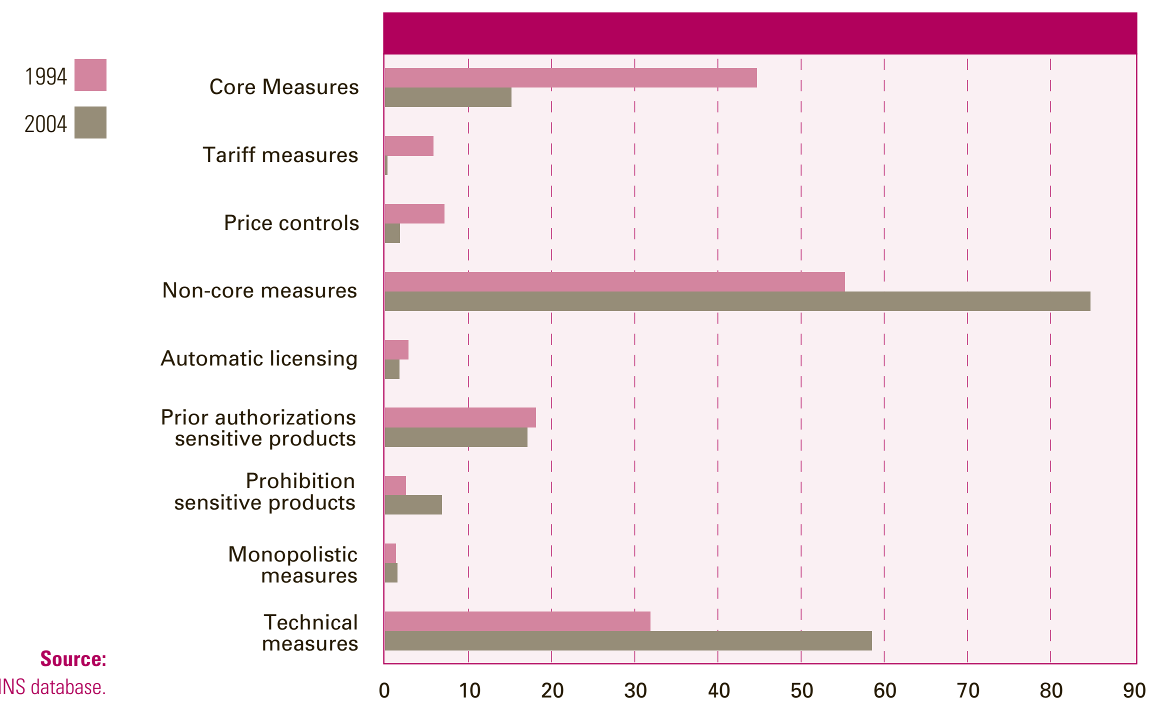
In the Doha Round, member States have submitted notifications of NTBs according to an agreed inventory.[24] Approaches and modalities on how to deal with NTBs are identified on the basis of five categories: (1) dispute settlement; (2) request/offer, bilateral, or plurilateral; (3) vertical or sectoral approaches; (4) horizontal or multilateral approaches; and, (5) tariffication of NTBs. By the end of November 2005, about 40 WTO member States had submitted around 250 notifications or proposals on NTBs—78 per cent of which were notifications by developing countries. Of the notifications or proposals, customs and administrative entry procedures (32.5 per cent), technical barriers to trade (21.9 per cent) and specific limitations, such as requirements for marking, labelling and packaging, quantitative restrictions, and export restrains (25 per cent) are among major concerns. On a sectoral basis, the top five sectors affected by NTBs are: chemicals (11.5 per cent), machinery and equipment (9.2 per cent), textiles and clothing (9.2 per cent), motor vehicles and parts (7.3 per cent) and fish/fishery products (6.1 per cent).[25] The results of OECD surveys with the business communities in several developed and developing countries (in 1995-2002), on the other hand, suggest that natural resource-based industries (for example, agriculture and food, mining, and textiles) are most strongly affected by NTBs.[26]

24 It is noted that this NTB classification is distinct, however, from UNCTAD's TRAINS.

25 WTO/Negotiating Group on Market Access, *Overview of Proposals Submitted, Non-Tariff Measures* (documents TN/MA/9/Rev.1, 29 October 2004 and Job(04)/62/Rev.7, 22 November 2005).

26 OECD, *Overview of Non-Tariff Barriers: Findings from Existing Business Surveys* (TD/TC/WP(2002)38/FINAL), (Paris, OECD, 2003).

Figure II.8.
Non-tariff trade barriers, 1994 and 2004



Source: UNCTAD TRAINS database.

NTBs and developing countries

Products of export interest for developing countries are often more affected than other products

Developing countries confront different types of NTBs when accessing different markets. In markets of developed countries, developing countries often face NTBs, such as conditions regarding technical specification of products, price controls and other NTB measures. In South-South trade, developing countries confront NTBs such as customs and administrative entry procedures, para-tariff measures (for example, import surcharges and other additional charges), as well as other obstacles, such as poor infrastructure, measures taken to protect intellectual property rights and inadequate governance. In this sense, the scope of NTBs becomes even wider in trade among developing countries. In general, export products of interest to developing countries, such as fisheries products, electrical equipment, pharmaceutical and textiles are more affected by NTBs than other products.

Increased use of measures by developed countries regarding the technical specification of products places additional costs and burdens on companies in developing countries in accessing markets. In general, costs arise from the translation of foreign regulations, hiring of technical experts to explain foreign regulations and adjustment of production facilities to comply with the requirements.

Applied standards are higher than international norms implying additional costs to exporters

In many developed countries, regulatory policy focuses on protection of the environment, public health and safety and often includes higher standards for the domestic market than existing international standards. While these regulations are legitimate from a legal point of view and are often in accordance with international norms, they entail greater compliance costs than would otherwise be the case. For example, it has been estimated that African banana exports could grow by $410 million a year if the EU used international standards for traceability requirements and regulations on pesticide residues for agricultural imports, instead of its own standards.[27] Overall, it is estimated that at least 10 per cent of export losses of all developing countries arise from Sanitary and Phytosanitary Measures and Technical Barriers to Trade (SPS/TBT) related measures.

WTO negotiations in this area are progressing slowly

From the above, one important challenge for the current WTO multilateral negotiations is to allow Governments to achieve their genuine regulatory objectives while preventing protectionist abuses. Negotiations on ‘behind-the-border’ policies, including NTBs, have proven to be complex owing to the difficulties in trading ‘concessions’ in this area. As a result, negotiations have focused on the identification of specific rules to be adopted at the multilateral and regional levels, which reinforces the need to generate equitable and balanced rules. For developing countries, it is vital that the Doha Round outcome on NTBs be both ambitious and commercially viable. Another challenge for the multilateral negotiations is to ensure that NTB rules in RTAs (both North-South and South-South) are coherent and compatible with the relevant WTO multilateral rules and disciplines. The Hong Kong Declaration, however, does not show evidence of any progress on these issues. It just takes note of the approaches being followed in the negotiations and encourages members to submit specific negotiating proposals “as quickly as possible”.[28]

Developing countries need to be proactive to avoid missing export opportunities because of NTBs

Furthermore, developing countries need to take steps to improve their legal and regulatory environment to support the participation of their national firms in international markets and enhance their competitiveness. Product standards and domestic sector regulations are areas that require attention. The modernization of standards systems, including

27 J.S. Wilson and V.O. Abiola, eds., *Standards and Global Trade—A Voice for Africa* (Washington, D.C., World Bank, 2003).

28 WTO, Ministerial Conference, Sixth Session, Doha Work Programme, *Draft Ministerial Declaration. Revision* (Document WT/MIN(05)/W/3/Rev.2), 18 December 2005, p. 5.

institutions and infrastructure for certification, is essential for operating in the current global trade environment. Meeting international standards for quality, safety, health, environment and consumer protection is increasingly becoming a precondition for competing in international markets. It has also become a major factor constraining many exporters, particularly in the LDCs, from benefiting fully from preferential access initiatives. Technical assistance for raising capacity to comply with regulations and standards should also be strengthened. Moreover, the participation of developing countries in international standard setting activities should be facilitated, including in the outcomes of the Doha Round. Finally, the promotion of mutual recognition agreements (MRAs) between developed and developing countries, as well as among developing countries, will also help substantively in reconciling frictions and disputes caused by different regulations between trading partners and lead to large cost savings for exporting firms worldwide.

Textiles and clothing: post-ATC developments

On 1 January 2005, the Agreement on Textiles and Clothing (ATC) ended, and all remaining quotas were abolished. The ATC expiration marked the end of the discriminatory trade regime of over 40 years, which targeted and restricted textiles and clothing exports from developing countries. As the expiration of the ATC approached, concerns were raised about potential negative consequences.

The end of ATC was anticipated to bring considerable changes to countries benefiting from quotas

Developing countries that had relied heavily on quota protection for market access of their textiles and clothing were expected to be seriously affected by the post-ATC competition. In addition, it was expected that preference-receiving developing countries could be adversely affected by the termination of the ATC because of their limited capabilities to adjust to the negative impact of preference erosion. Furthermore, there were concerns that the quota restrictions could be replaced by contingent protection measures such as anti-dumping actions and special safeguard measures.[29]

As anticipated, China increased its market share in both the United States and the European Union, which led to the re-imposition of quotas on some Chinese imports in these markets. In 2005, the EU and the United States concluded agreements with China to limit certain imports of Chinese textiles and clothing until the end of 2007 for the former, and the end of 2008 for the latter. The agreements were concluded separately from the WTO Accession Protocol on Textiles Specific Safeguard Clause in China. For those products not covered by the respective agreement, the EU and the United States can impose safeguards under the Textiles Specific Safeguard Clause.

While textiles and clothing importers in these two markets are again restrained by the quotas, the agreements provide them with a more predictable business environment than the disruptive safeguard regime experienced previously in the context of the WTO Accession Protocol on Textiles Specific Safeguard Clause in China. There is concern, however, that these agreements would prevent domestic textiles and clothing industries in both markets from making necessary adjustments.

29 *World Economic Situation and Prospects 2005* (United Nations publication, Sales No. E.05.II.C.2), pp.40-42.

Developments in the Generalized System of Preferences

Changes were introduced in the Generalized System of Preferences (GSP) schemes of both the EU and the United States to take into account the possible adverse impact of the quota elimination on LDCs and other small and vulnerable countries.

Developed countries have introduced changes in their GSP systems

The guidelines for the EU GSP scheme for the period 2006-2015, adopted by the European Commission in July 2005, address some of the post-ATC concerns of LDCs and other vulnerable countries. In this regard, a new graduation mechanism was established in the new EU GSP scheme which simplifies the existing mechanism and focuses the GSP benefits on those developing countries that are most in need. Graduation would take place when a "group of products" from a particular country exceeds 12.5 per cent on average of total EU imports of the same products under GSP over the last three consecutive years, with some exceptions. Under the new graduation mechanism, Chinese textiles, which benefited from the EU GSP, will be graduated.[30]

Conditionalities, however, remain stringent

Textiles and clothing exports from certain GSP beneficiary countries will be able to benefit from the "GSP-plus" provision, if certain conditions are met.[31] In order to secure this benefit, countries must ratify 27 key international conventions on sustainable development and good governance. "GSP-plus" preferences are immediately granted to countries that have ratified and effectively implemented the 16 core conventions on human and labour rights and 7 (out of 11) of the conventions related to good governance and the protection of the environment. Moreover, they must commit themselves to ratifying and effectively implementing the international conventions which they have not yet ratified, by 31 December 2008. The "GSP-plus" provision is also applicable for the countries that are classified as drug eradication countries. Yet, besides the latter, the only countries that benefited from the GSP-plus provision in 2005 were Georgia, Mongolia and Sri Lanka. This suggests that the conditions required are stringent and difficult to meet.

Rules of origin remain an issue in some GSP schemes for textiles and garments

The EU is also in the process of reforming the GSP rules of origin to increase the effectiveness of its GSP scheme. In many exporting countries, particularly LDCs and other low-income countries, the garment industry is not fully integrated into the local textile industry—or the countries lack capacity in textile production—and thus depend on imported inputs. Preferential treatment, however, applies only to those garments that use locally produced yarns or textiles. Consequently, only a few of these countries are able to take full advantage of the preference provided under the EU GSP scheme. But proposals to have less stringent rules of origin have been facing resistance by domestic EU producers.

In the United States, changes in its GSP scheme for textiles and clothing were considered under the Tariff Relief Assistance for Developing Economies Act of 2005 (TRADE Act of 2005). This Act proposes to extend the benefits given under the African Growth and Opportunity Act (AGOA) to 14 Asian LDCs and Sri Lanka. It also includes the special rule of origin for textiles and clothing, that is to say, the "third-country" fabric rule, which permits beneficiary countries to export clothing to the United States market duty- and quota-free regardless of origin of fabric and yarn. The TRADE Act of 2005 is set to expire on 31 December 2014.[32] Moreover, the Government of the United States has also initiated

30 Chinese clothing has been already graduated.

31 The countries are those for which the five largest sections of their GSP-covered imports to the EU represent more than 75 per cent of their total GSP-covered imports, and GSP-covered imports from them represent less than 1 per cent of total EU imports under GSP. The "GSP-Plus" benefits comprise duty-free access to the EU for around 7,200 products that include textiles and clothing.

32 AGOA, however, is set to expire on 30 September 2007. The LDCs concerned are: Afghanistan, Bangladesh, Bhutan, Cambodia, Kiribati, Lao People's Democratic Republic , Maldives, Nepal, Samoa, Solomon Islands, Timor-Leste, Tuvalu, Vanuatu and Yemen. For Sri Lanka, the benefits would be extended for economic emergency support in the aftermath of the tsunami disaster.

actions aimed at improving the effectiveness of its GSP scheme. The current scheme expires on 31 December 2006.

The Government of Canada also introduced reforms in its GSP scheme by extending duty-free access to imports from all LDCs, with the exception of some agricultural products, under its Market Access Initiative effective 1 January 2003. The most important addition under this initiative has been the granting of duty-free access to textiles and clothing articles with the beneficiary-friendly rules of origin.

Developments in the WTO on post-ATC adjustment

Within the WTO framework, post-ATC adjustment is being discussed in the Subcommittee on LDCs and the Council on Trade in Goods (CTG). The discussions in the CTG, however, have been inconclusive. Since the end of 2004, some countries have been pressing the WTO Secretariat to conduct a study on the post-ATC impact with a view to identifying adjustment-related measures that could be taken by the WTO.[33] Turkey, for instance, proposed the establishment of a "work programme" for textiles and clothing that would make recommendations to avoid the deterioration of trading conditions in the sector, including possible ways to stabilize prices.[34] The proposal, however, was rejected by major textile and clothing exporting countries who argued against the introduction of new exceptions for a sector that had just been fully integrated into WTO discipline. Instead, they suggested that post-ATC adjustments should be dealt with in the context of the overall trade adjustment issue. No convergence has emerged in this debate, and the discussions in the CTG will continue in 2006.

Overall assessment of the post-ATC situation

Adjustments are still taking place in textiles and clothing markets

Post-ATC developments present a mixed picture. Adjustments to the new framework would take several years. Trends need to be monitored continuously, as the impact of the end of the ATC could be particularly harsh for countries highly dependent on the sector which have not diversified into other economic activities.

Improvements in the effectiveness of the current GSP schemes could help ease the adverse impact of the termination of the ATC. In this regard, the initiatives mentioned above are steps in the right direction. Yet, problems remain with the GSP schemes, namely, not-user-friendly rules of origin, difficult conditionalities, uncertainty of benefits and uneven coverage of products and countries.

A managed trading system for textiles and clothing should be avoided

Textiles and clothing are now fully integrated into the normal WTO rules and disciplines. The legacy of protectionism still continues, however, in the post-ATC phase, as discussed above. Some WTO member States suggested the creation of what appears to be a managed trading system for textiles and clothing aiming at price and market share stability. The termination of the ATC marks the end of the discriminatory measures that targeted products from developing countries for so long and caused so much distortion in the international allocation of resources. It is thus crucial to ensure that international trade in textiles and clothing does not slip back to the protectionism of the past.

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33 WTO, Initial submission on Post-ATC Adjustment-Related Issues from Bangladesh, the Dominican Republic, Fiji, Madagascar, Mauritius, Sri Lanka, and Uganda (Document G/C/W/496), 30 September 2004. Also, "WTO Members Deadlocked on Impact of Jan.1 Elimination of Textile Quotas", *International Trade Daily,* 27 October, 2004.

34 WTO, *Issues related to trade in textiles and clothing. The perspective of Turkey on the issues involved* (Document G/C/W/522), 30 June 2005.

Annex
Developments in non-oil commodity markets

Agricultural commodities

After a 30 per cent decrease in 2004, the price of **wheat** recovered in 2005 and rose by 11 per cent between January and October. World wheat production in 2005 is estimated to have decreased by more than 2 per cent, mainly owing to weakening yields in the United States and in some European countries (for example, Italy, Poland and Spain). World wheat consumption is forecast to rise by 1 per cent, while global stocks are projected to decrease by 5 per cent. As a result, wheat prices are likely to be firm in the near future.

Maize prices increased by 6 per cent between January and October 2005, which was not sufficient to compensate for the large drop recorded in 2004. The increase was mainly the result of moderately bearish supply and demand conditions. World maize output is estimated to be at 672 million tons in 2005/2006 (compared with 706 million tons a year earlier), while global consumption is forecast at 670 million tons (below the record last year of 675 million tons).Yet, in addition to higher stock levels, concerns about avian influenza (see box IV.3), weighed negatively on price prospects, as nearly two thirds of maize is used for feeding, including in the poultry sector.

The **rice** market is definitely bullish. The recent revival in world production, which is expected to reach 606 million tons of paddy rice in 2005/2006, corresponding to 405 million tons of white equivalent, will not be enough to meet consumption needs, estimated to be at 414 million tons of white equivalent. Furthermore, Viet Nam has issued a trade directive recommending the suspension of new export contracts, because of lower output in its northern provinces, a situation which may influence the rice market. On the other hand, there has been a small increase in rice production in the EU, despite the reform of its common organization market (COM) for rice (with 50 per cent of the EU price cut being replaced by expanded direct-aid payments). EU rice trade, however, represents only about half a per cent of world trade.

Banana prices were volatile in 2005: prices increased by 79 per cent from December 2004 to February 2005, dropped through August (by some 55 per cent) and recovered thereafter. This situation was mainly driven by late arrivals in early 2005 and, subsequently, by a sudden return of shipments from Cameroon and Suriname, among others.

Despite increased world **sugar** output in 2005-2006, sugar prices skyrocketed with a 34.7 per cent increase during the first 10 months of 2005. The rise in production was mainly driven by Brazil, which reached a peak of 29 million tons, and by India, which increased its output to 19 million tons. The stock-to-consumption ratio declined and was one of the factors underpinning higher prices. This decline was not the main reason, however, but rather the increasing importance of ethanol in the sugar market both in sugar-producing countries—the development of flex-fuel vehicles in Brazil is a case in point—and elsewhere, owing to soaring oil prices. The world sugar market is likely to undergo a period of change as the new EU sugar regime comes into force in 2006/07 (see box II.1). In the near future, the sugar market may face a tighter supply situation and much will depend on the capacity of Brazil to meet future demand for sugar and ethanol.

The **coffee** composite price index increased by 6.2 per cent during the first 10 months of 2005, but this masks the duality that exists in this market: the price of Robusta increased by 28.7 per cent, while the price of arabica in October 2005 was only slightly above the level in December 2004.[a] Speculative funds have been the main driving force in this market, particularly during the first semester of 2005. World production in 2005/06 is expected to be around 108 million bags, compared with 115 million a year earlier. In comparison, world consumption amounted to 115 million bags in 2004 and 112 million in 2003. Several factors tend to confirm an upward trend in prices in the near future. These include, inter alia, the negative impact of Hurricane Stan on crops in Central America and Mexico, declining stocks, the recent growth of consumption in exporting countries as well as unusual weather conditions in Viet Nam related to the lack of rainfall in the main producing areas.

Cocoa prices decreased by 12 per cent from the end of 2004 to October 2005, despite a decline of 10 per cent in West African output in 2004/05 and a 6 per cent decline in overall world cocoa output. Global grindings increased by 3 per cent. The current production shortfall, however, has been limited to around 50,000 tons, while last season produced a surplus of 250,000 tons. A number of key features may influence cocoa prices in the near future. In the very short term, speculation may boost the price as hedge funds have taken massive positions in the New York Board of Trade (NYBOT), purchasing 15,000 lots equivalent to 150,000 tons of cocoa, or 5 per cent of world output.[b] Substantial supply disruptions are not anticipated in the long run, and thus prices may not increase abruptly. On the other hand, depressed prices may stimulate the demand for cocoa and cocoa products. In the near future, the arrival of Viet Nam as a new competitor in the market represents an additional challenge for traditional producers.

The price of **tea** increased, on average, during 2005 but a reversal in trend could be observed: the sharp increase in price in the first quarter of 2005 was followed by lower prices for the rest of the year. Traditional producers, such as Bangladesh, India, Kenya and Sri Lanka, account for the major share of world tea exports. In 2005, however, China, which had abolished an 8 per cent tax on tea production, emerged as an important exporter and is likely to overtake large exporters such as Sri Lanka and Kenya in the near future. Prices are expected to remain weak owing to current excess supply, which is likely to persist with the soaring production in China, India and Kenya. Recent initiatives may not be enough to offset demand-supply imbalances. For example, India decided in October 2005 to destroy substandard tea, and China established tea promotion policies.

After an historical peak in March 2004, average prices of **vegetable oilseeds and oils** declined and remained relatively stable in 2005. Trends were very divergent at the individual commodity level: cottonseed oil prices increased by almost 55 per cent from December 2004 to October 2005, while the price of soybean oil and palm oil rose by much less (around 4.5 per cent in both cases). Other commodities in this group, however, recorded steep price declines during the period: sunflower oil (11 per cent), groundnut oil (14 per cent) and coconut oil (11 per cent). Among the factors that may influence the vegetable oilseeds and oils outlook are weakening Brazilian soybean and cottonseed production and the record Russian sunflower seed output. The appreciation of the real, together with limited access to credit and higher transportation costs, is reported to have depressed Brazilian output. Demand growth is anticipated to be strong over the medium term, notably from developing

a International Coffee Organization, "ICO Indicator of Prices, Monthly and Annual Averages", available from http://www.ico.org/prices/p2.ht (accessed on 14 December 2005).

b Radio France Internationale, "Le marché du cacao sort de la léthargie", 22 November 2005.

countries, in particular China, for both oilseed and oilseed products for human consumption as well as oilseed meal for the expanding livestock sector.[c]

During 2005, **cotton** prices increased by 17 per cent owing to lower output in China and, to a lesser extent, in the United States. World cotton output in 2005/2006 is estimated at 25 million tons, which corresponds to a 5 per cent decline from the 2004/2005 harvest. World cotton demand is still quite robust and mainly driven by China, whose share in world imports is estimated to have jumped to 37 per cent in 2005/06 from 20 per cent in 2004/2005. The International Cotton Advisory Committee (ICAC) projected an Index A Cotton Outlook of $0.65 per pound on average in 2005/2006, which is 7.25 cents above the October 2005 price (a record level over the past 16 months).[d] On the other hand, stocks are likely to reach more than 11 million tons by the end of this season, the highest level in 20 years, which may put a brake on prices.

Owing to the rise in price of synthetic products, the price of natural **rubber** soared, increasing by about 40 per cent during the period January-October 2005 to peak at $2.91 per kilo in October 2005, the highest in nominal terms since November 1980. On the consumption side, there was a switch from synthetic to natural rubber, a trend likely to continue as long as oil prices remain under pressure. Sustained economic growth in major consuming markets was another important factor pushing up prices. China has a dominant role in the market: it is the largest world consumer, accounting for nearly one fifth of global rubber consumption. In this context, the recent decision of China to eliminate import duties on natural rubber is likely to boost imports further and support the current upward trend in prices. On the supply side, natural rubber production is constrained in the short term owing to low investment in the sector. Thus, in the outlook, the rubber market is expected to stay tight.

Minerals and metals

The **steel** market was expected to cool as demand fell in most parts of the world. While crude steel production in the rest of the world in the first ten months of 2005 fell by 1 per cent (when compared with the same period in 2004), production in China increased by 26 per cent, indicating that demand in that country held up well. Accordingly, the international steel market remains strong, and there is little reason to expect a "hard landing" in 2006.

The **iron ore** industry is experiencing an unprecedented boom as the commodity price witnessed a spectacular increase of 71.5 per cent in 2005. The explosive growth of demand for steel in China is driving this spectacular development.[e] China remained the largest importer of iron ore, accounting for roughly one third of world imports. In many countries, production underwent a process of vertical integration as producers tried to secure a stable supply of iron ore. The push for consolidation has been strongest in the fragmented iron ore mining sectors of China, the Russian Federation and Ukraine. Iron ore prices for 2006 are under negotiation and industry observers are forecasting another double-digit price increase for 2006. The price increase will again be driven by demand from China, which for the first time may play a pivotal role in the negotiations.

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c European Commission/Directorate General for Agriculture *Prospects for Agricultural Markets and Income 2005-2012,* July 2005 available from http://europa.eu.int/comm/agriculture/publi/caprep/prospects2005/index_en.htm (accessed 4 January 2005).

d According to OECD and ICAC projections, prices may increase slightly up until 2007, especially under the influence of an increasing demand from the spinning sector.

e UNCTAD, *Iron Ore Market 2004-2006* (Geneva, UNCTAD, May 2005).

Although **aluminium** prices remained at historically high levels, they increased at a more modest 4.3 per cent during the period January-October 2005. High energy prices have been a driving force in the aluminium sector, particularly since energy price increases have caused some producers to close down smelters. Aluminium output in the period January-October 2005 was about 3.3 per cent higher than in the same period in 2004, and industry inventories have not changed drastically,[f] while London Metal Exchange (LME) stocks of primary aluminium have been decreasing. The bullish trend is expected to be sustained as the market is moving slowly to deficit, with LME warehouse stocks of aluminium down to 6.5 weeks of global consumption and expected growth in production predicted to be 4.5 per cent in 2006, compared with an anticipated 5 per cent increase in consumption.[g]

Copper prices increased by 41 per cent in the period January-October 2005, indicating a sharp and firm upward trend. Late-year surges in the copper price, however, were not due to the interplay between fundamentals in supply and demand, but generated by speculative uncovered positions. It was reported that the State Reserve Bureau of China has had a large short position of 200,000 tons with delivery on 21 December 2005 and, as a consequence, speculators have entered the futures market with the expectation that China will have to cover the position it has assumed.

The high copper prices are likely to curb demand,[h] while supply is expected to grow in 2006. Thus, although prices are expected to remain high up to early 2006, a downturn can be foreseen thereafter, particularly as the market shifts to a situation of excess supply. Finally, it should be noted that Chile, the world's largest copper producer, entered into a free trade agreement with China, the leading copper-consuming country. The free trade agreement (FTA) is expected to come into force on 1 July 2006 and will provide, inter alia, tariff-free access of Chilean copper to China.

Next to copper**, zinc** was the best performer of the base metals in the last year as prices rose by 26 per cent during the first 10 months of 2005. The upward trend was mainly driven by supply disruptions, such as strikes at Teck Cominco's Trail operations, and by a demand upturn, particularly in the United States, which registered a significant increase in galvanized steel products. The increasing influence of China, which is emerging as a net importer, adds even more force to this bullish trend. Despite rising output, stocks are falling rapidly, albeit from very high levels, a situation that is expected to support the price in the near term.

In contrast, the price of **nickel** decreased by 10 per cent. The fall came after a period of high price instability and historically extremely high prices during the first three quarters of 2005, which were mainly driven by huge speculative positions estimated to be 30 to 40 times the level of annual consumption. The market correction may be sustained as LME stocks have been increasing both in Europe and in Singapore and demand has been lethargic. On the supply side, a modest growth of 3 per cent is forecast, and some industry sources are expecting a surplus in 2006 and 2007, despite the growing demand in China.

The price of **lead** has kept up its good performance with a 3 per cent increase in the period January-October 2005, reaching an historical peak on the LME (since the launch of the contract in 1993) with a monthly average of $1,005 per ton in October 2005. China overtook the United States as the leading consuming country in 2005 with a share of 25 per

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f International Aluminium Institute (www.world-aluminium.org).

g Aluminium demand by China has been forecast to grow by an annual rate of 7.2 per cent until 2010. (*Diapason Monthly Report,* October 2005).

h Copper demand growth is expected to ease to 3.2 per cent in 2005 from 8.9 per cent in 2004. See "Speculation is main driver behind high metals prices", *Financial Times,* 30 November, 2005.

cent of global consumption, and it is also the main producer, accounting for 30 per cent of world output. Thus, China is the price maker, and its net position will influence the market. Worldwide mine output remains tight, however, while metal stocks are increasing,[i] making the outlook uncertain.

The **tin** price decreased towards the end of 2005 owing to rapidly rising LME stocks, notably in Singapore. The fall came after an upward trend during the first nine months of the year, caused by disruptions on the production side[j] and growing demand. China is a key tin supplier and drives the market. Recently, a decision was taken to control illicit tin mining operations, and this has restrained national production capacity. However, this limit on supply was insufficient to alter the bearish market conditions.

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i *Metal Bulletin Monthly*, London, October 2005.

j *Mining Journal,* London, 7 October, 2005

Chapter III
Financial flows to developing and transition economies

Net transfers of financial resources

Net transfer of financial resources from developing to developed countries continues to increase

Over an extended period of nearly ten years, the international financial system has seen net transfers of financial resources from developing to developed countries. Net transfers are the net flow of financial resources less net interest and investment income payments. The magnitude of these transfers has risen steadily from an estimated $8.1 billion in 1997 to $483.4 billion in 2005 (see table III.1). The net transfer of resources from economies in transition has also followed a similar pattern since 1999, reaching an estimated $95.5 billion in 2005.

The most important destination of the net outward transfer of financial resources from developing countries taken as a whole has been to the United States of America, and has more than offset the net outward transfer from other major developed countries, namely the European Union (EU) countries and Japan, to developing countries.

Table III.1.
Net transfer of financial resources to developing economies and economies in transition, 1995-2005

Billions of dollars	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[a]
Developing economies	38.9	16.2	-8.1	-40.7	-129.3	-192.4	-163.6	-215.6	-302.1	-374.0	-483.4
Africa	6.4	-5.7	-4.7	15.6	4.5	-26.5	-16.0	-4.9	-19.6	-32.4	-55.6
of which:											
Sub-Saharan (excluding Nigeria and South Africa)	7.4	5.3	7.5	12.1	9.3	2.8	6.8	6.1	7.0	5.3	2.0
Eastern and Southern Asia	22.1	18.5	-31.1	-128.3	-142.2	-124.3	-118.3	-149.1	-173.0	-184.8	-189.1
Western Asia	13.9	3.9	4.9	28.1	-0.9	-39.5	-32.6	-27.8	-47.6	-75.6	-154.6
Latin America	-3.5	-0.5	22.8	43.9	9.4	-2.0	3.3	-33.7	-61.8	-81.1	-84.1
Economies in transition	-2.3	-6.2	2.7	3.5	-23.6	-47.8	-29.3	-26.6	-34.5	-57.5	-95.5
Memorandum item:											
Heavily indebted poor countries (HIPCs)	6.4	7.0	7.5	8.6	10.0	8.8	8.7	9.8	10.0	10.6	12.3
Least developed countries	12.9	11.3	10.4	13.3	12.6	6.4	9.7	8.3	9.1	6.1	5.2

Sources: UN/DESA, based on International Monetary Fund (IMF), World Economic Outlook Database, September 2005, and IMF, *Balance of Payments Statistics*.
a Preliminary estimates.

As discussed in chapter I, the counterpart of the net outward transfer of financial resources from developing countries and transition economies is reflected in the growing net export surpluses of an increasing number of developing countries, caused by rapidly rising export volumes and higher prices for oil and non-oil commodities. The major increases in net export surpluses in 2005 continued to be in Western Asia, while the surpluses in East and South-East Asia and Latin America increased at a slower pace. Net transfers to sub-Saharan Africa (excluding Nigeria and South Africa) are still positive but have declined to a meagre $2 billion in 2005.

Net private capital flows: sustained positive investor sentiment and ample liquidity

Developing countries have experienced declining portfolio investment and rising FDI

Net private capital inflows to developing countries as a group fell substantially in 2005 to $95 billion from a peak of $184 billion reported in 2004 (see table III.2). Most of the decline was due to falling inflows into East, South and Western Asia, while inflows increased for Africa and Latin America and the Caribbean. There were substantial declines in portfolio investments and other investments. In contrast, foreign direct investment (FDI) flows continued to increase and remained the largest type of net capital flow to developing countries. At the same time, improved economic performance eased access to private capital markets and allowed many countries to reduce their indebtedness to official creditors. Net official flows were negative in all regions except East and South-East Asia and for countries with economies in transition.

There is strong demand for emerging market financial instruments

Sustained favourable conditions in international financial markets and strong global economic growth also continued to facilitate the access of developing and transition economies to international financing. Demand for emerging market financial instruments was boosted by the increased willingness of investors to take risks in the markets for those instruments; their search for high-yield investments was in response to continued low long-term international interest rates as well as increased international liquidity. At the same time, risk in emerging market investments was diminished by declining default risk buoyed by the continued economic growth and continued improvement in domestic and external account balances that enabled substantial reserve accumulation and repayment of debt, lowering the debt ratios of many emerging market countries. In addition, active debt management operations in a number of countries, in particular in Latin America and the Russian Federation, improved debt profiles by lengthening average debt maturities as well as by reducing the share of external and foreign currency-indexed debt. The result was an increased number of upgraded credit ratings for emerging market issuers, some to investment grade. Improved credit ratings produced a further broadening of the investor base of emerging market issuers to include global investment funds, institutional investors and hedge funds.

Yield spreads on emerging market bonds continue to decline

This positive investor sentiment was reflected in low yield spreads on global emerging market bonds in 2005 (see figure III.1). Strong financial conditions in emerging markets allowed low yield spreads to persist despite the volatility in the high-yield corporate bond markets in developed countries in early 2005 and to continue to decline through the end of the year. The surge of debt issuance by developing countries and the continued increase in international financial imbalances, however, have led to growing concerns that the low yield spreads of late 2005 may not adequately reflect the risks in emerging market bond markets.

Table III.2.
Net financial flows to developing countries and economies in transition, 1993-2005

Billions of dollars	Average annual flow				
	1993-1997	1998-2002	2003	2004	2005[a]
Developing countries (including economies in transition)					
Net private capital flows	148.4	48.2	104.6	184.0	95.4
Net direct investment	87.5	137.8	134.4	153.7	172.1
Net portfolio investment[b]	65.4	-7.2	-7.3	39.6	-28.2
Other net investment[c]	-4.5	-82.3	-22.4	-9.4	-48.5
Net official flows	12.6	7.8	-55.1	-76.5	-130.1
Total net flows	161.0	56.1	49.5	107.5	-34.7
Change in reserves	-79.9	-93.9	-323.2	-452.1	-423.7
Africa					
Net private capital flows	3.9	6.8	11.2	11.8	17.0
Net direct investment[b]	3.8	12.9	15.4	14.0	19.5
Net portfolio investment[c]	4.0	0.2	-0.9	5.3	3.2
Other net investment	-3.9	-6.3	-3.3	-7.4	-5.7
Net official flows	1.5	1.2	1.8	-0.6	-9.5
Total net flows	5.4	8.0	12.9	11.2	7.5
Change in reserves	-7.2	-7.3	-23.1	-40.2	-51.1
East and South Asia					
Net private capital flows	73.4	0.7	67.0	138.0	88.4
Net direct investment[b]	48.1	56.8	69.5	83.3	86.5
Net portfolio investment[c]	15.6	-11.7	0.8	21.3	-12.3
Other net investment	7.6	-53.7	-19.7	18.2	-0.4
Net official flows	4.2	-0.5	-16.5	6.1	13.4
Total net flows	77.6	0.2	50.5	144.0	101.8
Change in reserves	-44.2	-89.7	-231.5	-351.0	-313.4
Western Asia					
Net private capital flows	10.6	3.8	11.2	27.7	-21.8
Net direct investment[b]	4.5	4.1	11.6	11.4	17.0
Net portfolio investment[c]	-0.6	-2.9	0.4	16.1	-25.8
Other net investment	6.7	2.5	-0.8	0.1	-13.0
Net official flows	0.0	-5.4	-49.8	-77.7	-127.6
Total net flows	10.7	-1.7	-38.6	-50.0	-149.4
Change in reserves	-5.9	-1.2	-29.8	-36.9	-29.6

Table III.2 (continued)	Average annual flow				
	1993-1997	1998-2002	2003	2004	2005[a]
Latin America and the Caribbean					
Net private capital flows	59.4	35.4	18.5	9.9	15.3
Net direct investment[b]	30.8	62.4	36.1	46.6	46.1
Net portfolio investment[c]	40.8	1.1	-9.0	-10.3	1.7
Other net investment	-12.1	-28.0	-8.5	-26.4	-32.5
Net official flows	2.8	12.6	7.3	-5.4	-9.0
Total net flows	62.2	48.1	25.8	4.5	6.2
Change in reserves	-19.5	5.0	-37.5	-23.7	-28.0
Economies in transition					
Net private capital flows	8.5	1.0	28.4	20.9	2.2
Net direct investment[b]	4.4	7.8	10.5	19.4	15.2
Net portfolio investment[c]	-0.2	-3.4	-3.4	4.2	-16.0
Other net investment	4.3	-3.4	21.3	-2.6	3.0
Net official flows	7.3	-0.1	-4.5	-3.5	-4.1
Total net flows	15.8	0.9	23.9	17.4	-1.9
Change in reserves	-4.8	-9.2	-37.4	-57.6	-80.8

Source: International Monetary Fund (IMF), *World Economic Outlook Database*, September 2005.

a Preliminary estimates.
b Including portfolio debt and equity investment.
c Including short- and long-term bank lending, and possibly including some official flows to data limitations.

Figure III.1.
Yield spreads on emerging market bonds, 1 January 2004-30 November 2005

Source: JPMorgan Chase Co., New York.

Under these conditions, continued monetary tightening in the United States or a slowdown in emerging market growth and export performance could result in a sharp readjustment of yield spreads and significant volatility in capital flows. Furthermore, the large holdings of emerging market securities by hedge funds could exacerbate volatility if yield spreads rise.

Under favourable financing conditions, net private capital flows in the form of investments in emerging market bonds increased substantially in 2005. Net inflows to Latin America increased, primarily to Brazil, where high domestic interest rates were combined with currency appreciation. In response to improved macroeconomic conditions, net inflows to Turkey were also strong and financed a widening current-account deficit. Net inflows to East and South-East Asia moderated, however, with declines to major borrowers such as China, the Republic of Korea and Malaysia. Promotion to investment grade of the Russian Federation, accompanied by continued rapid foreign reserve accumulation and a significantly improved debt profile, drew increased net inflows.

Governments of emerging markets issued a high volume of bonds

The high volume of net bond issuance in 2005 reflected the decisions by Governments of emerging markets to take advantage of the low financing costs, and a number of them used favourable market conditions to pre-fund 2006 and some 2007 funding requirements. The currency composition of bond issuance diversified, particularly through a substantial increase in non-dollar bonds (mostly euro) in response to strong demand from European institutional investors. Corporate bond issuance also continued to be strong, accounting for approximately half of total emerging market issuance for the year.

Conditions that supported the global emerging bond market contributed to the continued increase in foreign investment in domestic local currency bonds of emerging market countries, as well as to an incipient growth of global local currency bonds from those countries. A number of Latin American countries were able to replace sovereign foreign currency debt with local currency denominated debt, reducing the risk of currency mismatches. Prospects of monetary easing in some countries, as well as the development of local bond markets that have improved investor access and introduced new financial instruments, further boosted capital inflows to local bond markets. The creation in June 2005 of an emerging market local bond index of 19 government bond markets, an equivalent of the global emerging market bond indexes, has further facilitated the growth of foreign investment in those markets.[1] The pace of issuance of global local currency sovereign bonds by emerging market countries also accelerated in 2005, with Colombia and Brazil issuing more bonds. The size and number of these bonds, however, are still small and the investor base is narrow.

2005 saw positive net commercial bank lending to emerging markets

Net commercial bank lending to emerging markets was positive in 2005, continuing the recovery that began in 2003 after an extended decline since the late 1990s. Economies in transition accounted for a substantial part of the increase, with a strong increase in net inflows to the Russian Federation. While Latin America still registered net outflows to commercial banks in 2005, they had declined sharply from 2004. Net lending to East and South-East Asia declined, with China accounting for most of the fall owing to curbs on the overseas borrowing of banks. On the other hand, net lending to India remained substantial, owing to demand for credit from strong investment and expanding trade.

In 2005, the cost of bank credit was competitive with other sources of financing and was under almost continuous downward pressure because of abundant liquidity. Emerging market economies generally benefited from declines in spreads. In Latin America, corporations in dynamic sectors, such as oil and cement, were able to secure exceptionally low priced loans.

Net capital inflows from portfolio equity investment increased in 2005, while emerging market stock prices resumed a rising trend after a correction early in the year.

1 JPMorgan's GBI-EM (Government Bond Index—Emerging Markets).

Latin America received net inflows, mainly to Mexico and Brazil, on the strength of corporate earnings. There were also increases in net inflows to Turkey for investment in a new placement of shares issued by a State-owned company. The volume of net inflows to East and South-East Asia moderated in 2005, while investment in China and India continued to dominate inflows. Inflows to the Russian Federation strengthened as prices in the local stock market rose sharply in the latter part of the year.

Increasing foreign direct investment

FDI inflows to developing countries increased by 18 per cent in 2005

Worldwide, FDI inflows are estimated to have increased by 18 per cent to $762 billion in 2005. FDI flows increased across the board. In absolute terms, the bulk of the increase going to the EU and East and South Asia (see table III.3). FDI also increased strongly in Africa and Western Asia in relative terms, but up from low initial levels. Total FDI flows to developing countries reached $278 billion in 2005, up from $233 billion in 2004.

Two factors seem to explain much of the recent surge in FDI flows. First, corporate restructuring and buoyant profits in the major economies have pushed up share prices, while interest rates have remained low. Increased profits and favourable financing conditions have helped expand corporate investments abroad. Increasing stock market values produce positive wealth effects and facilitate takeovers, especially through stock swaps. Higher stock market valuations also boost the value of cross-border mergers and acquisitions. Most FDI takes the form of mergers and acquisitions. Second, high commodity prices have produced a recovery of FDI flows to natural resource-rich countries. The higher prices and supply

Table III.3.
Inflows of foreign direct investment, 2003-2005

Billions of dollars

Host region/country	2003	2004	2005[a]	Growth rate for 2004-2005 (percentage)
World	633	648	762	17.6
Developed economies	442	380	443	16.6
European Union	339	216	293	35.4
United States	57	96	104	8.3
Developing economies	166	233	278	19.2
Africa	18	18	30	65.8
Latin America and the Caribbean	47	68	74	9.6
Asia and Oceania	101	148	174	17.7
Western Asia	7	10	15	55.9
South, East and South-East Asia	95	138	158	15.0
South-eastern Europe and the Commonwealth of Independent States	24	35	41	16.7

Source: UNCTAD.

Note: World foreign direct investment inflows are projected on the basis of 59 economies for which data are available for part of 2005, as of 16 September 2005. Data are estimated by annualizing their available data, in most cases first-quarter data. The proportion of inflows to these economies in total inflows to their respective region or subregion in 2004 is used to extrapolate the 2005 data. Data refer to gross inflows (rather than net flows) and are based on a different reporting system, explaining the differences with the figures presented in table III.2.

a Preliminary estimates.

shortages have induced transnational corporations (TNCs) to invest in new exploration and production facilities, especially in Africa, Latin America, the Russian Federation and Central and Western Asia. Lifting constraints on foreign participation in the mining and oil sectors, particularly in Africa and Latin America, further contributed to the rise in FDI in natural resource sectors.

FDI for privatization in economies in transition decreased

FDI related to the privatization process in the economies in transition slowed down somewhat as this process nears completion in many countries. More noteworthy is the surge in FDI originating from developing countries, especially by Asian firms. In 2004 (the most recent year for which data is available) these outflows amounted to $83 billion, or about 12 per cent of worldwide FDI in that year. FDI outflows from developing countries mainly comprise mergers and acquisitions, including takeovers of large firms in developed countries. In Hong Kong Special Administrative Region (SAR) of China, Singapore and Taiwan Province of China, FDI outflows have become quite substantial when measured against domestic fixed capital formation (see table III.4). Brazil, China and India also record substantial FDI outflows in absolute terms, even though these represent relatively small shares of domestic investment levels.

Research and development are being internationalized

Another salient change to the FDI landscape relates to the internationalization of the research and development (R&D) activities of TNCs. In a number of cases, these activities target global markets and are being integrated into the core innovation networks of TNCs. This is a new development. R&D is an activity with very demanding skill, knowledge and support needs that were traditionally met only in developed countries with strong national innovation systems. As a result, few developing countries traditionally attracted R&D activities by TNCs.

Table III.4.
Outflows of foreign direct investment as a percentage of gross fixed capital formation in selected developing economies, 2002-2004

Economy	Shares in per cent[a]
Hong Kong SAR[b]	58.0
Singapore	26.1
Taiwan Province of China	11.0
Malaysia	7.7
Chile	6.4
Brazil	4.2
India	1.1
China	0.2
Memorandum items:	
Sweden	32.9
United Kingdom	20.0
France	15.0
United States	7.8
Japan	3.0
Greece	1.0
Germany	0.3

Source: UNCTAD, FDI/TNC database, available from http://www.unctad.org/fdistatistics.

a Annual average for 2002-2004.

b Special Administrative Region of China.

TNCs are the key players in global R&D, accounting for close to half of all R&D expenditures ($677 billion in 2004) and more than two thirds of global business R&D expenditures ($450 billion). Major businesses are shifting more of their R&D abroad. German companies set up more foreign R&D units in the 1990s than in the preceding half century; among major Swedish firms, the share of foreign R&D shot up from 22 per cent to 43 per cent between 1995 and 2003. The R&D expenditures of foreign affiliates worldwide climbed from an estimated $30 billion in 1993 to $67 billion in 2002.

R&D investment in developing countries has grown

TNCs also need to support their expanding production activities in developing countries with local R&D. More R&D is going to developing countries. More than half the world's top R&D spenders already conduct R&D activities in China, India or Singapore. Since the early 1990s, when Motorola established the first foreign-owned R&D laboratory in China, the number of foreign R&D units in China has grown to some 700. From practically nothing in the mid-1990s, South-East and East Asia now account for 30 per cent of all semiconductor design in the world. Thailand was the fourth overseas R&D centre for Toyota. STMicroelectronics, one of the world's largest semi-conductor companies, has located some of its design work in Morocco. The number of such examples in developing countries is rising.

International financial cooperation

Official flows: IMF is a net receiver of resources from developing countries

IMF lending continued to decline

International Monetary Fund (IMF) support lending to developing countries continued to decline sharply in 2004, producing a net reflow of financial resources from developing countries to the IMF of $7.6 billion. This represents the reversal of a three-year trend begun in 2001. In 2003, the IMF was still a net provider of resources, transferring $4.6 billion to developing countries. One reason for the shift in the IMF's position from net provider to net recipient of financial flows from the developing countries in 2004 was fact that the IMF provided loans that were smaller in size, on average, to relatively fewer countries, resulting in lower levels of disbursements that were outpaced by the higher volume of repayments to the IMF. The continuation of a crisis-free financial environment meant that there was little demand for IMF financial support such as that extended to Argentina in 2003 ($12.6 billion), Brazil in 2002 ($35.4 billion), and Turkey, also in 2002 ($16.6 billion), to help support their crisis-recovery efforts. Data for the first nine months of 2005 seem to indicate that this trend has accelerated with net reflows of $11.7 billion from developing countries to the IMF. The IMF, in 2004, was also a net recipient of $2.4 billion from countries with economies in transition. Flows to the IMF from this group accelerated to $3.7 billion during the first nine months in 2005.

Argentina paid off and Brazil will pay off debt owed to the IMF

There was a sharp rise in loan commitments to developing countries to $12.5 billion in the first nine months of 2005, compared with $1.2 billion for the whole of 2004. This rise will, however, be countered by the announcements by both Brazil and Argentina[2] that they intend to repay their outstanding commitments to the Fund and by the near elimination of commitments to countries with economies in transition, owing to their access to the European Bank for Reconstruction and Development (EBRD). Argentina effectively paid off all of its debt to the IMF in January 2006.

2 The obligations of Argentina and Brazil to the Fund are around $25 billion and represent over 50 per cent of the outstanding support financing of the International Monetary Fund.

Overall, international financial institutions (IFIs), including the regional development banks and the World Bank, were also net receivers of funds from the developing countries in 2004, albeit on a reduced scale. Net reflows to the IFIs declined from $11 billion in 2003 to $7.1 billion in 2004 as loan repayments from developing countries and other related charges outpaced disbursements.

Official development assistance: more but still not enough

Development aid rose...

According to preliminary data from the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD), in 2004 official development assistance (ODA) to the developing countries totalled $79.5 billion in nominal terms, an increase of 15 per cent over the $69 billion recorded in 2003. The average share of ODA to gross national income (GNI) of all DAC countries in 2004, however, rose only slightly to 0.26 per cent.[3] Even more encouraging is the prospect for ODA over the medium term, as significant progress has been made on commitments by major donors to deliver increased and more effective aid. More specifically, if DAC members make good on their publicly announced pledges to deliver more aid, according to projections of the DAC Secretariat, ODA will increase rise to about $130 billion in 2010.[4] This would be the largest increase in ODA by DAC countries since the Committee was established in 1960. It should be noted, however, that even with that increase, the average share of ODA to GNI of DAC countries in 2010 is forecast to equal 0.36 per cent, still far short of the 0.7 per cent commitment reaffirmed in the Monterrey Consensus and the 2005 World Summit Outcome and even below the 0.54 per cent ratio of ODA to GNI for all DAC countries recorded in 1967.[5]

...but not enough to help finance actions to meet the MDGs

The forecast increase in ODA to $97.2 billion for 2006 is still far short of the $150 billion which, according to some estimates, would be needed each year by developing countries to meet the Millennium Development Goals (MDGs) by 2015.[6] Moreover, the projected increases for ODA would make it one of the fastest-growing segments in the public spending of the donor countries. Current pressures on governments to keep fiscal balances in check could make delivery on these commitments a difficult challenge.

ODA to LDCs still falls short of the target

Not only is it important to increase ODA substantially to improve the chances of developing countries for meeting MDGs, but priority should be given to aid flows (particularly grants) to the poorest and least developed among them. With the adoption of the Programme of Action for the Least Developed Countries for the 1990s by the Second United Nations Conference on the Least Developed Countries in Paris in September 1990, the developed countries agreed that, within their 0.7 per cent overall ODA target, they would provide 0.15-0.20 per cent of their GNI as ODA to assist the least developed countries (LDCs). A few individual donors (Denmark, Luxembourg, the Netherlands, Norway and Sweden) have met this target, but aggregate ODA to LDCs fell to about half the target in the 1990s. Aid has recovered strongly

3 See "OECD-DAC Secretariat Simulation of DAC Members' Net ODA Volumes in 2006 and 2010, in constant 2004 US$ million", 12 September 2005, available from www.oecd.org/dac.

4 Ibid; see also Statement by Richard Manning, Chairman of the OECD Development Assistance Committee (DAC) to the Development Committee Meeting, 25 September 2005, available from www.oecd.org/dac.

5 See OECD, *Development Cooperation: Efforts and Policies of the Members of the Development Assistance Committee, 1974 Review* (Paris: OECD, 1974), table 55, p. 246.

6 The estimate for the amount of aid required to finance the MDGs comes from the UN Millennium Project.

since the Monterrey Conference. In 2003, for instance, ODA to LDCs totalled $19.6 billion, an increase of 42 per cent (in nominal terms) from the $13.8 billion recorded in 2000.

Meeting the MDGs will require increased shares of aid going to national development strategy budgets

The call by the development community to channel ODA towards financing specific expenditures to meet the MDGs has become stronger. The shares of technical assistance, emergency assistance and debt relief in total bilateral grants and grant-like assistance have increased over the 1990s.[7] Preliminary data for 2004 broadly confirm the levels reached in 2003 (see table A.25). While the share of aid due to debt relief has declined slightly, it is likely to be reversed, as the figures for 2005 will include Paris Club debt relief for Iraq and Nigeria (see below), while figures for 2006 will include the impact of the recently approved Multilateral Debt Relief Initiative (see below) on aid flows from multilateral institutions. Debt relief does not generally provide fresh money to debtor countries, emergency aid is not designed to assist long-term development and the contribution of technical assistance to closing financing gaps is hard to measure.[8] Meeting the MDGs will thus require increasing shares of aid that are administered directly through recipient-country budgets in support of national development strategies that incorporate the internationally agreed development goals, including the MDGs.

Official financial cooperation for development exhibited exceptional progress in the run-up to the 2005 World Summit. In May 2005, the EU responded to the call made by the Secretary-General in his report "In larger freedom: towards development, security and human rights for all" for all countries to achieve 0.5 per cent of their GNI in official assistance by 2009 and to set firm dates to reach the agreed aid target of 0.7 per cent. The EU agreed to set a collective target of 0.56 per cent for 2010. EU member States also agreed to achieve the 0.7 per cent target by 2015, while those that have achieved the target committed themselves to remaining above that target; member States which joined after 2002 agreed to strive to increase their share of ODA in GNI to 0.33 per cent by 2015.[9]

The United States has proposed a doubling of its ODA to sub-Saharan Africa between 2004 and 2010, to be disbursed through the Millennium Challenge Corporation (MCC). The MCC is a government corporation which was created in January 2004 to administer the Millennium Challenge Account (MCA), the United States' foreign aid programme. To date it has approved nearly $1 billion in assistance to five countries (Cape Verde, Georgia, Honduras, Madagascar and Nicaragua) and two Threshold Programme Funding Agreements totalling $34 million with Burkina Faso and Malawi.[10] The United States Congress approved, through the Foreign Operations Appropriations Bill, the allocation of $1.77 billion for the MCC for the fiscal year 2006 (an increase of 18 per cent over the amount approved for the fiscal year 2005). With that and the selection of 23 countries eligible for MCA funding in the fiscal year 2006, the MCC is positioned to disburse higher levels of ODA.[11]

7 See *World Economic and Social Survey 2005: Financing for Development* (United Nations publication, Sales No. E.05.II.C.1), pp. 110-112.

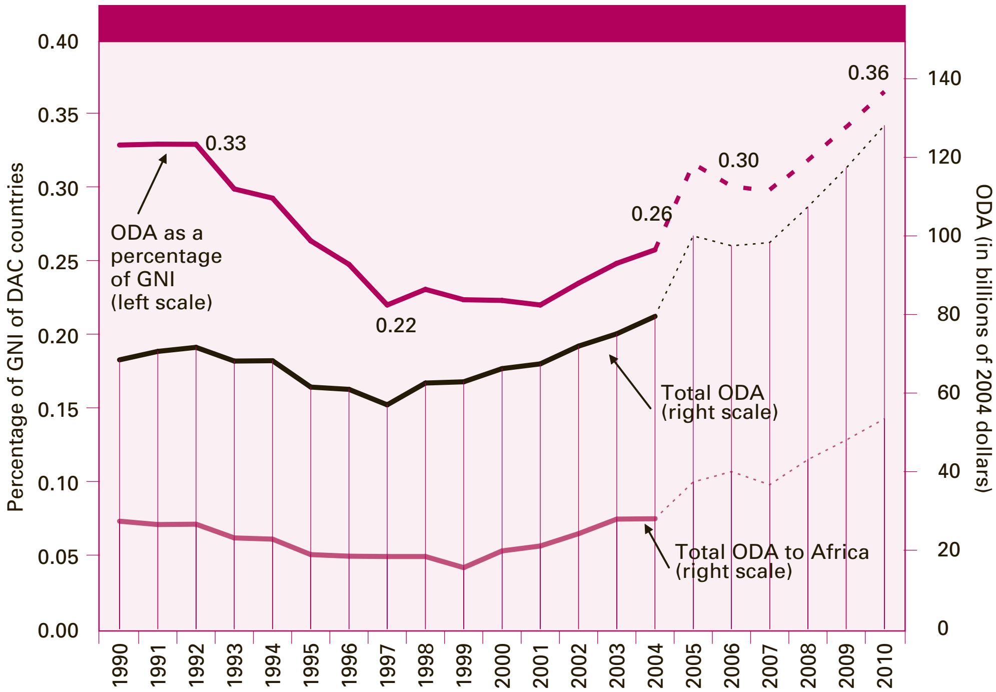
8 Statement by Richard Manning, Chairman, OECD Development Assistance Committee (DAC), to the Development Committee Spring Meeting (Washington, D.C., 17 April 2005), para.5.

9 See *World Economic and Social Survey 2005: Financing for Development*.(United Nations publication, Sales No. E.05.II.C.1), pp. 110-112.

10 The Threshold Programme is designed to assist countries committed to implementing the reforms needed to improve policy performance and eventually qualify for MCA funding. For the fiscal year 2006, 13 countries have been selected to participate in the Threshold Programme, namely: Guyana, Indonesia, Jordan, Kenya, Kyrgyztan, Malawi, the Republic of Moldova, Paraguay, the Philippines, Sao Tome and Principe, Ukraine, Uganda and Zambia.

11 The MCA-eligible countries for the fiscal year 2006 are: Armenia, Benin, Bolivia, Burkina Faso, Cape Verde, Timor-Leste, El Salvador, Gambia, Georgia, Ghana, Honduras, Lesotho, Madagascar, Mali, Mongolia, Morocco, Mozambique, Namibia, Nicaragua, Senegal, Sri Lanka, United Republic of Tanzania and Vanuatu.

Figure III.2.
Net official development assistance by DAC countries, 1990-2010[a]



Source: OECD/DAC.

a Data for 2005-2010 are projections based on commitments and pledges by DAC member states.

Initiatives to enhance aid effectiveness

In recent years there has been increasing attention to both the quantity and the quality of aid. The High-Level Forum on Aid Effectiveness, held in Paris in February-March 2005, inaugurated a system to monitor and measure progress on the delivery of pledges to enhance aid effectiveness. In preparation for the 2005 World Summit, the Working Party on Aid Effectiveness announced that it had reached a consensus on targets for the 11 indicators set out in the Paris Declaration.[12] Performance on these targets and indicators will be reviewed at the next High-Level Forum on Aid Effectiveness, to be held in Ghana in 2008.

In addition to the indicators and targets agreed by the Working Party, a follow-up to the commitments made at the 1995 World Summit for Social Development, where donors pledged to spend 20 per cent of ODA on basic social services in developing countries, would go a long way towards moving forward efforts to enhance aid effectiveness by ensuring that it is channelled through the budgets of recipient countries.

Efforts to improve aid effectiveness through institutional capacity-building continue at the regional level

Efforts to improve aid effectiveness through, among other factors, institutional capacity-building continue at the regional level. The Commission for Africa issued its report, *Our Common Interest*, evaluating progress made in Africa's objective of achieving sustainable economic growth and development.[13] On the recommendation of the Commission, and with the support of G-8 leaders at the Summit Meeting at Gleneagles, the Investment Climate Facility for Africa (ICF) was established in November 2005, designed to lower the cost of

12 The measure of progress for the twelfth indicator (untying aid) is defined as "continued progress over time". See Statement of Richard Manning, Chairman, OECD Development Assistance Committee to the Development Committee Meeting (Washington, D.C., 25 September 2005), available from www.oecd.org/dac); for the list of all 12 indicators, see also Annex in the Statement, p. 8.

13 For the full report, see www.commissionforafrica.org/english/report.

doing business in Africa and to promote a better investment climate throughout the region.[14] The ICF, a seven-year programme, is a public-private partnership funded by companies and bilateral and multilateral donors, which will work closely with African Governments and regional organizations. The United Kingdom of Great Britain and Northern Ireland is the Facility's first donor and the Royal Dutch Shell and Shell Foundation have pledged their contributions. The ICF aims to raise $120 million in its first three years of operation.

The creation of a framework for mutual accountability between Africa and its development partners is under discussion

The Economic Commission for Africa (ECA) and the OECD/DAC are engaged in a collaborative effort to create an institutional framework for mutual accountability between Africa and its development partners. The Africa Partnership Forum (APF), at its meeting in Abuja in April 2005, endorsed the creation of this framework, declared in its Communiqué that the APF is a valuable forum for enhancing mutual accountability and agreed on the need for a mutual monitoring process with clearly defined benchmarks to measure progress.[15] The participants at the meeting also agreed that the APF should provide a clear mandate to the African Union (AU), the ECA, the OECD and the New Partnership for Africa's Development (NEPAD) to provide appropriate guidelines for monitoring country performance which will serve as the basis for discussion at the next APF meeting.

South-South Cooperation is increasing

Commitment towards stronger South-South cooperation in various areas has grown

There has been growing political commitment in recent years towards stronger and wider-ranging cooperation among developing countries in trade, finance, technical cooperation and humanitarian assistance. The 2005 World Summit agreed to encourage South-South cooperation to complement North-South cooperation as an effective contribution to development.[16] Notable efforts on the part of developing countries to this end include the adoption of the Doha Plan of Action at the Second South Summit. The South Summit established the New Asian-African Strategic Partnership and other regional cooperation mechanisms and encouraged support from the international community through triangular cooperation. The Summit also created "the South Fund for Development and Humanitarian Assistance" to support economic and social development and address problems of hunger, poverty and human catastrophes in developing countries.

The major form of South-South development cooperation is technical cooperation. A recent multilateral initiative in this regard is the India-Brazil-South Africa (IBSA) Dialogue Forum. The IBSA Dialogue Forum serves as a mechanism among other things, for strengthening cooperation in specific economic and sectoral areas, and for improving economic relations between the three participating countries.[17] China has given strong support to South-South cooperation with its Technical Cooperation and Development Network, comprising 26 centres of excellence. At the 2005 World Summit it announced that it will expand its existing training and technical assistance to developing countries over the next three years.[18] India, under the India Development Initiative founded in March 2003, plans to

14 See "Blair jump-starts Africa Fund", *Business Day* (20 November 2005).

15 See "Communiqué issued at the End of the 4th Meeting of the Africa Partnership Forum held at the Nicon Hilton Hotel", Abuja, Nigeria, 9-10 April 2005", para. 10, available from www.dfid.gov.uk/pubs/files/apf/gleneagles-communique.pdf.

16 See "2005 World Summit Outcome", 20 September 2005 (A/60/L.1*), section on "Global partnership for development", pp.4-5.

17 See "Cape Town Ministerial Communiqué, India-Brazil-South Africa (IBSA) Dialogue Forum", press release, 13 March 2005, Republic of South Africa, Department of Foreign Affairs, available from www.dfa.gov.za/docs/2005/ibsa0311.htm.

18 See "Promoting universal development to achieve common prosperity", Statement by President Hu Jintao of China at the United Nations Summit (14 September 2005, New York).

provide financial and technical support to other developing countries. Brazil and Morocco underwrite scholarships to their universities and support technical and professional training for students of developing countries. Singapore offers training programmes in various disciplines, and Sri Lanka offers training in indigenously developed technology (crab breeding, uses of banana fibre, etc). Cuba has provided medical training as well as experts and support for health-care systems in and outside the Latin American and Caribbean region.

South-South cooperation in finance is flourishing

South-South cooperation in the monetary and financial areas is flourishing. The Asian financial crisis in 1997 led to the creation by the 10 members of the Association of Southeast Asian Nations (ASEAN) and China, Japan and the Republic of Korea, collectively known as "ASEAN+3" of regional institutions to harmonize financial policies and standards, regulatory systems and tax treatments. ASEAN+3 have also launched Asian Bond Funds and are currently studying the feasibility of a Pan-Asian bond index fund and a fund of bond funds.

Development cooperation among developing countries also takes the form of the provisioning of debt relief to debt-distressed developing countries. In 2000, China provided $1.27 billion (10.5 billion renminbi) in debt relief to 31 African countries. More recently, China announced that it is expanding its aid programme to the HIPC countries and LDCs. It will write off or forgive within the next two years all the overdue parts as of end-2004 of the interest-free and low-interest governmental loans owed by HIPCs that have diplomatic relations with China. Mexico and Costa Rica have also offered major debt relief to the HIPC countries in Central America. India has forgiven some $500 million in debt owed by developing countries.

Several developing countries have also been providing grant assistance. For instance, assistance flows from the financing facility of the IBSA Dialogue Forum will be in the form of non-reimbursable grants. Morocco has also provided assistance in grant form to Cotonou for the construction of a university dormitory.

HIPC Initiative and other debt-relief measures

The implementation of the HIPC initiative continues to progress slowly

Under the Heavily Indebted Poor Country (HIPC) Initiative, three countries (Honduras, Rwanda and Zambia) reached completion point in April 2005. At the end of 2005, 18 countries had reached completion point under the HIPC Initiative[19] and 10 countries had reached decision point, making them eligible to receive interim debt relief.[20] The implementation of the HIPC Initiative thus continues to progress slowly, owing mainly to the difficulty that eligible countries have in complying with the conditions required to receive full and unequivocal debt relief. To many of these countries in the interim phase of the Initiative, maintaining macroeconomic stability remains a major challenge. It is anticipated that Chad and Malawi could arrive at completion point by the first half of 2006, and the Democratic Republic of the Congo could arrive at decision point by the end of 2006. Of the countries that have reached

19 The 18 countries which have reached completion point are: Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, United Republic of Tanzania, Uganda, and Zambia. Completion point is the stage whereby the country receives the bulk of its assistance under the HIPC Initiative, without any further policy conditions. See IMF and IDA, "Heavily Indebted Poor Countries (HIPC) Initiative—status of implementation", prepared by the Staff of the IMF and the World Bank (19 August 2005).

20 The countries which have reached decision point are: Burundi, Cameroon, Chad, Democratic republic of the Congo, The Gambia, Guinea, Guinea-Bissau, Malawi, Sao Tome and Principe, and Sierra Leone.

decision point, six are moving closer to reaching completion point with the implementation of their Fund-and IDA-supported reform programmes.

Total cost to creditors of the debt relief for 28 countries is $38 billion

The total cost to creditors of the HIPC Initiative for the 28 countries in decision point and completion point is estimated to equal $38.2 billion in 2004 net present value (NPV) terms, slightly higher than the $35.7 billion estimated in 2003. The costs are about equally divided between multilateral and bilateral creditors, with the World Bank, IMF, the African Development Bank and the Inter-American Development Bank accounting for 44 per cent, and the Paris Club group of creditors accounting for 36 per cent.

Debt indicators of developing countries have improved

As a result of debt relief extended under the HIPC Initiative, most debt indicators of developing countries have improved. The debt stocks of the 18 HIPC completion point countries have fallen from $59 billion to $21 billion, or an average of 64 per cent (in NPV terms), with an additional reduction of $1 billion owing to topping up.[21] Debt-service costs for most of the 28 decision point countries are projected to be reduced sharply to less than 10 per cent of their exports. The debt service-to-exports ratio of this group fell from an average of 15.7 per cent in 1998-1999 to 7.3 per cent in 2004; as a result, debt service as a share of revenue has declined by almost half, or about $2.3 billion a year.

Countries face difficulties in reconciling objectives of debt sustainability, growth and poverty reduction

By linking the HIPC Initiative to the poverty reduction strategy (PRS) approach, more debt relief has probably led to increased poverty-reducing expenditures in the beneficiary countries. According to IMF estimates, such expenditures have risen on average by 12 per cent in 2004.[22] However, it is hard to obtain a precise estimate for the increase in pro-poor spending because of the lack of comparability of the budget accounting of such expenditures across countries. The other side of the coin is, however, that these countries continue to face difficulties in reconciling the objectives of achieving and maintaining debt sustainability, promoting long-term growth and reducing poverty. Since the implementation of poverty reduction strategies prioritizes spending in the social sectors, especially on health and education, there have been cases where some countries have had to engage in borrowing to meet deficits created by these new expenditure commitments. Sustained poverty reduction and debt sustainability also require increased domestic investment in infrastructure and in production capacity in order to raise economic growth and accelerate development.

Debt sustainability is also affected by vulnerability to external shocks. For a number of HIPCs, shocks from collapses in principal exports, droughts and other natural disasters, as well as civil unrest, have led to unsustainable debt levels. Moreover, eight of the 10 countries that have yet to reach decision point are in conflict or post-conflict situations, as well as having accumulated large protracted arrears with the international financial institutions.[23]

Other problems continue to affect, in varying degrees, the implementation of the HIPC Initiative. For instance, the number of non-Paris Club creditors that have provided or committed to deliver their share of debt relief on all claims to the HIPCs has declined. As at August 2005, eight out of the 51 non-Paris Club official bilateral donors remained fully committed themselves to delivering their share of debt relief to the HIPCs. As a result, the share of estimated HIPC Initiative debt relief that these creditors have delivered or promised to deliver had declined in 2004 from 13.6 per cent to 6.4 per cent of the estimated $3.6 billion

21 The four cases of topping-up which have been approved so far are Burkina Faso, Ethiopia, Niger and Rwanda.

22 International Monetary Fund and The World Bank, "2005 Review of the poverty reduction strategy approach: balancing accountabilities and scaling up results", prepared by the Staff of the International Monetary Fund and the World Bank, Washington, D.C. (19 August 2005).

23 This group numbered eleven as at August 2004, including Burundi which reached decision point in August 2005.

(in 2004 NPV terms).[24] Some of the reasons why non-Paris Club creditors have thus far not participated in the HIPC Initiative include a lack of understanding of the HIPC methodology and the fact that some HIPC countries have not contacted them to actively seek debt relief. Commercial creditors, which account for a small share of total debt relief under the Initiative, have not provided their share. Moreover, several commercial creditors have instituted litigation proceedings and other unilateral actions to pressure HIPCs to settle claims.[25]

The Paris Club concluded several debt-cancellation agreements

The Paris Club group of creditor countries has continued to play an active role in the HIPC process. In 2005, the Paris Club also concluded several debt-cancellation agreements, most notably with Nigeria in October. The debt-relief agreement has to be implemented in two stages after IMF approval of the Policy Support Instrument (PSI) (see below). The agreement includes the reduction of eligible debt under Naples terms and a buy-back at a market-related discount on the remaining debt after the reduction. The first phase of the agreement requires Nigeria to pay arrears due on all categories of debt and Paris Club creditors to grant a 33 per cent cancellation of eligible debts. In the second phase, and after IMF approval of the first review of the PSI, planned for March 2006, Nigeria will pay the amounts due under post-cut-off date debt, accompanied by a cancellation by Paris Club creditors of 34 per cent on eligible debt, and a buy-back by Nigeria of the remaining eligible debt. These provisions amount to a total debt cancellation of $18 billion, representing a 60 per cent reduction of the debt of Nigeria, or $30 billion, owed to the Paris Club.[26] The Paris Club also agreed on a debt-consolidation arrangement with the Dominican Republic, resulting in a significant reduction in debt service. The Paris Club also met several times during 2005 to agree to reduce debt of $124 million owed by Kyrgyzstan and to recommend to their Governments the cancellation of debts owed by Honduras, Rwanda and Zambia.[27]

Debt relief extended to post-conflict countries

The Paris Club has also actively supported post-conflict countries. In November 2004, it reached agreement on a debt reduction of $38.9 billion out of a total foreign debt of $120 billion owed by Iraq to Paris Club creditors. The arrangement featured an initial cancellation of interest arrears ($11.6 billion) in January 2005, with the balance to be deferred, pending IMF approval of its economic reform programme. Further debt reduction will reduce the debt of Iraq to the Paris Club to $7.8 billion; the rest of the debt will be payable over 23 years, with a grace period of six years. The agreement is expected to serve as a benchmark for other creditors, including Saudi Arabia and Kuwait, which hold the bulk of the debt of Iraq.

Initiative endorsed to cancel all debt owed by HIPCs to multilateral financial institutions

At the Gleneagles meeting of the G-8 in July 2005, Heads of State and Government proposed the cancellation of all debts owed by countries to the International Development Association (IDA), the IMF and the African Development Fund (AfDF) of the African Development Bank (AfDB) by HIPC countries reaching completion point.[28] The proposal was endorsed by the International Monetary and Financial Committee (IMFC) at the Annual Meeting of the World Bank and the IMF in September 2005 as the Multilateral Debt Relief Initiative (MDRI). It would cancel an estimated $55 billion in debt owed to these institutions by developing countries.

Multilateral debt relief should be additional to ODA and not impair lending capacity of multilateral institutions

The relief provided to these countries was to be in addition to official assistance available to other low-income countries and should not impair the lending capacity of the multilateral financial institutions. For IDA and AfDF these conditions were met by a G-8

24 See p. 16 of the report mentioned in footnote 22.

25 For a list of these commercial creditors, see table 3, p.19 of the report mentioned in footnote 22.

26 See Club de Paris, “Paris Club agrees on a comprehensive treatment of Nigeria’s debt”, press release, 20 October 2005, available from www.Clubdeparis.org.

27 See News at Club de Paris website, available from www.Clubdeparis.org.

28 See Chairman’s summary, Gleneagles Summit, 8 July, in Gleneagles 2005 Summit Documents, available from www.g8.gov.uk.

pledge and laid down in a letter to the President of the World Bank, stating the commitment "to cover the full cost to offset dollar for dollar the foregone principal and interest repayments of the debt cancelled for the duration of the cancelled loans".[29] Compensation from donors for costs of providing this relief will take place via an additional contribution to the current replenishment.[30] The IMF, on the other hand, will meet the costs of debt relief from its own resources. To meet a requirement, specific to the IMF, that the use of its resources be consistent with the principle of uniformity of treatment it was agreed that all countries with per capita income of $380 a year or less (HIPCs as well as non-HIPCs) would receive debt relief from IMF resources in the Poverty Reduction Growth Facility (PRGF) Trust. HIPCs with per capita income above that level will receive the Multilateral Debt Relief Initiative (MDRI) relief from existing and, if necessary, additional, bilateral contributions to the PRGF Trust.[31] A call for bilateral contributions will be issued if additional funding is necessary.

While it was agreed that there would be no new conditions applied to countries benefiting from relief, countries would be expected to maintain their existing commitments. For HIPC completion point countries, IDA relief is expected to become effective on 1 July 2006 for debts in existence at end 2003. For the IMF and the AfDF, this should occur on 1 January 2006 for debt in existence at the end of 2004, subject to approval by the bilateral contributors to the Trust.

Proposed debt relief leaves debt difficulties of non-HIPCs unresolved

While the proposal seeks to resolve known difficulties in ensuring debt sustainability for countries emerging from the HIPC process, it leaves unresolved the debt difficulties of other low and middle-income countries facing severe debt-service burdens not eligible for HIPC relief. Although initial discussions suggested that relief might be extended to non-HIPC low-income developing countries, no action was taken.[32]

In addition, the proposal only provides 100 per cent relief for debt from the three above-mentioned lenders. It provides no relief for debt to other institutional lenders such as the Inter-American Development Bank, the Caribbean Development Bank, the Asian Development Bank, or for as well as debt to bilateral official creditors who have not participated in the Paris Club, debts to commercial creditors and debts under the equal treatment clauses of the Paris Club that were incurred after the cut-off date. This means that the proposal has a differential impact across countries with similar debt burdens and in different regions.

Some regional development banks will not provide debt relief

The proposal also has implications for the approach of the participating institutional lenders to debt sustainability, since preliminary analysis suggests that countries emerging from the HIPC process and receiving full relief would have values of the relevant ratios far below the new threshold ratios proposed by the World Bank-IMF forward-looking approach to debt sustainability to allow them to qualify for grant-based aid. In the absence of providing additional grant financing for these countries, they would thus have to rely on new market borrowing to fund their MDG expenditures, creating the possibility of a new cycle of excessive borrowing and unsustainable debt.

29 See "Letter to the President of the World Bank from the G8 Finance Ministers on the G8 Debt Proposal, Washington, 23 September 2005," in "The Multilateral Debt Relief Initiative: Implementation Modalities for IDA", International Development Association, 18 November 2005, Annex 1.1, pp. 19-21.

30 These contributions will be made on the basis of the IDA 13 burden-sharing framework. Since the G-8 only covers 90 per cent of the required additional funding, however, these shares will have to be scaled up proportionately to reach full coverage. See "The Multilateral Debt Relief Initiative: Implementation Modalities for IDA", International Development Association, 18 November 2005, p. 11.

31 See "The Multilateral Debt Relief Initiative (G-8 Proposal) and its implications for the Fund—Further considerations: Supplement on Financing arrangements", 1 November 2005.

32 Aside from IMF relief under MDRI for Cambodia and Tajikistan owing to the application of the uniformity principle noted above.

Governance of the global financial system

The International Monetary Fund has recently embarked on a reassessment of its role in the international financial system through a medium-term strategic policy review.[33] One conclusion of this review, and in line with the recommendations made in chapter I, is that international policy coordination is at its most effective when undertaken within a multilateral institution. It thus stresses the importance of safeguarding and strengthening the central role of the IMF, particularly in the area of multilateral surveillance.

The influence of the IMF in this area has been marginal because industrial countries have not required financial support since the 1970s. As a result, it has lost leverage over exchange-rate and macroeconomic policies of those countries. In addition, changes in the international financial architecture and in the Fund operations have continued to erode its original role as arbiter of the international monetary system. The inability to influence policies affecting current global imbalances, accompanied by the decision of many emerging market countries to build large foreign exchange reserves as self-insurance against crises, has further reduced the influence of the IMF.

IMF should contribute more to international policy coordination

Despite the increasing support given to low-income developing countries and to emerging market economies suffering financial crises, it is widely accepted that the Fund should remain the central institution charged with fostering global financial stability and growth. Consequently, the Fund should contribute more to international policy coordination in order to address risks to the international monetary system and global growth.

However, there is as yet no consensus on how to safeguard the central role of the IMF as the principal institution responsible for global economic and financial stability. To supplement the discussion of these issues in the medium-term strategic review, the International Monetary and Financial Committee, in September 2005, requested more specific proposals and timelines on the main tasks identified in the document. In October 2005, the G-20 Finance Ministers and Central Bank Governors also emphasized the need for more work to develop a more detailed "road map" for the future strategic reform of the Bretton Woods Institutions.

The effectiveness of IMF in this role is dependent upon an adequate voice by all members

The effectiveness and credibility of the IMF in this role as a universal and cooperative institution is dependent on adequate voice and participation by all members. After several years of extensive deliberations, the IMF and its members have, in principle, recognized the need for changes in representation and in the distribution of quotas to reflect the increased economic importance of many emerging market economies, especially in Asia, and to ensure that low-income countries are adequately represented. Political consensus has yet to be reached, however, on how to implement this general recommendation and the Spring 2006 meeting of the IMFC will only hear a progress report. In its turn, the October 2005 G-20 meeting underscored the importance of identifying principles for quota reform, which could be an important input into the IMF's Thirteenth General Review of Quotas, scheduled to be completed by January 2008.[34]

33 "The Managing Director's Report on the Fund's Medium-Term Strategy", IMF, 15 September 2005, available from www.imf.org.

34 "The G-20 Statement on Reforming the Bretton Woods Institutions", Meeting of Finance Ministers and Central Bank Governors, Xianghe, Hebei, China, 15-16 October 2005, available from www.g7.utoronto.ca/g20-051016bwi.html.

An IMF quota increase appears unnecessary

Given the assessment that the current level of the Fund resources is adequate, there appears to be no need for a quota increase. Any change in representation will then require redistribution of quotas and voting power within the existing total via an absolute reduction in quotas and voting shares of countries considered to be "overweight". Such changes are politically difficult.

Multilateral surveillance

There is a consensus that multilateral surveillance and the associated process of policy coordination and cooperation should also continue to be the core of crisis prevention efforts. In particular, with the advent of globalization, there is a need for more candid and effective surveillance over systemically important economies, with specific attention to the impact of their policies on other countries and the international economy. As noted above, improving coordination of the economic policies of the major industrialized countries is not an easy task for the IMF since those countries do not have IMF support programmes and can easily disregard its advice. As a result, some observers have suggested that the surveillance function of the IMF become fully independent of its lending and other activities. It has also been suggested that there should be increased transparency, candour and more specificity in the surveillance activities, as well as a change in the focus of multilateral surveillance from a bottom-up to a top-down approach. This new approach would involve starting with an evaluation of the needs and objectives of the international monetary system and then proceeding to the assessment of how the policies of systemically important countries can be made compatible with this evaluation.

Multilateral surveillance can only be effective if larger economies accept IMF advice

Improving the efficiency of the multilateral surveillance process, however, can only be achieved if the larger economies accept the advice of the Fund. To this end, the IMF has decided to put stronger focus on understanding and taking into account the reasons why its advice is not acted upon in specific instances.

As for bilateral country surveillance, the September 2005 IMFC meeting agreed that it should focus on areas in which the Fund can add value, such as macroeconomic and financial stability, and fiscal and debt sustainability, rather than structural policies. It should take into account particular circumstances and constraints facing individual countries in implementing policy in order to make the Fund advice more effective. An important element of this is better integration of technical assistance into the surveillance process to ensure that Governments have the expertise and capacity to implement necessary changes.

The increased size and volatility of international capital flows has been one of the most important factors affecting the Fund over the last two decades. There is now almost universal consensus that there is no need to amend the Articles of Agreement of the IMF to give the institution formal jurisdiction to deal with capital-account issues. At the same time, the strategic review emphasized the need to deepen understanding of capital movements, including the causes and potential policy implications of the pro-cyclicality of international capital flows, and to expand the analysis of the financial sector and capital markets. It is recognized that the Fund needs to ensure that its surveillance produces effective advice to individual countries on which strategies are best suited for their particular capital-account liberalization process.

International standards and codes

In 1999, the IMF and the World Bank launched an initiative to promote greater financial stability through development, dissemination, adoption and implementation of international standards and codes. As a result of its broad coverage, the initiative effort is now concentrated on updates and follow-ups according to country needs, in order to minimize their resource implications and maximize outcomes.

Preparations for implementation of the revised BIS capital adequacy requirement have been completed

The emphasis now given to international standards has produced greater interest in the arrangements for setting those standards. At their meeting in September 2005, the members of the Financial Stability Forum (FSF) encouraged standard-setting bodies to strengthen transparency and governance of their standard-setting process and to give priority to developing standards that address the most pressing risks with appropriate regard for the potential costs and benefits of implementing new standards.[35] At its 2006 meeting, the FSF will discuss work by standard-setting bodies to establish and implement best practices in their processes. The preparations for implementation of the revised Bank for International Settlements (BIS) capital adequacy requirement in the course of 2006 have also been completed (see box III.1).

The role of financial accounting and reporting standards, as well as their harmonization in safeguarding financial stability, is well understood. The process of harmonization of accounting standards began several years ago and is being coordinated by the International Accounting Standards Board (IASB). A number of international financial reporting standards (IFRS) have been finalized and have been applicable to all listed companies in the European Union since 1 January 2005. Several other countries have also adopted IFRS as their national accounting standard. It is estimated that by 2007 more than 90 countries will either permit or require the use of IFRS for publicly traded companies.[36] Common financial reporting is considered to be a major step towards improving the efficiency of international financial markets. And the momentum in the adoption of IFRS across countries is growing.

The modalities for official liquidity provision

Conditions for liquidity provision by the IMF are under discussion

In addition to the question of quota increases, the conditions for liquidity provision by the IMF to members is also under discussion. One view is that, owing to the massive support required for capital-account crises, the Fund's resources are insufficient and thus the limited nature of potential Fund financial support in response to such events should be more clearly and consistent signalled to members by enforcing regular access limits and applying the exceptional access conditions predictably and consistently. This new strategy would provide incentives for early implementation of adjustment policies in borrowing countries and for private creditors to follow the rule of prudent risk taking, thereby safeguarding the Fund's credibility. It would therefore ensure that Fund financing was combined with appropriate and timely adjustment policies in order to restore market confidence, while at the same time

35 Statement by Roger W. Ferguson, Chairman of the Financial Stability Forum, International Monetary and Financial Committee Meeting, Washington, D.C., 24 September 2005, available from www.fsforum.org.

36 Malcolm Knight, "Global banking—paradigm shift", Speech at the Fourth Conference of the Federation of Indian Chambers of Commerce and Industry, Mumbai, India, 5 October 2005, available from www.bis.org.

Box III.1

Basel II Capital Adequacy Framework

In order to eliminate anomalies in the 1988 Basel Accord on Capital Adequacy, the Basel Committee launched a proposal for revision in 1999. The revision culminated in June 2004 in what is called the Basel II Capital Adequacy framework. Guidance on two technical matters was published in July 2005 and, in November 2005, an updated version of Basel II, labelled as "International convergence of capital measurement and capital standards: A revised framework" was released.[a] Since one of the basic objectives of the Basel Capital Accords is to create uniformity of treatment of banks undertaking cross- border operations, the BIS has engaged in a series of Quantitative Impact Studies (QIS) to assess the impact of implementation of the new Accord on different types of banks operating in different countries.

The results of the fifth QIS, however, indicated substantial differences in the impact on small and large banks in developed countries. In the United States, where smaller banks have already been advised to use an adaptation of the Basel I framework,[b] the differences in effective minimum required capital for individual institutions ranged from a decrease of 47 per cent to an increase of 56 per cent. Since these difference were larger than expected and difficult to explain, the United States has decided that further study will be necessary for before proceeding to implementation[c] and full implementation is unlikely before 2011. This process will be undertaken on the basis of the fifth QIS (QIS5), which is expected to be concluded in the second quarter of 2006.

Another important area is to ensure consistency of implementation of Basel II across borders while avoiding a "one-size-fits-all" approach. The Basel Committee, through its Accord Implementation Group (AIG), is engaged in outreach efforts with supervisors in different member countries in order to promote cross-border cooperation. This cross-border work has accelerated over the past year. It has been recognized, however, that more must be done to foster greater consistency.

In many emerging economies Basel II is seen as an important catalyst for accelerating the introduction of best risk-management practices within the banking sector in the medium and longer term. According to the Financial Stability Institute (FSI), close to 90 non-member countries intend to adopt Basel II by 2010.[d] The Basel Committee itself has indicated, however, that moving rapidly to introduce the Accord is not the first priority for non-G-10 countries, which should instead first concentrate on building a strong supervisory foundation. In this regard, immediate implementation of some of the principles of Pillars 2 and 3 of the New Accord, addressing supervisory practices and expanded market discipline as preparation for the formal transition to Basel II has been suggested as a first priority.[e] A special regime, similar to that being worked out in the United States, might be more appropriate for financial institutions in developing countries.

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a See Bank for International Settlements, *Basel Committee on Banking Supervision*, available from http://www.bis.org/publ/bcbs118.htm.

b United States banking agencies have proposed a separate "Basel 1A" framework that increases the number of risk-weight categories to which credit exposures may be assigned, expands the use of external credit ratings, and employs a range of other techniques aimed at increasing the risk sensitivity of capital requirements... See NR 2005-111, United States Office of the Comptroller of the Currency, "Comptroller Dugan says Basel II capital framework will substantially enhance safety and soundness", 10 November 2005.

c See NR 2005-46, United States Office of the Comptroller of the Currency, "Acting Comptroller of the Currency Julie L. Williams testifies before House Subcommittees on Basel II framework issues", 11 May 2005.

d See Bank for International Settlements, "Implementation of the new capital adequacy framework in non-Basel Committee member countries", *Occasional Paper*, No. 4, Executive Summary, Financial Stability Institute, July 2004, available from www.bis.org/fsi.

e Jaime Caruana, "Basel II progress", 26 September 2005, available from www.bis.org.

avoiding over-lending and prolonged access to Fund resources. Financial assistance should be carefully considered in view of the overall capacity of a country to repay.

On the other hand, it is argued that, despite the rapid development and integration of international financial markets, there is still a strong rationale for the Fund to provide financing when countries face sharp declines or reversals of private capital flows. Consequently, access to liquidity during capital-account crises should be commensurate with potentially large-scale financing needs of countries that may surpass normal lending limits based on quotas of members. Large-scale financing to support economic activity, employment and trade may also be necessary owing to the fact that the catalytic effects of IMF programmes have thus far been limited. Moral hazard issues are considered to be exaggerated as empirical support is not sufficient or lacking. It has also been stressed that too much emphasis on the rules governing lending access could be counterproductive as the case of each country tends to be different, if not unique.

Moral hazard issues in IMF liquidity provisioning among financial crises are seen to be exaggerated

Another issue under discussion is the lack of harmonization of charges for different Fund facilities. This practice has opened arbitrage possibilities across different Fund instruments and has resulted in the increased attractiveness of longer-term exceptionally large borrowings, as well as "facility shopping", in which countries request support under the cheapest, but not necessarily most appropriate, facility. There is a broad agreement that this perverse incentive structure should be changed.

Use of Fund resources for crisis prevention remains one of the most important unresolved issues. Since the expiration of the Contingent Credit Line (CCL) in November 2003, there have been discussions on the possibility of adapting an existing instrument, such as the stand-by precautionary arrangements, to the needs of countries with strong policies facing a potential capital-account shock. Thus far, those discussions have not produced any formal recommendation because of disagreements about the feasibility of exceptional access under the precautionary arrangements as well as about the very principle of ex ante open-ended commitment of Fund resources. Meanwhile, in the absence of multilateral insurance mechanisms, emerging market countries have continued the massive build-up of reserves as a form of self-insurance. In addition, greater attention is being given to strengthening regional financial arrangements, especially in Asia. Amid these developments, the Strategic Review called for a second round of debate on the issue.

The use of IMF resources for crisis prevention remains an important unresolved issue

Policies on crisis resolution

There has been important progress in advancing a market-based approach to the orderly and cost-efficient resolution of financial crises. The Collective Action Clauses (CACs) in sovereign bond issues have become a market standard. The inclusion of CACs in new bond contracts, as well as in new bonds issued in sovereign debt-exchange offers, has resulted in increases in value terms of the outstanding stock of emerging market sovereign bonds that include CACs from approximately 31 per cent at the end of 2002 to approximately 53 per cent at end-June 2005.[37] Thus far, the inclusion of CACs does not appear to have had an adverse impact on the cost of issuance.

Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets agreed by four emerging market issuers—Brazil, Mexico, Turkey and the Republic of Korea—and by the Institute of International Finance (IIF) and the International Primary Market Association (IPMA), were released in November 2004 following the endorsement by

37 See IMF, "Progress report on crisis resolution", 21 September 2005, p. 3, available from www.imf.org.

the G-20. The aim of the Principles is to provide a flexible framework for communication and cooperation between debtors and creditors in order to contain crises at an early stage and resolve sovereign debt restructuring where it becomes unavoidable. The Principles are not legally binding but are meant to constitute an important complement to CACs.

Emerging market issuers and private sector creditors are now developing a process for monitoring and assessing implementation of the Principles. This work should identify circumstances where early correction could prevent crises from unfolding and offer guidance for the restructuring process in cases where debt restructuring is needed, as well as facilitate continued relevance of the Principles in light of changing market characteristics and help reveal whether the right balance has been achieved between providing sufficient guidance and allowing flexibility.[38]

There is no consensus on the role of the official sector in market-based crisis resolutions

While the market-based approach to crisis resolution and debt restructuring has received increased support in recent years, there is no consensus on the role to be played by the official sector. The debt restructuring process of Argentina has shown the need for a better framework. IMF financial support for Argentina was made difficult by the fact that an ongoing Fund programme had been suspended just before the default. Negotiations with creditors concerning sustainable debt levels could only be initiated after the Government had agreed to the economic policy conditions for continuing the existing IMF support programme. Delays in reaching agreement with the IMF were due to political instability and to the fact that the negotiations only kept existing programmes in place, rather than providing additional financial assistance. These delays meant that Argentina was to engage in negotiations with creditors over two years after the default. The extremely large size of the default, the wide geographical dispersion of creditors and the diverse nature of the credit instruments and legal regimes governing them complicated negotiations further.[39] The creation of a number of individual national and international "creditor committees" with unclear representative mandates made the bargaining process even more difficult. Finally, there was a clear divergence between the objectives of the creditors and the IMF on the one hand and the Argentine government on the other. The creditors argued in favour of the highest possible payout, while the IMF urged the government to adopt policies that maximized the fiscal surplus to provide funding for the restructuring. The Government argued that fiscal policy and the payout should be set at levels that could be sustained on a permanent basis by producing economic recovery and sustained growth of national income. The result was a divergence in the interpretation of "good faith" negotiations required for IMF lending in arrears programmes and the requirement of market support for the restructuring. In the end, a voluntary unilateral exchange offer by Argentina with an implied pay out of around 25 per cent was accepted by 75 per cent of its foreign creditors. The Government interpreted this as representing market support for the package and thus satisfying the good faith requirement. The IMF, however, continued to urge Argentina to provide conditions for the holdout creditors and a number of them continued to seek relief in court.[40] The question of the resolution of the outstanding creditors is still pending, although Argentina has clearly stated that the exchange offer will not be reopened.

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38 See, for example, the critical comments in "Observations regarding the principles for stable capital flows and fair debt restructuring in emerging markets", Ministerio de Economia y Produccion de Argentina, available from http://www.mecon.gov.ar/finanzas/download/critica_a_principles%20_final_%20exe.pdf.

39 See J. F. Hornbeck, "Argentina's sovereign debt restructuring", CRS Report for Congress (Washington, D.C., The Library of Congress, 19 October 2004).

40 The most recent filing was in mid-December 2005.

Hence, a review of the effectiveness of the instruments of the Fund to facilitate crisis resolution, including the "lending into arrears" policy and information dissemination, would help to clarify the role the Fund could be expected to play in market-based resolutions. In particular, dissemination of timely and accurate information of the debt sustainability analysis of the Fund would facilitate negotiations between the debtor and its private creditors.

IMF engagement with low-income countries

It is recognized that the IMF should not be turned into another development agency

The role of the Fund in the global development partnership has been the subject of extensive debate. It has been recognized that the IMF should not be turned into another development institution. Others, such as multilateral development banks and bilateral donors, are in a better position to provide medium- and long-term development assistance. The IMF should rather stick to its core areas of expertise, which, in the case of low-income countries, means addressing macroeconomic aspects of the development challenge, including maintaining macroeconomic stability and debt sustainability, through policy advice, capacity-building and, when necessary, financial assistance.

In this respect, one of the most important areas of work has been identified as advising low-income countries on how to deal with macroeconomic effects of higher aid flows. This includes improving public expenditures management and domestic resource mobilization, as well as increasing absorptive capacity. No less important is finding ways to deal with real exchange-rate appreciation resulting from rising aid flows.

Policy Support Instruments are established for low-income countries

In October 2005, the Executive Board of the IMF approved a proposal establishing Policy Support Instruments (PSI) for PRGF eligible members. The PSI will provide policy support and signalling to low-income countries that do not need or want financial assistance from the IMF, but still want the Fund to support their poverty reduction programmes and endorse the quality of their policies. The Instrument will be available on a voluntary basis and based on policies that meet the standard of upper credit trance conditionality. Unlike Article IV consultations, the PSI will provide an explicit endorsement of policies of low-income members.

According to the IMFC, the PSI would provide the benefits of IMF advice and policy support to countries that do not require financial support, while the PRGF would remain the main instrument for IMF financial support for low-income countries. In this regard, it has been decided to establish a new "shock window" within the PRGF for low-income countries that do not have a PRGF. This should help these countries cope with adverse short-term balance-of-payments shocks mainly in their terms of trade. Countries that are "on-track" with PSI conditions would get rapid access to the window in the event of a shock.

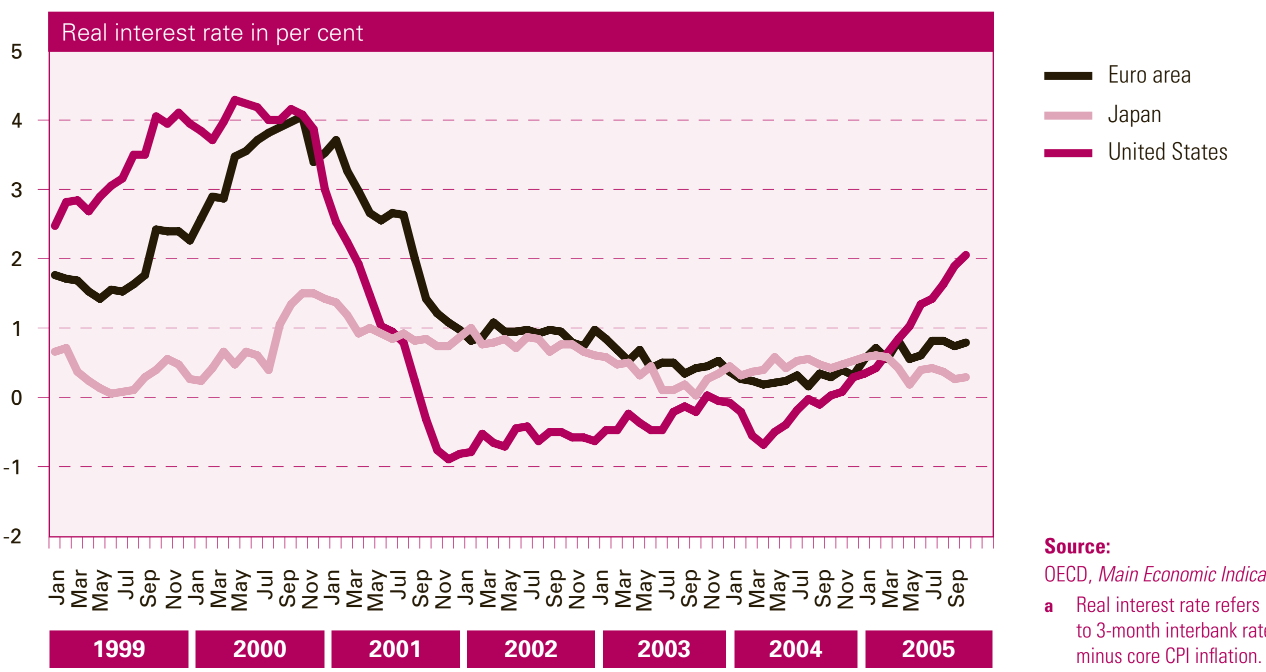
Chapter IV
Regional developments and outlook

Developed market economies

Across the developed economy region gross domestic product (GDP) growth rates decelerated in 2005, partly because of the surge in energy prices during the year, as well as the hurricanes that hit the United States of America, and partly because of a natural moderation from above-trend growth in 2004 for some countries, in tandem with the gradual removal of policy stimulus. There were positive developments, however, in the form of still modest, but continuing growth in Japan suggesting a convincing end to its long period of stagnation. On the other hand, growth remains weak in the euro area. The rate of expansion of investment spending has been slow in most countries in the region, despite the favourable financing conditions and strong corporate profits for a number of years. A key to the expected growth performance in 2006 will be a significant pick-up in investment.

Inflationary pressures increased with the surge in oil prices, but to date there is little evidence of second-round effects through wage and price mechanisms. The era of zero or negative real interest rates, however, is coming to a close, as some central banks are well on the way to a neutral policy stance, while others are beginning to shift from an accommodating to a restrictive stance (see figure IV.1).

Figure IV.1.
Real interest rates[a] in the euro area, Japan and the United States: January 1999-October 2005



Source: OECD, *Main Economic Indicators.*

a Real interest rate refers to 3-month interbank rate minus core CPI inflation.

The large macroeconomic imbalances remain and in some cases are increasing and not expected to shrink significantly in the outlook. The exchange-rate movements that accelerated at the end of 2004 and that were expected to lead to some diminution of the imbalances had a negligible effect and have since reversed. Thus it is increasingly likely that progress on adjusting the imbalances will be achieved only through a broader macroeconomic policy framework (see chapter I).

North America: imbalances and risks increase

The growth moderation in the economy of the United States during 2005 is expected to continue into 2006. GDP is forecast to grow by about 3 per cent in 2006, slightly lower than the pace estimated for 2005, but noticeably lower than the 4.2 per cent registered in 2004 (see table A.1). The economy has slowed with the maturing of the economic cycle, but the two devastating hurricanes along with the associated spikes in energy prices have also affected growth. Additionally, the economy is increasingly showing a number of structural weaknesses, as indicated by the extremely low household saving rate and the large and growing external deficit. Growth will continue to be supported by low interest rates, good corporate profitability and the improving labour market; however, risks are growing towards the downside.

Two large hurricanes reduced GDP growth

The two large hurricanes, Katrina and Rita, led to a catastrophic loss of human life and devastating structural damage, but the impact on GDP growth, while significant, was more modest. The negative effects on economic growth were concentrated in the short run. The economy-wide effects came from the vital features of the Gulf of Mexico as a centre for energy production and supply and as a major harbour for exports and imports. In the aftermath of the hurricanes, energy prices surged: while the prices of crude oil and gasoline retreated in the subsequent months, the price of natural gas remained high. Consumer confidence was also significantly affected. The overall impact of the hurricanes was estimated to have reduced GDP growth by about 0.5 of a percentage point for the second half of the year.[1] Rebuilding in the region is expected to stimulate growth in 2006, including an estimate of federal government spending of about $100 billion spread over the next few years, plus some private investment.

Consumption is expected to moderate

Resilient household spending has been the key to the growth of the United States for the past few years, but has led to the average household savings rate falling below zero in 2005, for only the second time since the Second World War. With employment and real wages growing at only a modest pace in the past few years, an important source for financing household spending has been the strong housing market. Wealth effects from the appreciation of house prices have stimulated household spending while reducing the saving rate, as households refinance their mortgage loans and withdraw equity to finance current spending. It is estimated that about 30 to 40 per cent of the increase in household consumption has been financed by equity withdrawal in the past few years.[2] To some extent, the wealth effects also

1 See Global Insight, *U.S. Economic Outlook,* monthly, various issues (2005).

2 See Alan Greenspan and James Kennedy, "Estimates of Home Mortgage Originations, Repayments, and Debt On One-to-Four-Family Residences", *Finance and Economics Discussion Series,* No. 41 (Washington, D.C., Federal Reserve Board, 2005) and Remarks by Chairman Alan Greenspan, *Mortgage banking*, to the American Bankers Association Annual Convention (Palm Desert, California, 26 September 2005).

explain the smaller-than-expected impact of higher oil prices on household spending thus far: while the share of household disposable income spent on energy has increased markedly in the past two years (to about 6 per cent, the highest in two decades), consumers have managed to cope with the higher energy bill through withdrawing equity and lowering savings, instead of curtailing their spending on other goods and services. Such spending behavior is, however, expected to change as house prices are cooling off and interest rates are moving upward. A downward shift in household spending was already evident in the last quarter of 2005, with the growth of real private consumption moderating markedly. Although some specific factors were behind the recent moderation, such as the phase-out of automobile promotional sales and the spike in energy prices, the growth of private consumption for 2006 as a whole is expected to be significantly lower than that of the previous years.

Business investment is expected to be on a more positive trend

In contrast to consumption expenditure, business investment is expected to strengthen somewhat. Over the past five years since the bursting of the information and communication technology (ICT) bubble, business capital spending in the United States has been low, registering an outright decline in two of those years, compared with an average rate of increase of about 10 per cent in the late 1990s. Nevertheless, an end to the investment anaemia as discussed in chapter I could be in sight. Some cyclical recovery in business investment seems to have gathered momentum in the past two years, particularly in information-processing equipment. Corporate financing conditions have improved markedly, with corporate earnings growing at double digits for the past few years. Those factors, together with favourable business surveys and strong factory orders, presage a further strengthening in business capital spending in 2006. The post-hurricane rebuilding will also give some impetus to business investment.

Employment continues to strengthen but at a very modest pace

Employment has gradually improved during 2005. Even abstracting the displacement of labour caused by the hurricanes, however, the average increase in payroll employment is still below the pace necessary to accommodate the natural growth of the labour force and thus maintain a stable unemployment rate. Although the unemployment rate has retreated to about 5 per cent by the end of 2005, down from 5.5 per cent in 2004 (see figure IV.2), most of the improvement reflects a decline in the participation rate. In addition, employment in the manufacturing sector continued to diminish, remaining about two million persons lower than the level registered in 2000. According to the outlook, the moderate rate of employment growth is expected to continue, with the unemployment rate stabilizing at about 5 per cent (see table A.7).

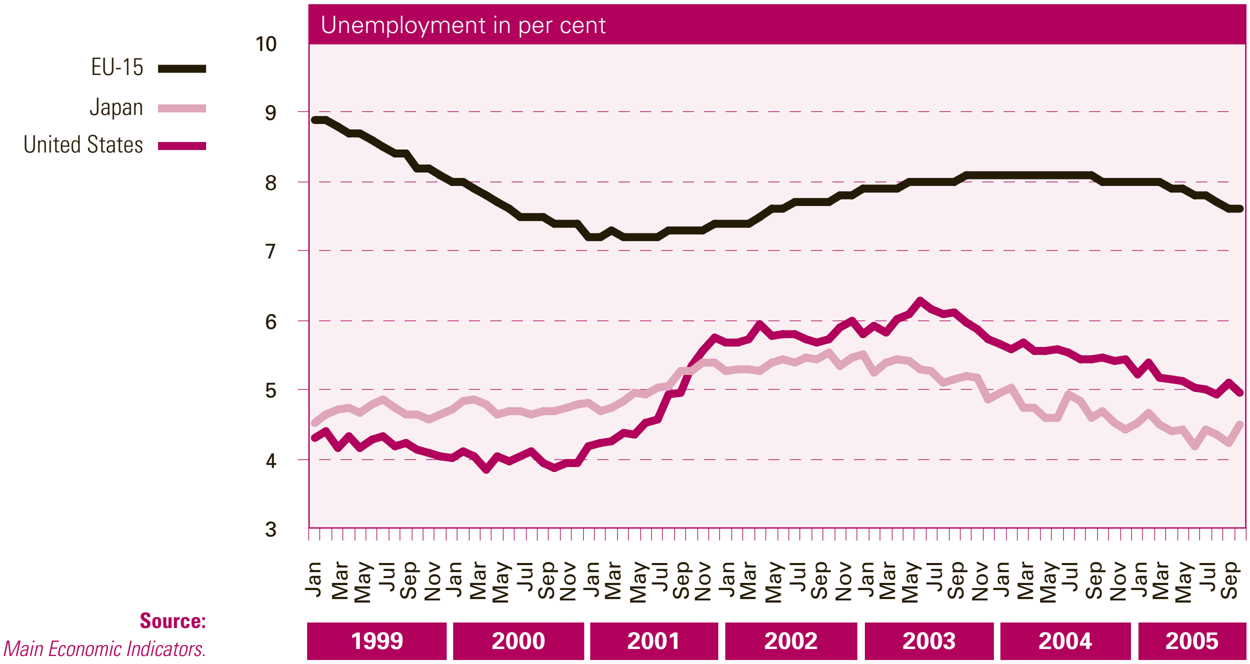
Inflationary pressures remain, but pass-through is limited so far

Headline consumer price index (CPI) inflation moved upward measurably in 2005, reaching 3.5 per cent on average, mainly owing to the spikes in energy prices. At 2.2 per cent, the core inflation rate is much lower. While the pass-through of higher energy prices has been limited to date, the pressure on producers to raise prices of final goods has been mounting noticeably, particularly in the last quarter of 2005, and the core CPI rate is estimated to have risen by more than a half percentage point compared with the previous quarter. Inflation expectations remain well anchored. A competitive international and domestic environment continues to contain the pricing power of firms, although labour seems to bear a larger proportion of the squeeze than capital, as indicated by the mediocre growth of wages. The outlook foresees a retreat in the headline inflation rate in 2006 (see table A.4) as the effects of the spikes in energy prices abate, but core inflation is expected to continue to rise slightly.

Exports pick up, but the current account is expected to deteriorate further

The external sector has improved in terms of real exports growing faster than real imports during 2005, for the first time in a decade. Real exports have gained momentum since the second half of 2005, driven especially by foreign demand for capital goods. In value terms, however, the current-account deficit widened further to about $800 billion in 2005,

Figure IV.2.
Standardized rates of unemployment in the EU-15, Japan and the United States: January 1999-October 2005



Source: OECD *Main Economic Indicators.*

an increase of more than $100 billion from the previous year, with a large proportion of the increase owing to the higher bill for oil imports. Robust export performance is expected to continue, but with total exports being only half the value of total imports, the deficit will continue to expand unless import demand were to slow down significantly.[3]

Monetary policy is challenged by conflicting pressures

Since mid-2004, the United States Federal Reserve (Fed) has gradually raised its policy interest rate—the federal funds rate—by more than 300 basis points to 4.25 per cent. The effects of the monetary tightening have, however, not been fully channelled into the economy, as long-term interest rates determined in capital markets have not moved in tandem, leaving the long-term financial costs for consumers and businesses at the same level as a year earlier. Monetary policy is increasingly challenged by the potential inflationary risks from greatly elevated energy prices, with core inflation rising. The inflationary risk is balanced, however, by downside risks to output and employment, particularly if the housing market were to react sharply to further tightening (or if long-term rates were to more fully reflect the previous degree of policy tightening). The Fed is expected to raise the federal funds rate to 4.5 per cent in early 2006.

Fiscal policy was neutral to restrictive in 2005, and is forecast to be marginally expansionary in 2006; the budget deficit will remain high

Fiscal policy became much less stimulatory in 2005 than in the previous few years, or even became restrictive if measured by such indicators as "fiscal impulse", with government expenditure growing more slowly than GDP and government revenue growing faster. As a result, the budget deficit fell by about one percentage point of GDP from the previous year, to 2.5 per cent of GDP. Given a planned increase in government spending for the reconstruction in the aftermath of the hurricanes, fiscal policy is expected to be slightly more expansionary in 2006, with the deficit increasing modestly. The policy debate will continue to be focused on long-term fiscal sustainability, particularly with the looming pressures on entitlement programmes arising from the retirement of the baby-boom generation.

3 See chapter II for a more detailed discussion of trade prospects.

Downside risks predominate

Major downside risks for the economy of the United States are associated with the future developments of house prices and energy prices in the context of the stretched indebtedness of the household sector, the protracted huge external deficit for the economy as a whole, and the gradual tightening of monetary conditions (see chapter I for a more detailed discussion of downside risks).

Canada picks up

Bucking the trend of modest deceleration in the United States, as well as in the world economy, the Canadian economy has notably strengthened in the course of 2005 from the earlier soft patch. High primary commodity prices and a relatively accommodating monetary stance have buttressed strong growth in domestic demand. As a net energy exporter, the Canadian economy on balance gains from the higher energy prices, despite some adverse effects of the higher prices on consumer spending. GDP growth is estimated to be 2.7 per cent for 2005, near potential growth, and a similar pace is forecast for 2006 (see table A.1).

Employment growth has been robust, driving the unemployment rate to below 7 per cent, the lowest in a decade. The inflation rate has been on a modest rise, as the average annual rate of CPI inflation has moved upward to 2.2 per cent in 2005 from 1.8 per cent in the previous year. The inflation outlook remains within the upper bound of 1-3 per cent, the target range of the Bank of Canada. Monetary policy remains accommodative, with the real short-term interest rate slightly above zero. Fiscal policy is expected to remain neutral. With a modest budget surplus, the Canadian Government is adhering to its plan of steadily reducing the debt-to-GDP ratio.

Developed Asia and the Pacific: ending deflation in Japan

The Japanese economy has sustained an expansion, however modest, for about four years. Despite a notable deceleration in the second half of 2005, GDP growth is estimated to have reached 2 per cent for the year, and a similar rate is forecast for 2006 (see table A.1). Cumulative gains in corporate profits from earlier years have finally spread to household income, leading to a gradual strengthening in domestic demand. The prolonged adjustment in excess capacity and employment by many firms has in the end produced results, as various measures of corporate profitability have finally surpassed the heights recorded before the decade-long stagnation. Progress continues in corporate financial restructuring, with non-performing loans declining.

Corporate sector restructuring advanced; investment spending is yet to pick up

A crucial turning point has been reached, and the protracted adjustment pressures in the corporate sector and the financial system have finally dissipated. Firms have almost resolved their problems of excess in debt, employees and capacity. The associated problem of large non-performing loans in the financial system has nearly been worked out. Corporate profitability has improved substantially. Japanese firms have experienced remarkable growth in cash flows over the past few years. Business fixed investment has been increasing modestly, but remains weak relative to the growth of corporate savings, leading to increased private-sector savings surpluses. Firms have been using financial surpluses to increase spending on land purchases, dividend payments, buy-backs of own shares, loans repayments and mergers and acquisitions. The latest business survey indicates that many firms still appear cautious about accelerating inventory and capital investments in response to increases in sales and production. In the outlook, business investment is expected to pick up.

Consumption spending remains subdued but underlying driving factors are improving

The strength of the corporate sector is steadily spreading to the household sector. In particular, improvements in the employment and income situation are becoming more apparent. Firms had been placing priority on restraining labour costs, but their stance has gradually changed: employment has picked up, with the ratio of part-time workers to regular employees starting to decline; bonus payments have recorded relatively high increases; and regular compensation has started to increase, though at a slow pace. With the improvement in employment and remuneration, household income is likely to continue to grow moderately, supporting the already evident rise in private consumption.

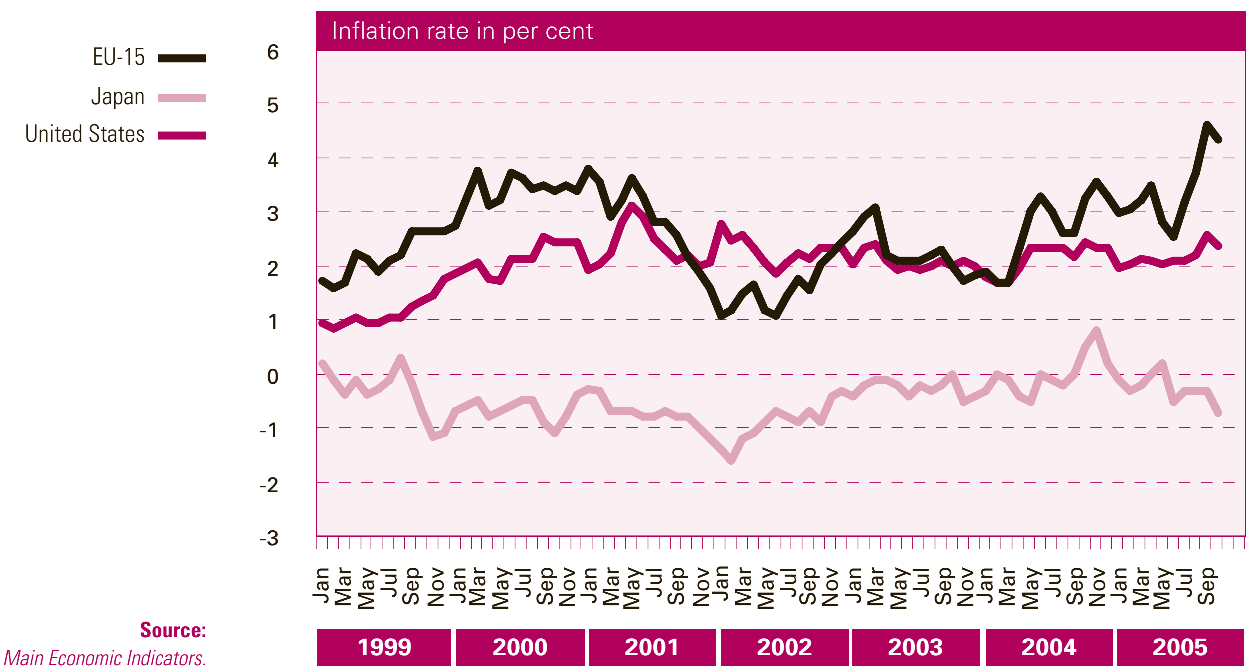
Growth is less dependent on external demand

The contribution of the external sector to GDP growth has become less significant recently, with the growth of real exports moderating notably during 2005. A lacklustre global demand for ICT related goods in the early part of the year and a moderation in the growth of China's import demand have been the main causes. Real imports have been rising steadily owing to increased domestic demand. Despite this lessening dependence on the external sector for growth, solid external demand from Japan's major trade partners, particularly, the United States and China, remains important for sustaining growth.

Positive inflation is expected

Japan has experienced a protracted deflation for more than seven years, but the pace of decline in the core CPI has recently slowed considerably (see figure IV.3). The year-on-year changes in the CPI are expected to turn positive and to remain so in 2006. The pace of GDP growth in Japan in the past two years was considered to be above its potential rate, reducing the output gap that had opened up in the late 1990s. The impact on prices, however, has remained small. A decline in wages and a rise in productivity over the previous few years had driven down unit labour costs and contained pressures on prices. Unit labour costs are unlikely to increase in the near future because rising productivity will still tend to hold them down despite the recent recovery in wages. Higher oil prices in the past few years seemed to have had only a marginal effect on prices, as the Japanese economy is highly energy-efficient

Figure IV.3.
CPI inflation in the EU-15, Japan and the United States: January 1999-October 2005



Source: OECD *Main Economic Indicators.*

compared with other major economies. Stock prices have been strong in Japan, and land prices in some parts of Tokyo and other major metropolitan areas have also started to rise, reflecting to some extent an upturn in expectations of investors about the economy.

Monetary Policy: unorthodox measures to combat deflation are expected to be gradually phased out

For about four years, the Bank of Japan (BoJ) has adopted an unorthodox framework of monetary policy aimed at eradicating deflation. The framework consists of two components: the provision of liquidity to the money market so that the outstanding balance of current accounts at the BoJ exceeds the amount of required reserves; and a commitment to continue the quantitative easing until the year-on-year rate of change in the core CPI registers zero per cent or higher on a sustainable basis. This policy has maintained short-term interest rates at zero per cent and longer-term interest rates stable at low levels. Along with the expectation for the annual change of the CPI to turn positive, the present monetary policy framework is likely to be phased out in the course of 2006. The monetary authorities are expected to proceed prudently, taking into account developments in economic activity and prices, as well as in financial market conditions.

Fiscal consolidation is to continue with the aim of primary balance by 2010

Fiscal consolidation will continue in 2006 in order to curb the rise in the large public debt, in line with the medium-term goal of reaching a zero primary balance in 2010. The target is mainly to be reached by expenditure cuts, including reduction of public investment, reductions in subsidies, as well as through a rewinding of tax cuts introduced in earlier years and an increase in the value added tax. Structural reforms will likely continue.

Risks remain

Downside risks include a further increase in oil prices, even though the economy has not been overly affected by the higher oil prices. Fiscal consolidation to reduce the large public debt remains difficult, with downside risks to growth. Consequently, monetary policy should continue to maintain an accommodative position until the economy solidly extricates itself from the protracted deflation.

Australia and New Zealand slow down in 2005

Both Australia and New Zealand experienced a notable slowdown during 2005, although this was attributable to different factors. A sharp cooling in the housing boom has contained growth in Australia, while in New Zealand the slowdown has been concentrated in sectors exposed to the appreciation of the currency. In the outlook, growth in Australia is expected to stabilize at about 3 per cent, but a further deceleration in New Zealand will be most likely. In both economies, large current-account deficits encompass some risks, with some adjustment already occurring in Australia and problems looming in New Zealand.

A booming housing sector had been the key factor for Australia's economic performance for many years. During this period, households increased consumption expenditure faster than income, either by reducing discretionary savings or by borrowing against the equity in their home. This phenomenon was particularly evident in 2002 and 2003. Since then, however, average house prices have not risen. As a result, consumption and borrowing have slowed noticeably as households have become more cautious. The downturn in the housing construction cycle has also been dampening household spending. On the other hand, growth in household income and spending continues to be supported by strong growth in employment and real wages, and by recent tax cuts. In contrast to the household sector, business-investment spending has been expanding rapidly, stimulated by the high level of commodity prices, and has been particularly strong in the mining sector and in resource-related manufacturing and infrastructure projects.

In New Zealand, the housing boom continues, but house prices seem to have reached unsustainable levels. This condition has been accompanied by an extremely low savings rate. With rising interest rates, many households, already spending over half of their disposable income on servicing their mortgages, are potentially at risk and are vulnerable if property prices were to fall. Additionally, high interest rates have attracted international hot money and induced an appreciation of the currency and a widening of the external imbalance.

Western Europe: a weak recovery in 2005

Recovery in Western Europe is weaker than expected

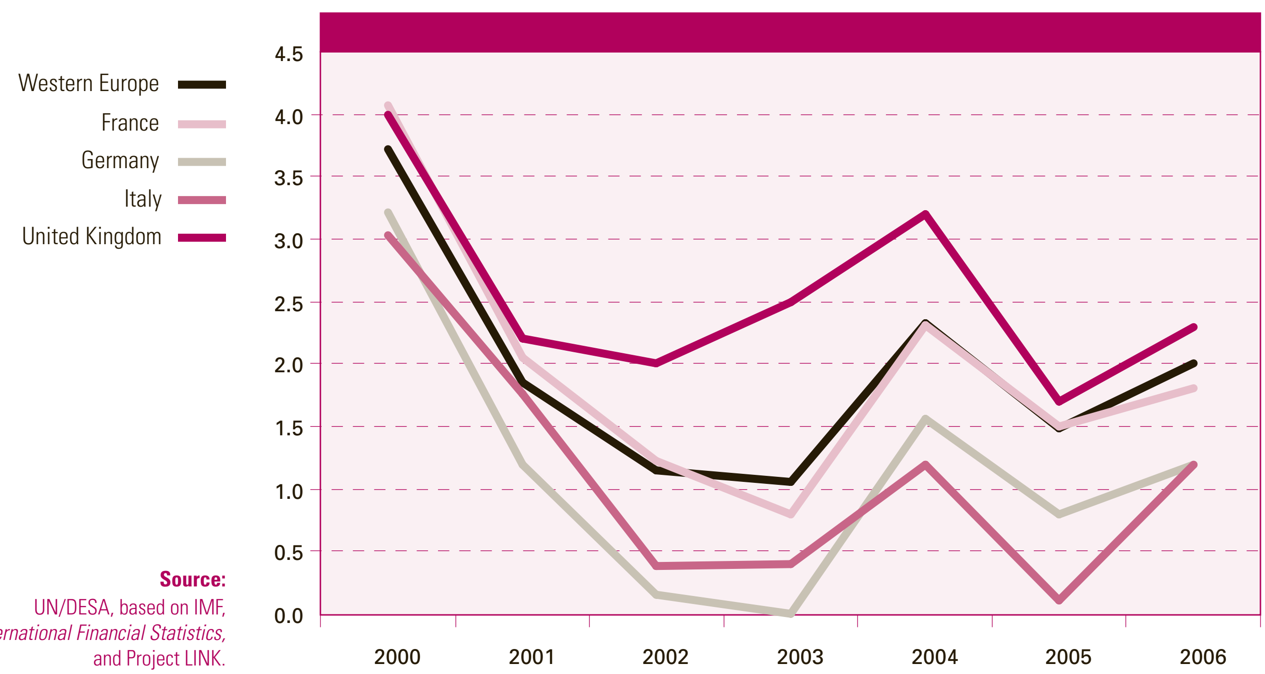
The recovery in Western Europe was weaker than expected in 2005. Economic growth was dampened by high oil prices, cautious spending behaviour by private households and moderate investment by the business sector. Exports were the most dynamic component of demand. For the area as a whole (20 countries), real GDP rose by 1.5 per cent compared with the preceding year. In the euro area, average annual economic growth was only 1.3 per cent in 2005, which is significantly below the estimated growth of potential output, itself quite moderate at 2 per cent (see table A.1). As a result, the gap between potential and actual output widened further. A direct consequence of the low growth of potential output is that new adverse shocks always risk pulling down the economy of the euro area to near stagnation.

Growth diverged in the euro area

Annual GDP growth rates of the member countries of the euro area continued to diverge significantly in 2005 (see figure IV.4) with below average growth in Germany (0.8 per cent) and Italy (0.1 per cent) and a somewhat stronger performance of 1.5 per cent in France. The variations in growth performance can be traced back to the differential strength of domestic demand and changes in net trade. In Germany, the moderate recovery continues to be driven by exports, on the back of strengthened international competitiveness. The weak growth performance reflected stagnating domestic demand, in particular private consumption, so that the increase in real net exports accounted for all of the average annual economic growth in 2005. In sharp contrast, in France and Italy, the deterioration in international competitiveness dampened exports with the consequence that changes in real net exports subtracted from economic growth. This reduction was more than offset, however, by the rise of domestic demand (which was only moderate in Italy). Outside the euro area, in the United Kingdom of Great Britain and Northern Ireland, annual economic growth slowed down to only 1.7 per cent in 2005, the lowest increase over the past ten years. The low increase re-

The modest recovery in Germany is driven by exports

Figure IV.4.
Annual rates of real GDP growth in Western Europe: selected countries, 2000-2006



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

flected a weakening growth of all major components of final domestic demand, notably a softening expansion of private consumption owing to the moderating house-price increases. Changes in net trade were broadly neutral to economic growth in 2005.

In the rest of Western Europe, robust domestic demand continued to yield well-above-average rates of growth in Spain and Ireland in 2005, although at a slower pace than that of the late 1990s. The oil sector is providing a boost to growth in Norway. Denmark and Sweden are also estimated to grow faster than the Western European average. At the other end of the spectrum, Portugal remains severely constrained by fiscal difficulties, while the Netherlands continues to suffer from weak private consumption, as well as from the very slow growth in the German economy, its main trading partner (see table A.1).

Against the backdrop of a continued favourable international environment and supportive financial conditions, economic growth in Western Europe is expected to accelerate slightly in 2006. For the whole area, real GDP is forecast to increase by 2.0 per cent compared with 1.5 per cent in 2005. In the euro area, the average annual growth rate of real GDP is forecast to be 1.9 per cent in 2006.

Business investment is expected to carry growth in 2006

The strengthening economic expansion over the course of 2006 will be driven largely by a pick up in fixed investment. Business spending on new equipment is projected to pick up following subdued growth in 2005, which was partly owing to sluggish domestic demand and ample spare capacity. Continuing corporate restructuring of balance sheets and the uncertainties associated with the rapid exchange-rate movements and surging oil prices also likely played a role. The restructuring is well advanced, however, and the uncertainties regarding exchange rates and oil prices have receded. Business investment will continue to be supported by strong corporate profitability, favourable financing conditions and robust growth of foreign demand, but the acceleration of investment activity will also continue to be limited by the ongoing moderate expansion of private consumption, the major domestic expenditure item. The slow growth of consumption reflects largely the situation in labour markets, where minor increases in employment have offset the wage restraint yielding modest gains in labour incomes and in real disposable household incomes. Household precautionary savings will, moreover, remain high in the face of lingering labour-market risks and uncertainties about the outcomes of the reforms of pension and health systems. Exports will therefore continue to be the major driver of economic activity in the euro area and Western Europe at large. Changes in real net exports are expected to make only a small positive contribution to growth in 2006.

Growth remains weak in Germany and Italy into 2006

In the euro area, weak growth in Germany and Italy (1.2 per cent in both cases), which account for some 45 per cent of euro area GDP, will continue to weigh on the overall economic performance of the area in 2006. In France, real GDP is forecast to increase at a somewhat stronger rate of 1.8 per cent. As in 2005, growth in Germany will rely to a large extent on favourable changes in net trade, whereas in France and Italy net exports will continue to make a negative contribution to growth. Outside the euro area, economic growth in the United Kingdom is forecast to accelerate to an average annual rate of 2.3 per cent in 2006, which is broadly in line with trend output. After a long period where growth was dominated by domestic demand, net trade is expected to make a small positive contribution to growth, a pointer that growth in the United Kingdom has become more balanced than in recent years.

The forecast for Germany is subject to particular uncertainty, because it remains to be seen what impact the agreed economic programme of the new grand coalition Government will have on business and consumer sentiment and economic activity. Only a limited growth stimulus can be expected from a €25 billion spending programme on innovation and investment that will be spread over a period of four years. Some stimulus to private consumption in 2006 can be expected from the likely bringing forward of expenditures in anticipation of the sharp rise in value added tax at the beginning of 2007, which, in turn, will tend to dampen private consumption during 2007.

Inflationary pressures are expected to remain subdued

In 2005, sharply rising energy prices drove headline inflation in the euro area above the ceiling of 2 per cent established by the European Central Bank (ECB). Core inflation declined, a pointer to the absence of demand pressures on non-energy product prices. Labour costs increased only slightly and there are no indications for second-round effects in price and wage setting to compensate for the rise in energy prices. Inflationary expectations, as gauged from 10-year index-linked bonds, have remained stable at close to 2 per cent. Forecasts are for headline inflation to fall back below 2 per cent during 2006. The outlook for inflation is similarly favourable in the United Kingdom, where inflation moved above the central target of the Government of 2 per cent in 2005 (see table A.4).

There are no significant improvements in the labour market

Despite the moderate rate of economic growth, employment edged up further in Western Europe in 2005. In the euro area, it rose by about 1 per cent, but this outcome was influenced by government measures in some countries that aimed at boosting part-time employment and self-employment. The average annual rate of unemployment in the euro area rose slightly to 8.9 per cent. Looking ahead, employment growth is expected to strengthen moderately in 2006 and the unemployment rate will decline to an annual average of 8.7 per cent.

ECB maintains an accommodative policy stance...

Against the backdrop of sluggish economic activity, monetary policy in the euro area had been on hold since June 2003, when the ECB lowered its main refinancing rate to 2 per cent. But concerns about the potential inflationary consequences of the ample liquidity supply and possible lagged effects of the sharp rise in energy prices on price and wage setting, led the ECB to raise interest rates by 25 basis points in early December 2005. The marked depreciation of the euro against the dollar since May 2005 could have also played a role. In the run-up to this decision, the ECB had stepped up considerably the use of moral suasion to signal its readiness to raise interest rates "at any time".

...and should remain accommodating

Despite this move, the monetary policy stance remains accommodating. The increase in official interest rates was anticipated by market participants, as reflected in a significant steepening of the money-market yield curve in October and November 2005. This partly offset the easing of overall monetary conditions on account of the weakening of the euro. In the medium term, the ECB will be looking to bring short-term rates to a neutral position, as the United States Federal Reserve has been doing since July 2004, and there is some probability of a further modest increase in interest rates in the course of 2006. But, given the fragility of domestic growth forces in the euro area, it is expected that this policy change will be very slow to materialize. The risk of accelerating inflation appears to be low, suggesting there is scope for continuing the wait-and-see policy until the recovery is more firmly established. Chapter I of this report argues why the ECB should maintain an accommodative stance in the interests of stimulating growth and in the context of adjusting global imbalances.

In the United Kingdom, the stronger than anticipated economic slowdown in the first half of 2005 led the Monetary Policy Committee of the Bank of England to reduce the bank lending rate in August 2005. With inflation forecast to remain close to the central target of 2 per cent and economic growth expected to return to trend in 2006, it can be assumed that interest rates will not be cut further in 2006.

The rapid expansion in money supply in the euro area over the past years has been associated with strong growth of private sector credit, especially mortgages for house purchases by private households. With the major exception of Germany, low interest rates have spurred housing investment and house prices have risen to elevated levels. The dynamism of the real estate market contrasts with the relative sluggishness of private consumption and suggests that the transmission of monetary policy stimuli to private consumption via housing market dynamics is weaker in the euro area than in other economies, such as the United Kingdom or the United States (see box IV.1).

The moderate strength of recovery limits the scope for fiscal consolidation

In the face of moderate growth forces, the aggregate fiscal policy stance in the euro area was broadly neutral in 2005. The overall actual government budget deficit edged up slightly to 2.9 per cent of GDP. Fiscal policy is expected to maintain a broadly neutral stance in 2006 also. In five economies (France, Germany, Greece, Italy and Portugal), overall budget deficits are projected to remain above the 3 per cent threshold established in the Stability and Growth Pact. Outside the euro area, in the United Kingdom, which is at a more advanced stage of the business cycle, the government is expected to continue the tightening of fiscal policy that started in 2005.

Risks to the outlook are tilted to the downside

Risks to the outlook in Western Europe are tilted mainly to the downside. They are related to the possibility of a further pronounced rise in oil prices, a disorderly unwinding of global imbalances and an associated renewed strong appreciation of the euro and a sharper increase in long-term interest rates in the case of a more pessimistic assessment of inflation prospects in financial markets. A potential upside factor could be a stronger than expected response of business investment to rising activity levels in the presence of continued favourable financing conditions and strengthened corporate balance sheets. A sharp fall in house prices from their current elevated levels remains another major downside risk in the United Kingdom and some other western European economies (France, Ireland and Spain).

The new EU members: dynamic but uneven growth

Economic activity in most of the new EU members from Central Europe and the Baltic region (EU-8) preserved its dynamism in 2005, but the pace of growth was uneven across countries. Aggregate GDP in the region grew by some 4 per cent in 2005, down from 5.1 per cent in 2004. The lower average growth reflects mainly the economic slowdown in Poland. Performance in the other economies was mixed, with growth in the Baltic States outpacing the rest of EU-8. The slowdown in some of the new members is mainly due to stagnating import demand by the EU-15 and to the fact that the one-off effect of the EU accession has been consumed.

Aggregate GDP growth is expected to accelerate to about 4.3 per cent in 2006 (see table A.1), driven by stronger exports, ongoing long-term investment projects, EU aid and a temporary boost to public consumption preceding upcoming elections.

Expansion is driven by external demand

In 2005, the expansion of economic activity in the EU-8 region was driven mainly by external demand, reversing the pattern of growth that had prevailed in the previous years. GDP growth was supported by a combination of strong exports and slowing imports, largely offsetting a declining growth contribution of domestic demand. Given the continuing expansion of FDI-dominated production capacity—for example, in the automotive industry in the Czech Republic and Slovakia—exports are set to remain buoyant in 2006 as well. Import growth has become less dynamic, reflecting weaker growth of consumer and investment expenditure; however, it may accelerate if domestic demand picks up.

Disinflation resumes in Central Europe

Following an upward adjustment in prices related to the EU accession, disinflation resumed in Central Europe. Apart from the sharp increase in energy costs in 2005, there was little change in domestic core inflation in the EU-8, as labour-cost pressures were low.

Box IV.1

The role of housing markets in the transmission of monetary policy

Weak economic performance and diverging views about the adequacy of the monetary policy stance of the European Central Bank (ECB) have propelled the debate over the strength of monetary policy transmission in the euro area. Recent empirical estimates[a] suggest that the size and timing of the response of overall output and prices to monetary shocks in the euro area and the United States are rather similar. Significant differences emerge, however, with respect to the composition of the output response: the role of household consumption in driving output changes has been found to be much greater in the United States than in the euro area. There is also evidence that the transmission of monetary policy in the United Kingdom of Great Britain and Northern Ireland is generally stronger than in the euro area, particularly with respect to the consumption channel.[b]

There are various explanations for the apparent weak impact of monetary policy shocks on private consumption in the euro area, but increasing attention has recently been paid to the role of housing markets. The monetary transmission through the housing market works as follows: monetary shocks determine changes in the market interest rate; the interest rate affects housing prices, which in turn influence consumption via a wealth effect. Assuming that monetary authorities are equally able to determine interest rates, differences across countries in the strength of those links will depend on: (i) the extent to which interest-rate changes pass through to housing prices; and (ii) the size and speed of the response of private consumption to the housing price fluctuations, in other words, the strength of the wealth effect.

Data for the economies of the OECD[c] indicate that there is a positive correlation between changes in house prices and household consumption expenditures practically everywhere. But this correlation is much lower in the large European continental economies (France, Germany and Italy) than in the United States, the United Kingdom and several of the smaller European Monetary Union (EMU) member States. This lower correlation is mirrored by marginal propensities to consume out of housing wealth being significantly lower in France, Germany and Italy than in the other high-income OECD economies. In a similar vein, there is evidence that the pass-through of interest rate changes to housing prices is greater (and more rapid) in the United Kingdom, the United States and other OECD economies than in France, Germany and Italy.

The root cause of those differences seems to lie in the differential degree of development of the mortgage markets and hence in the ability of homeowners to borrow against housing wealth. In the United Kingdom and the United States (but also in many smaller Western European economies) mortgage markets are offering a larger variety of products to serve a broad range of potential borrowers than in France, Germany and Italy. As a result mortgage debt ratios tend to be higher in the former economies. This higher stage of development also results in lower housing transaction costs. The upshot is that withdrawal of housing equity (that is, the amount of liquidity that the household sector extracts from the housing market) and the refinancing of mortgages are easier in the United Kingdom and the United States, thus making the effect of interest-rate changes on private consumption stronger.[d]

Industrial economies have been experiencing a rapid pace of financial innovation, in particular more flexible refinancing terms, on the one hand, and increased consumer access to unsecured credit, on the other hand. A key question is thus how these structural changes are affecting the monetary policy transmission via housing prices. On the one hand, easier access to unsecured credit should relax credit constraints and thereby reduce the responsiveness of consumption to changes in the value of collateral, including house values. On the other hand, more flexible refinancing terms for mortgages should increase the elasticity of consumption with regard to changes in housing prices. Which of the two effects prevails is then an empirical question.[e]

In any case, the development and structure of the housing and mortgage markets are important in determining the strength of monetary policy transmission. The liberalization of mortgage markets and the elimination of regulations and transaction costs that reduce the extent of capital gains will improve the scope for housing equity withdrawal and hence strengthen the housing channel of monetary policy transmission. To prevent the emergence of financial instability problems, however, liberalization should be accompanied by improved surveillance and regulatory procedures.

a See, for example, I. Angeloni and others, "The output consumption puzzle: a difference in the monetary transmission mechanism in the euro-area and the U.S.", *European Central Bank Working Paper* No. 268 (Frankfurt, September 2003).

b H.M. Treasury "EMU and the Monetary Transmission Mechanism" (2003), available from www.hm-treasury.gov.uk.

c P. Catte and others, "Housing markets, wealth and the business cycle", *OECD Economic Department Working Paper* No. 394 (Paris, OECD, June 2004).

d On structural aspects of housing markets in the EU see European Central Bank, "Structural factors in the EU housing market", March 2003, available from www.ecb.int/pub.

e K. Aoki and others, "Houses as Collateral: Has the Link between House Prices and Consumption in the U.K. changed?", The Federal Reserve Bank of New York, *Economic Policy Review*, No. 8, pp. 163-177 (2002).

The ongoing gains in labour productivity have also helped contain cost pressures, and hence rises in domestic prices. Slower nominal wage growth, increasing productivity and stronger retail competition, following the abolishment of the remaining trade restrictions with the EU, should sustain low inflation for the forecast period.

Unemployment rates decreased slightly in most countries

Labour market developments in the new EU member States were on average favourable in 2005, but the positive changes were marginal (see also box IV.2). Moderately positive rates of employment growth were accompanied by a slight decrease in the unemployment rate in most countries. This was the case in Poland, the largest economy in the region: for the first time in years, there was a notable decline in the rate of unemployment (see table A.7). In 2006, employment growth might slow down relative to 2005, reflecting the deceleration in the rate of output growth in 2005.

Macroeconomic policies have been supportive of growth

Macroeconomic policies have been broadly supportive of growth. In most EU-8 countries, better than expected fiscal outcomes and low inflationary pressures have allowed the central banks to preserve accommodating monetary conditions. With inflation down, interest rates were reduced in Central Europe in an attempt to stave off further currency appreciation. Fiscal deficits are likely to either decline or remain unchanged in 2006 throughout the EU-8. The upcoming elections in the Czech Republic, Hungary and Slovakia, however, may be associated with some spending hikes. Fiscal consolidation, related to the medium-term goal of the European Monetary Union (EMU) entry, will therefore be delayed in a number of member States; and fragile fiscal positions pose certain risks for Central Europe, where budgets are under pressure from social spending and the co-financing of EU-related projects.

The growth in trade throughout the region began to taper off in mid-2005 from the more robust pattern in the previous year. Nevertheless, export growth remained strong, as the countries increased their share in the EU market and continued to diversify their trade. Although the aggregate merchandise trade deficit of the EU-8 shrank compared with 2004, current accounts remain under the pressure of profit repatriation by foreign investors. The EU-8 continues to attract relatively large capital inflows, including significant levels of FDI, averaging 5 per cent of their aggregate GDP.

The principal downside risks to the outlook include a delayed recovery in the euro zone and significantly higher than expected energy prices. The most pressing policy challenges facing the larger new EU States in Central Europe are to achieve sustainable fiscal consolidation and to continue with the implementation of structural reforms for job-creating growth.

Economies in transition

After an exceptionally good economic performance in 2004, growth in the economies in transition moderated in 2005 but still preserved its dynamism and continued to outpace that of the world economy, albeit at a lower rate than in the previous two years (see table I.1). This outcome reflects strong growth in both subregions. In the CIS region, growth was supported by higher commodity prices, in particular for oil and gas, metals and agricultural products, and by domestic demand. In South-eastern Europe, growth was helped by the prospects of EU accession for three countries in this region (Bulgaria, Croatia and Romania) (see figure IV.5). With a strong pace estimated at 6.0 per cent on average in 2005, growth is set to stay robust, stabilizing at about 5.9 per cent in 2006.

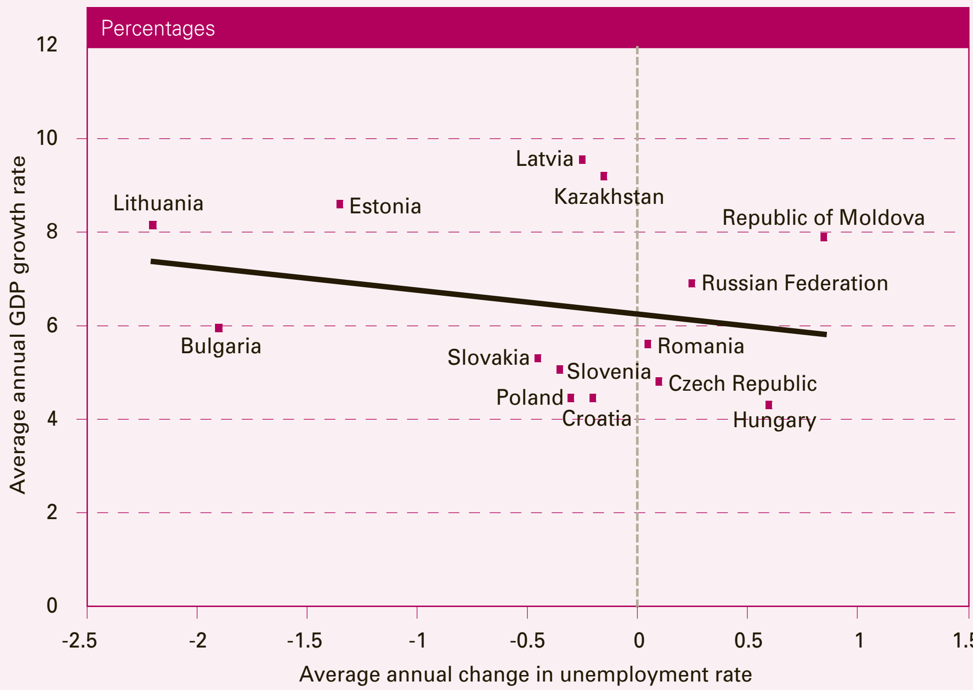
Notwithstanding the heterogeneity among economies in transition, growth has become less divergent in the past few years after the initial rebound following the transitional

Box IV.2

Economic growth and labour market outcomes in Eastern Europe and the CIS

A strong pace of economic activity is often regarded as the best way to stimulate the growth of employment. Indeed, the figure below, based on recent data for a group of Eastern European and CIS economies, indicates that the changes in their unemployment rates correlate negatively with the corresponding rates of GDP growth. This correlation does not appear to be particularly strong, however, suggesting that cyclical expansions *per se* may not be sufficient for a sustained improvement in labour market outcomes in these economies. Their recent experience also suggests that a stronger focus on labour market policies and reforms may be required to strengthen labour market performance.

Economic growth and changes in unemployment in selected Eastern European and CIS economies, 2003-2005



Source: UN/ECE Statistical database.

Several factors seem to have weakened the association between aggregate output growth and labour market outcomes in Eastern Europe and the CIS. First of all, employment data indicate that employment fluctuations have been only mildly pro-cyclical or even acyclical in some economies, and generally less volatile and more persistent than output fluctuations. This might suggest widespread labour hoarding, implying that employment responses to output cycles are smooth and occur with a longer lag. Second, economic expansion in many countries has taken place in sectors that are not labour-intensive, particularly in the commodity-exporting CIS economies. Expansions driven by extractive industries that use relatively low labour inputs cannot be expected to generate much growth in total employment and/or reduction in unemployment. Third, labour mobility across sectors of production and regions is still relatively low in most of these economies, implying a low degree of labour redeployment from declining to expanding sectors or

Box IV.2 (cont'd)

regions. This, in turn, tends to push up unemployment, especially to the extent that the economic restructuring and transformation involves "creative destruction" and hence the clustering of job opportunities in a few sectors and regions.

Last but not least, the data seem to suggest that labour markets have been relatively more responsive to GDP growth in countries that have made more progress in enterprise and labour market reforms: countries with more responsive labour markets, such as Bulgaria, Estonia, Lithuania and Slovakia, are situated on the left side of the chart. Thus, active restructuring of inefficient firms, in particular, firms inherited from the era of central planning, reduces the incidence of labour hoarding which, in turn, facilitates the transmission of labour demand associated with output growth into net job creation. The existing labour-market rigidities, (such as entry and re-entry barriers and skill mismatches) in these emerging market economies contribute to raising the average duration of unemployment and create the potential for hysteresis effects. Removing or reducing the rigidities contributes to greater responsiveness of employment to output growth.

All this evidence tends to suggest that a more proactive government stance on labour market policies could have a beneficial effect on the labour market outcomes in Eastern Europe and the CIS. Thus, devoting more resources to training and retraining programmes, job search and job placement assistance, and possibly subsidized employment, could help reduce the existing labour market rigidities. Measures to improve transportation infrastructures and develop housing markets, and international cooperation on legislation to liberalize cross-border labour movements, could facilitate labour mobility. Finally, public policies supporting the development of services that strengthen economy-wide productivity growth and the competitiveness of the economy at large (such as telecommunications and financial services) will at the same time have a positive labour market effect, especially in those countries where there is a high concentration of economic activity in extractive industries. Such policies facilitate the diversification of the production structure, help domestic producers endure the real appreciation of the exchange rate and hence create the basis for a sustained increase in labour demand.

slump. This pattern, however, is changing: differences between the growth rates within the economies in transition, as well as within the CIS region, have started to widen in 2005 (see table A.2). In contrast, growth among the countries of South-eastern Europe is converging—a pattern which is likely to continue, underpinned by foreign direct investment (FDI) and export expansion in the short run.

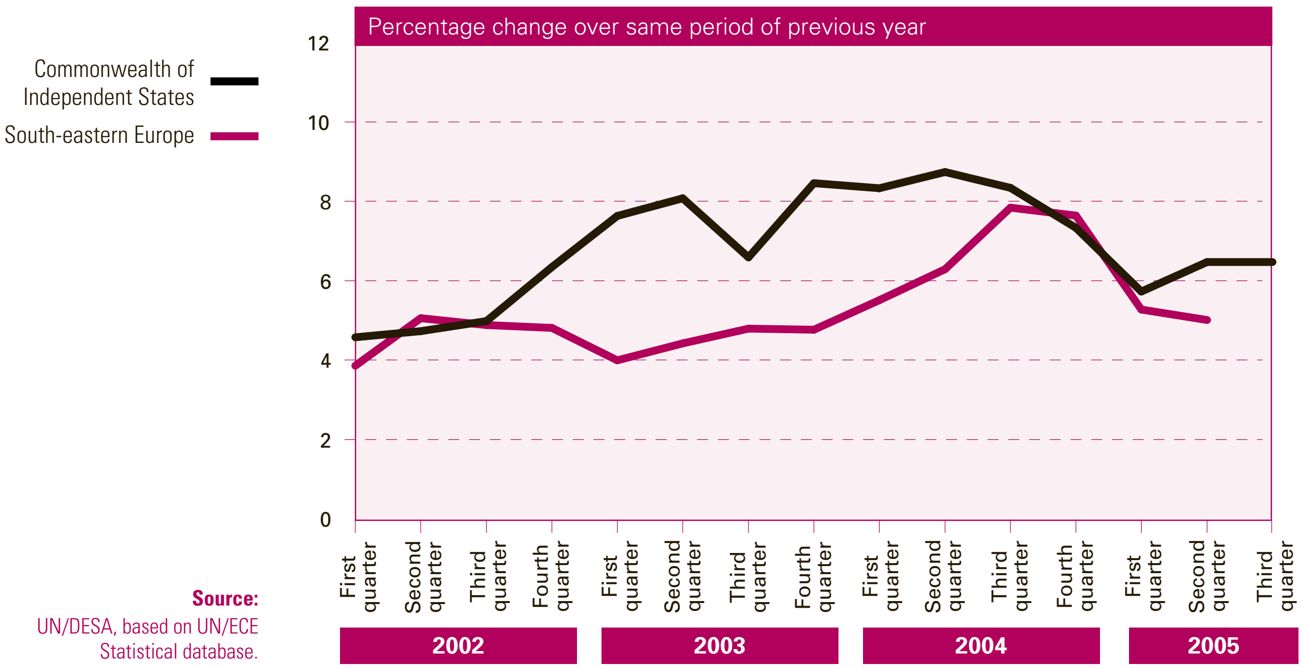
South-eastern Europe: dynamic growth continues but at a slower pace

Economic growth remained robust in South-eastern Europe in 2005 with aggregate GDP increasing by some 5 per cent. A slowdown from 6.5 per cent registered a year earlier reflected a base-year effect, as well as some constraints imposed on growth by strong currencies. In addition, the agricultural sector was affected by recent floods. Strong growth in this subgroup is expected to continue in 2006, albeit at a slightly lower rate of 4.4 per cent (see table A.2).

EU accession candidates benefit from a solid flow of inward FDI

The EU accession candidates (Bulgaria, Croatia and Romania) continued to benefit from rising investor and consumer confidence, reflected in a solid inflow of FDI, continued restructuring and expansion of export-oriented production capacity and improved financial intermediation. Economic consolidation gained momentum in the remaining part of South-eastern Europe, combining successful post-conflict reconstruction and further macroeconomic stabilization.

Figure IV.5.
Quarterly changes in real GDP in South-eastern Europe and the Commonwealth of Independent States, first quarter 2002-third quarter 2005



Source: UN/DESA, based on UN/ECE Statistical database.

Aggregate output in this subregion is likely to continue to grow at a relatively fast pace in 2006, although implementation of some corrective policies to prevent overheating may slow growth, mostly affecting private consumption. Investment is expected to remain strong, as privatization programmes continue to attract FDI. There is also an important number of ongoing public investment projects.

Growth is driven by robust domestic demand

In 2005, growth in South-eastern Europe continued to be driven mostly by robust domestic demand, fuelled by a boom in private credit. Total exports from the subregion increased by about one fifth in dollar value, although some labour-intensive industries faced increasing competition from Asia. A number of bilateral agreements facilitated intraregional trade. Import growth was even stronger, reflecting booming domestic credit and imports of machinery to upgrade the capital stock. As a result, trade deficits continued to widen.

Disinflation continues

In most of the South-eastern European economies, disinflation continued in 2005, reflecting a further tightening of the macroeconomic stances and low levels of domestic cost pressures (see table A.5). Growing competition in local markets has prevented the passing of demand pressures onto domestic prices. Those effects are likely to carry on in 2006.

Labour market performance within the region is divergent

The labour markets in the EU accession candidate countries benefited in 2005 from the expansion of economic activity in 2004 and some progress in labour market reforms, which is likely to continue in 2006. The rest of South-eastern Europe was characterized by very high unemployment and persistently feeble employment growth. Ongoing enterprise restructuring and the structural nature of unemployment suggest no major improvement in the labour-market situation in those countries in 2006 (see table A.8).

Current-account imbalances widened ...

Large current-account deficits widened further in several economies in the region in 2005, mostly reflecting the dynamics of the merchandise trade deficits, explained in part by strong currencies and rising energy prices. Rising domestic demand, outpacing output, and, in some cases, inflows of speculative capital and/or increased private foreign borrowing further contributed to the widening of the external deficits. Nevertheless, FDI inflows continued to increase in the region, especially for the EU accession countries.

... with complications for policy

The policy response to those deficits is complicated, since higher interest rates may induce even larger inflows of speculative capital. The authorities resorted in 2005 to various types of credit restrictions and tighter bank regulations in an attempt to cool down the credit boom and foreign borrowing. Further liberalization of the capital account should be expected, however, over the longer-run.

The main risks to the outlook are related to the excessive reliance on domestic demand as a source of growth. Policies should target expanding export-oriented sectors in order to reduce the external deficit. Attempts to curb these deficits via fiscal restraint may have negative implications for economic activity.

The CIS: strong growth prevails despite some slowdown

The pace of economic expansion in the CIS region slowed in 2005, after two years of exceptionally strong growth: aggregate GDP increased by just over 6 per cent in 2005, down from 7.6 per cent in 2003 and 7.9 per cent in 2004 (see table A.2). This outcome reflected a deceleration of growth in the two largest economies, the Russian Federation and Ukraine, where the deceleration was particularly pronounced. The smaller economies fared better, with the notable exception of Kyrgyzstan. Regional GDP growth is forecast to stay robust in 2006, maintaining the same pace as in the previous year.

Export performance is mixed, while strong domestic demand drives growth

External factors were generally supportive of growth in 2005, with oil and gas prices reaching new highs, but there were adverse developments as well. Worsened conditions for exporters in the global markets for metals, in particular steel and steel products, and sharply lower cotton prices exerted a negative influence on the economies specializing in those commodities. Domestic demand remained the main driver of economic expansion in the CIS countries. Robust consumer demand played a key role, while fixed investment was less dynamic in the larger economies of the region. Imports were strong, fostered by robust domestic consumption and the ongoing appreciation of real exchange rates.

Despite favourable prices, export growth decelerated owing to a temporary slowdown in the growth of oil production in the Russian Federation, the result of supply constraints. The deceleration coincided with a sharp deterioration in the export performance of Ukraine. Those two factors explain why external demand negatively affected GDP growth for the region at large. In the outlook, domestic demand is anticipated to continue to drive growth in 2006, as private consumption grows rapidly on account of expectations of continued growth of real incomes and wages, and investment picks up in many CIS countries, boosted by government support to new investment projects.

Strong growth continues in the Russian Federation

Despite a notable deceleration in the Russian Federation in the first quarter of 2005, growth picked up at a rate of 6 per cent throughout the rest of the year. A slightly lower rate is forecast for 2006. Robust domestic demand was the main driving force in 2005 and is expected to remain so in the forecast period. In particular, domestic consumption expanded further, owing to continued strong growth in real incomes and wages, underpinned by increasing social expenditures and growing employment, and benefiting from increased bank lending to households. In addition, fixed investment rebounded after a relative moderation in the first quarter of 2005 and is expected to strengthen further throughout 2006, stimulated by the newly established Investment Fund. In the near future, investment levels and output growth are expected to be sustained at high levels in Azerbaijan and Kazakhstan, thanks to the further development of the hydrocarbons sector.

Despite strong growth, improvements in labour markets remain elusive

As with other emerging market economies in Eastern Europe, labour demand responded with a lag to aggregate output dynamics in the CIS countries, suggesting a relatively high degree of labour hoarding (see box IV.2). Therefore, there was only a limited amelioration of the employment situation, even in countries that experienced high rates of economic growth. In the oil-exporting countries, employment increased only marginally compared with the rate of output growth and unemployment rates did not decrease significantly. The other CIS countries achieved even lower rates of employment expansion. The prospects for a visible improvement of the situation in the labour market hinge upon the growth performance in labour-intensive sectors, such as services, and the facilitation of intraregional labour mobility through the establishment of an adequate legal framework and social policies.

Inflationary pressures remain a concern

Inflation accelerated further in most CIS countries during 2005. The main factors underlying this trend were the generally expansionary stance of fiscal policies, fast rising consumer demand and rising energy costs. In many CIS economies, the official year-end inflation targets for 2005 were revised upward, particularly in the Russian Federation and Ukraine. Industrial producer prices continued to surge in 2005, albeit at a slower rate than in the previous year. Given the inherent inertia, a further rise in inflation cannot be excluded in some of the countries in the region in the short run. Limiting the increases in tariffs on gas, electricity, rail transport and houses, as well as lowering barriers for food imports, however, is likely to keep inflationary pressures down in 2006 in some of the largest economies, including the Russian Federation. Curtailing further inflationary pressures would require a more comprehensive policy approach and a major policy effort towards fiscal consolidation.

Macroeconomic policies face conflicting policy goals

Macroeconomic policies were generally supportive of growth in 2005, continuing a pro-cyclical fiscal policy stance and expansionary monetary policy by the governments of the primary commodity-exporting countries. High oil prices have exacerbated the old dilemma faced by monetary authorities in the oil-exporting CIS countries, as they attempt to target two monetary goals simultaneously—inflation (seeking price stability) and the exchange rate (preventing excessive real appreciation)—using only one instrument, namely, intervention in the foreign-exchange market. Given the persistently large current-account surplus and some fiscal loosening, the management of excessive liquidity is even more complicated in the Russian Federation. A higher degree of exchange-rate flexibility may be required to prevent inflation from becoming entrenched. The rapid credit expansion and growing foreign liabilities in the private sector are further risks that need to be closely monitored.

Most energy and commodity exporters achieved significant merchandise and current-account surpluses and sizable increases in their foreign exchange reserves. Those trends should persist as oil prices remain high in 2006. The remaining CIS countries are likely to continue to rely on external finance in order to cover moderately sized current-account deficits.

There has been effective management of oil revenues through stabilization funds

The management of the booming oil revenues has been reasonably prudent and the stabilization funds functioned efficiently. In the Russian Federation, the expansionary effect of high oil prices was significantly contained through changes in the tax system during 2005. A further relaxation of the fiscal stance, however, could increase the vulnerability of public finances to external shocks. Further fiscal expansion is expected in a number of economies, including the Russian Federation, as governments seek to stimulate economic activity further. Given the generally low domestic supply responsiveness, however, a significant part of the stimulus is likely to leak into higher imports.

Risks include rising inflation and volatile commodity prices

Looking forward, the major risks for the CIS economies are rising inflationary pressures, volatility of commodity prices, particularly for oil, gas and steel, as well as continuing real exchange-rate appreciation and rising production costs. Those potential risks should be addressed through consistent monetary and fiscal policies. In addition, these countries face the challenge of creating appropriate conditions for increased business investment in order to address the erosion of competitiveness and to broaden the basis of economic expansion beyond the current narrow specialization in a handful of commodities.

Developing economies

The overall benign international economic environment supported economic growth in developing countries, which reached 5.7 per cent in 2005 after having recorded 6.6 per cent in 2004. The slowdown—albeit moderate—was present in most regions and related to the deceleration in the global economy because of the maturing of its cyclical recovery (see chapter I). Owing to increased globalization and economic integration, external demand conditions are becoming progressively relevant for growth in developing countries, while domestic demand remains constrained or subdued in many economies.

Africa was the exception to this general deceleration in developing countries, as the region was able to maintain its economic performance thanks to favourable conditions in agriculture and higher prices and volumes for the main exports of the region. Equally important, the group of least developed countries (LDCs) was also able to sustain fast rates of growth, which were above the average for developing countries for the fifth consecutive year (see table A.3). The overall outcome was, however, mostly owing to very fast growth in the new net fuel exporters in this group and in countries recovering from conflict. Given the particular circumstances underlying this growth performance, sustained high growth is not guaranteed.

The outlook for oil-importing developing countries remains positive, despite the fact that the expected persistence of high oil prices will negatively affect their terms of trade and put stronger upward pressure on inflation rates. In 2006, developing countries are expected to keep up the current rate of growth and expand output by 5.6 per cent.

Africa: GDP growth continues to be robust

Africa's real GDP is estimated to have grown by 5.1 per cent in 2005, roughly the same rate that was achieved in 2004. Steady growth in the latter half of the 1990s and the relatively high rates of growth recorded over the last five years confirm the continued recovery of African economies (see table A.3). Growth in 2005 was underpinned by the same factors that drove growth in 2004. The agricultural sector had a good overall performance, which benefited Africa in the aggregate, although several countries suffered from drought and other setbacks, such as the locust invasion in West Africa in 2004 that affected crop yields in 2005. Continued progress in macroeconomic and structural reforms, including the unification of foreign exchange markets and better public expenditure and financial management, and a high degree of macroeconomic stability in a large number of countries encouraged economic activity and improved economic welfare. Parliamentary and presidential elections in Burundi and Liberia, and the signing of a peace agreement in the Sudan, improved the growth prospects of those countries and underscored recent gains made throughout Africa in strengthening civil and political governance.

The near-term outlook is also favourable...

The region also benefited from a supportive international economic environment. Higher oil prices and buoyant world market prices of some of Africa's main non-fuel, primary export commodities contributed to growth in export earnings and GDP. Increased FDI and official development assistance (ODA) inflows and a reduction in the stock of debt were also factors supportive of growth. Growth is expected to be sustained at 5.5 per cent in 2006. The favourable factors underlying the current growth performance are unlikely to change substantially in the outlook, despite some risks discussed below.

GDP expanded robustly in North African countries in 2005, except in Morocco, owing to the poor performance of its agricultural sector and a contraction in textile and clothing exports. Increased oil and gas exports (in both value and volume) underlined Algeria's GDP growth. Windfall earnings from higher oil prices led to large current-account and fiscal surpluses (estimated at 22.2 and 11.7 per cent of GDP, respectively) and allowed for a reduction in external indebtedness. Algeria continued with its reform efforts, aimed at attracting FDI in telecommunications, power and water industries and generating faster employment creation in other sectors of the economy by diversifying away from the oil and gas sector. Egypt's GDP growth in 2005 was largely explained by the rise in oil prices, strong performance in the services sector and an increase in domestic demand following the reduction of customs duties and income tax rates.

Economic growth in sub-Saharan Africa (excluding Nigeria and South Africa) averaged 5 per cent in 2004 and 2005 and is expected to remain at roughly the same rate, possibly with a slight acceleration, in 2006. Most countries in this subregion will achieve GDP growth rates in the range of 3 to 7 per cent. Oil-exporting countries such as Angola and Chad grew at double-digit rates in 2005 (and the Sudan at a slightly lower rate of 7.0 per cent) as a result of higher export volumes and stronger domestic spending. Mauritania will also join the group of fast-growing economies in the region when new oil fields come on stream in 2006.

Nigeria's GDP growth decelerated in 2005 (see table A.3), but increased oil and gas export revenues enabled the country to run a current-account surplus. Part of the increase in revenues is being used to upgrade infrastructure in order to lay a solid foundation for future growth. Additionally, agriculture has been the focus of recent policy measures to promote economic diversification and the revitalization of sectors other than the hydrocarbons sector.

South Africa's GDP grew by 5.0 per cent in 2005, driven mainly by growth in real domestic expenditure owing to rising real incomes, low interest rates and moderate inflation. Strong global demand boosted exports, although the current account remained in deficit because of faster import growth. The high unemployment rate (officially reported at 26.5 per cent) remains a major challenge and was further complicated in 2005 by a large influx of illegal and unskilled workers from neighbouring countries and a large outflow of skilled workers constituting a "brain drain" to the rest of the world.

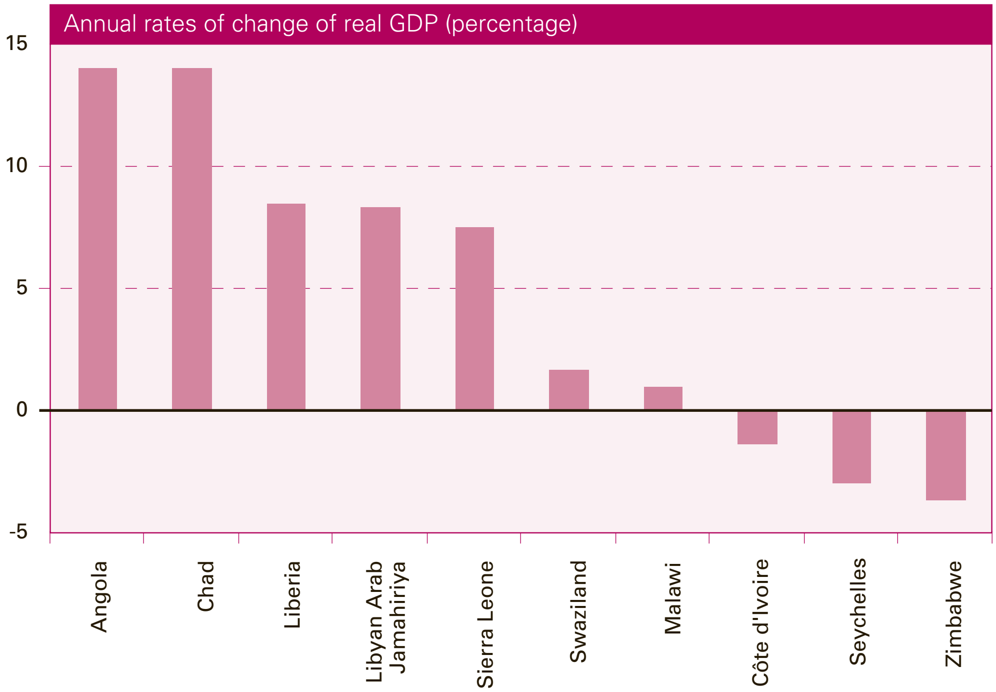
...but conflicts and weak domestic demand continue to constrain growth in a few countries...

Côte d'Ivoire, Seychelles and Zimbabwe were the only African countries where GDP contracted in 2005 (see figure IV.6). Economic decline in Côte d'Ivoire and Zimbabwe was associated with political instability and civil unrest, while the economy of the Seychelles contracted as the result of weak domestic demand and decreased tourism revenues.

...and the end of the ATC took a heavy toll on textile exports and formal employment in some countries

Despite the overall benign external environment, there was a decline in manufacturing output in countries heavily dependent on textiles and clothing exports, owing to the end of the Agreement on Textiles and Clothing (ATC) in January 2005 and increased competition from low-cost producers in China and other Asian countries (see chapter II). For example, from January to September 2005, the value of sub-Saharan African textile and ap-

Figure IV.6.
Real GDP growth in Africa: the five fastest and five slowest performers in 2005



Source: UN/DESA.

parel exports to the United States dropped by 11 per cent compared with the same period in 2004.[4] Thousands of jobs were reportedly lost in Lesotho, Madagascar, Malawi, Mauritius, Swaziland and South Africa as a result of the contraction of the textile sector, with little opportunity for the displaced workers to be absorbed in other sectors of the formal economy.

Fiscal and monetary policies were generally cautious in Africa

Fiscal policies remained cautious in Africa, as reflected in the generally low fiscal deficits (and surpluses in a few countries). South Africa, for instance, maintained an ongoing policy of moderate fiscal expansion that focused on programmes aimed at improving government services and infrastructure for the poor and increasing employment opportunities through public works projects. Public expenditures also increased, albeit less than revenues, in countries that benefited from higher oil export earnings, with Algeria and Nigeria as cases in point.

Monetary policies remained relatively tight in most countries. Some oil-producing countries used monetary policy tools, including sterilization and credit controls, to avoid excess money-supply growth and to dampen inflationary pressures.

Africa's average inflation remained at low double-digit rates in 2005 (see table A.6). Increased inflationary pressures, however, were recorded in countries such as Ghana, Guinea, Malawi, Zambia and Zimbabwe that faced currency depreciation and/or the immediate pass-through of higher imported oil and food prices to consumers.

There exists a stronger commitment to better political and economic governance

The commitment of Africa to economic and political reforms was further underscored as 23 African countries have signed up for the African Peer Review Mechanism (APRM) as of November 2005. The main objective of the APRM exercise is to encourage

4 Exports include Generalized System of Preferences (GSP) and African Growth and Opportunity Act (AGOA) provisions. See United States International Trade Commission, Sub-Saharan Africa: "U.S. exports, imports, GSP imports, AGOA imports, by major commodity sectors, annual and year to date" (January-September 2005), available from http://reportweb.usitc.gov/africa/by_country_agoa.jsp.

integrity and transparency in political and economic governance of individual countries and thereby secure the confidence of external development partners and foreign investors in the sustainability of African reform efforts. It is hoped, in particular, that the APRM process will eventually confirm Africa as a desirable destination for FDI. In 2005, the first stage of APRM reviews was conducted for two countries (Ghana and Rwanda).

The external debt situation of Africa improved in 2005—and is expected to improve further in 2006—owing to higher export earnings, continued debt relief and more active debt management. The G-8 proposal to write off multilateral debt owed by the heavily indebted poor countries (HIPCs), emanating from the July 2005 Gleneagles Summit, is expected to facilitate long-term debt sustainability in many African countries if commitments are met (see chapter III). The decision of Algeria, Nigeria and other African oil-producing countries to use their windfall oil earnings to repay some of their debt ahead of schedule also enhanced their debt sustainability.

Many challenges remain ahead

Despite the relatively positive aggregate economic performance, African economies are faced with fundamental challenges that require attention if better and faster growth is to be achieved in the future. The aggregate rate of growth has remained below 7 per cent, which the Economic Commission for Africa (ECA) and the World Bank estimate as the minimum average rate at which sub-Saharan African countries need to grow in order to achieve the first Millennium Development Goal of halving poverty on the continent by 2015.[5] Thus far, increased growth seems to have had a limited effect on poverty reduction. In fact, growth has largely concentrated in relatively capital-intensive sectors with little spillover effects on employment creation and on the rest of the economy. Moreover, its benefits have been unequally shared owing to the pattern of income distribution of the region (Africa is the region with the second highest inequality in the world after Latin America). In addition, pandemics such as HIV/AIDS and malaria continue to exert tremendous pressure on Africa's productive resources, which might impose additional constraints on the long-term growth prospects of some of the more seriously affected countries.

Adverse external shocks, conflicts and poor weather conditions are the major risks to continued strong growth

There are a number of downside risks to economic growth in 2006. First, prolonged high oil prices over the next one to two years will have a stronger inflationary impact on most African economies. Despite the higher oil prices, many countries registered terms-of-trade gains owing to increased commodity prices (particularly minerals and base metals) and lower prices of imported manufactures, thus offsetting inflationary pressures until recently. Price gains of some commodities, however, weakened in 2005 (see chapter II). Many net fuel importers will therefore be hit if oil prices remain high. This additional burden could be severe since, in some countries, oil imports account for up to 50 per cent of their total import bill. Second, a possible disorderly adjustment of the current-account deficit of the United States (see chapter I) could seriously undermine exports and growth in many African countries, as this might entail a significant depreciation of the dollar and contraction of United States imports. Third, African countries will face increased competition in global markets for textiles and apparel from lower-cost producers as the impact of the elimination of the ATC continues to unfold. Fourth, continued tensions in Côte d'Ivoire, the Ethiopian-Eritrean border, the Darfur region of the Sudan and Zimbabwe are a source of great concern and could jeopardize progress made in reducing conflicts and improving civil and political governance in a large number of African countries in recent years. Fifth, the eventual reduction and/or removal of market-distorting subsidies on agricultural products—within the framework of

5 United Nations Economic Commission for Africa, *Economic Report on Africa 1999, The Challenges of Poverty Reduction and Sustainability* (May 1999), available from http://www.uneca.org/eca_resources/Publications/ESPD/economic_report_1999.htm#ii, and World Bank, *Can Africa Claim the 21st Century?* (Washington, D.C., World Bank, 2000).

WTO negotiations—may benefit some African agricultural exporting countries in the long-run, provided they are able to compete in global markets. Many net food importers, however, are likely to suffer from higher food prices in the short term. Finally, African economies remain vulnerable to weather shocks, and the projected increased growth rate would have to be revised downwards if bad weather were to seriously affect the agricultural sector.

East Asia: solid growth amidst increased downside risks

Despite a slowdown in 2005, regional economic growth is expected to remain well supported

East Asia's GDP growth is estimated to have reached 6.7 per cent in 2005, supported largely by China, whose rate of GDP growth surpassed 9 per cent in the year. GDP growth decelerated in the majority of the economies in the region. Besides higher oil prices, the region has been confronted with several non-economic shocks, with the recent outbreak of avian influenza remaining a source of concern. Average regional growth is anticipated to continue at the current rate in 2006 (see table A.3), albeit less divergent across the region owing to a variety of factors, including the expectation of a continued stable performance of the economy of the United States, the largest destination of the region's exports, expectations of a continued turnaround in the economic performance of Japan and the bottoming out of the global electronics cycle.

Economic policies will slow the economic expansion of China

As in 2005, China is expected to drive economic growth in East Asia as well as that of the global economy in 2006. The GDP growth of China, however, is anticipated to slow down but still remain robust at above 8 per cent. This deceleration is expected to take place following the implementation of measures by policy makers to cool off investment in key sectors with excess capacity (for example, steel and cement manufacturing, consumer electronics and real estate). Imports of raw materials and manufactured components for domestic consumption are anticipated to decelerate. Conversely, imports of services will rise as China seeks to improve its underdeveloped service sector. Exports will continue to support growth in view of the only limited currency appreciation brought about by the change in the exchange-rate regime (see chapter I), the competitive level in labour costs of China as well as increasing labour productivity. Economic restructuring through disinvestment of public enterprises—particularly in the banking sector—is likely to intensify in 2006, thus potentially bringing efficiency gains to the entire economy.

China's financial sector remains in need of further reforms

The situation in China's banking sector has improved, based on a fall in the amount of non-performing loans, which was largely owing to write-offs and the recapitalization of banks. It is less clear, however, whether processes of risk assessment and risk management have been strengthened enough to avoid a renewed increase in non-performing loans in the future. The increased presence of foreign banks in the Chinese banking sector could have a positive effect in this regard, as it is likely to lead to the establishment of improved management and governance practices. Conversely, stock markets remain surrounded by uncertainties regarding future government action with respect to its shares in firms listed on the stock exchange. In addition, bond markets require further reform and deregulation so that economic fundamentals and market perceptions could have a greater role in determining prices and yields.

The performance of the economy of China will have mixed effects on other economies in the region

Although modest, the slowdown of the Chinese economy will be felt by the economies of the region that trade heavily with China. Growth in Hong Kong Special Administrative Region (SAR) of China is expected to decelerate in 2006, despite the potential boost to the economy stemming from the likely influx of tourists from the mainland and elsewhere to the Disneyland that opened for visitors in September 2005. In the case of the Republic of Korea, faster growth in 2006 will be based on sustained growth in private consumption as well as positive impetus from increased trade with a recovering Japanese economy.

An upturn in the global electronics cycle and tourism create upside potential for economic growth in the region

The expected upturn in the global electronics cycle will contribute to faster growth in the region. Accordingly, Taiwan Province of China and Malaysia are both likely to see a moderate acceleration in their rate of GDP growth in 2006. Similarly, exports of high-tech products will continue to support the economic expansion of Singapore.

As in the case of Hong Kong SAR, tourism will be an important driver of economic growth in Thailand, especially after the slump in tourist arrivals in 2005 in the aftermath of the tsunami disaster. Increased tourist arrivals combined with further fiscal stimulus coming from enhanced public expenditures on large infrastructure projects will lead to faster growth in the country in 2006. As in other countries relatively dependent on the tourist sector, however, a severe outbreak of avian flu poses a significant downside risk to this outlook (see box IV.3).

External imbalances are accompanied by an investment shortfall

The export orientation of the region has contributed to the generation of current-account surpluses since it recovered from the 1997 crisis. Lately, however, current-account surpluses have declined largely owing to higher oil prices, especially in such economies as the Republic of Korea and Taiwan Province of China, which are fully dependent on oil imports to cover demand. Against the backdrop of persistent trade imbalances, evidence of "investment anaemia" is well pronounced in many East Asian economies (see chapter I). Several governments in the region are reluctant to stimulate domestic investment because it was precisely excessive investment, particularly in real estate, that triggered the financial crisis in the previous decade. Thus, any adjustment is likely to take place only slowly.

Increasing inflationary pressure ...

Despite higher oil prices, inflation rose marginally in the region (see table A.6). Inflationary pressures were muted—until the second quarter of 2005—owing to the use of subsidies by several governments, which kept a lid on domestic fuel prices. Yet, oil subsidies eventually became unsustainable as they implied a heavy fiscal burden and had to be phased out. Accordingly, the region has experienced renewed inflationary pressures. In the outlook, the extent of the impact of higher oil prices on inflation, however, will depend not only on the monetary policy stance (see below) but also on exchange-rate movements, as oil prices are quoted in United States dollars. Despite current trends, the dollar is expected to continue to fall against East Asian currencies in 2006. Thus, the appreciation of Asian currencies is likely to alleviate potential inflationary pressures coming from higher oil prices.

... will imply a further tightening bias in monetary policy

Low interest rates prevail in most countries of the region, but monetary policy has been tightening in response to inflationary pressures as discussed above. This stance will continue in 2006, especially in Malaysia and Taiwan Province of China, where real interest rates are negative. Notable exceptions to this trend are likely to be Indonesia and the Philippines, where interest rates are already higher than the regional average and have dampened private consumption and its contribution to GDP growth.

Lower oil subsidies will support fiscal consolidation

Fiscal policy in the region is expected to be generally cautious, with the leading economies (except China) continuing to use a moderate amount of fiscal stimulus to promote growth. An important determinant of fiscal positions, however, will be the policy responses of individual countries to higher oil prices. In the case of Thailand, for instance, the elimination of oil subsidies in July 2005 is likely to narrow the budget deficit sufficiently to allow the release of funds for large infrastructure projects. The phased elimination of oil subsidies in Indonesia, Malaysia and Viet Nam is also likely to reduce the fiscal deficit, although by a smaller margin. In the Philippines, on the other hand, the primary policy response to higher oil prices has been to use administrative methods such as curtailing working hours to cut fuel consumption. Given that in the past such measures have largely failed to reduce fuel consumption, the Philippines is likely to be saddled with a higher fiscal deficit in 2006.

Box IV.3

Avian influenza: worries in Asia[a]

Avian influenza was first identified over 100 years ago: since then, the disease has been reported at irregular intervals in all regions of the world. In addition to the current outbreak in Asia, recent epidemics have occurred in Hong Kong in 1997-1998 and 2003, in the Netherlands in 2003, and in the Republic of Korea in 2003.

Once domestic birds are infected, avian influenza outbreaks can be difficult to control and may cause major economic damage to poultry farmers in affected countries, since mortality rates are high and infected fowl generally must be destroyed—the technical term is "culled"—in order to prevent the spread of the disease.

The outbreak is caused by the highly pathogenic H5N1 strain of the virus. Recently, outbreaks of avian influenza in poultry, associated with the H5N1 virus have been reported from Croatia, Kazakhstan, Romania, the Russian Federation, Turkey and Ukraine. Migratory wildfowl have been identified as viral carriers: it is thought that they may be responsible for this spreading pattern of infection. By early December 2005, 137 human cases—all in South-East Asia and China—had been reported. These sporadic infections have mainly occurred among persons who have close contact with live poultry or poultry products. Seventy ended in deaths.[b]

Avian influenza is very different from seasonal influenza which occurs each year, is transmitted between humans, and usually causes a mild illness. It can have severe consequences—and even death—usually among older people. But, the H5N1 virus is coming under close scrutiny because of the possibility that it might undergo genetic change and be capable of direct transmission from one person to another. This could well trigger the next human influenza pandemic.

East and South-East Asia has suffered significant human and economic losses owing to the present outbreak. Small and medium-sized farmers, whose stocks are often not insured and who have no alternative sources of income, have been hit the hardest. Overall, 140 million birds have been destroyed so far. Poultry meat imports from affected areas were prohibited in many countries. As the size of the poultry sector ranges from 0.6 per cent of GDP in Thailand and Viet Nam to over 2 per cent of GDP in the Philippines, a fall in poultry output by 15 per cent, as has already been the case in Viet Nam, can imply a reduction in GDP by up to 0.3 per cent.[c] Across the region, the total losses from the damaged poultry sector amounted to about $10 billion by the end of 2005.

The estimates of deaths from a possible global pandemic of highly pathogenic avian influenza depend on several factors including the assumptions on timing, morbidity and mortality rates as well as the availability and efficacy of control measures such as vaccination or drugs. It is difficult to give any precise estimates of potential numbers of deaths from the next pandemic. Experience with the severe acute respiratory syndrome (SARS) outbreak in 2003 suggests, however, that the reaction to pandemic risk could result in major consequences for economies and societies. The economic losses associated with an avian influenza pandemic could well amount to $200 billion in just one quarter, with the Economic and Social Commission for Asia and the Pacific (ESCAP) region bearing most of the brunt. This corresponds to 2 per cent of world GDP.[d] The impact on some specific sectors, however, could be catastrophic. Tourism, one of the industries to be potentially affected by an outbreak, accounts for over 9 per cent of GDP in East Asia and about 11 per cent in South-East Asia. As in the SARS outbreak, significant economic costs may arise in the form of people trying to avoid personal contact in order to reduce the risk of infection and/or from psychologically-induced effects, affecting overall consumer and investor confidence and therefore resulting in reduced spending.[e]

Countries are adopting a two-pronged strategy to address threats caused by influenza. This involves steps to control the outbreaks in the poultry populations thus minimizing the chance of spread to humans, and preparation of a comprehensive multisectoral plan to tackle a possible pandemic. Despite measures to control the disease among poultry, countries face considerable challenges, including slow and/or absent reporting of cases, which makes surveillance difficult; financial and technical constraints confronting small, often poor, breeders; overall lack of resources in countries to implement comprehensive plans; and difficulties in stockpiling antiviral medicines.

In this regard, regional and multilateral cooperation has a vital role to play, also with respect to the adoption of measures that ensure access to the required medicines by the poor. Sharing information through a regional forum as well as ensuring transparency in coordinating responses to a possible pandemic is also vital. Last but not least, the most important element remains sustainable funding. Donors and affected countries have been discussing ways of financing the enormous cost of the contingency plans. Regional arrangements such as the creation of an Asia-Pacific health emergency fund to deal with such health emergencies, including establishing and financing a regional stockpile of lifesaving medicines, are worth serious consideration.

a Based on ESCAP, *Socio-Economic Policy Brief*, Issue No. 1, October 2005, available from http://www.unescap.org/pdd/publications/se%5Fbrief/1.pdf.

b WHO, "Cumulative Number of Confirmed Human Cases of Avian Influenza A/H5N1reported to WHO", available from http://www.who.int/csr/disease/avian_influenza/country/cases_table_2005_12_09/en/index.html.

c World Bank, *East Asia Update* (November 2005), available from http://siteresources.worldbank.org/ INTEAPHALF-YEARLYUPDATE/Resources/EAP--Brief-final.pdf.

d Ibid.

e Canada/Department of Finance/Economic Analysis and Forecasting Division, "The Economic Impact of an Influenza Pandemic", 28 November 2005 (mimeo).

Downside risks include protectionist trade measures, speculation in the housing market, large build-up of currency reserves, higher oil prices and avian flu

The forecast for the region is subject to some risks and uncertainties. First, the surge in garment exports from China following the abolition of the ATC has led to emergency safeguard measures by the EU and the United States (see chapter II). The emergence of these and other protectionist measures is of particular concern to East Asia owing to its dependence on trade for economic growth. Second, low interest rates, particularly on mortgages, have led real estate prices to soar to record levels in several economies. This development is a source of concern for policy makers in such countries as Malaysia and Thailand, where a real estate bubble was an important catalyst of the 1997 financial crisis. Careful surveillance by central banks is needed in order to minimize the potentially destabilizing effects of unsustainable lending against real estate. A third potential risk is the high accumulation of foreign exchange reserves in China, the Republic of Korea and Taiwan Province of China. A sizable portion thereof corresponds to inflows of portfolio capital, which are highly volatile and, hence, a possible source of macroeconomic instability, although the higher level of currency reserves also serves as a shield against such negative effects (see chapter I). Moreover, holding the accumulated currency reserves could also imply additional costs (owing to asset value losses) in the case of a depreciation of the United States dollar. Fourth, prospects of higher oil prices are an adverse risk confronting the region. Policy responses—whether in the form of incentives to divert production away from fossil-fuel-intensive processes, raising taxes to discourage consumption, or continuing with subsidies to avoid burdening firms with higher input costs—will ultimately depend on the constraints stemming from the macroeconomic fundamentals of each country. Finally, concerted efforts are required to contain the outbreak of avian flu currently affecting some of the regional economies in order to avoid the loss of human life and the economic costs that would be associated with a more widespread pandemic.

South Asia: a sustained broad-based growth

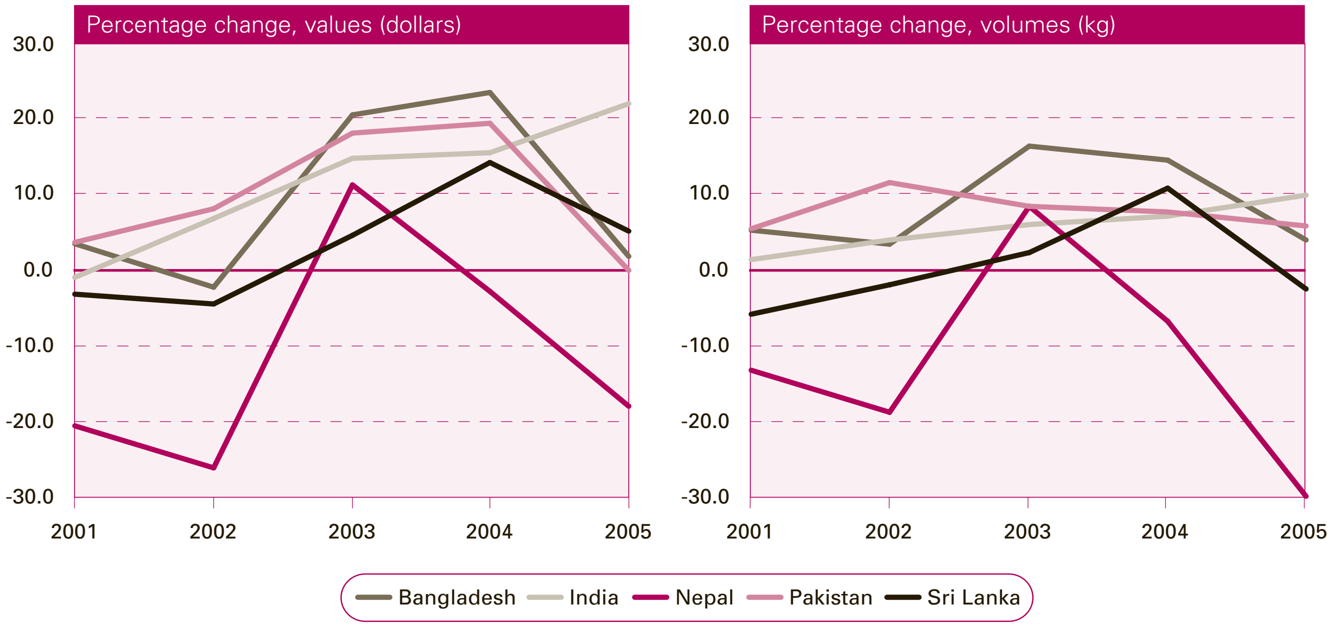
South Asia is on track for sustained healthy growth in 2005 and 2006

After posting an average GDP growth rate of 6.7 per cent in 2004, the region was on track to reach a similar result of about 6.5 per cent in 2005, sustained by normal monsoon rains and strong domestic demand. Continuing reforms and structural changes that have accompanied increasing integration of the region into the global economy will contribute to sustaining growth of 6.4 percent for 2006 (see table A.3), albeit with diverging trends across countries. After two consecutive years of high growth, Pakistan is expected to slow down slightly and the Islamic Republic of Iran is likely to be hit by falling oil production owing to a deterioration in production facilities. The rest of South Asia is expected to post constant or accelerated GDP growth in the coming year.

The textiles sector and services are contributing to strong growth

Growth was broad based in 2005, as normal monsoon rains in most countries allowed the agricultural sector to recover from its lacklustre performance in 2004, while industrial growth and the services sector remained strong. One important driver of manufacturing growth and investment is the textiles and ready-made garment (RMG) industry, particularly in Bangladesh, India, Pakistan and Sri Lanka. The exports of those countries held up after the termination of the ATC (see chapter II, and figure IV.7), rebutting earlier fears of disruptive crises, especially in Bangladesh. While tourist arrivals in Sri Lanka increased by around 10 percent over 2004, earnings from tourism were down, indicating that a large number of arrivals were business travellers and relief workers rather than leisure travellers. Conversely, Nepal suffered from a continuing downturn in tourist arrivals, which is not expected to improve until the political situation stabilizes. Moreover, the country suffered from insufficient rainfall in 2005 and a decline in RMG exports.

Figure IV.7.
Growth in textile and clothing exports from selected South Asian countries to the European Union and the United States, 2001-2005[a]



Sources: Eurostat; IMF, *International Financial Statistics*; United States Department of Commerce.

a Growth for 2005 refers to the first three quarters over the same period in 2004.

India maintained a strong economic performance in 2005, driven largely by the manufacturing sector, owing to booming domestic demand for consumer goods as well as infrastructure development. There has been a strong response by the business community to the opportunities created by an expanding domestic market as the middle class grows—thus sustaining consumption demand—infrastructure bottlenecks started to be addressed, and prospects for exports remained positive. The "Building India" programme, which comprises investments totalling $40 billion over a four-year period starting in 2005, will add impetus to demand for industrial goods over the medium term.[6] The services sector also performed well, supported by the continued strong growth of information technology (IT) services as well as tourism and tourism-related activities. Agriculture remains dependent upon monsoon rains, but there has been a return to near normal harvests, which contributed to growth in the year.

Domestic demand is a key driving force behind robust growth in India

The impact of the October 2005 earthquake in South Asia was felt largely in Pakistan, resulting in massive human losses, devastation of dwellings and infrastructure. GDP growth is likely, however, to decrease by less than half a percentage point in fiscal year 2005-2006, since no major industries are located in the affected area, and contributions to the agricultural or services sectors of the national economy are small. Over the medium term, reconstruction activities and investments are expected to offset the negative impact on GDP. Owing to the vast amount of resources needed for relief and reconstruction, an adverse impact on the national budgetary position is expected in the near term, part of which may be financed through ODA pledged during an international donor conference in November (overall, $4 billion were pledged in loans and $2.2 billion in grants). Also, inflationary pres-

The October 2005 earthquake will have a limited impact on the growth of Pakistan

6 Asian Development Bank, *Asian Development Outlook 2005 Update* (Manila, ADB, 2005), available from http://www.adb.org/documents/books/ado/2005/update/ADU2005-Full.pdf.

sures may increase from supply bottlenecks (for example, in non-tradable reconstruction materials).

Regional unemployment remains high

Despite sustained growth, unemployment remains a problem in the region. While official unemployment rates fell slightly in the Islamic Republic of Iran and in Pakistan, they remain stubbornly high in all countries. With a rapidly growing workforce, the formal sector is not able to absorb all job seekers who enter the labour market. Unemployment is highest among the young, and especially among educated young people—who are less likely to be absorbed by the informal sector.

Inflationary pressures are fuelled by increasing pass-through of high international oil prices...

High growth rates were accompanied by strong inflationary pressures in most of the economies of the region, with consumer price inflation rising to 6.5 per cent in 2005. Country-specific drivers of inflation were high food prices (as in Bangladesh and Sri Lanka), as well as strong private-sector credit expansion and increases in property prices. The real estate sector is believed to be overheated in many cities of both India and Pakistan. In addition, price levels were rising in all net oil-importing countries as Governments allowed international oil price increases to feed through to domestic fuel prices in 2005. Earlier subsidies had by then become unsustainable as they increasingly stretched public finances and distorted market signals. The oil price hike, however, has not yet been entirely passed on to consumers, and further adjustments are likely in 2006.

...triggering further cautious monetary tightening

In order to keep inflation in check, monetary policies continued the tightening trend, raising key policy rates in several steps throughout 2005, and taking measures to rein in monetary expansion. Given that real interest rates still remain comparatively low, the measured tightening is expected to continue into 2006. Only the Islamic Republic of Iran is avoiding monetary tightening, in order to further strengthen private consumption and investment, particularly in the agricultural sector where lending interest rates have become negative. Inflation posted an annual rate of 13.5 per cent in 2005, the highest in the region.

Government spending on infrastructure and human development will increase

There has been a renewed focus in national budgets on development of infrastructure and the provision of health and education services in order to accelerate growth, resulting in expansionary fiscal policies in many parts of the region. As the imposition of new taxes in the near term will be difficult, and privatization of State-owned enterprises is stalling in all countries but Pakistan (and, to a lesser extent, India), these initiatives are likely to weigh on the region's fiscal deficits, unless they can be financed through improved revenue collection.

Most countries face—sustainable—current-account deficits...

Unlike East Asia, most economies in South Asia face current-account deficits, caused by increased expenditure on oil imports and by strong import demand. Increased private savings are mostly channelled into domestic private investments through the financial system, as visible from the strong demand for private credit for emerging business opportunities in industry and services, as well as the strong increase in home loans in many parts of the region. Consequently, there is only a small ex post gap between private savings and investment. As a percentage of GDP, current-account deficits remain within acceptable limits, owing to the continuing flow of remittances from South Asians working overseas. In the case of India, service income also remains strong thanks to buoyant IT and back-office service exports. Apart from the net oil exporter, the Islamic Republic of Iran, only Bhutan and Nepal posted current-account surpluses, as official and private transfers sufficed to offset the merchandise trade deficit.

...while capital inflows remain strong, bolstering foreign exchange reserves

There has been a rise in portfolio capital flows to emerging markets (see chapter III) and South Asia has not been an exception, facilitating India's stock market to rise by 17.6 per cent in dollar terms since December 2004. Those inflows are also partly responsible for the growth in India's foreign exchange reserves to $143 billion by October 2005, covering around nine months of 2006 imports of goods and services. In contrast, the Islamic Republic of Iran experienced increased capital outflows since the elections in mid-2005, accompanied by a decline of more than 20 per cent in the stock market. Gross official reserves in most countries are at healthy levels, with the lowest relative levels in Bangladesh and Sri Lanka, where reserves cover 2.6 and 3.3 months of imports, respectively. Most currencies, except the Bangladeshi taka, are expected to appreciate in real terms against the United States dollar in 2006. On the back of continued strong capital inflows, the Indian rupee is expected to appreciate also in nominal terms.

Finally, while security concerns persist across the region, Indian-Pakistani relations appear to be continuing to thaw slowly. In case the political momentum is maintained in 2006, both countries stand to gain economically through mutually beneficial trade, particularly in energy and water resources.

A further increase in international oil prices is the major downward risk

Provided the political and security situation in the region remains stable, a major downward risk for the region is a further increase in international oil prices, raising fiscal and inflationary pressures as well as current-account deficits. Insufficient monsoon rains could also undermine the optimistic growth prospects by hurting agricultural growth and hence rural incomes and consumption. In addition, the region remains prone to natural disasters with potentially large disruptive effects on economic activity.

Western Asia: boom conditions persist amidst uneven growth

The region continued to benefit from booming oil revenues in 2005, and momentum remains in the outlook

The Western Asian region continued to enjoy a general economic bonanza stimulated by booming oil revenues in 2005, largely a result of surging prices. The region is estimated to have grown by 5.3 per cent in 2005, with oil-exporting countries enjoying a continued expansion at 5.9 per cent, and oil-importing countries posting a somewhat lower rate at 4.6 per cent. With oil prices expected to stay high, momentum is seen as remaining strong in the outlook, and the region is expected to expand a further 5 per cent in 2006 (see table A.3).

The boom is especially benefiting the oil-exporting economies of the Gulf Cooperation Council (GCC),[7] through rising trade surpluses and fiscal expenditures, along with growth in asset prices and credit to the private sector, that stimulate consumption and investment.

Intraregional remittances and tourism flows support demand in oil-importing countries

Despite suffering from falling terms of trade, oil importers in the region have benefited from spillover effects emanating from the oil boom, as workers' remittances from the Gulf and increased intraregional tourism flows supported demand expansion, particularly in the Syrian Arab Republic and Jordan. Jordan has also benefited from inflows of capital and skilled labour from Iraq, as many Iraqis flee their country.

Growth in Turkey stays high, but the current-account deficit raises concern

Turkey registered exceptionally fast growth in 2004 based on strong consumer and investor confidence as the country continued its recovery from the 2001 crisis. Rapid expansion of domestic credit and a strong external sector were also a factor. Growth, albeit still robust, dropped to more sustainable levels, reaching 4.6 per cent in 2005 as growth of private consumption and investment moderated and net exports became increasingly negative. In the outlook, Turkey is expected to grow by around 5.3 per cent in 2006, with all demand components (private and public consumption and investment and exports) growing at healthy rates. Large trade and current-account deficits, high interest rates and an appreciated real exchange rate, however, remain a concern in the medium run. In Israel, the economic momentum of the

7 The Gulf Cooperation Council consists of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

last two years continues, despite some signs of softening in the manufacturing export sector in 2005, whereas tourism and other services increased their contribution to overall growth.

In Iraq and the Occupied Palestinian Territory, progress is stalled by acute conflict

Conditions are strikingly different in the economies of the region afflicted by severe political conflict or insecurity. In Iraq, pervasive violence, weak rule of law and severe energy shortages continue to seriously undermine economic activity and exacerbate unemployment and poverty. Despite some relief brought about by debt cancellation by the Paris Club of bilateral creditors of about $35.7 billion, available resources are dwarfed by the sheer magnitude of the reconstruction needs. Economic growth in the Occupied Palestine Territory (OPT) is estimated to have reached 2.5 per cent in 2005, down from 6.1 per cent in 2003, but slightly recovering from the meagre 1.6 per cent in 2004.[8] Output growth in recent years constitutes a weak recovery from a severe economic decline in 2001 and 2002. Calculated in constant United States dollars of 2000, GDP per capita in 2005 was 15 per cent lower than the level attained in 2000. Low growth of domestic output and restrictions on labour mobility and trade continue to contribute to high poverty rates. Remittances from Palestinians residing abroad provide a significant and stable compensatory source of income to support livelihoods in the OPT. The wage bill of the Palestinian Authority (PA), the largest employer in the OPT, grew substantially in 2005. The PA is thus faced with a major fiscal problem with the budget deficit expected to increase to $900 million in 2006.

Unemployment in the region remains high, and growth is doing little to bring it down

Higher growth has done little to dent high unemployment rates in Western Asia. The region's unemployment rate is currently estimated at around 15 per cent, with youth unemployment reaching well over 20 per cent. This is largely the result of rapid population growth, an increasing female participation rate and a large supply of temporary extraregional immigrant labour in the oil-exporting economies of the Gulf. Oil-exporting economies typically face segmented labour markets and a structural mismatch between the demand for labour and the characteristics of the domestic labour force, resulting in significant unemployment rates for nationals coexisting with the employment of large volumes of immigrant labour. In Bahrain and Saudi Arabia, Governments have recently enacted labour "nationalization" policies by setting limits on hiring immigrant workers. It is not clear, however, how effective such policies will be in redressing the labour-market mismatches.

Political conflict further complicates progress on the unemployment front

The open unemployment rate of the Syrian Arab Republic was above 12 per cent in 2004. This rate is likely to have increased further, along with greater demands on the scarce social welfare resources, following the forced return of workers from Lebanon. Unemployment rates in Iraq and the OPT are currently estimated at about 27 per cent. Conversely, labour-market conditions continued to improve in Israel, with the unemployment rate declining to 9 per cent in 2005, down from 10.4 per cent in 2004 (see table A.9).

Inflationary pressures are on the rise region-wide

Strong expansion of both domestic liquidity and private sector credit are stoking inflationary pressures throughout the region. The average inflation rate in the region (excluding Iraq) is estimated at 4 per cent for 2005, with a slightly higher 4.1 per cent expected for 2006 (see table A.6). In many countries, however, official inflation indicators are believed to significantly underestimate current inflation levels.

In the United Arab Emirates, heavy expatriate demand for housing and strong activity in the construction sector have also contributed to rising inflationary pressures, with housing rental costs having increased between 20 to 40 per cent in 2005, whereas prices of

8 A recent report by the IMF, although acknowledging enduring poverty and lower nominal per capita income, estimated faster GDP growth for the period 2003-2005 (see IMF, *Macroeconomic Developments and Outlook in the West Bank and Gaza*; Ad Hoc Liaison Committee Meeting, London 14 December 2005). The IMF estimates are based on rather optimistic assumptions regarding developments in the OPT.

building materials are also estimated to be growing strongly. In Iraq, general disruption and supply shortages in key sectors of the economy have pushed the inflation rate to an estimated level of around 34 per cent in 2005, with very limited progress in cutting inflation expected for 2006, if any. Inflation in Turkey was on track to easily meet the central bank's target of 8 per cent by the end of 2005. In Israel, inflation edged up towards the upper end of the target of the Central Bank during the second half of 2005.

Monetary policies in the region continue to be largely growth-supportive, but disinflation is still a key priority in Turkey

Monetary policy in most of Western Asia is subject to maintaining fixed or semi-fixed pegs to the United States dollar, in many cases supported by surpluses in the current and capital accounts and the accumulation of international reserves. Those policies have largely succeeded in supporting domestic growth while keeping inflation rates within reasonable levels, despite the recent increase in inflationary pressures. Both Israel and Turkey maintain floating exchange rates; while Israel's monetary policy continues to be generally accommodative, real interest rates are still high in Turkey as the country's central bank has been following a cautious stance and giving priority to meeting its inflation target. Nominal interest rates, however, declined along with inflation.

Oil revenue is estimated to reach $300 billion in 2005-2006

With international oil prices about 42 per cent higher than in 2004 on average, the combined nominal oil export revenues of the region are estimated to have reached almost $300 billion in 2005. Given current assumptions for international oil prices in 2006, and the fact that many oil-producing countries are close to capacity, combined oil export revenues of Western Asia can be expected to stay at roughly similar levels in 2006.

Oil exporters are saving a large share of the windfall and investing in diversified portfolios

Fiscal expansion in the GCC countries is taking place despite relatively prudent budgetary stances by Governments, which since 2003 have been saving a significant share of their revenues. Available estimates indicate that Governments in the region are saving about 70 per cent of additional oil revenue in the current oil price cycle,[9] a significantly larger share than in the oil shocks of the 1970s and 1980s. Saved funds are being invested in regional and international capital markets, for example, through national investment and oil stabilization funds. Bahrain, Kuwait, Oman and Qatar are cases in point. Some countries are using windfall gains to reduce high public debt levels, as is notably the case in Saudi Arabia. Additionally, there is evidence that saved funds are being invested in a more diversified range of assets compared with the previous oil price shocks,[10] including private and treasury bonds, portfolio equities and private equity. Moreover, investment opportunities at the regional level, notably in stock markets and the real estate sector, are also absorbing part of these flows while concerns of a possible bubble in these sectors have increased (see box IV.4).

Saved funds will support fiscal expansion in 2006 and beyond

Current fiscal policies in the region are consistent with conservative budgetary assumptions for oil prices, which were within a range of $21 to $27 per barrel for 2005, far below their average level in the year. Lagged expenditures of accumulated fiscal surpluses are expected to provide considerable economic momentum for these economies in 2006 and beyond, thus helping offset the significant deceleration of oil-revenue growth currently expected in the outlook.

Fiscal consolidation is still a priority in some countries

Fiscal consolidation and the reduction of public debt-to-GDP ratios remain a key priority in some of the oil-importing countries, namely Israel, Jordan and Lebanon. In the case of Lebanon, financing conditions have deteriorated in 2005 as a result of the heightened political uncertainty, whereas in Israel the Government continues to implement restrictive measures to reduce the fiscal gap.

9 International Monetary Fund, "Regional Economic Outlook, Middle East and Central Asia Department" (September 2005).

10 Bank for International Settlements, *The Quarterly Review* (December 2005).

Asset price bubbles and an end to the oil boom are significant risks in the outlook

The economic outlook of the region is subject to risks in the medium run. The risks largely stem from the vast savings surpluses fuelling booming real estate and financial markets in many countries of the region (see box IV.4). Those markets may well collapse following a substantial correction in oil prices. Productive diversification is still modest, particularly in the oil-exporting countries, and the economies of the region continue to be strongly oil-dependent, therefore, vulnerable to oil-market conditions. This dependence is particularly relevant at present since many see current oil prices driven to a significant extent by speculative factors, estimated to account for between $15 and $20 out of the current price of a barrel of crude. Thus any major shifts in oil supply or demand could cause speculative expectations to reverse and eventually result in substantial declines in oil prices.

Box IV.4

Oil windfall, booming stock markets and real estate sectors: is there a bubble on the way?

Booming oil prices since 2003 and the surge in revenues that have come along with them have induced euphoria for domestic investment throughout the Western Asian region. This has translated into a considerable measure of speculative activity in both capital and real estate markets leading to steep increases in asset prices.

The growth in market capitalization, especially in the Gulf oil-exporting countries, seems to be related to the strong expansion of liquidity and the associated surge in demand for stocks and securities. These were a result of both booming oil revenues and the repatriation of capital flows by Arab investors following more restrictive requirements for portfolio investments in the United States after the attacks of 11 September 2001.

The combined market capitalization of the nine major stock markets in Western Asia surged 205 per cent from $317.6 billion at the end of 2003 to $968.2 billion by the end of the second quarter of 2005. The markets of Abu Dhabi and Dubai were the fastest-growing in the region. Market capitalization in Saudi Arabia, the largest in the region, jumped by 229 per cent between end of 2003 and the second quarter of 2005 (see figure below).

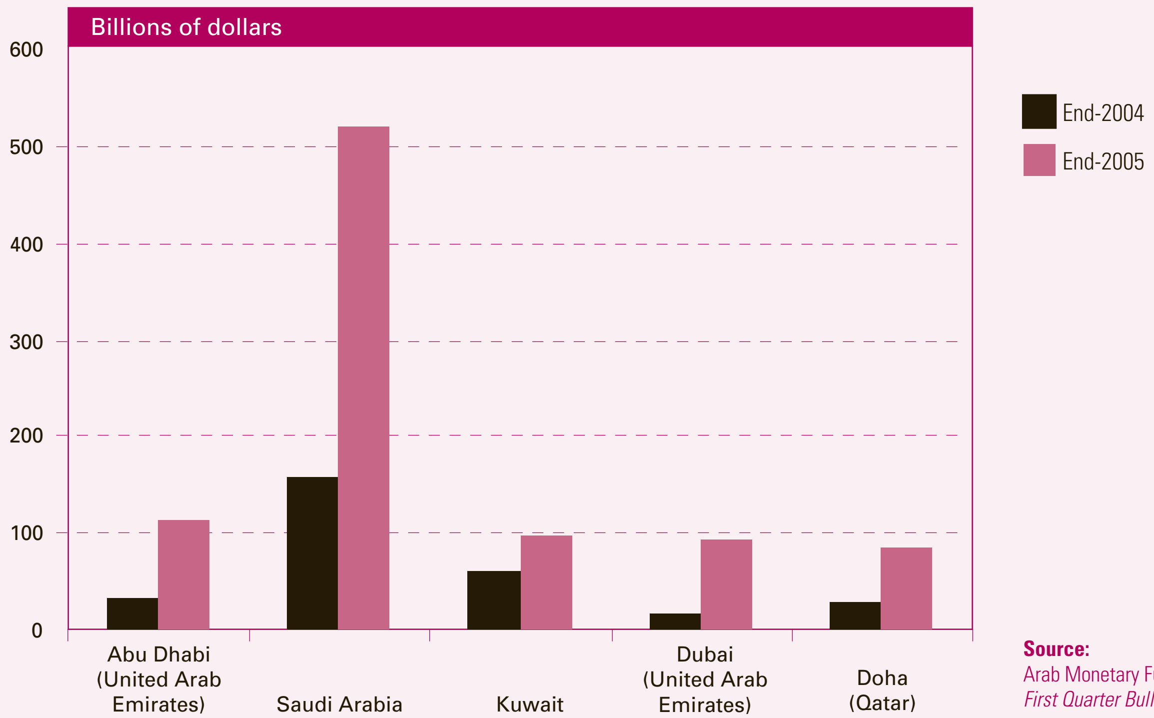
Higher oil prices, however, were not the only factor underpinning these developments. In the Amman Stock Exchange, for instance, trading was boosted by a significant inflow of capital originating in Iraq. Massive capital flight from Iraq was initially prompted by the general confusion and chaos following the fall of the regime of Saddam Hussein, and then reinforced by the ensuing period of serious violence and uncertainty. A considerable share of these capital outflows have been invested in the economies of Jordan, Lebanon and the United Arab Emirates, particularly in the real estate sector and financial markets, thus contributing to the surge in asset prices in those markets.

An unprecedented surge in investment in real estate development has also taken place in the region. In many countries, the real estate boom has been compounded by the absence of alternative investment opportunities with an appropriate profitability-risk mix. The latter is mainly a result of largely undiversified economic structures, low competitiveness of the domestic industry owing, inter alia, to relatively high labour costs, restrictive regulations and lack of a transparent and open general business environment.

As many episodes in the global economy have clearly shown, investment surges in asset markets can take prices beyond their long-run sustainable levels, thus creating a risk of bubble-bursting that can have very damaging consequences both for the financial sector and the real economy. While it is unclear whether prices in certain asset classes in Western Asia are already beyond those levels, the recent surges in prices do indicate that they may be approaching unsustainable levels, particularly in view of associated risks. For example, an unexpected and significant decline in oil prices, a crisis in a major regional market, or the accumulation of significant levels of unsold housing units or vacant rental units in real estate markets are all factors that could provoke shifts in investor sentiment and potentially damaging reversals in market conditions.

Box IV.4 (cont'd)

Western Asia: stock market capitalization, 2004-2005



Source: Arab Monetary Fund, 2005, *First Quarter Bulletin.*

Latin America and the Caribbean: export-led growth

Latin America and the Caribbean continued to benefit from a favourable external environment. The GDP of the region is expected to expand by about 4 per cent in 2006, similar to the economic performance in 2005, but well below that of 2004 when growth reached 5.6 per cent (see table A.3). Despite the slowdown, the cumulative increase in GDP per capita would be around 10 per cent during 2004-2006, well above welfare improvements of the recent past. The moderation of the average growth performance was largely due to what is happening in the two major economies, Brazil and Mexico. High interest rates weakened domestic demand in Brazil. This was also the case in Mexico, but its growth performance was affected more importantly by slower export growth. In contrast, fuel and mining exporters such as Chile, Colombia, Peru, Trinidad and Tobago and Venezuela (the Bolivarian Republic of) sustained good macroeconomic performances in 2005. Growth decelerated in Ecuador—another fuel exporter—reflecting domestic factors, such as the end of the stimulus provided by the construction of the new oil pipeline and lower than expected oil production caused by a lack of investment over the past decade.

Since the 1980s, economic growth has been mainly export-led in most countries of the region. This trend has continued in recent years. In 2004 and 2005 the rate of growth of the volume of exports from the region was slightly above the world average (see table A.17) and more countries are diversifying into industrial manufactures and non-traditional products, beyond the customary raw materials. This upswing in exports has been reinforced by more flexible exchange-rate systems that have resulted in steady depreciations in real terms until 2004, when compared with the averages observed in the 1990s. More recently, however, the exchange-rate based gains in competitiveness have been partially offset by renewed tendencies towards currency appreciation (see chapter I).

Terms of trade continue to improve...

Increased Asian demand for primary products from the region has contributed to an improvement in the terms of trade of the region. Such gains differ widely, however, among countries. Net fuel exporters, such as Bolivia, Colombia and Venezuela (the Bolivarian Republic of), and to a lesser extent, Ecuador and Mexico, benefited from higher oil prices. Chile and Peru improved their terms of trade thanks to record levels of prices for metals and minerals, which compensated for the higher cost of oil imports. On the other hand, higher fuel costs worsened the terms of trade of Central America and the Caribbean. The Bolivarian Republic of Venezuela's provision of oil at preferential terms has attenuated part of the negative impact in the latter region.

... while dependence on external financing is reduced

Buoyant trade has allowed economic growth to be accompanied by current-account surpluses. The region as a whole has been running savings surpluses for three consecutive years. Low international interest rates have kept debt-servicing costs down. In addition, country-risk ratings are at their lowest levels of the past 15 years for most countries. Furthermore, the region's debt-to-export ratio has dropped considerably, along with a significant reduction in short-term debt as a proportion of total external debt. Several Caribbean countries form an exception as their debt-to-export ratios continue to be critically high.

Export growth is concentrated in South America

South American countries accumulated the bulk of the regional trade surplus through the strong rise in export values, despite a boost in imports due to greater economic activity. In contrast, in Mexico and Central America the merchandise trade deficit widened because of the loss of export buoyancy owing to competition from China in the United States market, combined with the appreciation of the peso in Mexico and the higher oil import bill for the Central American countries. Surpluses on the services account and substantial inflows of worker remittances were not enough to offset the deficit in merchandise trade in this subregion (see figure IV.8). A similar situation arose in the Caribbean countries, which also recorded negative current-account balances, except Trinidad and Tobago, whose exports climbed by over 20 per cent, mainly as a result of the increase in oil prices.

Capital flows are bolstering reserves...

Although most countries have official flexible exchange-rate regimes, central banks have been intervening in foreign exchange markets (especially in South America, with the exception of Chile), purchasing foreign exchange and increasing their international reserves in an effort to maintain exchange-rate stability, attenuate the recent appreciation or build up foreign reserves (see chapter I). The region as a whole has increased its reserves on average by around 1.5 per cent of GDP per annum over the past three years. Available reserves now cover eight months worth of imports, up from five months in 2002.

...and increasing revenues improve fiscal balances

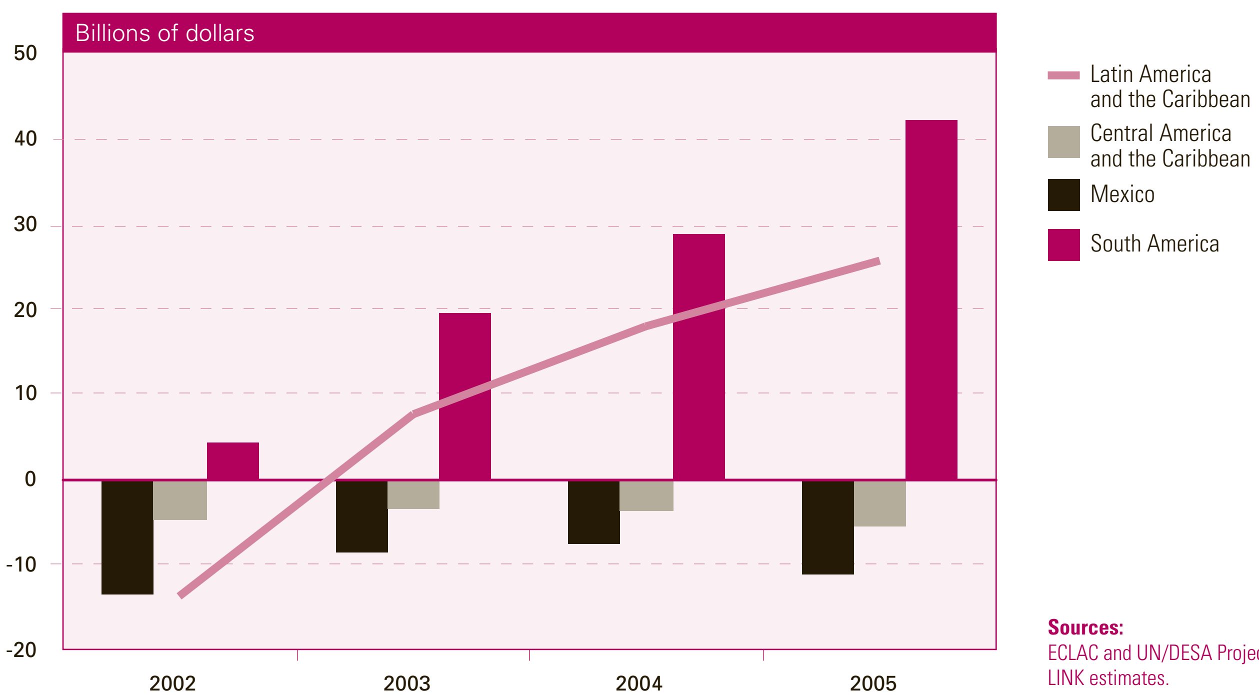
Most countries are taking advantage of the favourable economic environment to fortify their fiscal balances. Brazil's primary surplus continued to improve in 2005 owing to higher revenues, mostly from direct taxation. Part of this increase is also attributed to an improvement in the efficiency of tax collection. This revenue has contributed to reducing public debt, although it still weighs around half of the GDP of Brazil. Interest payments remain high, however, at around 7 per cent of GDP as domestic interest rates are still up. Similarly, the Argentine primary surplus was helped by the strong growth in revenues, which was mostly due to increases in revenues from personal and corporate income and value-added taxes. As a result, the public debt burden of Argentina was reduced to 70 per cent of GDP in June 2005, which is about half of the ratio in 2002. Next to primary surpluses, the restructuring of the external debt was a crucial factor in bringing down the debt-to-GDP ratio. The debt restructuring was accepted by the majority of the bond holders in March 2005, which included large value discounts and maturity period extensions. A strong recovery of the economy helped the negotiation which included GDP-linked bonds and demonstrated the trust of the debt holders in the recovery of Argentina. Furthermore, on 15 December 2005, Argentina announced its intention to make an early repayment of the entire outstanding obligations to the IMF.

Windfall gains from higher export commodity prices have helped a great number of countries to improve their fiscal balances, allowing also for greater expenditures. Part of the oil export revenues of the Bolivarian Republic of Venezuela have been earmarked to a special fund directed to help the needy cover their health and education costs. Chile increased its public surplus for a second consecutive year thanks to greater copper and tax revenues and high growth. Chile follows a structural budget rule, requiring the Government to have a surplus of at least 1 per cent of GDP while calculating mineral resource revenues at the average medium-term copper price and measuring GDP by its trend-level growth. The Copper Stabilization Fund is to smooth government revenue over time.

Favourable conditions have strengthened domestic demand and unemployment is reduced

Although external demand was a major source of growth in the region, domestic demand is also picking up, though at a slower pace than output growth. The relatively slow rise in private consumption, combined with fiscal austerity and the effect of improved terms of trade and remittances, has boosted national savings to the equivalent of 21.4 per cent of GDP (in 2000 dollars), which represents an increase of 3.4 percentage points of GDP over the average of the 1990s. Also, the investment rate of the region is up, apparently putting an end to the investment anaemia in previous years. Investment growth is estimated to have out-

Figure IV.8.
Latin America and the Caribbean: current-account balance, 2002-2005



Sources: ECLAC and UN/DESA Project LINK estimates.

paced GDP growth in 2005 and the gross investment rate is estimated to have increased from 18.6 per cent to 19.6 per cent of GDP from 2004 to 2005. Yet, the upward trend is not uniform across the region. Investment rates are still virtually stagnant in Brazil and Mexico. The average is mainly pushed up by strong investment growth in Chile, Colombia and Venezuela (the Bolivarian Republic of), riding high on booming commodity prices. Investment growth has also been strong in Argentina since the recovery from the deep economic crisis at the beginning of the century. The recovery in investment has been concentrated in construction and manufacturing of machinery and equipment. Investment in the production of tradable goods has been favoured by the relative stability of the Argentine peso.

Employment has gradually improved and contributed to the modest recovery of domestic demand mentioned above. The open unemployment rate reached 9.3 per cent in 2005, the lowest rate since 1997 and one percentage point lower than in 2004. Estimated projections suggest the poverty incidence for the region has fallen from 41.7 per cent in 2004 to around 40 per cent in 2005.

Inflation was reduced through stricter monetary policies in some countries...

Average weighted inflation for the whole region reached a little over 6 per cent at the end of 2005, down from 7.4 per cent in December 2004. This result mainly reflected trends in the two largest economies of the region (Brazil and Mexico). In those countries, monetary authorities followed stricter inflation-target objectives after 2003, complemented by a more austere fiscal policy. Recently, inflationary pressures brought about by higher oil prices have been offset by currency appreciation. During the latter half of 2005, monetary policy eased in those countries as inflation remained under control.

...but it increased in others

In other countries (especially those in Central America and the Southern Cone) inflation rates for 2005 were higher owing to increased oil prices, higher prices of some industrial manufactures, and higher transportation costs. Inflation in Argentina was around 10 per cent in 2005, as prices of tradables rose with economic activity and the money supply was buoyed by an expansion of international reserves. Capital inflows, the current-account surplus, and active buying of dollars (only partially sterilized) have increased reserves as the monetary authority pursues prudential objectives.

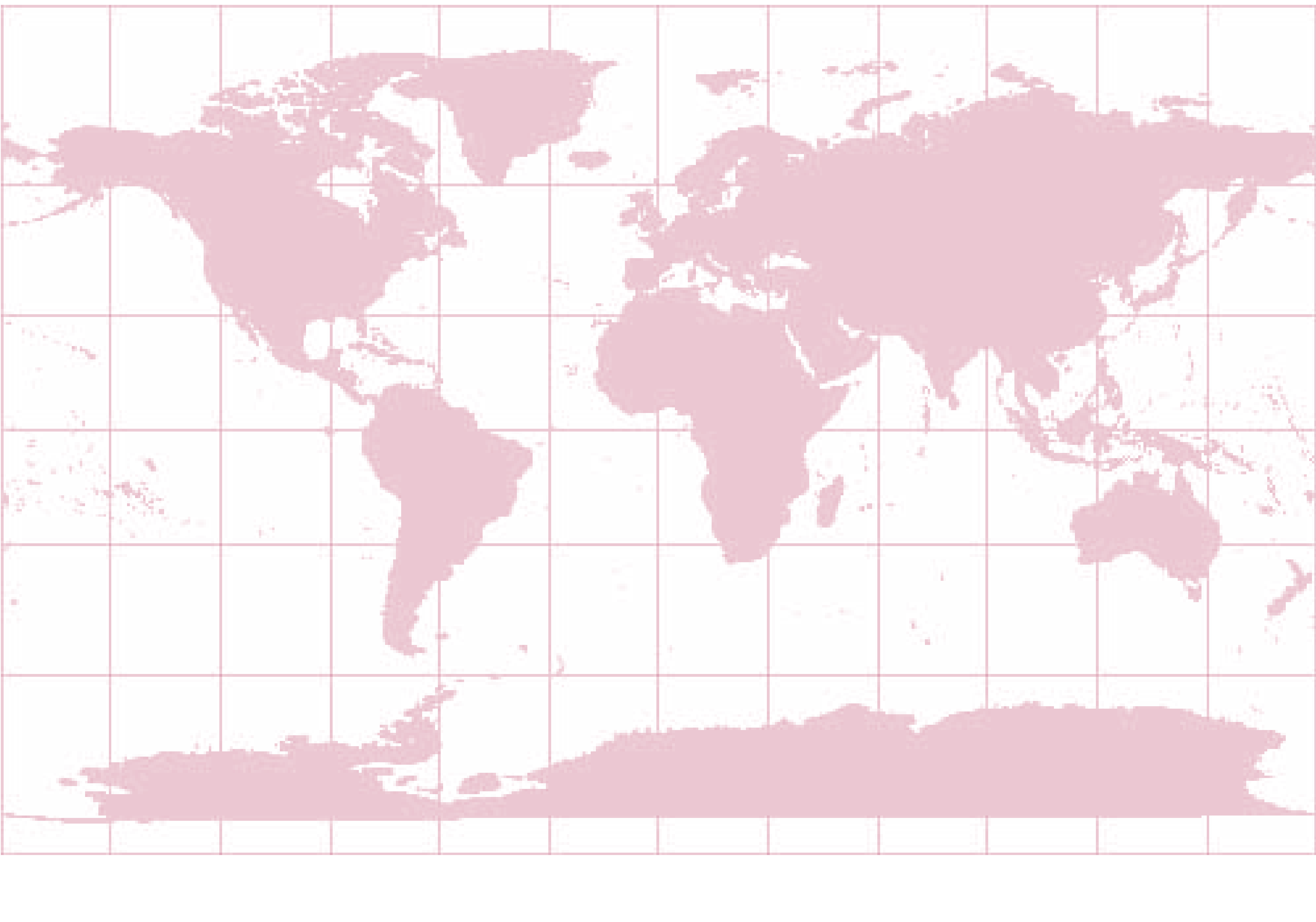
Risks are present from both changes in the external situation themselves and...

Downside risks to the outlook of the region may come from the same international macroeconomic situation underpinning the positive performance. Of particular concern are the possible negative effects of a disorderly adjustment of the global imbalances on reducing the external demand for exports from the region and rising international interest rates (and the impact of the latter on financial inflows, the cost of debt servicing and risk ratings of countries). External demand will also depend on the sustainability of demand by China for the exports of the region. However important this demand is for export growth, Latin America needs to focus on speeding up its efforts to diversify and increase the value added of its exports in order to achieve faster and sustained rates of growth in the future.

...possible domestic problems brought about by appreciation of the currencies

Domestic risk factors include the challenges to domestic policies posed by appreciating exchange rates that can, on the one hand, compromise export growth, particularly of manufactures, and, on the other hand, support fast growth in import demand. In such a context, the trade balance surplus the region sustained in the past three years could quickly disappear, thus increasing, once again, one of the main vulnerabilities of the region, that is, its dependence on external finance. Policy measures adopted to restrain currency appreciation, such as intervention in foreign currency markets, however, could generate additional inflationary pressures (as liquidity increases) or widen the quasi-fiscal deficit (if intervention is sterilized), thus creating tension with other macroeconomic policy objectives (see chapter I).

Annex: **Statistical tables**



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I. Global output and macroeconomic indicators

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I. Global output and macroeconomic indicators

Table A.1.
Developed market economies: rates of growth of real GDP, 1996-2006

Annual percentage change[a]

	1996-2004	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[b]	2006[c]
Developed economies	2.5	2.9	3.3	2.7	3.0	3.5	1.1	1.2	1.9	3.2	2.4	2.5
United States	3.3	3.7	4.5	4.2	4.5	3.7	0.8	1.6	2.7	4.2	3.3	3.1
Canada	3.4	1.6	4.2	4.1	5.5	5.3	1.9	3.3	1.7	2.9	2.7	2.6
Japan	1.2	3.4	1.8	-1.0	-0.1	2.4	0.2	-0.3	1.4	2.7	2.1	1.9
Australia	3.8	4.2	3.9	5.3	4.3	3.2	2.5	4.0	3.3	3.3	2.4	2.9
New Zealand	3.3	3.2	2.7	1.0	5.2	2.3	3.7	4.5	3.7	3.6	2.5	2.0
European Union	2.3	1.9	2.8	2.9	3.0	3.8	1.9	1.2	1.2	2.4	1.5	2.1
EU-15	2.3	1.8	2.7	2.9	3.0	3.7	1.9	1.2	1.1	2.3	1.4	2.0
Euro zone	2.1	1.5	2.6	2.9	3.0	3.7	1.8	1.0	0.8	2.0	1.3	1.9
Austria	2.2	2.6	1.8	3.6	3.3	3.4	0.7	1.2	0.8	2.4	1.8	2.1
Belgium	2.2	1.2	3.3	1.9	3.1	3.9	1.0	1.5	0.9	2.6	1.5	2.4
Finland	3.6	3.8	6.2	5.0	3.4	5.0	1.0	2.3	2.4	3.6	1.6	3.7
France	2.3	1.1	2.4	3.6	3.3	4.1	2.1	1.2	0.8	2.3	1.5	1.8
Germany	1.4	1.0	1.8	2.0	2.0	3.2	1.2	0.2	0.0	1.6	0.8	1.2
Greece	3.8	2.4	3.6	3.4	3.6	3.9	4.0	3.8	4.6	4.6	3.1	3.1
Ireland	7.7	8.0	10.8	8.6	11.6	9.2	6.2	6.1	4.4	4.5	4.8	4.7
Italy	1.5	1.1	2.0	1.8	1.6	3.0	1.8	0.4	0.4	1.2	0.1	1.2
Luxembourg	4.9	3.3	8.3	6.9	7.8	9.0	1.3	1.7	2.1	4.5	3.8	3.0
Netherlands	2.4	3.0	3.8	4.3	4.0	3.5	1.4	0.1	-0.1	1.7	0.5	2.5
Portugal	2.6	3.2	3.5	3.5	8.5	3.4	1.6	0.4	-1.4	1.2	0.5	1.0
Spain	3.5	2.4	4.0	3.7	4.9	4.4	3.5	2.7	2.9	3.1	3.4	3.6
Other	2.8	2.6	3.1	3.1	3.1	4.0	2.0	1.9	2.2	3.2	1.9	2.4
Denmark	2.0	2.5	3.0	2.5	2.6	2.8	1.3	0.5	0.7	2.1	2.3	2.5
Sweden	2.7	1.3	2.4	3.6	4.6	4.4	1.1	2.0	1.5	3.6	2.9	2.9
United Kingdom	2.9	2.8	3.3	3.1	2.9	4.0	2.2	2.0	2.5	3.2	1.7	2.3
EU-10	3.8	4.7	4.8	3.8	3.4	4.2	2.3	2.3	3.7	5.0	3.9	4.2
EU-8	3.8	4.7	4.9	3.7	3.3	4.1	2.3	2.3	3.8	5.1	3.9	4.3
Czech Republic	2.1	4.2	-0.7	-1.1	1.2	3.9	2.6	1.5	3.2	4.4	4.3	4.5
Estonia	6.2	4.4	11.1	4.4	0.3	7.9	6.5	7.2	6.7	7.8	7.5	6.5
Hungary	3.8	1.3	4.6	4.9	4.2	5.2	3.8	3.5	2.9	4.2	3.6	4.0
Latvia	6.3	3.8	8.3	4.7	3.3	6.9	8.0	6.4	7.5	8.3	7.5	6.8
Lithuania	5.7	4.7	7.0	7.3	-1.7	3.9	6.4	6.8	10.5	7.0	6.5	5.4
Poland	4.1	6.0	6.8	4.8	4.1	4.0	1.0	1.4	3.8	5.4	3.4	4.0
Slovakia	4.1	6.1	4.6	4.2	1.5	2.0	3.8	4.6	4.5	5.5	5.2	5.5
Slovenia	3.9	3.6	4.8	3.9	5.4	4.1	2.7	3.5	2.5	4.2	4.0	4.0
Other	3.1	2.5	3.1	4.5	4.6	5.5	2.7	1.8	0.8	3.0	2.8	2.7
Cyprus	3.4	1.9	2.3	5.0	4.8	5.1	4.1	2.1	1.9	3.8	3.5	3.2
Malta	2.5	4.0	4.9	3.4	4.1	6.4	-0.4	1.0	-1.8	1.0	1.0	1.5
Other Europe	2.0	2.4	3.3	2.7	1.7	3.3	1.7	0.6	0.1	2.5	2.6	2.0
Iceland	3.5	5.2	4.7	0.7	4.4	5.7	2.6	-2.1	4.2	6.2	6.6	4.6
Norway	2.8	5.3	5.2	2.6	2.1	2.8	2.7	1.1	0.4	2.9	3.7	2.0
Switzerland	1.5	0.5	1.9	2.8	1.3	3.6	1.0	0.3	-0.3	2.1	1.6	1.9
Memorandum item:												
Major developed economies	2.4	2.9	3.2	2.5	2.9	3.4	0.9	1.0	1.9	3.3	2.4	2.4

Source: UN/DESA, based on IMF, *International Financial Statistics* and individual national sources.

a Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2000 prices and exchange rates.

b Partly estimated.

c Forecasts, partly based on Project LINK.

Table A.2.
Economies in transition: rates of growth of real GDP, 1996-2006

Annual percentage change[a]

	1996-2004	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[b]	2006[c]
Economies in transition	3.6	-2.5	1.0	-3.2	4.0	8.3	5.7	5.1	7.1	7.7	6.0	5.9
South-eastern Europe	2.6	2.8	-0.9	0.2	-2.2	3.5	5.0	4.8	4.4	6.5	4.7	4.4
Albania	5.4	9.1	-10.2	12.7	10.1	7.3	7.0	2.9	5.7	5.9	6.0	5.6
Bosnia and Herzegovina	14.2	54.2	36.6	16.6	9.5	5.4	4.5	3.7	3.2	4.0	4.5	5.2
Bulgaria	1.6	-9.4	-5.6	4.0	2.3	5.4	4.1	4.9	4.5	5.6	5.6	4.0
Croatia	3.9	5.9	6.8	2.5	-0.9	2.9	4.4	5.2	4.3	3.8	3.2	4.0
Romania	1.9	3.9	-6.1	-4.8	-1.2	2.1	5.7	5.1	5.2	8.3	5.0	4.5
Serbia and Montenegro	2.2	5.9	7.4	2.5	-17.7	5.2	5.3	3.8	2.1	8.0	5.0	5.0
The former Yugoslav Republic of Macedonia	1.8	1.2	1.4	3.4	4.3	4.5	-4.5	0.9	2.8	2.9	4.0	4.0
Commonwealth of Independent States	3.8	-3.6	1.4	-4.0	5.4	9.3	5.9	5.1	7.6	7.9	6.2	6.2
Net fuel exporters	3.8	-3.2	1.5	-4.7	6.1	9.8	5.6	5.1	7.4	7.4	6.4	6.2
Azerbaijan	8.5	1.3	5.8	10.0	7.4	11.1	9.9	10.6	11.2	10.2	18.5	22.0
Kazakhstan	6.0	0.5	1.7	-1.9	2.7	9.8	13.5	9.8	9.3	9.4	9.0	8.5
Russian Federation	3.6	-3.6	1.4	-5.3	6.4	10.0	5.1	4.7	7.3	7.2	6.0	5.8
Turkmenistan	3.8	6.7	-11.4	7.1	16.5	5.5	4.3	0.3	3.3	4.5	5.0	5.0
Uzbekistan	4.5	1.7	5.2	4.4	4.4	4.0	4.5	4.2	4.4	7.7	7.0	7.0
Net fuel importers	3.7	-6.7	0.6	0.5	0.9	5.6	8.0	5.5	9.2	11.3	5.3	5.8
Armenia	8.2	5.9	3.3	7.3	3.3	5.9	9.6	15.1	14.0	10.1	10.0	7.0
Belarus	6.6	2.8	11.4	8.4	3.4	5.8	4.7	5.0	7.0	11.0	8.5	8.0
Georgia	6.3	11.2	10.5	3.1	2.9	1.8	4.8	5.5	11.0	6.2	7.0	5.5
Kyrgyzstan	5.3	7.1	9.9	2.1	3.7	5.4	5.3	..	7.0	7.1	4.0	5.8
Republic of Moldova	1.6	-5.9	1.6	-6.5	-3.4	2.1	6.1	7.8	6.6	7.3	8.0	7.0
Tajikistan	4.4	-16.7	1.7	5.3	3.7	8.3	9.6	10.8	11.0	10.6	8.0	7.0
Ukraine	2.8	-10.0	-3.0	-1.9	-0.2	5.9	9.2	5.2	9.6	12.1	4.0	5.0

Source: UN/DESA, based on data of Economic Commision for Europe (ECE).

a Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2000 prices and exchange rates.

b Partly estimated.

c Forecasts, partly based on Project LINK.

Table A.3.
Developing economies: rates of growth of real GDP, 1996-2006

Annual percentage change[a]	1996-2004	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[b]	2006[c]
Developing countries[d]	4.4	5.9	5.4	1.9	3.6	5.6	2.4	3.6	4.9	6.6	5.7	5.6
of which:												
Africa	3.8	5.3	3.4	3.0	3.1	3.4	3.5	3.5	4.4	5.1	5.1	5.5
North Africa	4.0	5.7	3.3	3.9	3.9	3.4	3.4	3.2	4.6	4.8	5.1	5.7
Sub-Saharan Africa (excluding Nigeria and South Africa)	4.1	5.9	4.6	4.1	3.2	2.8	4.1	3.9	3.2	5.6	5.3	5.3
Net fuel exporters	4.1	4.6	4.0	3.0	3.4	4.1	3.0	3.9	5.4	5.4	5.8	5.8
Net fuel importers	3.6	5.9	3.0	3.0	2.8	2.8	3.9	3.2	3.4	4.8	4.5	5.2
East and South Asia	5.8	7.5	6.0	1.1	6.2	6.9	4.1	6.1	6.6	7.4	6.6	6.5
East Asia	5.8	7.8	6.3	0.1	6.4	7.6	4.1	6.4	6.4	7.5	6.7	6.5
South Asia	5.5	6.4	4.9	5.0	5.7	4.6	4.3	4.7	7.1	6.7	6.5	6.4
Net fuel exporters	5.3	6.5	6.1	3.6	2.7	4.9	4.6	6.6	6.8	6.0	5.9	5.5
Net fuel importers	5.8	7.5	6.0	1.0	6.4	7.0	4.1	6.0	6.6	7.4	6.7	6.5
Western Asia	3.3	4.9	4.1	2.7	-0.7	5.5	-1.3	2.5	5.0	6.8	5.3	5.1
Net fuel exporters	3.4	4.0	3.4	2.2	0.8	4.8	1.9	1.0	5.8	6.5	5.9	5.5
Net fuel importers	3.1	5.8	4.8	3.2	-2.1	6.2	-4.7	4.2	4.1	7.2	4.6	4.7
Latin America and the Caribbean	2.7	3.9	5.3	2.4	1.1	4.1	0.5	-0.4	1.8	5.6	4.1	3.9
South America	2.1	3.2	4.8	1.2	-1.1	2.9	0.6	-1.2	2.0	6.4	4.6	4.1
Mexico and Central America	3.8	5.1	6.6	4.8	5.1	6.2	0.2	0.9	1.5	4.3	3.1	3.5
Caribbean	3.6	5.7	3.4	3.0	5.3	5.9	2.6	2.1	1.7	2.9	5.0	4.6
Net fuel exporters	3.2	4.1	6.0	3.6	2.5	5.7	0.7	-0.1	0.8	5.6	3.8	3.8
Net fuel importers	2.4	3.8	4.9	1.6	0.2	3.0	0.4	-0.6	2.6	5.5	4.3	4.0
Memorandum items:												
Least developed countries	5.6	5.5	5.1	4.6	5.3	4.8	5.9	6.2	6.5	6.8	6.5	6.6
East Asia (excluding China)	4.1	6.7	4.9	-4.5	5.9	7.2	1.7	5.0	4.1	6.0	4.6	4.9
South Asia (excluding India)	4.6	4.6	4.3	3.7	3.5	4.4	3.3	5.3	6.3	6.0	6.0	5.6
Western Asia (excluding Israel and Turkey)	3.3	4.0	3.4	2.2	0.8	4.6	1.9	1.2	5.6	6.4	5.7	5.3
Major developing economies												
Argentina	1.5	5.5	8.1	3.9	-3.4	-0.8	-4.4	-10.9	8.7	9.0	8.6	6.0
Brazil	2.2	2.9	3.5	0.2	0.8	4.1	1.5	1.5	0.6	4.9	2.5	3.0
Chile	4.1	7.0	7.6	3.9	-1.1	5.4	3.1	2.2	3.3	6.1	6.0	5.5
China[e]	8.5	9.6	8.8	7.8	7.1	8.0	7.5	8.3	9.5	9.5	9.2	8.3
Colombia	1.7	2.1	2.8	0.5	-4.3	2.7	1.6	1.6	4.1	4.1	4.3	4.5
Egypt	4.2	5.0	5.5	4.5	6.3	5.1	3.5	3.1	2.0	3.0	4.1	4.7
Hong Kong SAR[f]	3.5	4.3	5.1	-5.0	3.4	10.2	0.5	1.9	3.2	8.5	6.7	5.0
India	5.9	7.4	5.2	5.6	6.9	4.7	4.8	4.4	7.5	7.0	6.8	6.8
Indonesia	2.4	8.0	4.5	-13.1	0.8	4.9	3.8	4.4	4.9	5.1	5.4	5.3
Iran (Islamic Republic of)	4.9	6.0	5.6	3.3	2.1	4.5	4.0	6.7	6.9	5.6	5.5	5.1
Israel	2.3	4.5	2.1	2.2	2.2	6.0	-0.9	-1.2	1.3	4.4	5.1	4.0

Table A.3 (continued)											
	1996-2004	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[b]	2006[c]
Major developing economies (continued)												
Korea, Republic of	4.5	7.0	4.7	-6.9	9.5	8.5	3.8	7.0	3.1	4.6	3.6	4.5
Malaysia	4.6	10.0	7.3	-7.4	6.1	8.9	0.3	4.4	5.6	7.1	5.3	5.6
Mexico	3.9	5.5	6.8	4.8	5.2	6.6	0.0	0.7	1.2	4.4	3.0	3.5
Nigeria	4.3	4.3	2.7	1.9	1.1	5.0	4.0	3.5	10.2	6.0	5.0	6.0
Pakistan	3.7	2.4	1.2	3.1	4.0	3.0	2.6	4.1	5.9	7.1	7.5	6.3
Peru	3.0	2.5	6.7	-0.4	1.4	2.9	0.2	4.9	3.8	4.8	6.0	5.0
Philippines	3.9	5.8	5.2	-0.6	3.4	4.4	1.8	4.4	4.5	6.0	4.7	5.0
Saudi Arabia	3.1	4.0	3.0	1.6	0.5	4.5	1.2	0.1	7.7	5.2	6.0	5.2
Singapore	4.7	8.2	8.6	-0.8	6.8	9.6	-1.9	3.2	1.4	8.4	4.6	4.8
South Africa	3.0	4.3	2.6	0.8	2.1	3.4	2.8	3.7	3.0	4.5	5.0	5.0
Taiwan Province of China	4.3	6.1	6.4	4.3	5.3	5.8	-2.2	3.9	3.3	5.7	3.6	4.0
Thailand	2.5	5.9	-1.4	-10.5	4.4	4.8	2.2	5.3	6.9	6.1	4.2	5.1
Turkey	3.6	7.0	6.8	3.8	-5.1	7.1	-8.0	7.8	5.8	9.0	4.6	5.3
Venezuela (Bolivarian Republic of)	0.4	-1.3	5.1	0.2	-6.1	3.7	3.4	-8.9	-7.7	17.9	9.0	5.5

Source: UN/DESA.

a Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2000 prices and exchange rates.
b Partly estimated.
c Forecast, based in part on Project LINK.
d Covering countries that account for 98 per cent of the population of all developing countries.
e By the end of 2005, the China State Statistic Bureau released the revision of GDP data based on the latest economic census; the data for the Chinese economy used in this report, however, are prior to that revision. The revision will influence the data presented in the report as follows: (i) China's GDP growth rates will be revised upward by about 1 percentage point each year from 1993; and (ii) China's weight in the world gross product (WGP) will also increase (for example, from 4.4 per cent to 5.1 per cent for 2004). As a result, the aggregate growth rates for WGP for the period 2004-2006 will be about 0.07 percentage points higher after the adjustment. The impact of the revision for the average growth rates for developing countries and for Asia will be larger.
f Special Administrative Region of China.

Table A.4.
Developed market economies: consumer price inflation,[a] 1996-2006

Average annual percentage change

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[b]	2006[c]
Developed economies	2.3	2.2	1.5	1.4	2.3	2.0	1.3	1.7	1.8	2.2	2.0
United States	2.9	2.3	1.6	2.2	3.4	2.8	1.6	2.3	2.7	3.4	2.6
Canada	1.6	1.6	1.0	1.7	2.7	2.5	2.2	2.8	1.8	2.2	1.9
Japan	0.1	1.7	0.7	-0.3	-0.7	-0.7	-0.9	-0.3	-0.6	-0.2	0.1
Australia	2.6	0.3	0.9	1.5	4.5	4.4	3.0	2.8	2.3	2.4	2.8
New Zealand	2.6	0.9	1.3	1.4	2.7	2.7	2.3	1.8	2.4	2.8	3.0
European Union	2.9	2.5	2.0	1.4	2.6	2.5	2.1	2.1	2.2	2.2	2.3
EU-15	2.4	2.0	1.7	1.2	2.3	2.4	2.0	2.1	2.1	2.1	2.3
Euro zone	2.4	1.8	1.3	1.1	2.2	2.5	2.1	2.0	2.0	1.8	2.0
Austria	1.8	1.3	0.9	0.6	2.4	2.7	1.8	1.3	1.3	1.6	1.1
Belgium	2.1	1.6	1.0	1.1	2.5	2.5	1.6	1.5	1.5	2.3	2.1
Finland	0.6	1.2	1.4	1.2	3.4	2.6	1.6	0.9	0.1	0.8	1.5
France	2.0	1.2	0.7	0.5	1.7	1.7	1.9	2.1	2.1	1.7	2.1
Germany	1.4	1.9	0.9	0.6	1.5	2.0	1.4	1.0	1.7	1.4	1.9
Greece	8.2	5.5	4.8	2.6	3.2	3.4	3.6	3.5	2.9	3.6	3.0
Ireland	1.7	1.4	2.4	1.6	5.6	4.9	4.7	3.5	2.2	2.7	2.7
Italy	4.0	2.0	2.0	1.7	2.5	2.8	2.5	2.7	2.2	2.1	1.8
Luxembourg	1.4	1.4	1.0	1.0	3.1	2.7	2.1	2.0	2.2	3.0	2.8
Netherlands	2.0	2.2	2.0	2.2	3.0	4.2	3.3	2.1	1.2	1.5	1.0
Portugal	3.1	2.2	2.7	2.3	2.8	4.4	3.5	3.3	2.4	2.4	2.5
Spain	3.6	2.0	1.8	2.3	3.4	3.6	3.1	3.0	3.0	2.7	2.7
Other	2.2	2.7	2.8	1.5	2.7	1.9	1.8	2.7	2.5	3.2	3.4
Denmark	2.1	2.2	1.9	2.5	2.9	2.3	2.4	2.1	1.2	1.6	1.5
Sweden	0.5	0.7	-0.3	0.5	0.9	2.4	2.2	1.9	0.4	0.5	1.4
United Kingdom	2.4	3.1	3.4	1.6	2.9	1.8	1.6	2.9	3.0	3.8	3.9
EU-10	16.9	13.0	10.8	6.5	8.5	5.8	2.7	1.9	4.0	2.7	2.4
EU-8	17.5	13.4	11.1	6.7	8.7	6.0	2.7	1.9	4.1	2.8	2.4
Czech Republic	8.9	8.4	10.6	2.1	3.9	4.7	1.8	0.1	2.8	2.0	2.5
Estonia	23.1	11.2	8.2	3.3	4.0	5.8	3.6	1.3	3.0	4.0	3.2
Hungary	23.6	18.4	14.2	10.1	9.8	9.2	5.3	4.7	6.8	3.8	3.0
Latvia	17.6	8.4	4.7	2.4	2.6	2.5	1.9	2.9	6.2	6.5	5.0
Lithuania	24.7	8.8	5.1	0.8	1.0	0.3	0.4	-1.2	1.2	3.0	2.5
Poland	19.8	15.1	11.7	7.4	10.2	5.5	1.9	0.7	3.5	2.5	2.0
Slovakia	5.8	6.1	6.7	10.5	12.0	7.0	3.3	8.6	7.5	3.0	3.0
Slovenia	9.9	8.4	7.9	6.1	8.9	8.4	7.5	5.6	3.6	2.8	2.6
Other	2.7	3.4	2.3	1.8	3.6	2.3	2.6	3.1	1.7	2.3	2.7
Cyprus	3.0	3.6	2.2	1.7	4.1	2.0	2.8	4.1	1.9	2.0	2.5
Malta	2.1	3.1	2.4	2.1	2.4	2.9	2.2	0.7	1.3	3.0	3.0
Other Europe	1.0	1.4	1.0	1.5	2.2	1.9	1.0	1.4	0.7	1.4	1.6
Iceland	2.3	1.7	1.7	3.2	5.2	6.4	5.2	2.1	3.2	3.9	4.0
Norway	1.3	2.6	2.3	2.3	3.1	3.0	1.3	2.5	0.5	1.7	2.3
Switzerland	0.8	0.5	0.0	0.8	1.5	1.0	0.6	0.6	0.8	1.1	1.0
Memorandum item:											
Major developed economies	2.1	2.1	1.4	1.3	2.1	1.8	1.1	1.7	1.8	2.2	2.0

Source: UN/DESA, based on IMF, *International Financial Statistics* and individual national sources.

a Data for country groups are weighted averages, where weights for each year are 2000 GDP in United States dollars.
b Partly estimated.
c Forecasts, partly based on Project LINK.

Table A.5.
Economies in transition: consumer price inflation,[a] 1996-2006

Average annual percentage change

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[b]	2006[c]
Economies in transition	35.3	53.3	63.8	37.1	25.6	22.1	14.5	12.1	10.3	10.8	9.7
South-eastern Europe	47.7	242.6	33.0	25.1	30.8	28.3	13.0	8.3	7.6	7.0	6.0
Albania	12.7	33.2	20.6	0.4	0.0	3.1	5.3	2.5	2.5	2.5	2.5
Bosnia and Herzegovina	-20.3	8.6	6.8	-0.7	1.7	1.8	0.9	0.2	-0.3	1.5	1.5
Bulgaria	121.6	1 058.4	18.7	2.6	10.3	7.4	5.8	2.3	6.1	4.3	5.0
Croatia	4.3	4.1	6.4	4.0	4.6	3.7	1.7	1.8	2.1	3.0	3.0
Romania	38.8	154.8	59.1	45.8	45.7	34.5	22.5	15.4	12.0	9.0	7.0
Serbia and Montenegro	90.5	23.2	30.4	44.1	77.5	98.4	19.3	9.6	9.8	15.0	12.0
The former Yugoslav Republic of Macedonia	2.3	2.6	-0.1	-0.7	6.6	5.2	2.3	1.1	-0.4	1.0	1.0
Commonwealth of Independent States	32.8	14.8	70.1	39.6	24.6	20.9	14.7	12.9	10.8	11.6	10.5
Net fuel exporters	27.2	13.1	76.9	34.2	20.3	20.8	15.5	13.3	10.8	11.4	10.4
Azerbaijan	19.9	3.7	-0.8	-8.5	1.8	1.5	2.8	2.2	6.7	12.5	9.5
Kazakhstan	39.3	17.7	7.1	8.3	13.4	8.5	6.0	6.6	7.1	8.0	7.5
Russian Federation	21.8	11.0	84.4	36.5	20.8	21.6	16.0	13.6	11.0	11.5	10.5
Turkmenistan	992.4	112.0	16.7	23.5	7.0	8.2	15.0	15.3	10.0	12.0	10.5
Uzbekistan	54.0	58.8	17.7	29.1	25.0	26.6	21.6	19.0	14.2	15.0	13.0
Net fuel importers	71.3	25.9	23.0	76.4	54.0	21.4	9.7	10.1	10.5	13.0	11.0
Armenia	18.8	13.8	8.7	0.6	-0.8	3.2	1.0	4.7	6.9	2.0	3.0
Belarus	52.7	63.8	73.0	293.7	168.9	61.4	42.8	28.5	18.3	12.0	10.5
Georgia	39.4	7.1	3.6	19.2	4.2	4.6	5.7	4.9	5.6	9.0	8.0
Kyrgyzstan	32.0	23.4	10.5	35.9	18.7	6.9	2.1	3.1	4.1	5.0	4.0
Republic of Moldova	24.0	11.8	8.0	39.0	31.3	9.8	5.3	11.7	12.5	13.5	12.0
Tajikistan	270.2	71.7	43.0	26.3	32.9	38.6	12.2	16.3	7.2	8.0	7.0
Ukraine	80.3	15.9	10.6	22.7	28.2	12.0	0.8	5.2	9.0	14.5	12.0

Source: UN/DESA, based on data from Economic Commission for Europe (ECE).

a Data for country groups are weighted averages, where weights for each year are 2000 GDP in United States dollars.

b Partly estimated.

c Forecasts, partly based on Project LINK.

Table A.6.
Developing economies: consumer price inflation,[a] 1996-2006

Average percentage change	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[b]	2006[c]
Developing countries	15.2	10.2	10.3	6.7	5.9	5.8	6.3	6.4	5.2	5.2	4.9
by region:											
Africa	18.8	9.7	6.7	7.9	10.5	9.8	8.2	11.2	11.7	10.0	10.1
North Africa	9.2	4.3	3.9	2.6	2.0	2.5	2.4	3.3	7.0	4.4	4.0
Sub-Saharan Africa (excluding Nigeria and South Africa)	40.9	19.6	9.7	20.0	29.2	21.6	14.3	26.7	24.7	21.3	24.0
Net fuel exporters	14.6	5.8	5.4	3.2	3.2	6.4	4.7	5.9	9.4	7.3	5.7
Net fuel importers	22.0	12.6	7.7	11.5	16.0	12.3	10.8	15.3	13.4	12.0	13.4
East and South Asia	7.6	4.9	7.7	2.3	1.9	2.7	2.5	2.8	3.8	4.3	4.1
East Asia	6.5	3.8	6.3	1.1	1.0	2.1	1.6	2.1	3.3	3.7	3.5
South Asia	11.6	8.9	12.8	6.9	5.4	4.8	5.7	5.7	5.7	6.5	6.7
Net fuel exporters	28.9	17.3	17.9	20.1	14.5	11.3	14.3	16.5	14.8	13.5	17.7
Net fuel importers	6.9	4.5	7.4	1.8	1.5	2.4	2.1	2.4	3.5	4.0	3.7
Western Asia	30.0	30.0	28.7	21.9	17.9	18.0	16.1	8.9	3.6	4.0	4.1
Net fuel exporters	2.5	0.5	-0.1	-0.8	-0.7	-0.3	0.4	0.8	1.5	1.7	1.6
Net fuel importers	52.6	54.2	52.4	40.6	33.1	33.0	29.1	15.6	5.4	5.8	6.1
Latin America and the Caribbean	23.0	13.3	9.8	9.3	7.9	6.1	9.2	10.5	6.5	6.3	5.3
South America	18.3	10.0	7.0	5.9	7.2	5.8	11.7	13.5	6.6	7.3	5.4
Mexico and Central America	32.1	19.4	15.0	15.5	9.2	6.4	5.1	4.6	4.9	4.5	4.8
Caribbean	10.0	8.6	5.8	5.7	7.2	7.9	5.4	18.9	29.1	7.9	9.2
Net fuel exporters	38.5	23.1	18.4	17.1	11.8	7.7	7.0	7.5	6.4	5.3	5.6
Net fuel importers	11.6	6.1	3.6	3.6	5.1	4.8	10.8	12.7	6.6	7.0	5.1
Memorandum items:											
Least developed countries	35.3	21.2	19.5	20.1	21.4	17.6	17.1	13.8	5.5	10.7	11.3
East Asia (excluding China)	5.2	4.5	11.4	2.9	1.5	3.3	3.2	2.7	2.8	3.5	3.7
South Asia (excluding India)	17.0	12.4	12.0	11.4	8.3	7.1	8.4	9.6	9.6	10.7	11.8
Western Asia (excluding Israel and Turkey)	3.5	0.7	0.1	-0.5	-0.5	0.2	0.8	1.1	1.9	2.0	2.0
Major developing economies											
Argentina	0.2	0.5	0.9	-1.2	-0.9	-1.1	25.9	13.4	4.4	9.6	5.5
Brazil	15.8	6.9	3.2	4.9	7.0	6.8	8.5	14.7	6.6	6.9	5.0
Chile	7.4	6.1	5.1	3.3	3.8	3.6	2.5	2.8	1.1	3.1	3.2
China	8.3	2.8	-0.8	-1.4	0.3	0.5	-0.7	1.2	3.9	4.0	3.2
Colombia	20.2	18.5	18.7	10.9	9.2	8.0	6.3	7.1	5.9	5.1	5.0
Egypt	7.2	4.6	3.9	3.1	2.7	2.3	2.7	4.5	11.3	5.3	4.8
Hong Kong SAR[d]	6.4	5.8	2.9	-4.0	-3.7	-1.6	-3.0	-2.6	-0.4	1.5	1.6
India	9.0	7.2	13.2	4.7	4.0	3.7	4.4	3.8	3.8	4.4	4.1
Indonesia	8.0	6.2	58.4	20.5	3.7	11.5	11.9	6.6	6.2	6.8	6.9
Iran (Islamic Republic of)	28.9	17.3	17.9	20.1	14.5	11.3	14.3	16.5	14.8	13.5	17.7
Israel	11.3	9.0	5.4	5.2	1.1	1.1	5.6	0.7	-0.4	1.4	1.8

Table A.6 (continued)											
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[b]	2006[c]
Major developing economies (continued)											
Korea, Republic of	4.9	4.4	7.5	0.8	2.3	4.1	2.7	3.6	3.6	3.2	3.3
Malaysia	3.5	2.7	5.3	2.7	1.5	1.4	1.8	1.1	1.5	2.8	2.6
Mexico	34.4	20.6	15.9	16.6	9.5	6.4	5.0	4.5	4.7	4.0	4.6
Nigeria	29.3	8.2	10.3	4.8	9.0	18.8	13.5	14.0	15.0	16.3	10.8
Pakistan	10.4	11.4	6.2	4.1	4.4	3.1	3.3	2.9	7.4	9.5	8.8
Peru	11.5	8.6	7.2	3.5	3.8	2.0	0.2	2.3	3.7	1.6	1.5
Philippines	7.5	5.6	9.3	5.9	4.0	6.8	3.0	3.5	6.0	6.7	6.5
Saudi Arabia	1.2	0.1	-0.4	-1.3	-1.1	-1.1	0.2	0.6	0.5	1.0	1.0
Singapore	1.4	2.0	-0.3	0.0	1.4	1.0	-0.4	0.5	1.7	1.2	1.4
South Africa	7.4	8.6	6.9	5.2	5.3	5.7	9.2	6.8	4.3	4.6	5.0
Taiwan Province of China	3.1	0.9	1.7	0.2	1.3	0.0	-0.2	-0.3	1.6	1.7	1.5
Thailand	5.8	5.6	8.1	0.3	1.6	1.6	0.6	1.8	2.8	3.8	3.3
Turkey	80.3	85.7	84.6	64.9	54.9	54.4	45.0	25.3	8.6	8.4	8.6
Venezuela (Bolivarian Republic of)	99.9	50.0	35.8	23.6	16.2	12.5	22.4	31.1	21.7	16.0	15.0

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

a Data for country groups are weighted averages, where weights are based on GDP in 2000 prices and exchange rates.
b Partly estimated.
c Forecast, based in part on Project LINK.
d Special Administrative Region of China.

Table A.7.
Developed market economies: unemployment rates,[a,b] 1996-2006

Percentage of labour force	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[c]	2006[d]
Developed economies											
United States	5.4	4.9	4.5	4.2	4.0	4.7	5.8	6.0	5.5	5.1	4.8
Canada	9.7	9.2	8.4	7.6	6.8	7.2	7.7	7.6	7.2	6.8	6.8
Japan	3.4	3.4	4.1	4.7	4.7	5.0	5.4	5.3	4.7	4.5	4.5
Australia	8.2	8.3	7.7	6.9	6.3	6.8	6.4	6.1	5.5	5.1	5.2
New Zealand	6.1	6.6	7.4	6.8	6.0	5.3	5.2	4.6	3.9	4.0	4.2
European Union											
EU-15	10.1	9.8	9.3	8.5	7.6	7.2	7.6	8.0	8.0	8.1	8.0
Euro zone	10.6	10.5	10.0	9.2	8.2	7.8	8.3	8.7	8.8	8.9	8.7
Austria	4.4	4.4	4.5	4.0	3.7	3.6	4.2	4.3	4.5	4.7	4.6
Belgium	9.5	9.2	9.3	8.6	6.9	6.7	7.3	7.9	7.8	8.1	8.0
Finland	14.6	12.7	11.4	10.2	9.8	9.1	9.1	9.0	8.9	8.5	8.1
France	11.6	11.5	11.1	10.5	9.1	8.4	8.9	9.5	9.7	9.7	9.4
Germany	8.6	9.2	8.8	7.9	7.2	7.4	8.2	9.1	9.5	9.5	9.4
Greece	9.7	9.6	11.1	12.0	11.3	10.8	10.3	9.7	10.5	10.8	10.9
Ireland	11.7	9.9	7.5	5.6	4.3	3.9	4.3	4.6	4.5	4.2	4.1
Italy	11.2	11.2	11.3	11.0	10.1	9.1	8.6	8.4	8.0	8.1	8.0
Luxembourg	2.9	2.7	2.7	2.4	2.3	2.1	2.8	3.7	4.2	4.5	4.4
Netherlands	6.0	4.9	3.8	3.2	2.8	2.2	2.8	3.7	4.6	5.0	4.5
Portugal	7.2	6.8	5.2	4.5	4.1	4.0	5.0	6.2	6.7	7.3	7.1
Spain	18.1	17.0	15.2	12.8	11.3	10.6	11.3	11.3	10.8	10.7	10.6
Other	8.1	7.1	6.3	5.9	5.3	4.9	5.0	5.1	4.9	4.9	4.9
Denmark	6.3	5.3	4.9	4.8	4.4	4.3	4.6	5.6	5.4	4.9	4.7
Sweden	9.6	9.9	8.2	6.7	5.6	4.9	4.9	5.6	6.4	6.2	5.8
United Kingdom	8.0	6.9	6.2	5.9	5.4	5.0	5.1	5.0	4.6	4.7	4.8
EU-10											
EU-8											
Czech Republic	3.9	4.8	6.4	8.6	8.7	8.0	7.3	7.8	8.3	8.0	7.8
Estonia[e]	5.6	4.6	5.1	6.7	7.7	7.7	4.8	4.4	3.5	3.2	4.5
Hungary	9.6	9.0	8.4	6.9	6.3	5.6	5.6	5.7	6.0	7.0	6.8
Latvia[e]	7.2	7.0	9.2	9.1	7.8	7.7	8.5	8.6	8.5	7.6	7.5
Lithuania[e]	6.2	6.7	6.9	10.0	12.6	12.9	10.9	9.8	6.0	5.4	5.0
Poland	12.3	10.9	10.2	13.4	16.4	18.5	19.8	19.2	18.8	18.0	17.3
Slovakia	11.3	11.9	12.6	16.8	18.7	19.4	18.7	17.5	18.0	16.5	17.0
Slovenia[e]	14.4	14.8	14.6	13.0	12.0	11.8	11.3	11.0	10.4	10.0	9.6
Other											
Cyprus	4.7	5.2	5.2	5.5	5.2	4.4	3.9	4.5	5.2	6.0	5.8
Malta[e]	4.4	5.5	5.6	5.8	5.0	5.1	5.2	7.6	7.3	7.6	7.4
Other Europe	4.2	4.1	3.4	3.1	2.9	3.0	3.5	4.3	4.4	4.2	4.0
Iceland[e]	3.7	3.9	2.7	2.0	2.3	2.3	3.3	4.1	4.1	4.1	4.1
Norway	4.8	4.0	3.2	3.2	3.4	3.6	3.9	4.5	4.4	4.4	4.0
Switzerland	3.9	4.2	3.6	3.0	2.7	2.6	3.2	4.2	4.4	4.1	4.0
Memorandum item:											
Major developed economies	6.7	6.4	6.2	6.0	5.6	6.0	6.7	6.9	6.6	6.4	6.2

Source: UN/DESA, based on data of OECD and Economic Commission for Europe (ECE).

a Unemployment data are standardized by OECD for comparability among countries and over time, in conformity with the definitions of the International Labour Organization (see OECD, Standardized Unemployment Rates: Sources and Methods (Paris, 1985)).

b Data for country groups are weighted averages, where labour force is used for weights.

c Partly estimated.

d Forecasts.

e Not standardized.

Table A.8.
Economies in transition: unemployment rates,[a] 1996-2006

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[b]	2006[c]
South-eastern Europe											
Albania	12.3	14.9	17.6	18.2	16.8	16.4	15.8	15.0	14.4	14.3	14.0
Bosnia and Herzegovina	..	39.0	38.7	39.0	39.4	39.9	42.7	44.0	45.5	46.0	45.5
Bulgaria[d]	14.1	14.4	14.1	15.7	16.9	19.7	17.8	13.7	12.0	11.0	10.0
Croatia	15.9	17.6	18.1	20.4	22.3	22.8	21.3	18.7	18.5	18.0	17.6
Romania	6.6	8.8	10.3	11.5	10.5	8.8	8.4	7.4	6.2	6.5	7.0
Serbia and Montenegro	26.1	25.6	27.2	27.4	26.6	27.9	26.0	28.0	30.6	32.0	30.0
The former Yugoslav Republic of Macedonia	38.8	41.7	32.3	44.0	45.1	41.8	45.3	45.3	44.6	43.0	43.0
Commonwealth of Independent States											
Net fuel exporters											
Azerbaijan	1.1	1.3	1.4	1.2	1.2	1.3	1.3	1.4	1.4	1.4	1.3
Kazakhstan	4.1	3.9	3.7	3.9	3.7	2.8	2.6	1.8	1.5	1.2	1.0
Russian Federation[d]	10.0	11.2	13.2	12.6	9.6	8.9	8.6	7.8	7.9	6.9	6.7
Turkmenistan	..	..	..	..	..	..	..	..	..	..	..
Uzbekistan	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.3	..	0.4	0.4
Net fuel importers											
Armenia	9.7	11.0	8.9	11.5	10.9	9.8	9.1	10.1	9.0	7.5	7.0
Belarus	4.0	2.8	2.3	2.0	2.1	2.3	3.0	3.1	1.9	1.6	1.5
Georgia	3.2	5.0	4.2	5.0	3.5	5.5	1.2	2.1	2.0	2.0	1.9
Kyrgyzstan	4.5	3.1	3.1	3.0	3.1	3.1	3.1	2.9	2.9	3.0	3.0
Republic of Moldova	1.5	1.7	1.9	2.1	1.8	1.7	1.5	1.2	1.4	1.7	1.6
Tajikistan	2.4	2.8	2.9	3.1	3.0	2.6	2.6	2.3	2.0	1.8	1.7
Ukraine	1.5	2.8	4.3	4.3	4.2	3.7	5.0	4.7	4.7	4.4	4.2

Source: UN/DESA, based on data of Economic Commission for Europe (ECE).

a End-of-period registered unemployment data (as percentage of labour force).
b Partly estimated.
c Forecasts.
d Labour force survey data, annual average.

Table A.9.
Developing economies: unemployment rates,[a] 1996-2005

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[b]
Africa										
Algeria	..	..	..	..	..	27.3	..	23.7	17.7	16.0
Botswana	..	..	20.8	..	15.8	19.6	..	..	..	..
Egypt	..	8.4	8.2	8.1	9.0	9.2	10.2	11.0	10.6	..
Mauritius	5.8	6.6	6.9	7.7	8.8	9.1	9.7	10.2	..	..
Morocco	..	..	..	13.9	13.6	12.5	11.6	11.9	10.8	11.1
South Africa	..	..	..	..	25.4	27.9	30.1	29.6	27.1	26.5
Tunisia	..	15.7	..	15.8	15.6	15.0	14.9	14.3	13.9	..
Developing America										
Argentina[c]	18.8	16.8	14.8	16.1	17.1	19.2	21.8	16.8	13.3	11.5
Barbados	15.8	14.5	12.3	10.5	9.4	9.9	10.3	11.0	9.8	..
Bolivia[c]	3.8	3.7	..	7.2	7.5	8.5	8.7	9.2	8.5	..
Brazil[d]	..	..	..	..	..	..	11.7	12.3	11.5	10.0
Chile	6.5	6.1	6.2	9.7	9.2	9.2	9.0	8.5	8.8	8.2
Colombia[e]	11.2	12.4	15.3	19.4	17.2	18.2	17.6	16.7	15.4	14.6
Costa Rica	6.2	5.7	5.6	6.0	5.2	6.1	6.4	6.7	6.7	6.9
Dominican Republic	16.7	16.0	14.4	13.8	13.9	15.6	16.1	17.0	18.4	..
Ecuador[c]	10.4	9.2	11.5	14.4	9.0	10.9	9.2	11.5	8.6	8.2
El Salvador	7.7	8.0	7.3	7.0	7.0	7.0	6.2	6.5	7.2	..
Guatemala	..	..	..	1.9	1.4	1.3	3.1	3.4	3.1	..
Honduras	6.5	5.8	5.2	5.3	..	5.9	6.1	7.6	8.0	..
Jamaica	16.0	16.5	15.5	15.7	15.5	15.0	14.2	11.4	11.7	11.5
Mexico[f]	5.5	3.7	3.2	2.5	2.2	2.5	2.7	3.3	2.8	3.9
Nicaragua	16.0	14.3	13.2	10.7	9.8	10.5	11.6	10.2	..	..
Panama	16.4	15.4	15.5	13.6	15.2	17.0	16.5	15.9	14.1	12.0
Paraguay[c]	8.2	7.1	6.6	9.4	10.0	10.8	14.7	11.2	10.0	..
Peru[c,g]	8.0	9.2	8.5	9.2	8.5	9.3	9.4	9.4	9.4	10.1
Trinidad and Tobago	16.2	15.0	14.2	13.2	12.2	10.8	10.4	10.5	8.6	8.2
Uruguay[c]	11.9	11.5	10.1	11.3	13.6	15.3	17.0	16.9	12.9	12.2
Venezuela (Bolivarian Republic of)	..	..	11.0	14.5	13.2	12.8	16.2	16.8	15.1	12.7
Developing Asia										
Cambodia	0.9	0.7	5.3	0.6	2.5	2.8	3.0	3.5	3.1	..
China	3.0	3.0	3.1	3.1	3.1	3.6	4.0	4.3	4.2	4.2
Hong Kong SAR[h]	2.8	2.2	4.7	6.2	4.9	5.1	7.3	7.9	6.8	5.4
India	2.1	2.6	3.6	..	4.3	..	..	..	..	..
Indonesia	4.9	4.7	5.5	6.4	6.1	8.1	9.1	9.9	..	..
Iran (Islamic Republic of)	..	13.1	12.4	13.5	14.2	14.2	12.8	..	..	..
Israel	..	..	8.6	8.5	8.9	9.4	10.3	10.7	10.4	9.0
Jordan	..	..	..	..	13.7	14.7	14.4	14.8	12.5	15.7
Korea, Republic of	2.0	2.6	6.8	6.3	4.4	4.0	3.3	3.6	3.7	3.8
Malaysia	2.5	2.5	3.2	3.4	3.0	3.5	3.5	3.6	3.5	3.3

Table A.9 (continued)										
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[b]
Developing Asia (continued)										
Pakistan	5.4	6.1	5.9	5.9	7.8	7.8	8.3	8.3	7.7	..
Palestinian Occupied Territory	23.8	20.3	14.4	11.8	14.1	25.2	31.2	25.4	26.7	28.4
Philippines[i]	7.4	7.9	9.6	9.6	10.1	9.8	10.2	10.1	10.9	10.9
Singapore[j]	2.2	2.0	3.5	3.8	3.7	3.7	4.8	5.2	4.4	4.4
Sri Lanka	11.3	10.5	9.2	8.9	7.6	7.9	8.8	8.4	8.4	..
Taiwan Province of China	2.6	2.7	2.7	2.9	3.0	4.6	5.2	5.0	4.4	4.2
Thailand	1.1	0.9	3.4	3.0	2.4	2.6	1.8	1.5	1.5	2.5
Turkey	6.5	6.7	6.8	7.7	6.5	8.4	10.3	10.5	10.3	10.1
Viet Nam	..	..	4.5	4.4	2.3	2.8	2.2	2.2	2.1	..

Sources: UNCTAD, based on ILO LABORSTAT database; Economic Commission for Latin America and the Caribbean (ECLAC); Asian Development Bank (ADB) *Outlook 2005*; national sources.

a As percentage of labour force.
b Partly estimated.
c Urban areas.
d 6 main cities.
e 13 main cities.
f 32 cities.
g Metropolitan Lima: 2002, 2003 (July) and 2004 (August).
h Special Administrative Region of China.
i Philippine definition: it adopts partly the ILO definition, that is, it does not include one ILO criterion which is “currently available for work”.
j Resident unemployment rate.

Table A.10.
Major developed market economies: quarterly indicators, 2003-2005

	2003 quarters				2004 quarters				2005 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	2.8	-0.7	1.4	3.3	2.6	5.0	3.5	2.1	2.0	3.4	3.6
France	2.0	-1.6	4.2	1.6	2.2	3.1	0.3	2.6	1.6	0.5	2.8
Germany	-4.1	1.6	2.8	0.3	-2.5	2.5	1.3	0.5	-4.2	4.2	0.8
Italy	-0.4	-0.4	1.6	0.0	2.0	1.6	1.6	-1.6	-2.0	2.8	1.2
Japan	-0.6	2.7	1.9	6.7	3.4	-1.2	0.5	-0.3	5.7	5.0	1.0
United Kingdom	2.4	2.4	4.1	3.6	4.1	2.8	1.2	2.0	1.2	2.0	1.6
United States	2.0	3.1	8.2	4.1	4.5	3.3	4.0	3.8	3.5	3.3	4.3
Major developed economies	0.8	2.2	5.2	3.9	3.3	2.2	2.4	2.1	2.7	3.5	2.8
Euro zone	0.0	-0.8	2.0	1.6	2.8	2.0	1.2	0.8	1.6	1.2	2.4
	Unemployment rate[b] (percentage of total labour force)										
Canada	7.5	7.7	7.9	7.5	7.3	7.2	7.1	7.1	7.0	6.8	6.8
France	9.2	9.4	9.5	9.6	9.6	9.6	9.7	9.5	9.6	9.6	9.4
Germany	9.5	9.7	9.7	9.6	9.5	9.5	9.7	9.6	9.7	9.7	9.2
Italy	8.8	8.7	8.6	8.5	8.2	8.1	7.9	8.0	7.8	7.7	..
Japan	5.4	5.4	5.2	5.1	4.9	4.6	4.8	4.5	4.6	4.3	4.3
United Kingdom	5.1	5.0	4.9	4.8	4.7	4.7	4.6	4.6	4.6	4.6	4.6
United States	5.8	6.1	6.1	5.9	5.6	5.6	5.5	5.4	5.3	5.1	5.0
Major developed economies	6.7	6.8	6.8	6.6	6.4	6.3	6.3	6.2	6.2	6.0	5.9
Euro zone	8.0	8.1	8.1	8.1	8.1	8.1	8.1	8.0	8.0	7.9	7.8
	Change in consumer prices[c] (percentage change from preceding quarter)										
Canada	5.4	-0.5	1.5	0.5	2.0	4.7	0.8	1.7	1.4	3.8	3.7
France	3.4	1.5	1.1	2.6	2.2	3.7	0.4	2.2	0.5	3.6	1.4
Germany	3.7	-0.4	1.2	0.3	3.1	2.7	1.5	0.6	2.1	2.5	3.3
Italy	3.3	2.9	2.1	1.9	2.3	3.1	1.7	0.9	2.0	2.8	2.4
Japan	-1.6	1.8	-0.7	-0.7	-0.9	1.1	0.1	1.8	-3.7	1.5	-0.6
United Kingdom	2.3	4.8	1.0	2.5	2.0	5.6	2.4	3.8	1.1	4.9	1.5
United States	4.1	1.5	2.0	0.1	3.7	5.8	1.4	2.4	2.5	5.5	5.0
Major developed economies	2.6	1.6	1.2	0.4	2.2	4.2	1.1	2.1	0.8	3.9	2.9
Euro zone	2.5	2.8	0.4	2.3	1.4	4.1	0.7	2.2	1.1	4.0	1.8

Sources: UN/DESA, based on data of IMF, *International Financial Statistics*; Organisation for Economic Cooperation and Development (OECD) and national authorities.

a Expressed in annual rate. Major developed economies is weighted average with weights being annual GDP valued in 2000 prices and exchange rates.
b Seasonally adjusted data as standardized by OECD. Major developed economies is weighted average with weights being labour force of respective years.
c Expressed in annual rate. Major developed economies is weighted average with weights being 2000 GDP in United States dollars.

Table A.11.
Selected economies in transition: quarterly indicators, 2003-2005

	2003 quarters				2004 quarters				2005 quarters		
	I	II	III	IV	I	II	III	IV	I	II	III
	Rates of growth of gross domestic product[a,b]										
Armenia	12.5	17.2	15.6	11.4	7.4	10.1	11.5	9.7	7.8	11.5	12.9
Belarus	5.9	4.9	7.9	8.9	9.3	11.0	11.7	11.6	9.6	8.3	8.4
Bulgaria	3.6	4.6	3.8	5.7	4.5	5.5	5.8	6.2	6.0	6.4	..
Croatia	4.9	5.0	3.9	3.3	4.2	3.8	3.6	3.6	1.8	5.1	..
Georgia	5.7	11.9	10.4	15.5	6.3	9.7	3.0	6.3	4.5	8.8	9.4
Kazakhstan	10.5	9.6	7.7	9.2	9.0	9.2	9.1	10.3	9.0	9.2	8.3
Kyrgyzstan	5.0	2.6	8.2	10.0	6.1	11.4	4.8	7.4	2.0	2.7	-3.4
Republic of Moldova	10.3	9.3	2.9	6.4	7.5	2.2	7.7	10.5	8.2	8.6	..
Romania	4.5	4.9	5.8	5.2	6.2	7.1	10.0	9.7	5.9	4.1	..
Russian Federation	7.6	8.0	6.2	7.7	7.6	7.7	7.1	6.4	5.2	6.1	6.6
Ukraine	9.1	11.4	5.9	12.3	12.6	13.6	14.0	8.4	5.3	3.4	0.6
	Unemployment[c]										
Armenia	10.4	10.0	9.8	10.1	9.8	9.3	9.1	9.0	8.9	8.0	7.6
Belarus	3.2	3.2	3.1	3.1	3.0	2.4	2.2	1.9	1.9	1.7	1.6
Bulgaria[d]	15.6	13.7	12.7	12.7	13.3	12.0	11.0	11.8	11.3	10.0	..
Croatia	20.6	18.5	17.9	18.7	18.9	17.2	17.4	18.5	19.2	17.4	..
Georgia	..	..	..	..	0.5	0.6	1.2	2.0	2.8	..	..
Kazakhstan	2.6	2.4	2.0	1.8	1.9	1.9	1.6	1.5	1.5	1.4	1.3
Kyrgyzstan	3.1	3.0	3.0	2.9	3.0	2.9	2.9	2.9	3.0	3.1	3.0
Republic of Moldova	2.2	1.8	1.5	1.2	2.0	1.5	1.6	1.4	2.1	1.9	1.7
Romania	8.6	7.3	6.7	7.4	7.8	6.6	6.1	6.2	6.0	5.5	5.5
Russian Federation[d]	8.4	7.7	7.8	7.8	9.1	7.2	6.9	7.9	7.9	6.9	..
Ukraine[e]	5.4	5.0	4.7	4.7	5.1	4.8	4.4	4.7	5.0	4.4	..
	Change in consumer prices[a]										
Armenia	-4.9	-0.3	-1.0	1.3	1.7	-0.2	-1.1	1.5	1.3	0.1	-1.4
Belarus	15.4	2.6	-3.2	3.2	1.8	-0.5	0.9	3.4	1.6	0.4	-1.3
Bulgaria	1.8	1.4	0.6	0.1	1.7	1.6	1.4	0.6	0.8	2.0	-0.3
Croatia	0.5	0.2	0.9	0.3	2.2	0.3	1.2	0.5	2.1	1.2	1.5
Georgia	0.9	7.1	4.8	2.8	4.4	1.1	1.4	3.1	3.2	1.7	0.2
Kazakhstan	9.7	16.8	7.2	4.6	4.6	2.9	-0.8	3.0	3.0	3.7	-3.3
Kyrgyzstan	15.0	8.3	9.8	8.3	8.7	4.6	5.1	3.0	2.3	2.0	-1.9
Republic of Moldova	22.9	8.5	6.2	4.1	4.5	3.8	5.3	4.9	6.7	5.7	2.4
Romania	3.9	1.3	6.8	1.5	5.3	1.5	0.3	1.2	3.6	2.1	0.5
Russian Federation	9.4	8.7	19.3	-1.3	0.1	10.0	10.0	26.1	6.0	4.5	-0.8
Ukraine	12.0	5.4	1.1	7.2	9.5	3.5	2.2	10.0	7.8	6.0	1.9

Sources: UN/DESA, based on data of ECE, Economic Commission for Europe and Eurostat.

a Percentage change from the corresponding period of the preceding year.
b For 2005, partially estimated from cumulative data.
c Registered unemployment (end of period).
d Labour force survey data.
e Quarterly data refer to the last month's value which is the average unemployment rate of the month, not an end of period value.

Table A.12.
Major developing economies: quarterly indicators, 2003-2005

	2003 quarters				2004 quarters				2005 quarters		
	I	II	III	IV	I	II	III	IV	I	II	III
	Rates of growth of gross domestic product[a]										
Argentina	5.4	7.7	10.2	11.7	11.3	7.2	8.7	9.3	8.0	10.1	..
Brazil	1.8	-0.1	-0.4	0.9	4.0	5.1	5.9	4.7	2.8	3.9	1.0
Chile	3.9	4.1	4.1	2.8	4.7	5.3	7.0	7.3	6.1	6.5	5.2
China	9.9	6.7	9.6	9.9	9.7	9.7	9.5	9.5	9.5	9.5	9.4
Colombia	4.7	2.6	4.6	5.2	4.0	4.8	2.8	4.4	3.9	5.3	..
Ecuador	3.4	-0.8	2.1	6.0	6.3	10.0	7.4	4.3	3.2	2.9	..
Hong Kong SAR[b]	4.3	-0.7	4.0	4.8	7.4	12.0	6.7	7.2	6.2	7.3	8.2
India	4.2	5.5	8.8	11.0	8.4	7.6	6.7	6.4	7.0	8.1	8.0
Indonesia	5.9	5.2	4.2	4.7	4.4	4.4	5.1	6.7	6.2	7.3	8.2
Israel	1.2	2.7	2.9	3.8	4.3	4.4	4.8	5.4	5.1	5.2	5.7
Korea, Republic of	3.8	2.2	2.3	4.1	5.3	5.5	4.7	3.3	2.7	3.3	4.4
Malaysia	4.9	4.7	5.3	6.7	7.8	8.4	6.7	5.8	5.7	4.4	5.3
Mexico	2.3	0.2	0.4	2.0	3.7	3.9	4.4	4.9	2.4	3.1	3.3
Philippines	3.9	3.2	3.3	3.3	4.7	7.2	4.9	3.2	4.6	4.8	4.1
Singapore	2.2	-4.0	3.8	7.9	7.9	12.3	7.2	6.5	2.7	5.4	7.0
South Africa	3.6	3.1	2.8	2.4	3.2	4.0	4.8	5.8	4.6	5.4	4.2
Taiwan Province of China	3.5	-0.2	4.0	5.7	7.6	9.0	5.5	2.5	2.5	3.0	4.4
Thailand	7.3	6.5	6.6	7.8	6.7	6.7	6.3	5.1	3.3	4.4	5.3
Turkey	8.1	3.9	5.5	6.1	11.8	14.4	5.3	6.3	4.8	4.2	..
Venezuela (Bolivarian Republic of)	-24.9	-5.0	-7.1	6.6	35.0	14.3	14.2	4.5	16.2	10.8	9.8
	Unemployment rate[c]										
Argentina	20.4	17.8	16.3	14.5	14.4	14.8	13.2	12.1	13.0	12.1	11.1
Brazil	11.6	12.7	12.9	12.0	12.2	12.3	11.2	10.2	10.5	10.1	9.5
Chile	8.2	9.1	9.4	7.4	8.1	9.6	9.7	8.6	7.9	8.7	8.5
Colombia	15.2	14.0	14.3	13.1	15.3	14.1	12.8	12.1	13.4	12.0	11.4
Hong Kong SAR[b]	7.9	8.6	7.9	7.3	7.2	7.0	6.8	6.6	6.2	5.8	5.6
Israel	10.6	10.5	10.9	10.9	10.9	10.5	10.1	9.8	9.1	9.0	8.9
Korea, Republic of	3.6	3.3	3.3	3.4	3.8	3.3	3.6	3.4	4.2	3.6	3.8
Malaysia	3.8	4.0	3.4	3.2	3.8	3.7	3.4	3.3	3.5	3.1	..
Mexico	2.8	3.0	3.8	3.5	3.9	3.6	4.0	3.5	3.9	3.5	3.8
Philippines	10.6	12.2	12.6	10.2	11.0	13.7	11.7	10.9	11.3	8.3	..
Singapore	3.7	5.4	4.9	4.9	4.5	4.3	3.0	3.0	3.3	3.4	3.3
Taiwan Province of China	5.1	5.0	5.1	4.8	4.6	4.5	4.4	4.2	4.2	4.1	4.3
Thailand	2.8	2.5	1.5	1.8	2.9	2.5	1.5	1.5	2.5	..	..
Turkey	12.3	10.0	9.4	10.3	12.4	9.3	9.5	10.0	11.4	9.5	9.4
Uruguay	18.6	17.5	16.1	14.6	13.8	13.3	12.6	11.8	12.1	12.3	..
Venezuela (Bolivarian Republic of)	19.7	18.9	17.9	15.6	17.3	16.1	15.0	15.3	..	..	..

Table A.12 (continued											
	2003 quarters				2004 quarters				2005 quarters		
	I	II	III	IV	I	II	III	IV	I	II	III
	Change in consumer prices[a]										
Argentina	35.7	14.5	5.2	3.7	2.4	4.1	5.4	5.7	8.2	8.8	9.8
Brazil	15.6	16.9	15.2	11.4	6.8	5.5	6.9	7.2	7.4	7.8	6.2
Chile	3.8	3.7	2.7	1.1	0.0	0.4	1.5	2.3	2.3	2.8	3.3
China	-1.6	-1.3	-2.0	-1.4	-0.6	0.1	2.0	2.5	3.2	3.8	4.8
Colombia	7.4	7.6	7.1	6.4	6.2	5.6	6.0	5.7	5.2	5.0	4.9
Ecuador	9.7	8.2	7.5	6.5	3.9	3.2	2.0	1.9	1.2	1.1	3.1
Hong Kong SAR[b]	-2.0	-2.5	-3.6	-2.3	-1.8	-0.9	0.8	0.2	0.4	0.8	1.4
India	3.8	4.7	3.4	3.4	4.0	2.7	4.2	4.2	4.2	4.0	3.7
Indonesia	7.7	7.0	6.1	5.5	4.9	6.7	7.0	6.4	7.7	7.6	8.4
Israel	5.2	1.4	-1.6	-2.1	-2.5	-0.7	0.6	1.0	0.8	0.3	1.7
Korea, Republic of	4.1	3.4	3.2	3.5	3.3	3.3	4.3	3.4	3.1	3.0	2.4
Malaysia	1.3	0.9	1.0	1.0	0.9	1.2	1.5	2.3	2.4	3.0	3.4
Mexico	5.4	4.7	4.1	4.0	4.3	4.3	4.8	5.3	4.4	4.5	4.0
Philippines	-0.8	3.5	3.6	3.8	4.1	4.7	6.9	8.1	8.4	8.2	7.2
Singapore	0.7	0.2	0.5	0.7	1.3	1.9	1.9	1.6	0.2	0.0	0.5
South Africa	10.7	7.8	4.7	0.7	0.4	0.7	1.3	3.2	2.9	3.2	3.7
Taiwan Province of China	-0.2	-0.1	-0.6	-0.2	0.5	1.2	2.9	1.9	1.6	2.1	3.0
Thailand	2.0	1.7	1.9	1.6	1.9	2.7	3.3	3.2	2.8	3.7	5.6
Turkey	30.4	29.7	24.7	17.7	9.5	7.4	8.1	9.4	8.6	8.6	7.9
Venezuela (Bolivarian Republic of)	35.5	34.2	29.5	26.3	24.0	22.4	21.5	19.5	17.0	16.3	15.1

Source: 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 It reflects national definitions and coverage. Not comparable across economies.

Table A.13.
Major developed market economies: financial indicators, 1996-2005

Percentage	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[a]
Short-term interest rates[b]										
Canada	4.3	3.3	4.9	4.7	5.5	4.1	2.5	2.9	2.2	2.5
France[c]	3.7	3.2	3.4	3.0	4.4	4.3	3.3	2.3	2.1	2.1
Germany[c]	3.3	3.2	3.4	2.7	4.1	4.4	3.3	2.3	2.0	2.1
Italy[c]	8.8	6.9	5.0	3.0	4.4	4.3	3.3	2.3	2.1	2.1
Japan	0.5	0.5	0.4	0.1	0.1	0.1	0.0	0.0	0.0	0.0
United Kingdom	6.0	6.6	7.2	5.2	5.8	5.1	3.9	3.6	4.3	4.8
United States	5.0	5.0	4.5	5.0	6.0	1.3	0.8	2.0	3.2	3.9
Long-term interest rates[d]										
Canada	7.5	6.4	5.5	5.7	5.9	5.8	5.7	5.3	5.1	4.4
France	6.4	5.6	4.7	4.7	5.5	5.0	4.9	4.2	4.2	3.5
Germany	5.6	5.1	4.4	4.3	5.2	4.7	4.6	3.8	3.8	3.2
Italy	9.4	6.9	4.9	4.7	5.6	5.2	5.0	4.2	4.3	3.6
Japan	2.2	1.7	1.1	1.8	1.7	1.3	1.3	1.0	1.5	1.3
United Kingdom	8.1	7.1	5.4	4.7	4.7	4.8	4.8	4.6	4.8	4.5
United States	6.4	6.4	5.3	5.6	6.0	5.0	4.6	4.0	4.3	4.2
General government financial balances[e]										
Canada	-2.8	0.2	0.1	1.7	3.1	1.4	0.8	0.0	0.7	0.5
France	-4.1	-3.0	-2.7	-1.6	-1.4	-1.6	-3.2	-4.1	-3.7	-3.2
Germany	-3.4	-2.7	-2.1	-1.4	1.3	-2.9	-3.8	-4.1	-3.7	-3.9
Italy	-6.5	-2.7	-2.8	-1.9	-0.6	-3.2	-2.7	-3.2	-3.2	-4.3
Japan[f]	-5.0	-3.8	-5.5	-7.2	-7.4	-6.1	-7.9	-8.2	-7.2	-6.7
United Kingdom	-4.4	-2.0	0.4	1.3	3.8	0.7	-1.6	-3.3	-3.2	-3.4
United States	-2.2	-0.9	0.3	0.7	1.4	-0.2	-3.3	-4.9	-4.0	-3.7

Sources: UN/DESA, based on IMF, *International Financial Statistics*; OECD *Economic Outlook*; and EUROPA (EU on line), *European Economy*.

a Average of nine months data.
b Money market rates.
c From January 1999 onward, represents the three months Euro Interbank Offered Rate (EURIBOR), which is an interbank deposit bid rate.
d Yield on long-term government bonds.
e Surplus (+) or deficit (-) as a percentage of nominal GNP or GDP.
f The 1998 deficit does not take account of the assumption by the central government of the debt of the Japan National Railway Settlement Corporation and the National Forest Special Account, which amounts to 5.2 percentage points of GDP. Deferred tax payments on postal savings accounts included in 2000 and 2001.

Table A.14.
Selected economies: real effective exchange rates, broad measurement,[a] 1996-2005

2000=100	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Developed economies										
Australia	106.9	108.5	100.2	101.7	100.0	95.2	98.8	111.5	121.7	130.2
Canada	106.1	107.2	102.1	101.4	100.0	96.2	94.7	102.9	104.6	107.9
Denmark	104.1	101.2	104.9	105.9	100.0	102.5	106.7	113.9	114.2	111.6
Euro zone	119.3	109.1	112.3	108.0	100.0	101.0	105.3	117.4	121.2	120.0
Japan	93.1	88.1	88.9	98.0	100.0	89.6	84.2	83.3	84.0	79.0
New Zealand	128.2	131.3	117.0	112.1	100.0	99.9	112.6	132.2	141.8	148.4
Norway	99.2	98.6	98.9	100.1	100.0	102.5	109.2	108.5	110.8	117.0
Sweden	114.0	108.0	109.2	105.0	100.0	91.3	94.2	97.8	97.4	94.1
Switzerland	111.2	102.5	106.9	106.5	100.0	103.1	109.7	111.1	108.8	104.8
United Kingdom	87.1	99.4	103.6	102.3	100.0	97.7	98.3	95.7	99.9	97.6
United States	86.9	90.9	98.8	98.9	100.0	106.2	105.8	97.6	91.8	89.7
Developing economies										
Argentina	89.4	93.8	96.3	102.7	100.0	105.0	55.5	62.1	60.8	60.2
Brazil	107.4	112.8	112.3	83.0	100.0	90.3	88.9	98.8	106.4	130.3
Chile	97.4	101.8	97.9	95.3	100.0	94.5	92.8	92.6	99.9	109.1
China	91.5	97.8	102.1	97.1	100.0	105.0	101.9	97.2	95.7	98.7
Colombia	117.7	125.0	119.8	107.8	100.0	101.2	98.8	88.3	95.8	105.5
Ecuador	81.0	84.5	82.0	76.6	100.0	100.9	110.3	112.4	112.8	125.1
Egypt	80.0	89.5	95.6	98.6	100.0	91.2	81.6	64.5	66.6	72.5
Hong Kong SAR[b]	97.1	105.2	113.2	105.2	100.0	101.8	101.0	94.8	90.0	86.8
India	98.5	102.8	97.8	98.5	100.0	102.5	98.6	98.2	99.6	103.1
Indonesia	145.0	134.8	70.2	106.4	100.0	97.1	117.9	124.0	114.1	113.4
Israel	91.7	95.5	94.2	93.8	100.0	99.2	89.0	86.9	80.9	79.1
Korea, Republic of	112.9	105.0	86.4	94.4	100.0	90.8	93.9	92.9	96.6	106.2
Kuwait	90.4	94.5	99.3	97.3	100.0	107.4	108.6	101.8	94.7	96.6
Malaysia	126.1	122.1	101.4	99.3	100.0	105.1	104.4	99.7	94.8	93.5
Mexico	72.4	82.2	81.8	90.4	100.0	105.7	105.3	98.7	97.8	103.2
Morocco	92.0	92.6	97.6	99.7	100.0	97.2	98.5	98.0	95.0	91.7
Nigeria	152.9	175.5	192.5	97.6	100.0	111.0	111.6	104.6	107.2	117.2
Pakistan	103.0	106.2	101.7	99.8	100.0	95.5	100.2	101.2	100.5	103.1
Peru	105.9	107.3	107.6	99.4	100.0	103.9	103.6	99.5	99.3	99.3
Philippines	129.3	121.6	97.7	103.6	100.0	108.3	112.3	107.6	101.6	108.4
Saudi Arabia	90.4	96.1	101.9	99.3	100.0	103.6	101.7	93.9	87.4	85.0
Singapore	101.7	99.1	93.8	92.3	100.0	99.4	97.8	97.1	99.3	107.0
South Africa	109.5	115.8	104.1	101.3	100.0	89.7	82.5	109.6	118.4	118.4
Taiwan Province of China	106.0	107.0	100.3	96.6	100.0	95.7	93.2	89.1	91.4	89.3
Thailand	118.0	109.0	100.7	102.9	100.0	97.0	100.6	100.5	101.0	104.0
Turkey	92.4	93.4	92.2	90.8	100.0	87.2	100.3	108.6	116.6	124.9
Venezuela (Bolivarian Republic of)	68.1	78.0	88.8	96.3	100.0	109.4	90.6	94.3	98.7	99.4

Source: JPMorgan Chase and *International Financial Statistics*.

a Indices based on a "broad" measure currency basket of 18 OECD currencies (including the Euro) and 30 developing-economy currencies (mostly Asian and Latin American). The real effective exchange rate, which adjusts the nominal index for relative price changes, gauges the effect on international price competitiveness of the country's manufactures due to currency changes and inflation differentials. A rise in the index implies a fall in competitiveness and vice versa. The relative price changes are based on indices most closely measuring the prices of domestically produced finished manufactured goods, excluding food and energy, at the first stage of manufacturing. The weights for currency indices are derived from 2000 bilateral trade patterns of the corresponding countries.

b Special Administrative Region of China.

II. International trade

Table A.15.
Indices of prices of primary commodities, 1996-2005

2000 = 100

	Non-fuel commodities[c]					Combined index				*Memorandum item:*
	Food	Tropical beverages	Vegetable oilseeds and oils	Agricul-tural raw materials	Minerals and metals	Dollar	SDR	Manufac-tured export prices	Real prices of non-fuel commodities[a]	Crude petro-leum[b,c]
1996	144	136	159	137	110	135	123	118	114	73.5
1997	136	177	158	123	112	132	127	110	120	67.7
1998	118	150	170	108	91	114	112	110	104	44.5
1999	98	118	125	97	89	98	95	105	94	63.3
2000	100	100	100	100	100	100	100	100	100	100.0
2001	103	79	94	96	89	96	100	98	98	83.8
2002	102	89	117	94	87	97	99	98	99	88.3
2003	104	94	137	112	98	105	99	107	98	101.8
2004	119	100	155	123	137	126	112	115	110	130.6
2001 I	107	87	87	103	97	101	104	100	101	88.3
II	102	82	85	99	93	97	102	97	100	92.9
III	104	75	104	97	85	96	100	97	99	87.4
IV	98	73	99	86	82	91	95	96	95	66.7
2002 I	99	82	101	86	87	93	99	95	98	71.9
II	100	85	110	92	88	96	99	97	99	88.8
III	104	90	123	98	85	99	98	100	99	94.5
IV	106	97	133	99	87	101	101	101	100	97.2
2003 I	108	101	133	105	93	105	101	104	101	110.7
II	101	93	130	107	92	101	95	108	93	93.7
III	99	92	128	111	97	101	96	107	95	99.2
IV	109	91	158	126	109	114	104	110	103	104.6
2004 I	118	99	175	130	133	126	112	114	111	111.4
II	124	95	162	120	134	127	115	114	111	124.7
III	116	99	143	119	137	123	111	115	107	141.6
IV	116	107	141	125	145	126	110	118	107	145.0
2005 I	129	132	139	125	165	139	121	119	117	159.7
II	125	132	144	126	167	138	122	117	118	178.8
III	125	120	139	134	173	140	126	...	...	203.9
IV	129	119	141	137	180	144	131	...	...	198.0

Sources: UNCTAD, *Monthly Commodity Price Bulletin*; United Nations, *Monthly Bulletin of Statistics*; and *Middle East Economic Survey*, available from http://www.mees.com/Energy_Tables/basket.htm.

a Combined index of non-fuel commodity prices in dollars deflated by manufactured export price index.
b Composite price of the OPEC basket of seven crudes. Effective 16 June 2005, OPEC basket is composed of 11 crudes.
c The fourth quarter of 2005 is the October 2005 data.

Table A.16.
World oil supply and demand, 1996-2006

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[a]	2006[b]
World oil supply[c,d] (millions of barrels per day)	72.0	74.3	75.5	74.1	76.9	77.1	76.9	79.6	83.1	84.4	85.7
Developed economies	18.4	18.6	18.4	18.1	18.5	18.3	18.3	17.8	17.4	16.6	16.6
Economies in transition	7.3	7.4	7.5	7.7	8.1	8.7	9.6	10.5	11.4	11.8	12.3
Developing countries	44.8	46.7	48.0	46.7	48.6	48.3	47.3	49.6	52.4	54.1	54.9
OPEC	28.4	29.9	30.8	29.4	30.8	30.4	28.8	30.7	33.0	34.1	34.1
Non-OPEC	16.4	16.8	17.1	17.3	17.8	17.9	18.5	18.9	19.4	20.0	20.8
Processing gains[e]	1.5	1.6	1.6	1.7	1.7	1.7	1.8	1.8	1.8	1.9	1.9
World total demand[f]	71.6	73.1	73.5	75.4	76.2	77.3	77.7	79.2	82.2	83.3	85.0
Oil prices (dollars per barrel)											
OPEC basket[g]	20.29	18.68	12.28	17.47	27.60	23.12	24.36	28.10	36.05	50.38	..
Brent oil	20.45	19.12	12.72	17.81	28.27	24.42	24.97	28.85	38.30	54.70	59.00

Sources: United Nations, World Bank, International Energy Agency, U.S. Energy Information Administration, and *Middle East Economic Survey*, available from http://www.mees.com/Energy_Tables/basket.htm (accessed on 8 December 2005.

a Partly estimated.
b Forecasts.
c Including crude oil, condensates, natural gas liquids (NGLs), oil from non-conventional sources and other sources of supply.
d Totals may not add up due to rounding.
e Net volume gains and losses in refining process (excluding net gain/loss in the economies in transition and China) and marine transportation losses.
f Including deliveries from refineries/primary stocks and marine bunkers, and refinery fuel and non-conventional oils.
g Data for 2005 is from January to October 2005. Effective 16 June 2005, OPEC basket is composed of 11 crudes.

Table A.17.
World trade: changes in value and volume of exports and imports, by major country group, 1996-2006

Annual percentage change

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[a]	2006[b]
Dollar value of exports											
World	4.3	3.5	-2.3	3.9	14.9	-3.6	5.3	15.9	20.4	12.9	7.5
Developed economies	2.6	2.3	0.3	2.2	11.3	-3..9	3..3	13.9	17.9	8.1	5.2
North America	6.4	9.3	-0.7	5.0	13.3	-6.4	-3.0	3.6	14.1	9.6	6.9
Western Europe	3.0	-1.5	1.8	-0.3	10.6	-0.3	5.9	18.4	18.9	7.4	4.6
Japan	-7.3	2.5	-7.9	8.6	10.0	-17.3	3.9	13.4	20.1	8.0	6.9
Economies in transition	8.0	2.2	-2.1	-1.0	16.3	6.2	7.4	22.4	29.2	25.4	12.8
Central and Eastern Europe and Baltic States	5.7	6.5	13.5	-1.2	20.5	12.5	8.8	22.8	21.6	15.1	11.2
Commonwealth of Independent States	10.9	-1.8	-17	-1.0	10.0	-3.8	5.1	21.7	40.4	38.5	14.4
Developing countries	7.6	6.4	-6.5	7.7	22.8	-4.1	9.2	18.9	23.7	19.6	10.4
Latin America and the Caribbean	10.2	10.4	-2.4	5.6	19.4	-3.6	1.9	9.0	23.2	15.8	10.8
Africa	19.7	2.5	-15.0	10.3	7.3	-6.7	1.6	27.0	26.1	22.0	12.0
Western Asia	13.6	-5.7	-24.1	25.1	40.1	-3.3	6.6	24.9	35.0	34.1	8.1
East and South Asia	5.0	4.0	-6.9	6.5	22.2	-4.2	12.3	13.8	17.7	11.3	11.0
China	1.6	20.8	0.5	6.1	27.8	6.8	22.3	34.6	35.4	29.0	13.0
Dollar value of imports											
World	4.8	2.8	-2.3	5.4	13.7	-3.6	2.9	16.5	21.4	12.7	8.6
Developed economies	3.6	2.6	1.9	5.2	11.7	-3.6	2.1	14.9	18.6	12.0	5.4
North America	6.2	10.3	4.6	10.9	18.1	-6.2	1.9	7.3	16.2	13.9	5.4
Western Europe	2.3	0.0	3.8	1.4	7.6	-1.6	3.5	19.6	19.7	10.4	5.8
Japan	4.0	-3.0	-17.2	11.2	21.4	-7.4	-7.3	13.3	19.0	16.5	5.5
Economies in transition	13.9	9.0	0.5	-8.0	15.2	11.1	6.8	22.8	19.0	17.2	18.8
Central and Eastern Europe and Baltic States	16.5	6.7	13.0	-2.5	15.2	9.3	7.3	22.5	16.1	13.3	9.9
Commonwealth of Independent States	6.7	15.9	-19.0	-24.0	15.0	21.7	6.4	23.7	27.6	27.8	40.0
Developing economies	6.3	4.3	-10.2	4.4	19.0	-5.9	4.5	17.2	27.7	13.9	14.0
Latin America and the Caribbean	9.7	16.2	5.2	-3.7	15.7	-3.5	-6.1	6.5	23.4	17.6	16.5
Africa	2.0	6.0	-1.0	1.0	7.5	-0.1	10.4	18.5	27.3	21.0	9.5
Western Asia	9.3	0.6	-6.4	-0.3	2.7	4.0	8.6	20.9	26.2	16.3	12.6
East and South Asia	5.3	2.0	-20	7.6	25.4	-9.2	7.6	13.3	20.5	12.9	13.2
China	7.6	2.5	-1.5	18.2	35.8	8.2	21.2	39.8	36.0	20.0	19.0

Table A.17 (continued

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[a]	2006[b]
Volume of exports											
World	4.8	9.3	3.6	5.1	10.8	-0.9	3.0	6.4	11.0	7.1	7.2
Developed economies	4.2	9.2	4.0	4.4	10.1	-1.3	-0.1	1.8	7.9	4.5	6.0
North America	6.2	10.9	3.7	6.4	11.1	-5.3	-4.8	0.2	9.4	6.1	6.4
Western Europe	3.8	7.7	5.4	3.9	10.6	2.4	0.7	2.5	6.6	4.2	6.1
Japan	0.6	9.6	-3.7	2.7	5.1	-11.8	7.0	5.3	16.0	7.9	6.8
Economies in transition	6.0	-0.9	6.9	4.0	15.9	8.4	6.7	14.0	12.6	9.6	8.2
Central and Eastern Europe and Baltic States	4.5	0.8	15.0	7.0	20.5	11.1	5.3	16.2	13.1	11.5	9.4
Commonwealth of Independent States	7.9	-2.9	0.2	2.0	9.6	5.0	9.5	11.1	12.0	7.0	6.5
Developing countries	6.5	9.9	1.9	7.2	11.7	-1.3	9.2	14.0	15.8	10.9	8.7
Latin America and the Caribbean	9.3	12.8	7.8	6.6	7.6	1.9	0.8	5.1	11.2	7.9	7.5
Africa	8.2	5.2	-0.9	2.1	8.0	1.0	3.5	11.8	6.5	6.5	8.0
Western Asia	9.0	-0.7	-1.5	0.6	-19.9	4.7	2.9	12.6	11.1	4.4	3.3
East and South Asia	5.8	9.3	0.1	10.0	19.2	-3.1	13.2	16.0	19.0	13.2	10.6
China	2.4	26.3	4.1	7.4	25.5	7.9	23.6	34.8	33.9	26.8	12.6
Volume of imports											
World	6.1	9.0	3.0	5.3	11.6	-1.0	1.0	6.1	10.7	7.7	8.3
Developed economies	4.9	8.7	5.9	6.1	9.1	-1.2	-0.3	2.5	7.6	5.3	5.3
North America	5.6	13.3	10.3	10.4	13.8	-3.5	0.4	1.6	8.1	7.1	4.9
Western Europe	4.4	7.6	6.1	3.4	7.6	0.6	0.4	2.4	7.1	4.5	6.4
Japan	3.5	2.7	-10.0	9.5	0.3	-4.7	-8.3	6.1	7.3	5.5	3.4
Economies in transition	13.8	9.0	2.0	-6.0	17.6	11.5	7.6	10.0	10.1	12.3	13.1
Central and Eastern Europe and Baltic States	17.9	7.6	10.0	5.0	15.2	10.4	5.2	8.0	7.8	9.2	12.7
Commonwealth of Independent States	2.4	13.6	-15.0	-28.0	29.2	18.1	14.2	16.0	16.7	20.5	14.0
Developing countries	8.5	10.2	-4.7	4.0	17.5	-2.5	3.9	13.3	16.9	11.4	13.0
Latin America and the Caribbean	8.4	23.1	7.2	-6.9	3.9	2.2	-8.2	-3.7	15.1	11.5	10.6
Africa	3.8	6.3	2.0	1.5	15.0	0.3	5.0	8.0	10.0	11.0	8.2
Western Asia	11.8	6.4	-2.6	2.3	15.4	5.2	4.8	24.7	14.7	12.3	13.1
East and South Asia	8.2	8.4	-12.7	6.9	23.7	-6.0	6.6	16.2	18.7	11.2	14.3
China	11.4	9.4	6.0	18.6	52.8	10.9	17.8	42.0	31.3	18.1	19.2

Sources: UN/DESA/STAT, ECA, ECE, ECLAC, ESCAP, ESCWA, and IMF

a Partly estimated.

b Forecast based on Project LINK.

Table A.18.
European Union and United States: imports of textiles and clothing from selected trading partners, 2004-2005

European Union Imports			United States Imports		
Partner	Value (millions of 2004 dollars)	Percentage change January-September 2004/2005	Partner	Value (millions of 2004 dollars)	Percentage change January-September 2004/2005
Bangladesh	4 835	-6	Bangladesh	2 065	19
Bulgaria	1 566	4	Brazil	408	6
Cambodia	645	-11	Cambodia	1 441	17
China	18 519	49	China	14 559	61
Croatia	644	-9	Colombia	636	1
Egypt	807	-1	Costa Rica	524	-8
Hong Kong SAR[a]	2 519	-41	Dominican Republic	2 066	-7
India	5 517	20	El Salvador	1 757	-4
Indonesia	2 176	-15	Egypt	564	7
Korea, Republic of	1 788	-25	Guatemala	1 959	-2
Macao, China	533	-45	Honduras	2 677	0
Malaysia	497	-3	Hong Kong SAR[a]	3 959	-15
Mauritius	651	-15	India	3 633	26
Morocco	3 160	-6	Indonesia	2 620	15
Myanmar	465	-52	Macao, China	1 437	-24
Pakistan	2 920	-10	Maldives	81	-92
Philippines	456	-38	Malaysia	764	-7
Romania	5 247	-4	Mexico	7 739	-6
Sri Lanka	1 044	-3	Nepal	131	-26
Taiwan Province of China	941	-16	Nicaragua	595	21
Thailand	1 456	-11	Pakistan	2 546	11
Tunisia	3 521	-3	Peru	692	20
Turkey	1 309	6	Philippines	1 938	-3
Ukraine	632	-6	Sri Lanka	1 585	11
Viet Nam	904	-2	Taiwan Province of China	2 104	-22
			Thailand	2 198	11
			Viet Nam	2 720	-1

Sources: European Commission, http://europa.eu.int/comm/trade/issues/sectoral/industry/textile/stats.htm; U.S. Department of commerce, http://www.otexa.ita.doc.gov/msrpoint.htm.

a Special Administrative Region of China.

III. Global macroeconomic balances and international finance

Table A.19.
Balance of payment on current account, by region, summary table, 1996-2004

Billions of dollars

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Developed economies	14.5	50.7	-61.0	-203.5	-319.2	-266.7	-297.3	-313.5	-409.9
Japan	65.8	96.8	118.7	114.6	119.7	87.8	112.4	136.2	172.1
United States	-124.9	-140.9	-214.0	-300.1	-416.0	-389.5	-475.2	-519.7	-668.1
Europe[a]	78.3	107.7	53.6	-6.3	-33.4	20.6	71.5	90.7	108.7
of which:									
EU-15	72.6	100.4	55.7	-8.3	-62.8	-4.4	40.4	40.2	48.1
EU-10	-13.5	-15.9	-16.2	-22.0	-20.2	-15.6	-18.1	-22.0	-33.0
Economies in transition	1.3	-11.5	-13.1	18.9	44.5	27.1	22.7	24.8	47.9
South-eastern Europe	-4.0	-5.1	-5.8	-4.9	-3.6	-5.7	-7.7	-11.0	-15.2
Commonwealth of Independent States	5.3	-6.4	-7.2	23.8	48.0	32.9	30.4	35.9	63.1
Developing countries	-70.1	-47.7	-14.7	56.2	109.4	85.2	138.3	235.7	296.7
Net fuel exporters	26.0	6.1	-57.3	0.9	84.7	34.6	22.2	75.0	132.2
Net fuel importers	-96.2	-53.7	42.6	55.4	24.8	50.6	116.1	160.7	164.4
Latin America and the Caribbean	-38.6	-65.5	-89.2	-55.2	-46.9	-51.7	-14.4	10.3	19.3
Net fuel exporters	1.4	-11.3	-28.7	-10.7	-5.0	-17.0	-8.4	4.6	7.2
Net fuel importers	-40.1	-54.2	-60.5	-44.5	-42.0	-34.7	-6.0	5.7	12.0
Africa	2.3	-3.9	-19.6	-11.1	16.4	5.6	-6.9	5.4	9.5
Net fuel exporters	8.9	4.1	-11.0	-4.6	23.6	11.0	-0.8	14.4	23.3
Net fuel importers	-6.6	-8.0	-8.6	-6.6	-7.1	-5.4	-6.1	-9.0	-13.9
Western Asia	-0.7	1.0	-20.0	1.6	36.8	29.8	21.4	45.4	78.1
Net fuel exporters	10.5	10.8	-16.1	6.9	49.4	31.1	25.9	53.8	95.5
Net fuel importers	-11.2	-9.8	-3.9	-5.3	-12.6	-1.2	-4.5	-8.4	-17.3
East and South Asia	-33.2	20.8	114.0	121.0	103.2	101.5	138.3	174.7	189.8
Net fuel exporters	5.2	2.5	-1.5	9.2	16.7	9.6	5.6	2.2	6.2
Net fuel importers	-38.3	18.2	115.5	111.7	86.5	91.9	132.7	172.5	183.6
World residual[b]	-54.4	-8.4	-88.7	-128.3	-165.3	-154.3	-136.3	-52.9	-65.3

Sources: International Monetary Fund (IMF), *Balance of Payments Statistics*, and IMF, *World Economic Outlook Database*, September 2005.

a Europe consists of EU 25 plus Iceland, Norway and Switzerland.

b Statistical discrepancy.

Table A.20.
Balance of payment on current account, by region, 1996-2004

Billions of dollars	1996	1997	1998	1999	2000	2001	2002	2003	2004
Developed economies									
Trade balance	69.9	71.8	-2.4	-140.2	-269.0	-230.7	-232.0	-282.8	-376.2
Services, net	55.9	71.0	61.9	54.1	58.1	57.2	64.6	74.1	94.6
Income, net	0.6	20.6	11.8	12.2	28.7	31.8	10.0	62.9	63.1
Current transfers, net	-111.9	-112.7	-132.3	-129.6	-137.0	-124.9	-139.9	-167.7	-191.4
Current-account balance	14.5	50.7	-61.0	-203.5	-319.2	-266.7	-297.3	-313.5	-409.9
Japan									
Trade balance	83.6	101.6	122.4	123.3	116.7	70.2	93.8	106.4	132.1
Services, net	-62.3	-54.2	-49.4	-54.2	-47.6	-43.7	-42.2	-33.9	-37.9
Income, net	53.5	58.2	54.6	57.6	60.4	69.2	65.8	71.2	85.7
Current transfers, net	-9.0	-8.8	-8.8	-12.1	-9.8	-7.9	-4.9	-7.5	-7.9
Current-account balance	65.8	96.8	118.7	114.6	119.7	87.8	112.4	136.2	172.1
United States									
Trade balance	-189.1	-196.2	-244.7	-343.7	-449.8	-424.1	-478.8	-544.0	-661.9
Services, net	85.1	87.8	79.7	80.3	71.5	61.4	57.6	49.2	44.3
Income, net	22.3	12.6	4.3	13.9	21.1	25.2	10.0	46.3	30.4
Current transfers, net	-43.1	-45.2	-53.3	-50.6	-58.8	-51.9	-64.0	-71.2	-80.9
Current-account balance	-124.9	-140.9	-214.0	-300.1	-416.0	-389.5	-475.2	-519.7	-668.1
Europe[a]									
Trade balance	133.8	135.3	99.1	52.4	18.1	68.1	121.9	129.6	122.4
Services, net	40.9	44.8	38.8	32.7	36.7	44.0	53.9	66.4	96.6
Income, net	-39.6	-16.5	-18.2	-28.2	-22.7	-28.8	-32.6	-16.1	-7.6
Current transfers, net	-56.8	-55.9	-66.0	-63.3	-65.6	-62.6	-71.6	-89.2	-102.7
Current-account balance	78.3	107.7	53.6	-6.3	-33.4	20.6	71.5	90.7	108.7
of which:									
EU-15									
Trade balance	153.1	155.5	133.2	78.6	22.2	68.3	111.9	116.5	97.7
Services, net	16.7	21.1	14.3	11.3	11.8	20.8	31.1	41.8	66.2
Income, net	-39.4	-18.8	-23.1	-33.1	-28.9	-29.4	-33.3	-30.3	-14.1
Current transfers, net	-57.8	-57.4	-68.7	-65.1	-67.9	-64.1	-69.3	-87.6	-101.7
Current-account balance	72.6	100.4	55.7	-8.3	-62.8	-4.4	40.4	40.2	48.1
EU-10									
Trade balance	-23.5	-24.9	-27.4	-27.8	-26.6	-22.1	-21.1	-21.9	-24.1
Services, net	11.2	10.8	11.5	7.9	9.1	9.4	7.9	6.8	9.1
Income, net	-3.9	-5.2	-5.1	-6.2	-6.8	-7.6	-10.6	-13.8	-25.7
Current transfers, net	2.8	3.4	4.8	4.1	4.1	4.7	5.7	6.8	7.6
Current-account balance	-13.5	-15.9	-16.2	-22.0	-20.2	-15.6	-18.1	-22.0	-33.0

Table 20 (continued)

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Economies in transition									
Trade balance	6.6	-1.5	-5.1	22.8	50.4	32.5	29.5	36.3	62.9
Services, net	-2.1	-3.1	-1.8	-1.8	-4.2	-7.1	-7.5	-6.7	-10.6
Income, net	-6.9	-10.3	-11.8	-8.6	-8.7	-5.2	-7.5	-15.3	-17.3
Current transfers, net	3.6	3.5	5.6	6.6	7.0	7.0	8.3	10.5	12.8
Current-account balance	1.3	-11.5	-13.1	18.9	44.5	27.1	22.7	24.9	47.9
South-eastern Europe									
Trade balance	-6.8	-7.9	-13.1	-11.5	-12.1	-16.0	-19.1	-26.2	-33.1
Services, net	1.0	1.3	1.9	1.9	2.8	3.7	4.2	7.0	7.1
Income, net	-0.7	-0.7	1.1	0.6	1.0	1.6	1.4	0.8	1.4
Current transfers, net	2.5	2.2	4.3	4.2	4.8	5.0	5.8	7.3	9.4
Current-account balance	-4.0	-5.1	-5.8	-4.9	-3.6	-5.7	-7.7	-11.0	-15.2
Commonwealth of Independent States									
Trade balance	13.4	6.4	8.0	34.3	62.5	48.5	48.5	62.5	96.0
Services, net	-3.1	-4.4	-3.7	-3.7	-7.1	-10.8	-11.7	-13.7	-17.6
Income, net	-6.1	-9.6	-12.9	-9.1	-9.7	-6.8	-9.0	-16.1	-18.7
Current transfers, net	1.1	1.2	1.3	2.3	2.2	2.0	2.6	3.2	3.4
Current-account balance	5.3	-6.4	-7.2	23.8	48.0	32.9	30.4	35.9	63.1
Developing countries									
Trade balance	32.2	54.1	81.6	160.8	234.1	201.2	241.8	315.8	383.7
Services, net	-63.1	-69.1	-53.1	-57.9	-66.9	-67.4	-63.7	-65.9	-78.0
Income, net	-83.2	-81.3	-91.9	-97.7	-111.3	-109.1	-111.7	-114.4	-124.9
Current transfers, net	43.9	48.6	48.7	51.1	53.5	60.5	71.9	100.2	115.8
Current-account balance	-70.1	-47.7	-14.7	56.2	109.4	85.2	138.3	235.7	296.7
Net fuel exporters									
Trade balance	95.3	76.8	2.3	64.6	165.3	110.3	108.2	160.5	226.8
Services, net	-46.3	-50.2	-40.4	-41.3	-51.1	-47.5	-52.7	-54.6	-64.9
Income, net	-17.2	-13.0	-10.5	-14.6	-23.5	-23.6	-30.5	-33.7	-37.5
Current transfers, net	-5.8	-7.5	-6.4	-5.7	-6.1	-4.6	-2.7	2.8	7.9
Current-account balance	26.0	6.1	-55.0	3.0	84.7	34.6	22.3	75.0	132.3
Net fuel importers									
Trade balance	-63.1	-22.7	79.3	96.2	68.8	90.9	133.6	155.3	156.9
Services, net	-16.8	-18.9	-12.8	-16.5	-15.8	-19.8	-11.0	-11.3	-13.0
Income, net	-66.0	-68.2	-81.3	-83.1	-87.9	-85.5	-81.2	-80.7	-87.4
Current transfers, net	49.7	56.1	55.1	56.7	59.6	65.1	74.7	97.3	107.9
Current-account balance	-96.2	-53.7	40.3	53.2	24.8	50.6	116.1	160.7	164.3

Table 20 (continued)

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Latin America and the Caribbean									
Trade balance	4.1	-15.4	-37.6	-8.7	1.9	-5.3	21.8	42.8	57.0
Services, net	-14.6	-17.7	-17.3	-15.6	-17.0	-18.7	-13.9	-12.6	-13.9
Income, net	-43.6	-48.5	-52.1	-51.2	-53.4	-53.8	-51.9	-56.1	-66.7
Current transfers, net	15.5	16.1	17.9	20.2	21.6	26.2	29.6	36.1	42.8
Current-account balance	-38.6	-65.5	-89.2	-55.2	-46.9	-51.7	-14.4	10.3	19.3
Africa									
Trade balance	9.4	4.9	-12.4	-3.2	32.0	19.6	8.8	22.3	32.2
Services, net	-9.0	-10.2	-11.5	-7.9	-9.9	-10.6	-10.8	-10.0	-12.1
Income, net	-16.4	-14.4	-12.5	-14.4	-20.6	-19.8	-22.6	-27.4	-34.8
Current transfers, net	18.4	15.7	16.7	14.4	14.9	16.4	17.6	20.4	24.3
Current-account balance	2.3	-3.9	-19.6	-11.1	16.4	5.6	-6.9	5.4	9.5
Western Asia									
Trade balance	31.3	27.5	-6.8	26.6	67.9	64.3	63.6	87.2	118.3
Services, net	-25.8	-21.7	-10.2	-15.9	-17.9	-17.0	-20.3	-17.3	-20.5
Income, net	2.6	3.4	5.0	-1.2	-3.9	-6.2	-9.7	-12.0	-7.4
Current transfers, net	-8.8	-8.2	-8.0	-8.0	-9.4	-11.3	-12.2	-12.5	-12.3
Current-account balance	-0.7	1.0	-20.0	1.6	36.8	29.8	21.4	45.4	78.1
East Asia									
Trade balance	-2.1	48.8	155.1	152.7	134.4	127.2	148.7	172.3	192.4
Services, net	-5.6	-12.6	-8.9	-13.1	-16.7	-15.7	-13.4	-18.3	-19.0
Income, net	-19.9	-15.6	-25.8	-24.8	-25.5	-22.8	-20.3	-11.4	-9.6
Current transfers, net	1.6	3.6	5.2	4.7	4.5	4.5	8.0	20.6	25.0
Current-account balance	-26.0	24.3	125.7	119.5	96.7	93.2	123.1	163.2	188.9
South Asia									
Trade balance	-10.5	-11.8	-16.7	-6.7	-2.2	-4.6	-1.2	-8.8	-16.2
Services, net	-8.1	-6.9	-5.3	-5.4	-5.5	-5.4	-5.3	-7.8	-12.5
Income, net	-6.0	-6.3	-6.6	-6.2	-7.8	-6.5	-7.2	-7.4	-6.4
Current transfers, net	17.4	21.5	17.0	19.7	22.0	24.8	28.8	35.5	36.0
Current-account balance	-7.2	-3.5	-11.6	1.4	6.5	8.3	15.2	11.5	0.9
World residual[b]									
Trade balance	108.8	124.3	74.1	43.4	15.5	2.9	39.3	69.4	70.4
Services, net	-9.3	-1.2	7.0	-5.6	-13.0	-17.4	-6.7	1.5	6.1
Income, net	-89.5	-70.9	-91.9	-94.1	-91.3	-82.5	-109.2	-66.8	-79.1
Current transfers, net	-64.3	-60.6	-77.9	-72.0	-76.4	-57.3	-59.7	-57.0	-62.8
Current-account balance	-54.4	-8.4	-88.7	-128.3	-165.3	-154.3	-136.3	-52.9	-65.3

Sources: International Monetary Fund (IMF), *Balance of Payments Statistics*, and IMF, *World Economic Outlook Database*, September 2005.

a Europe consists of EU 25 plus Iceland, Norway and Switzerland.

b Statistical discrepancy.

Table A.21.
Savings, investments and current-account balances, by selected groups of countries as percentage of world gross product, 1970-2004

Percentage	1970-1980	1981-1990	1991-2000	2001	2002	2003	2004
World							
Savings	24.1	22.2	22.1	20.9	20.3	20.6	21.2
Investment	24.0	22.8	22.3	21.4	20.7	20.9	21.5
Developed Economies							
Current Account	-0.1	-0.4	-0.2	-0.9	-0.9	-0.9	-1.0
Savings	19.6	17.7	17.0	15.4	14.6	14.7	14.9
Investment	19.7	18.1	17.2	16.2	15.6	15.7	16.0
East Asia							
Current Account	-0.0	-0.0	0.1	0.2	0.3	0.4	0.3
Savings	1.3	1.6	2.4	2.8	3.0	3.1	3.2
Investment	1.3	1.6	2.3	2.5	2.7	2.7	2.9
Major Fuel Exporters							
Current Account	0.3	0.1	0.1	0.2	0.2	0.2	0.3
Savings	0.6	0.6	0.6	0.5	0.5	0.6	0.8
Investment	0.3	0.5	0.5	0.3	0.4	0.4	0.4
Other developing countries							
Current Account	-0.1	-0.3	-0.2	-0.1	0.0	0.1	0.0
Savings	2.7	2.4	2.0	2.2	2.2	2.2	2.3
Investment	2.8	2.6	2.3	2.3	2.1	2.1	2.2

Sources: World Bank, *World Development Indicators*; IMF, *International Financial Statistics*; and OECD National Accounts data.

Note: Savings rates have been derived as a residual following the identity that gross national savings must equal the sum of gross domestic investment and the current-account balance. The savings data may therefore not correspond exactly to the estimates based on the given data sources because of discrepancies between national accounts and balance-of-payments data.

Table A.22.
Savings, investments and current-account balances as percentage of regional GDP, 1970-2004

Percentage	1970-1980	1981-1990	1991-2000	2001	2002	2003	2004
Developed economies							
Current account	-0.1	-0.5	-0.2	-1.1	-1.2	-1.2	-1.3
Savings	24.1	22.0	21.3	19.6	18.5	18.6	19.0
Investment	24.3	22.6	21.6	20.7	19.7	19.8	20.3
Latin America							
Current account	-2.0	-1.7	-2.8	-2.7	-0.9	0.6	1.0
Savings	21.7	18.7	18.3	17.5	19.0	19.5	21.2
Investment	23.7	20.4	21.1	20.2	19.8	18.9	20.1
East Asia							
Current account	-0.8	-0.5	1.1	3.1	3.8	4.6	4.1
Savings	28.7	31.5	36.0	35.4	36.4	38.7	39.6
Investment	29.5	32.1	34.9	32.3	32.6	34.1	35.5
Western Asia							
Current account	11.1	1.7	-2.5	3.6	2.2	4.2	6.6
Savings	31.9	24.2	20.3	21.6	21.5	23.8	27.8
Investment	20.8	22.5	22.8	18.0	19.2	19.6	21.2
South Asia							
Current account	1.0	-1.5	-1.0	0.7	1.9	1.6	-0.5
Savings	20.2	20.5	21.6	24.7	26.5	26.8	24.0
Investment	19.2	22.0	22.5	24.0	24.6	25.2	24.5
Economies in Transition[a]							
Current account	..	-0.8	2.6	5.6	4.3	3.8	6.0
Savings	..	30.3	26.7	27.7	25.5	25.7	27.6
Investment	..	31.1	24.1	22.1	21.3	21.9	21.6
Africa							
Current account	-1.0	-2.4	-0.9	2.4	0.5	1.3	2.2
Savings	24.6	19.5	18.3	21.6	20.6	22.1	22.8
Investment	25.6	21.9	19.1	19.2	20.0	20.8	20.6

Sources: World Bank, *World Development Indicators*; IMF, *International Financial Statistics*; and OECD National Accounts data.

Note: Savings rates have been derived as a residual following the identity that Gross National Savings must equal the sum of Gross Domestic Investment and the Current-account balance. The savings data may therefore not correspond exactly to the estimates based the given data sources because of discrepancies between national accounts and balance-of-payments data.

a Savings, investment and current account for transition economies for 1981-1990 applies to 1989-1990.

Table A.23.
Major surplus and deficit countries: total and (non-residential) corporate fixed investment rates, 1970-2004

Shares of GDP

	Total Fixed Investment Rate (GFCF to GDP)							Total Fixed Investment Rate (non-residential) (NR-GFCF to GDP)							Change in percentage points from 2004: Total GFCF/GDP compared to:		Change in percentage points from 2004: Corporate NR GFCF/GDP compared to:	
	1970-1980	1981-1990	1991-2000	2001	2002	2003	2004	1970-1980	1981-1990	1991-2000	2001	2002	2003	2004	1980s	1990s	1980s	1990s
Main Deficit Countries (per 2004)																		
Australia	0.264	0.258	0.225	0.219	0.239	0.245	0.246	0.177	0.181	0.150	0.145	0.155	0.158	0.155	-1.2	2.1	-2.6	0.5
France	0.246	0.216	0.194	0.201	0.194	0.192	0.195	0.135	0.124	0.115	0.122	0.115	0.110	0.111	-2.1	0.1	-1.3	-0.4
India	0.161	0.207	0.222	0.220	0.219	0.225	0.227	0.016	0.034	0.068	0.049	0.049	0.040	0.040	1.6	0.5	0.7	-2.7
Italy	0.253	0.222	0.190	0.197	0.198	0.192	0.193	0.144	0.123	0.113	0.123	0.121	0.113	0.113	-2.9	0.3	-1.1	-0.0
Mexico	0.203	0.190	0.193	0.200	0.192	0.189	0.202	..	0.082	0.111	0.127	0.116	0.110	0.118	1.2	0.9	3.6	0.7
Portugal[a]	0.275	0.272	0.247	0.271	0.250	0.226	0.226	0.248	0.235	0.208	0.232	0.215	0.193	0.193	-4.6	-2.1	-4.3	-1.5
Spain	0.253	0.227	0.228	0.253	0.252	0.256	0.265	0.152	0.131	0.135	0.153	0.147	0.147	0.151	3.8	3.7	2.1	1.6
Turkey	0.189	0.220	0.243	0.182	0.166	0.155	0.178	..	..	..	..	..	..	..	-4.1	-6.5	..	..
United Kingdom	0.198	0.187	0.167	0.166	0.164	0.163	0.169	0.032	0.030	0.028	0.028	0.026	0.025	0.025	-1.8	0.2	-0.6	-0.4
United States	0.198	0.199	0.184	0.195	0.183	0.184	0.193	0.113	0.119	0.111	0.116	0.101	0.099	0.104	-0.6	0.9	-1.5	-0.7
Main Surplus Countries (per 2004)																		
Algeria	0.246	0.217	0.225	0.220	0.209	0.214	0.219	..	..	..	..	..	..	..	0.1	-0.7	..	..
Argentina	0.257	..	0.186	0.142	0.120	0.151	0.191	..	..	..	..	..	..	..	..	0.6	..	..
Belgium	0.240	0.191	0.204	0.209	0.195	0.189	0.186	0.132	0.121	0.136	0.143	0.131	0.125	0.124	-0.4	-1.8	0.2	-1.2
Brazil	0.224	0.246	0.201	0.206	0.190	0.168	0.182	..	..	..	..	..	..	..	-7.8	-3.3	..	..
Canada	0.227	0.215	0.189	0.196	0.196	0.195	0.199	0.127	0.127	0.114	0.122	0.114	0.108	0.108	-1.6	0.9	-1.9	-0.6
China	0.273	0.290	0.346	0.378	0.401	0.442	0.449	..	..	..	..	..	..	..	15.2	9.6	..	..
Egypt	0.220	0.286	0.187	0.164	0.165	0.164	..	..	..	..	..	..	..	..	-12.2	-2.2	..	..
Germany	0.244	0.225	0.224	0.203	0.186	0.179	0.173	..	..	0.128	0.121	0.110	0.107	0.104	-5.2	-5.1	..	-2.4
Indonesia	..	0.248	0.250	0.214	0.203	0.197	0.209	..	..	..	..	..	..	..	-5.1	-5.3	..	..
Japan	0.337	0.295	0.284	0.258	0.242	0.240	0.238	0.176	0.168	0.161	0.156	0.144	0.149	0.153	-5.7	-4.6	-1.5	-0.8

Table A.23 (continued)

	Total Fixed Investment Rate (GFCF to GDP)							Total Fixed Investment Rate (non-residential) (NR-GFCF to GDP)							Change in percentage points from 2004: Total GFCF/GDP compared to:		Corporate NR GFCF/GDP compared to:	
	1970-1980	1981-1990	1991-2000	2001	2002	2003	2004	1970-1980	1981-1990	1991-2000	2001	2002	2003	2004	1980s	1990s	1980s	1990s
Korea, Republic of[b]	0.273	0.301	0.350	0.295	0.291	0.299	0.295	0.211	0.217	0.238	0.200	0.196	0.201	0.195	-0.6	-5.5	-2.2	-4.2
Malaysia	0.238	0.297	0.355	0.249	0.231	0.220	0.198											
Netherlands	0.237	0.213	0.213	0.216	0.208	0.202	0.205	0.129	0.125	0.126	0.122	0.112	0.107	0.110	-0.8	-0.9	-1.6	-1.7
Nigeria	0.220	0.172	0.193	0.228	0.261	0.227	0.207								5.5	3.4		
Norway	0.303	0.264	0.207	0.183	0.181	0.174	0.180	0.194	0.177	0.143	0.120	0.116	0.109	0.114	-8.3	-2.6	-6.3	-2.8
Philippines	0.224	0.218	0.219	0.177	0.175	0.166	0.165	..	..	..	..	..	..	..	-5.2	-5.3	..	..
Russian Federation	..	..	0.171	0.189	0.179	0.182	0.192	..	..	..	..	..	..	..	..	1.1	..	..
Saudi Arabia	0.220	0.225	0.192	0.184	0.181	0.179	0.173	..	..	..	..	..	..	..	-4.6	-1.3	..	..
Sweden[c]	0.223	0.209	0.170	0.174	0.167	0.158	0.159	0.127	0.129	0.090	0.127	0.115	0.107	0.106	-5.0	-1.0	-2.3	1.6
Switzerland[d]	0.284	0.275	0.233	0.222	0.215	0.210	0.211	..	0.200	0.160	0.162	0.158	0.154	0.156	-6.4	-2.3	-4.4	-0.4
Venezuela (Bolivarian Republic of)	0.300	0.201	0.166	0.164	0.144	0.104	0.177	..	..	..	..	..	..	..	-9.7	-6.2	..	..

Sources: World Bank, World Development Indicators, OECD Analytical Database; UN/DESA/STAT, National Accounts Statistics at Central Statistical Organization of India, UN/DESA/DPAD staff calculations.

a Total fixed investment rate (non-residential) for 1970-1980 applies to 1977-1980.
b Total fixed investment rate (non-residential) for 1970-1980 applies to 1975-1980.
c Total fixed investment rate (non-residential) for 1991-2000 applies to 1993-2000.
d Total fixed investment rate (non-residential) for 1981-1990 applies to 1990.

Table A. 24.
Net ODA from major sources, by type, 1985-2004

Donor group or country	Growth rate of ODA[a] (2003 prices and exchange rates) 1985-1994	1995-2004	ODA as percentage of GNP 2004	Total ODA (millions of dollars) 2004	Percentage distribution of ODA by type, 2004: Bilateral: Grants[b]	Technical cooperation	Loans	Multilateral: United Nations	IDA	Other
Total DAC countries	1.39	1.26	0.26	79 513	71.7	23.6	-3.7	6.2	7.2	31.6
Total EU	2.36	0.93	0.35	42 887	62.5	18.5	-2.3	5.8	6.2	39.0
Austria	-3.41	7.06	0.23	678	5.6	19.6	-4.1	3.8	6.8	47.9
Belgium	-2.78	6.39	0.41	1 463	65.1	28.3	-3.4	3.6	6.3	38.3
Denmark	4.28	0.84	0.85	2 037	58.5	5.5	0.5	16.5	3.3	41.0
Finland	1.72	3.67	0.35	655	53.9	19.4	1.4	13.4	6.3	44.7
France[c]	3.02	-1.91	0.41	8 473	71.6	27.6	-5.9	2.1	4.7	34.3
Germany	0.75	-0.62	0.28	7 534	59.9	33.0	-9.2	3.8	15.2	49.3
Greece	..	..	0.23	465	65.4	42.2	0.0	1.7	0.9	34.6
Ireland	4.50	14.67	0.39	607	67.5	2.0	0.0	10.0	3.3	32.6
Italy	3.96	-4.28	0.15	2 462	34.7	5.7	-6.1	10.3	..	71.4
Luxembourg	16.59	12.01	0.83	236	72.5	1.7	0.0	5.1	3.4	27.1
Netherlands	0.73	2.49	0.73	4 204	76.5	15.8	-13.0	10.6	8.5	36.5
Portugal	25.89	5.90	0.63	1 031	17.4	11.1	67.3	1.0	1.2	15.3
Spain	18.65	2.45	0.24	2 437	50.3	14.0	7.1	2.0	7.4	42.6
Sweden	2.80	1.90	0.78	2 722	75.9	4.1	0.4	10.7	0.9	23.7
United Kingdom	1.31	4.62	0.36	7 883	66.5	9.5	1.3	4.8	3.2	32.3
Australia	0.53	0.72	0.25	1 460	81.6	47.4	0.0	3.0	5.8	18.5
Canada	1.66	-1.70	0.27	2 599	77.8	15.9	-1.2	6.0	6.8	23.4
Japan	1.44	-1.58	0.19	8 906	80.1	21.5	-13.6	14.0	8.6	33.6
New Zealand	0.24	3.22	0.23	212	75.0	21.7	0.0	7.1	3.8	25.0
Norway	2.48	3.14	0.87	2 199	68.0	13.1	1.9	19.5	5.4	30.1
Switzerland	3.26	3.20	0.41	1 545	75.9	7.6	0.9	7.6	9.4	23.2
United States	-1.17	4.12	0.17	19 705	86.4	37.3	-3.9	2.2	8.9	17.5
Arab countries[d]										
of which:										
Saudi Arabia	..	..	..	1 734	..	97.5	..	..	2.5	..
Kuwait	..	..	..	209	..	88.5	..	..	11.5	..
Other developing countries[d]										
Korea, Republic of	..	..	..	423	..	78.7	..	..	21.3	..
Taiwan Province of China	..	..	..	421	..	97.4	..	..	2.6	..

Sources: UN/DESA, based on OECD. *The DAC Journal Development Co-operation, Report 2005.*

a Average annual rates of growth, calculated from average levels in 1983-1984,1993-1994 and 2003-2004.

b Including technical cooperation.

c Excluding flows from France to the Overseas Departments, namely Guadeloupe, French Guyana, Martinique and Réunion.

d Bilateral ODA includes all grants and loans; multilateral ODA includes United Nations, IDA and “other”, including technical cooperation.

Table A.25.
Total net ODA flows from OECD Development Assistance Committee (DAC) countries, by type of flow, 1993-2004

	1993-1994 average	2000	2001	2002	2003	2004
	Net disbursements at current prices and exchange rates (millions of dollars)					
Official Development Assistance	57 484	53 749	52 435	58 292	69 085	79 512
Bilateral grants and grant-like flows	34 329	33 040	33 522	39 813	50 908	57 322
of which:						
Technical co-operation	12 911	12 767	13 602	15 452	18 352	18 764
Emergency and distress relief[a]	3 359	3 574	3 276	3 869	6 221	7 332
Debt forgiveness	3 077	2 045	2 514	4 534	8 338	7 084
Bilateral loans	5 665	3 024	1 602	939	-1 153	-2 937
Contributions to multilateral institutions[b]	17 489	17 685	17 311	17 540	19 330	25 126
	Share of total net flows (percentage)					
Official Development Assistance	38	40	49	80	55	53
Bilateral grants and grant-like flows	23	25	31	54	40	39
of which:						
Technical co-operation	9	9	13	21	15	13
Emergency and distress relief[a]	2	3	3	5	5	5
Debt forgiveness	2	2	2	6	7	5
Bilateral loans	4	2	1	1	-1	-2
Contributions to multilateral institutions[b]	12	13	16	24	15	17

Source: OECD, *The DAC Journal: Development Cooperation Report 2005*.

a Emergency food aid included with developmental food aid up to and including 1995.

b Grants and capital subscriptions, does not include concessional lending to multilateral agencies.

Table A.26.
Commitments and net flows of financial resources, by selected multilateral institutions, 1996-2004

Millions of dollars	1996	1997	1998	1999	2000	2001	2002	2003	2004
Resource commitments[a]	66 827	89 713	95 118	65 568	63 085	72 177	95 292	67 593	55 895
Financial institutions, excluding IMF	44 701	45 760	57 928	42 770	36 882	41 787	38 523	43 053	45 678
Regional development banks[b]	16 525	20 431	21 133	19 437	16 235	19 349	16 751	20 393	21 468
World Bank Group	27 729	24 899	36 352	22 899	20 238	22 004	21 382	22 230	23 743
IBRD	15 325	15 098	24 687	13 789	10 699	11 709	10 176	10 572	10 792
IDA	6 490	5 345	7 325	5 691	5 861	6 859	8 040	7 550	8 387
IFC	5 914	4 456	4 340	3 419	3 678	3 436	3 166	4 108	4 564
IFAD	447	430	443	434	409	434	390	430	467
IMF (billions of dollars))	18	41	33	19	22	26	52	18	3
UN operational agencies[c]	3 726	3 453	4 290	4 198	3 803	4 690	4 569	6 740	7 617
Net flows	2 060	21 227	28 825	-7 450	-10 859	14 931	2 001	-11 655	-20 235
Financial institutions, excluding IMF	1 460	6 827	9 525	5 150	-59	1 431	-11 199	-14 755	-10 235
Regional development banks[b]	2 376	5 334	7 971	4 229	327	1 696	-3 904	-8 025	-6 570
World Bank Group	-915	1 493	1 554	921	-386	-265	-7 295	-6 730	-3 665
IBRD	-6 128	-3 265	-2 723	-3 019	-4 079	-4 570	-12 126	-11 241	-8 930
IDA	5 213	4 757	4 276	3 940	3 693	4 432	4 831	4 511	5 265
IMF (billions of dollars)	1	14	19	-13	-11	14	13	3	-10
Memorandum item: (in units of 2000 purchasing power)[d]									
Resource commitments (millions of dollars)	54 776	78 696	87 264	62 446	63 085	73 650	97 237	63 171	48 604
Net flows (millions of dollars)	1 689	18 620	26 445	-7 095	-10 859	15 236	2 042	-10 892	-17 596

Sources: Annual reports various issues of the multilateral institutions.

a Loans, grants, technical assistance and equity participation, as appropriate; all data are on a calendar-year basis.

b African Development Bank (AfDB), Asian Development Bank (ADB), Caribbean Development Bank (CDB), European Bank for Reconstruction and Development (EBRD), Inter-American Development Bank (IaDB) (including Inter-American Investment Corporation), and the International Fund for Agricultural Development (IFAD).

c United Nations Development Program (UNDP), United Nations Population Fund (UNPF), United Nations Children's Fund (UNICEF), and the World Food Programme (WFP).

d Totals deflated by the United Nations index of manufactured export prices (in dollars) of developed economies: 2000 = 100.

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